Financial Topic Note

F12-14
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Pensions Issues: LGPS Funding Deficit & Future Arrangements

Introduction

NALC's Larger Councils' Committee raised a question about the Local Government Pension Scheme (LGPS) funding deficit. Although councils may not be aware of the true extent of the current deficits in all current LGPS Pension Funds, it is common knowledge that such deficits exist. For many, if not most, local councils who participate in such schemes, the deficit attributable to the council may well exceed the council's own available reserves. The Larger Councils' Committee (LCC) at NALC has expressed concerns at this situation, and NALC will, as and when the opportunity arises, take this matter up with relevant government departments and officials.

Deficit Funding

At present, LGPS Actuaries are tackling the deficits in one of two ways:

1. Progressive increases in employers' funding percentages, or

2. Retaining constant employers' percentages but adding a lump sum specifically targeted at reducing the deficit.

There are signs, within the recent round of (2013) Actuarial Valuations, that these strategies, coupled with improvements in Stock Market performance, are having an effect, but past performance is no guarantee of future returns. Future increases signalled in those Valuations appear to be tailing off, but the problem is certainly around for the foreseeable future.

Current Reporting and Accounting Requirements

Under present accounting rules, there is no requirement upon councils (unless preparing full FRSSE accounts and subjecting them to audit) to take account in any way for the impact of Fund deficits on their financial position. The practical solution is for deficits to be funded from future contributions determined and recommended by the relevant Fund actuaries at their triennial reviews of the funding position. This practically guarantees that employer contributions are unlikely to decrease in the foreseeable future, and may well continue to rise, albeit at a diminishing rate. The particular concern expressed by the LCC (and specifically being passed on by NALC at every opportunity) relates to the impact of such rises on future Precepts, especially with the continued threat of capping on the sector as a whole. Although it is in no way a requirement (and certainly not a recommendation) at present to make allowance for current pension liabilities (and future funding thereof), some might consider it prudent to make some sort of provision therefor in current financial and reserve reporting.

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It is, however, important to understand that the deficit, however large, **does not represent a current** liability, and is therefore not properly a charge against current funds. It is an estimate, based on statistical probabilities, of the present value of a (distant) future liability.

NALC is aware that some council's have even thought of making a lump sum payment into their fund, from existing reserves, to reduce their present deficit. This is not a practical, nor recommended, solution because:

1. In view of the pooling arrangements applicable to Local Council membership of the fund, LGPS administrators seem unable (or at least unwilling) to identify such additional contributions directly against an individual council's deficit, and

2. It is an inescapable fact of economic life that the Present Value of money is significantly greater, and therefore more beneficial, than surpluses available from future activities (in most cases many years into the future).

It might appear to some that an Earmarked Reserve should be built up in a step towards offsetting current deficits. This is perfectly permissible and feasible under present accounting rules but should only be implemented after full and careful consideration of all the implications. In particular, is it a right and proper practice to use current (taxation) income to allow for a liability that will only be payable in future years? Additionally, how can a current council possibly guarantee that future elected councils will continue the practice, rather than divert such reserves for other purposes?

The future

With the imminent (if not already present) impact of the imposition of compulsory workplace pensions (CWP), councils need to be aware of, and take into account, the ever increasing pressure on costs and resources when considering future services, budgets and Precepts.

The introduction of CWP does not necessarily mean that current non-participants in a council's LGPS (if offered) will choose, or indeed be given the choice, to join. This is a matter for each council to decide.

The choices available are:

1. If not already a member, whether or not to adopt the LGPS and/or a CWP scheme.
2. Offer all employees membership of the LGPS scheme only, or
3. Decide to open, additionally, a CWP compliant scheme to run alongside LGPS (if the council is party to the LGPS), or as the only scheme available

Any choices given to present, and employees who are not members of the council's LGPS, need to be considered in conjunction with their existing employment conditions. It is, nevertheless, highly likely that, if they are given the choice between the LGPS or a qualifying scheme offering lesser benefits, most employees will choose the former. When considering the terms to be offered to new employees, councils need to be aware of, and consider, all, not merely the financial, implications of establishing differing terms and conditions for different employees, based solely on when they joined the council's employment.

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Immediate actions

Given the size and scope of current LGPS deficits, at least or until they are reduced to manageable proportions, it is important that councils do not lose sight of, or indeed ignore this issue. It is strongly recommended that this item appear regularly on council agendas (at least annually) and decisions taken around whether, and if so how, the council wishes to deal with LGPS deficits.

It is also vital that the questions surrounding pension membership by present, and in particular future, employees is dealt with in staff employment conditions and decisions.

Other material related to pensions is available in Legal Topic Note 79.

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