PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

A GUIDE FOR EMPLOYERS PARTICIPATING IN THE LGPS

AN INTRODUCTION TO THE LGPS FOR SCHEDULED BODIES

CONTENTS

1. INTRODUCTION

ACADEMIES, COUNTY COUNCILS, LONDON BOROUGHS, POST-92 UNIVERSITIES AND FURTHER EDUCATION COLLEGES PARTICIPATE IN THE LOCAL GOVERNMENT PENSION SCHEME (LGPS) AS 'SCHEDULED BODIES'[1]. THE NUMBER OF SCHEDULED BODIES HAS RAPIDLY EXPANDED IN RECENT YEARS WITH THE CREATION OF SCHOOL ACADEMIES. SCHEDULED BODIES HAVE AN AUTOMATIC RIGHT AND REQUIREMENT TO BE AN EMPLOYER IN THE LGPS.

The LGPS provides a positive benefit for its members; however, participating in the LGPS as a scheduled body comes with a range of potentially significant obligations including:

- Making regular contributions on behalf of employees and making additional contributions if the scheme is in deficit;
- Facilitating communications with scheme members;
- Setting up administrative processes for making payments; and
- Providing accurate and complete data to the scheme when requested.

This guidance will help you to obtain a full appreciation of these obligations and any associated risks.

Most scheduled bodies will not be in the process of joining the scheme. Later versions of this guidance that look at best practice for participating in the scheme and managing exit may be more relevant for you if you already have an understanding of your obligations to the LGPS. However, this guidance will be a useful introduction for those working in scheduled bodies that have not had any experience with the LGPS.

In addition, since many schools are in the process of transitioning into academies, many of them will be entering the scheme for the first time. This guidance will be particularly helpful for those would be-academies.

WHAT IS THE LGPS?

The LGPS is a defined benefit (DB) pension scheme for employees working in local government. It is made up of three schemes – the England and Wales scheme and two additional devolved schemes in Scotland and Northern Ireland.

Members of DB schemes are promised a guaranteed pension income in retirement. This means that the financial risk of the scheme's investment falls to you as an employer in the scheme.

The LGPS is governed at national and local level by a number of different bodies[2]. Scheduled bodies will mainly deal with the local pension fund managed by the local administering authority. You may also have the opportunity to engage with the Local Pensions Board. This is a board made up of an equal number of employer and member representatives and helps to ensure each scheme complies with its governance and administration requirements.

1 These are listed in Schedule 2 of the LGPS regulations.
2 See here for more information about how the LGPS is governed.

HOW IS THE LGPS FUNDED?

The LGPS is funded through the contributions of all employers and employees participating in the scheme. The contributions you pay are valued as an estimate of what the benefits are likely to cost in the future. These contributions are then invested to seek a return that can meet the promises made to members.

If the value of the pension scheme assets is not sufficient to meet the promises made to scheme members then the scheme is considered to be in deficit. If you exit the scheme, the cost of meeting the pension scheme liabilities that have accrued during the time of your participation may have decreased or increased.

The local administering authority acts as scheme manager and so is responsible for investing and managing LGPS assets, setting employer contribution rates, collecting employer and employee contributions, paying pension benefits as they fall due and dealing with various other aspects of administration.

The LGPS' funding position has weakened considerably over the last decade. A number of factors, such as increasing longevity and low gilt yields, have contributed to this, resulting in a rising deficit[3].

WHAT DO YOU NEED TO KNOW ABOUT THE SCHEME?

- The process of joining the scheme (if you are about to become an academy);
- Risks associated with participating in the scheme;
- How these risks might affect your financial prospects and how you can monitor and respond to them; and
- Your obligations as an employer participating in the scheme and how they could change in the future.

3 A full set of figures from the latest scheme valuation can be found here.

WHO IS RESPONSIBLE?

A number of people in your organisation need to be alert to the pension obligations associated with participating in the LGPS. These include, but are not limited to:

- Your HR department;
- Your finance director; and
- Those negotiating business restructures (such as mergers and acquisitions).

These individuals will need to monitor a number of risks that come with participating in the scheme, so that they can manage and mitigate them.

In larger organisations you may have the capacity to train up senior staff to find out and interpret essential information from the administering authority about your participation in the scheme. In smaller organisations this may need to be your finance personnel, chief executive or even an accountant, actuary or legal adviser.

Ultimately, where LGPS participation involves significant risk, your senior executive team or board will need to understand the implications of this. They may at times wish to seek expert advice.

KEY QUESTIONS TO ASK

- How many employees participate in the LGPS?
  - What are their ages, salaries and accrued benefits?
- Who will you engage with on pension issues at the administering authority?
- Is there any guidance available for scheduled bodies?
- What does the latest actuarial valuation of the fund tell you?
- What exposure to additional costs could arise due to redundancy, ill health and death in service?

2. RISKS FOR SCHEDULED BODIES PARTICIPATING IN THE LGPS

THE MAJOR UNFORESEEN COSTS THAT MAY COME WITH LGPS PARTICIPATION ARE:

- Increases in contributions; and
- Exit debts.

Your personnel listed in the previous section need to be alert to these risks and monitor them in the context of:

- Your current financial position including your reserve position;
- Your current workforce structure and how the balance of pension provision across the workforce interacts with your HR policy (in particular, if you participate in other defined benefit schemes); and
- Whether you have any guarantor provisions in place.

INCREASES TO CONTRIBUTIONS

There are a large number of variables that determine the cost of benefits as they accrue, including:

- Economic conditions;
- The investment profile of the fund assets;
- The current membership of the scheme; and
- Longevity projections for scheme members.

The interplay of these variables, and changes in them over time, can lead to substantial changes in employer contributions. By law, the fund will undergo an actuarial valuation every three years to assess how these factors will affect contributions. However, there are circumstances where an employer's contributions can be assessed outside of this cycle. This normally occurs when there is material change in an employer's circumstances eg where there has been a large number of redundancies.

During the valuation the actuary will recalculate:

- The past service contribution rate – in relation to the deficit or surplus; and
- The future service contribution rate – in relation to the current estimated cost of providing the benefits promised in the scheme.

Your contribution rates will be affected by the administering authority's view of your 'covenant'. This is your financial ability to support your obligations to the scheme now and in the future.

You should take part in discussions about your covenant strength as it is being established[4]. Indeed, the more you engage with the administering authority regarding key financial aspects that could affect your covenant, the less you are going to be surprised by the results.

It is important that you understand the rationale behind your allocated covenant strength, and what factors will improve or worsen your position. Higher contributions are required from an employer with a 'weak' covenant, because the administering authority has concerns about weaker employers' ability to pay if the deficit increases.

4 The Pensions Regulator provides helpful guidance on covenant assessment for private pension schemes – many of the same principles apply to employers participating in public service pension schemes.

EXIT DEBTS[5]

Exit debts are paid when you cease to participate in the scheme, and have the potential to be very high.

You are deemed to exit the scheme, otherwise known as ‘a cessation event’, when you no longer employ any active members in the scheme. A cessation event could occur if you cease to exist as an organisation, whether due to insolvency or a corporate restructure. It is therefore important to understand the implications of any corporate activity that might result in a business restructure and what implications this might have for exit costs. There may be ways of undertaking the same restructuring activity while isolating yourself from exposure to LGPS risk.

Exit debts are generally calculated using more cautious assumptions (known as a ‘risk-free’ basis) than the basis used to calculate the cost of providing pensions for your employees, resulting in higher liabilities. Calculating liabilities on this basis minimises the risk that deficits attributable to affected members inadvertently fall onto other employers as ‘orphan liabilities’.

COST OF REDUNDANCIES, ILL HEALTH AND DEATH IN SERVICE

When an employee is made redundant or suffers ill health, they may be eligible for early retirement benefits from the LGPS. If an employee dies in service then their beneficiaries are due a sum that is a multiple of their salary. Some funds make their own insurance provisions for these purposes so that the employer rate includes a small amount intended to cover these costs.

5 Please see our ‘managing exit’ guidance for further information.

3. WHAT YOU CAN DO TO MANAGE THESE RISKS

THERE IS LITTLE YOU CAN DO TO ACTIVELY MANAGE THESE RISKS AS YOU HAVE NO SCOPE FOR NEGOTIATING THE TERMS ON WHICH YOU PROVIDE PENSIONS TO YOUR EMPLOYEES AS A SCHEDULED BODY (COMPARED TO ADMISSION BODIES FOR EXAMPLE). IT IS THEREFORE VERY IMPORTANT THAT YOU UNDERSTAND AND ASSESS THESE RISKS, AND THEN MONITOR THEM AND DEVELOP CONTINGENCY PLANS FOR RESPONDING TO ANY CHANGES[6].

If you are a school and about to become an academy and, after having assessed the financial implications of participating in the scheme, are concerned about the implications for your financial viability going forward, you should contact the Department of Education as your ultimate sponsor. If you participate in a group structure, you should also engage the parent body in that group.

REPRESENTATION

You can influence the strategic direction of the fund, its treatment of employers and its investment profile through the work of the local pensions board[7]. Any employer participating in the scheme may be nominated to sit on their local pensions board. It is worthwhile finding out what opportunities there might be for representation either in person, or by establishing relationships with board members.

6 While The Pensions Regulator's guidance on integrated risk management is aimed at trustees of private schemes, it is a useful framework for setting contingency plans for risks that are ultimately outside of your control.

7 Please see guidance from the Scheme Advisory Board on Local Pensions Boards.

NOTES

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