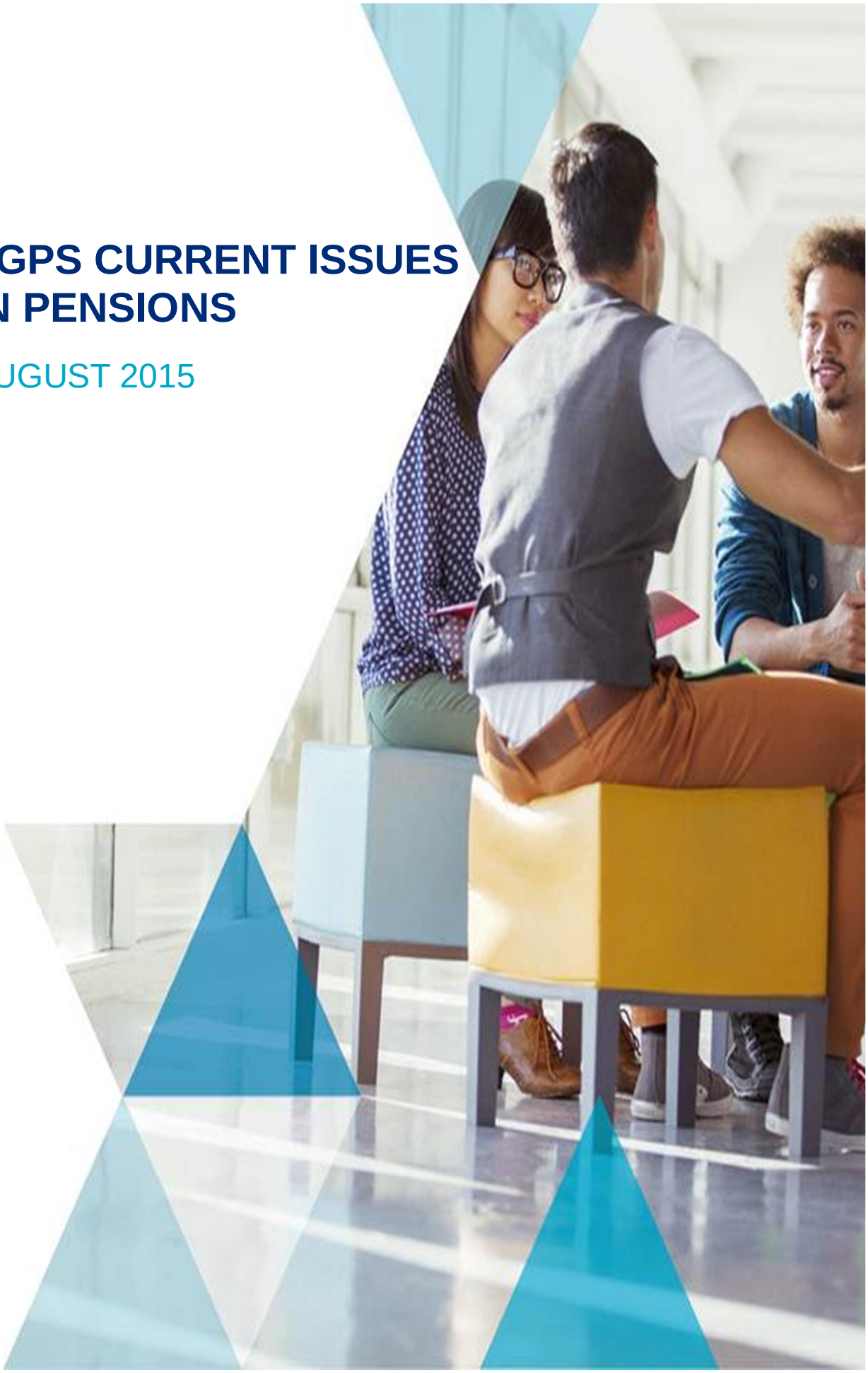
MERCER
MAKE TOMORROW, TODAY

LGPS CURRENT ISSUES IN PENSIONS

AUGUST 2015



AUGUST 24, 2015

IN THIS EDITION

MARSH & McLENNAN COMPANIES

SUMMER BUDGET

The end of meaningful tax-free pension savings?

The 2015 Summer Budget, delivered on 8 July, was the first conservative Government budget in almost 20 years, and some far-reaching changes were announced. Pension tax was once again an area of focus for the Chancellor, following on from the previously announced reduction in the lifetime allowance to £1 million.

A high-level overview of the three main pension issues announced is given below – more information can be found in our *Summer Budget 2015* paper. We will report on these areas in *Current Issues* over the coming months as further details emerge.

- The annual allowance will reduce from 6 April 2016 for high earners. This change will mean that, for individuals with "incomes" over £150,000, the annual allowance will reduce by £1 for every £2 of income, with a minimum annual allowance of £10,000. "Income" - to determine the amount of annual allowance someone has - is effectively defined as total taxable income, ***including*** the value of any pension contributions or accrual, and any income not related to main employment, such as rental income or income from other sources. Therefore many people may not be able to calculate their annual allowance until after the relevant tax year has ended and they have completed their annual tax return.

- Pension input periods to change. From 6 April 2016, all pension input periods will be the same period as the tax year. As this is not currently the case for the LGPS, 2015/16 will see a transition from the current pension input period to the tax year. The transition applies irrespective of whether or not a scheme already uses tax years. In general, the approach is that an individual can save (without an annual allowance charge) £80,000 in the current tax year but no more than £40,000 after 8 July 2015. For most individuals this approach to the transition is generous, and some may be able to save more through Additional Voluntary Contributions (AVCs) than they originally anticipated.

- Green Paper: a consultation on pension tax relief. Included in the Budget was the launch of a consultation on whether there is a case for reforming pension tax relief, or whether it is best to keep the current system. The Government has now issued its Green Paper consultation. It does not put forward any specific proposals, although it does outline some basic principles it believes any reform should meet. The paper acknowledges that there are many ways in which tax relief on pensions savings can be structured and indicates that all are open for consideration, including the option of keeping the current system of annual and lifetime allowances. At the other end of the range of options it gives the example of reversing the current position so that pension contributions would be paid out of taxed income, possibly with a government top-up of contributions, but benefits at retirement would be paid tax free.

  The paper gives the background to the consultation, highlighting increasing life expectancy and the marked shift from defined benefit to defined contribution pension provision. It sets out a framework for any reforms, citing the principles of simplicity, personal responsibility and fiscal sustainability, and the need to build on the early success of automatic enrolment.

The consultation asks for input on eight high-level questions, although respondents are encouraged to add any additional information they feel is relevant. **The closing date is 30 September 2015**.

- Annuity cash-ins. Following the earlier consultation on the establishment of a secondary market for annuities, the government will set out their plans for this in the Autumn. Implementation will be delayed until 2017 to ensure that appropriate support for consumers is in place.

The *annual allowance* is the maximum amount of tax-relievable pension savings that can be built up for an individual in one tax year. This includes savings made by the individual and the employer. The most that can be saved by the individual tax-free towards all of their pension arrangements is the lower of 100% of earnings and the *annual allowance*. Each pension scheme has a *pension input period*, over which an individual's savings in the scheme are measured for comparison with the *annual allowance*.

HM Revenue & Customs announced on 21 July that Fixed Protection 2016 and Individual Protection 2016 will be made available to individuals who are impacted by the reduction in the lifetime allowance from April 2016. These will be very similar to Fixed Protection 2014 and Individual Protection 2014; however HMRC is considering changing the deadlines for applying for these protections and potentially allowing individuals to apply for them at any time before they take their benefits. Full details of the new regime will be published later this summer.

PENSION FREEDOMS: THE STORY SO FAR

Pension freedoms gather pace in the DC world

Data released by the Association of British Insurers (ABI) in July gives us our first indication of what pension savers are doing with their funds in the new world of pension freedoms.

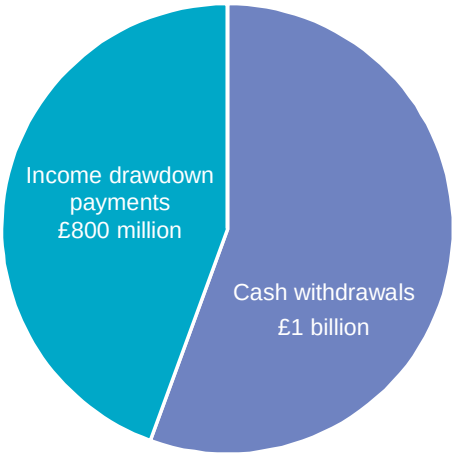
The headline conclusions are not surprising - people with small Defined Contribution pension pots tend to take them as cash (the average cash withdrawal was £15,500) and those with larger pots are more likely to buy an income, either via an annuity or income drawdown.

Digging a little deeper, the amount of money used to purchase income drawdown products has increased significantly, with £720 million used in the first two months compared to only £100 million per month in 2012. This surpasses the amount used to purchase annuities; however the actual number of people purchasing such products is still slightly less than the number purchasing annuities.

During April and May, £1.8 billion was paid out of pension pots and a further £1.35 billion was used to purchase retirement products. Figures 1 and 2 show how these amounts are broken down.

The ABI research also shows that customers are shopping around for the best deal – 45% of annuities and 52% of income drawdown products were purchased from a provider different to the one with which individuals were invested prior to taking their benefit.

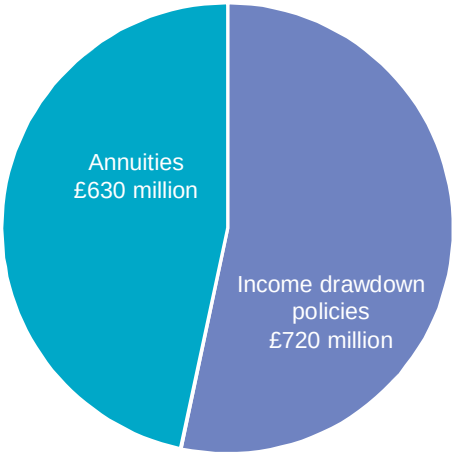
FIG 1: AMOUNT PAID OUT FROM PENSION POTS APRIL AND MAY 2015



No. of cash withdrawals:	65,000
Average cash withdrawal:	£15,500
No. of income drawdown payments:	170,000

Data source: Association of British Insurers, 16 July 2015

FIG 2: AMOUNT SPENT ON RETIREMENT PRODUCTS APRIL AND MAY 2015



No. of annuities purchased:	11,300
Average fund used for annuity purchase:	£55,750
No. of income drawdown policies purchased:	10,300
Average fund put into drawdown:	£69,900

Data source: Association of British Insurers, 16 July 2015

It is clear from the results to date that there is a large member appetite to cash in small pension pots (less than £30,000) through trivial commutation. LGPS funds who have not yet considered running a bulk trivial commutation exercise may perhaps reconsider this in light of the survey results to date as this can be an effective way of reducing administration costs as well as longer term pensions risks.

Furthermore, although drawdown type arrangements are not directly available through the LGPS, the survey could highlight an increased trend in members transferring out of the LGPS prior to retirement to access the freedoms through a Defined Contribution arrangement.

CESSATION OF CONTRACTING OUT

Loss of employer and employee NI rebated and costs of GMP reconciliation

DWP Consultation Response

On 16 July, the Department for Work & Pensions published a response to its consultation on draft regulations concerning the upcoming abolition of contracting out. The final regulations set out the rules with which schemes that currently contract out on a defined benefit basis will need to comply, on and from 6 April 2016, in respect of accrued contracted-out benefits. They aim to ensure that members' entitlements derived from contracted-out employment continue to be preserved, and that formerly contracted-out schemes continue to be operated appropriately.

As reported previously, there is currently no proposed mechanism in the LGPS through which employers can claw back lost National Insurance rebates as a result of the cessation of contracting out. Councils as well as other LGPS employers should therefore factor in the increased net costs of LGPS provision from 6 April 2016 onwards (which for a typical membership, could average out at around 2% to 3% of payroll). Furthermore, employers should also ensure employees are adequately informed of the impact of the lost NI rebates on take home pay.

Further consultation is expected later this year on a number of issues, including changes to the regulations governing transfers of contracted-out rights between schemes, and whether employers will need to notify and consult with members in advance of the cessation of contracting out.

GMP reconciliation

All Funds should now have registered with HMRC's reconciliation service to assist with the reconciliation of scheme GMP membership records in advance of the State Scheme changes and cessation of contracting-out in April 2016. This is a significant exercise for Funds and the level of resource needed to reconcile these records should not be underestimated. In the results of the stage 1 reconciliations we have seen to date, it is clear that in some instances HMRC's records differ markedly to those held by Funds.

Currently, a group of bodies, including the Local Government Association (LGA) are negotiating with the Treasury on how accurately LGPS funds' data must match that held by HMRC and will report further so that the agreed level of tolerance can be factored in to funds' reconciliation exercises.

CLOSURE OF THE EQUITABLE LIFE PAYMENT SCHEME

Closure to new claims on 31 December 2015

The Chancellor's Summer Budget announced that the Equitable Life Payment Scheme (ELPS) will close to new claims on 31 December 2015. Prior to this, the ELPS will undertake a further effort to trace the remaining investors who are due compensation of £50 or more.

With Profits annuitants will continue to receive the annual compensation payments for their lifetimes, as originally intended. However, the Chancellor also announced that the ELPS will make a further payment to Equitable Life policyholders (presumably including members of group pension schemes) who are in receipt of Pension Credit. This further payment will be equal to the payment they have already received and will be made early in 2016.

Any LGPS funds that have some AVC's invested with Equitable Life should ensure that any ELPS work is conclude prior to the year end.

The Equitable Life Payment Scheme was set up to make payments to Equitable Life With-Profits policyholders who suffered financial losses as a result of the Government's maladministration in the regulation of Equitable Life. Since the ELPS began making payments in 2011, it has paid out over £1 billion (of the £1.5 billion that Government set aside in 2010) to around 87% of the eligible policyholders it has managed to contact. To be considered for compensation, a policy must have been taken out between 1 September 1992 and 31 December 2000, and a qualifying member must have contributed to the policy between 1 January 1993 and 31 December 2000.

DC QUALITY FEATURES SURVEY

Increased focus on AVC schemes

The Pensions Regulator recently published the results of its 2015 survey into the presence of the defined contribution quality features in trust-based DC schemes.

As reported in our last issue, whilst not an explicit requirement as yet, it is likely that the Regulator is going to expect public sector schemes such as the LGPS to adopt the same standards for associated AVC arrangements.

Additionally, in its Code of Practice for the governance and administration of public service pension schemes the Regulator does make clear that "Where DC or DC AVC options are offered, pension board members should also be familiar with the requirements for the payment of member contributions to the providers, the principles relating to the operation of those arrangements, the choice of investments to be offered to members, the provider's investment and fund performance report and the payment schedule for such arrangements."

The 31 quality features - as set out in the November 2013 DC code of practice and associated guidance - are designed to ensure that schemes are run to a high standard, so that they can deliver good outcomes for members.

The survey revealed that large schemes (over 1,000 members) and master trusts had a very high level of awareness of the quality features and were also able to demonstrate the presence of a higher proportion of features. In contrast, three quarters of small schemes (12-99 members) and around half of medium-sized schemes (100-999 members) had little or no knowledge or understanding of the quality features.

The results showed that the areas with greatest scope for improvement across all schemes related to assessing and improving knowledge and understanding, linking investment strategies to member needs, and maintaining robust administration systems. These areas are covered by new legal minimum governance standards for DC schemes, which came into effect in April.

We are recommending to all LGPS clients that they should review their own AVC arrangements to demonstrate compliance/best practice versus the quality features.

LGPS COST MANAGEMENT

Funds could face onerous data requirements

The LGA have recently written to Funds concerning the accounting data which they will need to provide in connection with the cost management process. We envisage those requirements being somewhat complex, requiring benefit payments to be split between those in relation to pre April 2014 and post April 2014 service, and a further split of benefits and contributions between those in relation to the main scheme and 50:50 benefits. We envisage this split being somewhat difficult to provide (and this is a point we have been making for over well over 18 months since this methodology was first disclosed). It is almost certain to need the involvement of the pensions administration software and pensions payroll providers. At this stage we have not seen a specification of how the benefits will need to be split, so at this stage we do not know how it will work in practice or how much it will cost. The calculation of the data required could potentially be very intricate, so the costs of provision could be very significant.

One of the current proposals is to amend the Accounts and Audit Regulations so as to require Funds to provide the split of the information. This would mean administering authorities are being asked to commit to providing information in a format which is as yet unknown, and therefore with a cost which cannot be quantified. Against the background of continuing cuts to local authority budgets, this seems to us a cost which is unnecessary. We have made these points to the DCLG, and will continue to do so.

SINGLE FRAUD INVESTIGATION SERVICE (SFIS) – BULK TRANSFERS

Transfer terms soon to be finalised

The Single Fraud Investigation Service (SFIS) involves the transfer of about 600 local authority staff to the DWP (2-3 staff per local authority on average). The staff will be offered membership of the Civil Service Pension Scheme, and will be given the option of transferring their LGPS benefits across to the Civil Service Scheme. We and the other local authority advisory firms have been engaged in discussions with GAD about the transfer terms which can be offered. The discussions have centred around a “share of fund” methodology for the calculation, and we expect to be approaching our clients within the next few weeks with the formal proposals. The

benefits in the Civil Service Scheme to be provided from the transfers will be calculated on a "year for year" basis, adjusted to reflect the different benefit structures between the two schemes.

HMT CONSULTATION ON PUBLIC SECTOR EXIT PAYMENTS CAP

Consultation on new £95,000 cap closes 27 August

HM Treasury has published a consultation on a proposed public sector exit payment cap on redundancy payoffs in the public sector which could limit early pension payments from the (LGPS).

The Government is consulting on introducing a £95,000 cap on the total payments when a public sector worker loses their job in certain circumstances. This is in response to concerns over the increasing cost to the taxpayer of financing early retirement packages.

Of particular note is that the Government said the cap is to ***include*** exit payments such as employer pension contributions associated with early access to an unreduced pension.

This would conflict with LGPS regulations where members aged 55 and over are entitled as of right to an immediate and unreduced payment of accrued pension where their employment ends on the grounds of redundancy or efficiency. Currently, the employer normally has to pay a "strain cost" to the LGPS in order to "buy out" the reduction in pension benefits which the member would normally face on retiring early.

Under the proposals public sector employees would still be able to take early retirement but the extra cost to the employer of buying out part or all of the early retirement reduction should not exceed the £95,000 cap. If a lump sum redundancy payment is offered as well, this when taken together with the total employer cost of buying out the reduction in pension must not exceed the cap.

These costs can be substantial. For example, if an employer wanted to make a 55 year old LGPS employee redundant with 35 years' past service and a pensionable salary of £50,000 per annum, the cost of providing an immediate pension unreduced could be up to £150,000 (depending on the particular circumstances). This cost falls on the employer at the time of redundancy – in addition to any other non-pension related redundancy costs.

This would require a change to the current LGPS regulations to facilitate this cost cap for public sector employees and quite how this will be incorporated into the regulations remains to be seen.

In addition, it is not yet clear how the new policy would affect other (non-public sector) employers in the LGPS.

Mercer will be responding to the consultation, but we would also encourage you to respond to this consultation with a view to ensuring that there are no unintended consequences from a change to the LGPS Regulations as a result of the new policy.

NEW FAIR DEAL

Further consultation due September 2015

As reported in the last issue, DCLG have formed a working group, made up of the LGA, Trade Unions and practitioners, to consider how the principles of new Fair Deal might apply for the LGPS – in the spirit as it applies to the other public sector schemes.

There have been no major developments to report over the summer and it is expected that there will be a further consultation in September 2015, which will run for three months. It is hoped that any new regulations will be implemented in the second Quarter of 2016.

TPR's PUBLIC SECTOR PENSION SCHEME SURVEY

Take the survey now

The Pensions Regulator (TPR) are currently asking schemes to take part in their survey on the governance and administration standards in public service schemes.

TPR are strongly encouraging public sector administrators/officers to participate in this survey.

The results will play a key part in TPR's understanding of how schemes are meeting legal requirements and will help them to focus on areas where we can provide more support, help and guidance.

You can start the survey here

OMBUDSMAN ACCEPTS LGPS MEMBER'S COMPLAINT OVER EARLY RETIREMENT ACCESS

Consequences of not having clearly defined policies

The Pensions Ombudsman (PO) has ruled in favour of a deferred member of the Local Government Pension Scheme (LGPS) who sought early access to her pension.

Jacqueline Elliot had become a deferred member of the LGPS in 2011 after having accrued a significant amount of service and had a Rule of 85 age of 55. In August 2011, when she turned 55, Elliot wrote to the East Riding Pension Fund (ERPF) to request unreduced early retirement from deferred status and the ERPF pointed out that she would need the consent of her employer Care Trust Plus (CTP). However, CTP turned down the request on the ground that she had opted out of the LGPS before age 55.

In March 2013, the Department of Health inherited responsibility for the defunct Care Trust Plus. It told Elliott that a discretions policy regarding early retirement had come into effect from July 2012 which meant no one would have been granted employer consent to take their benefits before age 60. But Elliott argued the discretion policy was written after she applied for her

benefits. She also discovered through a Freedom of Information request that other members had accessed early retirement under the rule of 85 following the employment transfers.

The Ombudsman agreed it would be unfair for Elliott's request to be considered under a discretions policy that came into effect after she made her application. He also rejected claims by Care Trust Plus that the application could only be considered alongside a ‘trigger event' (meaning when she left the LGPS scheme and not when she applied later).

The case serves as a reminder to all funds and employers to ensure appropriate up-to-date discretionary policies are in place, particularly with regard to accessing early retirement pensions from active and deferred status.

UPDATE ON THE 50:50 SCHEME

Take up lower than expected

Take up rates to the LGPS 50:50 scheme have been far lower than expected prior to the scheme being rolled out. Initially, it was expected that take up rates of the 50:50 would be towards the 10% mark. However, experience to date suggests that take up is only around 1% and this is primarily higher earners who would exceed the Annual Allowance of Lifetime Allowance tax charge.

It’s not clear why take up has been so much lower than expected, with some commentators suggesting that it has not been publicised adequately.

CONTACTS

Paul Middleman
paul.middleman@mercer.com
0151 242 7402

Leanne Johnston
leanne.johnston@mercer.com
0161 837 6649

Bhavna Kumar
bhavna.kumar@mercer.com
0151 242 7404

Ian Kirk
ian.x.kirk@mercer.com
0151 242 7141

Nigel Thomas
nigel.thomas@mercer.com
0151 242 7309

Clive Lewis
clive.lewis@mercer.com
0151 242 7297

John Livesey
john.livesey@mercer.com
0151 242 7324

Cefn Willis
cefn.willis@mercer.com
0151 242 7303

MERCER
MAKE TOMORROW, TODAY

No 4 St Paul's Square,
Old Hall Street,
Liverpool
L3 9SJ