HYMANS ROBERTSON

A better future for the LGPS

Employer diversity: one size doesn't fit all

What is the employer experience in the LGPS? This is the first in a series of briefing notes where we consider some of these experiences, how they affect the employers concerned, and what solutions might be available for funds to secure better outcomes for everyone.

As we see time and again across humankind, the differences **between** groups tend to pale into insignificance beside the variation which exists **within** each group.

This is also true in the Local Government Pension Scheme: we could analyse the 101 funds in England, Scotland, and Wales and flag up their differing characteristics, but the reality is that there are hugely greater disparities between the employers within any given fund. As we've always said, an LGPS fund is just the sum of its employers; the gap between (say) the best- and worst-funded employer will be very much larger than the gap between the best- and worst-funded funds.

Prompted by Section 13 of the PSPA[1], DCLG, assisted by the Government Actuary's Department, are doing LGPS-wide analysis comparing the funds. The Scheme Advisory Board is taking a different route and considering LGPS issues on a sector-by-sector basis. Rather than duplicate the work being done elsewhere, and on the back of the 2016 funding valuations, Hymans Robertson asks a key question: what is the employer experience in the LGPS?

What did we find across the LGPS?

We carried out a unique analysis across nearly half the LGPS in England & Wales (advised by Hymans Robertson), which looked at these different employer experiences. This showed for instance that:

- 1% of employers account for more than 60% of the assets and liabilities in the LGPS, whereas 90% of employers account for less than 10%;
- Even ignoring the most extreme employers, funding levels range from 60% to 140%, a much broader range than that shown in the GAD Section 13 analysis;
- Academy schools make up 1/8 of the active membership but only 1/20 of the assets;
- Colleges have a maturity measure (liabilities divided by payroll) of 5.5, vs 8.5 for councils;
- Larger councils such as counties, unitaries and metropolitans, have an average cashflow position of -1% of assets, whereas their District and Borough neighbours have -5%.

These statistics, and others like them which we have unearthed from our analysis, illustrate some key themes:

[1] Public Service Pensions Act 2013: http://www.legislation.gov.uk/ukpga/2013/25/section/13

1. Different groups of employers have very different characteristics from each other and from funds as a whole;

2. Maturity and funding levels mean employers have hugely varying balances required between future cashflows, investment returns and contributions;

3. Employer groups with reduced anticipated lifetimes in the LGPS, for whatever reason, have even greater differences from the average.

Each statistic is a headline average of a multitude of individual stories affecting employers and their staff. In this series we will consider a few of these, illustrating each of the three key themes, starting with:

Case Study 1: Multi Academy Trust ("MAT")

History: The MAT has gradually evolved over the years, taking on former Council-run schools who have converted from LEA status and also starting one or two free schools. Now it has many active members, a relative handful of ex-employees, and a small but rapidly-growing asset share in the fund. Its funding level looked very poor at the outset, but this has become less of an issue as its contributions grow in line with payroll and help repair the deficit, whilst new staff don't bring any pensions baggage with them.

Current issues: One of the new staff is a business manager with experience of managing pensions. She has appointed a new payroll provider for the MAT and has spent time ensuring that the data required to manage the LGPS is recorded and reported correctly. She's very engaged with the administering authority.

There is now a variety of contribution rates paid by the different schools, and although they could switch to all pay the same rate, the manager is conscious of the issues which would arise should individual schools leave or join the MAT.

She is also aware that the annual fee for obtaining accounting pension disclosures (under FRS102) increases whenever they bring on a new school.

Solution: The fund encourages the MAT to think about paying the same rate across all schools and to think of itself as a single entity. The fund is also willing to incorporate the different investment needs of different employer groups into its asset allocation. Following conversations across the academy community in the area, the MAT agrees with the fund that they (and the other academy trusts in the fund) would be better served by a different investment strategy: this would follow a longer-term growth-oriented approach, tying in with the strongly positive cashflow of this employer group, instead of the main strategy which is more appropriate to the Council and its need for investment income to help pay benefits.

This solution means that:

- The MAT pays one contribution rate and receives one accounting report for all LGPS pension obligations in the Fund. There is cross subsidy between the individual schools within the MAT, and their underlying positions are no longer tracked. This reduces annual costs and administration for the MAT;
- In the event that a school leaves the MAT, it will be assigned a share of the MAT's fund assets in proportion to the funding level of active members of the MAT, after deferred and pensioner members are fully funded. This will be higher or lower than an exact calculated share of assets based on historic cashflows, but is far cheaper and simpler to arrange;
- The combination of the more growth-oriented asset strategy, and the strongly positive cashflows into the fund, mean academies are on a very different looking (but more appropriate) path to long-term funding compared to the Council. This will help to keep the contribution rate lower than it would have been, and therefore leave more of the MAT's funds available for education purposes;
- There might be a "rockier ride" for the MAT's funding level in the short-term, but this is of no particular concern, given the academy-appropriate path to long-term funding;

- Contributions will be stabilised using the DfE guarantee as a basis, to dampen the impact of short-term market fluctuations.

There are other possible solutions, depending on the fund's and MAT's circumstances. However, the above demonstrates that practical and helpful solutions are available now, without relying on SAB or Government intervention, leading to better outcomes all round.

Conclusion

There are over 13,000 employer stories in the LGPS, and counting: the number grows with every academy conversion, outsourcing contract, and service delivery re-design. To date, these stories have emerged in occasional newspaper articles, employer accounts, or even insolvency details. However, we think it is time to take a step back and tell these stories before they finish, while there is still time to change the ending.

The Government can play its part, through financing arrangements, continued academy guarantee, etc. We know that SAB are looking at options around different groups of employers such as academies and charities. This is to be welcomed, provided this doesn't simply move the LGPS problem elsewhere (as the colleges insolvency regime consultation did in effect).

We think it is increasingly untenable for LGPS funds to have a "one size fits all" approach to investment strategy. Whilst different funds may take different approaches, it is clear that re-considering investment and funding strategies in tandem, on an employer-focussed basis, will lead to better outcomes. We look forward to discussions with funds on what can be done.

Next month, we look at the experience of charities within the LGPS:

"*When the Charity began working in partnership with the Council many years ago, it seemed fair and relatively inexpensive to offer its staff LGPS membership. Now however, the FD rues the day his predecessors made that pension decision …"*

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