PENSIONS COMMITTEE, 03.12.10

Present: Councillor Keith Greenly-Jones (Chairman)
Councillor John W. Jones (Vice-chairman).

Councillor Trefor Edwards

Co-opted Member:- Councillor Margaret Lyon (Conwy County Borough Council).

Officers:- Dilwyn Williams (Corporate Director), Dafydd Edwards (Head of Finance Department), Gareth Jones (Pensions Manager), Caroline Roberts (Investment Manager) and Gwyn Parry Williams (Committee Officer).

Apologies: Councillors Simon Glyn, John G. Jones, J. R. Jones (Gwynedd Council) and Councillor Tom Jones (Isle of Anglesey Council)

1. DECLARATION OF PERSONAL INTEREST

No declarations of personal interest were received from any member present.

2. MINUTES

The Chairman signed the minutes of the previous meeting of this committee held on 5 July 2010, as a true record.

3. FUNDING STRATEGY STATEMENT 2011/12 – 2013/14

Submitted – the report of the Corporate Director noting that it was required to review and publish a triennial Funding Strategy Statement (FSS) by 31 March 2011. The current Gwynedd FSS had been approved by the Pensions Committee on 7 February 2008 and as part of the review, the administrating authority would have to consult with the 40 employers that were part of the scheme, with the actuary and fund consultant and any other persons who were deemed appropriate.

He noted that the triennial actuarial valuation was being undertaken at the moment and that the preliminary results would be available late November and that they would be reported upon to this committee. Some pension funds in Wales had already received their results, but unfortunately, the Gwynedd Pension Fund results were late because of a delay in receiving required information from some of the fund’s employers. The assumptions that had been agreed for the previous valuation had been used when preparing the current actuarial valuation. The periods for recovering deficit for the various categories of employers were prudent and consistent with the previous valuation.

On 16 December 2009, this committee resolved to adopt the “Compass” system in order to develop a longer-term plan for employer contributions which had assurance of a long-term future. This would spread out the change in contributions over a longer period of time and would restrict the change in individual years. It was not possible to include some employers in this system as their long-term future had not been guaranteed. As the administrator of the Pension Fund, the Council had to protect the interests of all

employers in the fund and protect them from a position where an employer was closed down and left a deficit unpaid in the Pension Fund, as had happened in the case of Theatr Gwynedd recently. After receiving an early warning report from the actuary, a preliminary indication of potential general increases in employer contributions had been sent to the bodies that were not included in the “Compass” scheme. A number of them had responded with observations and concerns and he provided details of the employers that had responded thus far. The main concern raised was the affordability of the preliminary increase in the current financial climate. It was noted that some bodies would face financial problems and as a result would consider closing the fund to new employees, or even withdraw from the fund. Some employers had asked for a deficit recovery period as long as that of the councils, whilst others were eager to spread out the increase over at least three years. In addition, it was suggested that high increases in employer contributions should be avoided until the impact of the Government’s amendments to public sector pensions would be known.

He noted that the decisions of this committee would be submitted to a meeting of the employers on 6 December when discussing the actuarial results.

After receiving the preliminary results of the valuation recently, the committee would be required to decide upon the proposed policies to be included in the draft statement that would be the subject of a consultation with all employers of the fund. He asked the committee to decide upon the following issues -

The Equity Risk Premium
The expected additional gains from investing in equity rather than bonds. This referred to the difference between the gains expected from equity and the gains expected from bonds. As the presumption of the difference between the expected gains increased, the risk increased and the funding base became less prudent. In the 2007 valuation, the presumption for the expected additional gains from investing in equity and corporate bonds was 1.4%. Most of Hymans’ client funds assumed a less prudent equity risk premium, but investment experience (equity v bonds) since the previous valuation (and the decade since 2000) did not support the case for increasing the risk premium. He asked whether or not the committee was comfortable with using the same assumption (an equity risk premium of 1.4%) for the 2010 valuation.

Deficit recovery period
In the 2007 valuation, the administering authority decided that statutory bodies with tax raising powers would be able to recover any deficit over a period of 20 years. These statutory bodies included the three local authorities, community / town councils, North Wales Police Authority and the Snowdonia National Park Authority. It was also agreed to allow colleges to recover any deficit over a period of 15 years rather than over the expected future working lifetime. This affected Coleg Menai, Coleg Meirion-Dwyfor and Coleg Llandrillo. Coleg Harlech was part of the small admitted body pool, therefore, they were not allowed to change the deficit recovery period. For all other employers, the deficit was to be recovered over the expected future working lifetime of the remaining scheme members. The committee needed to decide whether or not the deficit recovery period of the statutory bodies should be reduced to 17 years, and whether or not the 15 year period of the colleges should be reduced. The reduction would reflect the three years that had passed since agreeing to the 20 or 15 year recovery period.

Phasing in of Contributions
Further to the discussions of the administrative authority with the employers and meeting with the actuary on 25 November 2010, there was a need to consider the period for phasing in employer contributions. Because of increases in excess of 3% in some

cases, there was an option to phase in the increase over a period of 6 years with an increase of at least 0.5% per annum until the full increase would be achieved. The committee needed to decide whether or not it was comfortable to continue with this policy.

RESOLVED
a) To agree that the same presumption should be used for the expected additional gains from investing in equity, namely an equity risk premium of 1.4% for the 2010 valuation.
b) To keep to 20 years as the deficit recovery period of the statutory bodies and 15 years for the colleges.
c) To extend the period for phasing in employer contribution increases over six years in those cases where the increase in the valuation exceeds 1.5%, however, should such a facility be provided, an increase of at least 0.5% per annum should be ensured until the full increase is achieved.

4. RESTRICTING TAX RELIEF ON PENSION SAVINGS

Submitted – the report of the Pensions Manager noting that the Government had confirmed in June 2010 its commitment to restrict the level of tax relief available when accumulating annual and lifelong pension allowances in a way that would *ensure that the system of pensions' tax relief remains fair and sustainable, and to protect the public finances.* The Government had said that it provided generous tax relief to save for a pension, encouraging individuals to take responsibility for retirement planning and recognising that pensions were less flexible than other forms of saving. The cost of pension tax relief net of income tax was around £19bn in 2008/09.

He noted that the Annual Allowance would be reduced from April 2011 for tax-privileged saving from its current level of £255,000 to £50,000. Tax relief would be available at the individual's marginal rate. Deemed contributions of defined benefit schemes would be valued at a "flat factor" of 16 with individuals being allowed to offset any contributions exceeding the Annual Allowance against unused allowances from the previous three years. The advice of the Government's Actuary was sought on the appropriate level of the factor and it was decided to set the level at 16, which meant that an increase in annual pension benefit of £1,000 would be deemed to be worth £16,000 against the allowance. The previous year's benefits would be re-valued against the CPI index with any negative accruals being treated as zero. The Government would consult on options that would enable individuals who saw a very significant increase in their pension rights in a specific year to pay the tax charge out of their pension rather than from current income. It had been decided to exclude deferred members from the regime.

The Government believed that the restriction of pension tax relief should be applied fairly to individuals in different circumstances as far as possible, but that it had to also be robust against risks of avoidance. In addition, it was not suitable to apply the Annual Allowance test in the year of death or the year which lump sums were paid where contributions were paid to individuals who had been diagnosed with serious terminal / ill health. The Government also recognised that it would be inappropriate to implement the Annual Allowance in some cases of the most serious ill health and consideration would also be given to exempting ill health benefits from the Annual Allowance scheme. The Government did not believe that an exemption should be made for individuals being made redundant. Most redundancy packages included an upfront payment, with the first £30,000 being tax-free. In many cases, the entire redundancy package was less than £50,000.

The Government was expecting schemes to adapt to provide more flexibility of choice for members on how to take redundancy packages, and in the rare cases where redundancy payments caused large one-off spikes in pension accrual, it was believed that the right to carry over up to three years' unused allowances would be likely to offset any excess of Annual Allowance in most cases. The Government intended to set out further details on how exemptions would operate and at the same time how to manage the risks of avoidance that would open up in draft clauses planned to be included in the Finance Bill 2011, due to be published for consultation in late 2010. In addition, and subject to the results of the consultation on the details and handling, it was proposed to reduce the lifelong level from its current level of £1.8m to £1.5m from April 2012. Although there was no confirmation of the final details on how to implement the new procedure thus far, it was expected that individual members would be responsible for monitoring and reporting any excess accrual to HMRC. However, it was expected that pension scheme administrators needed to inform members of the value of annual accruals within a specific timetable.

He noted that a newsletter had already been produced on this and other changes and that it had been distributed to members. There would be a need to upgrade the administration software, also the employers of the fund would need to provide annual contribution reports earlier than currently done in order to enable the administration unit to process and produce the Annual Benefit Statements within the timetable set by HMRC.

Agreed, at the request of a member, that members of the committee received a copy of the newsletter.

RESOLVED to accept the report.

5. INDEPENDENT PUBLIC SERVICE PENSIONS COMMISSION INTERIM REPORT BY LORD HUTTON OF FURNESS (THE HUTTON REPORT)

Submitted – the report of the Investment Manager, noting that public sector pensions provided retirement income for millions of people in the UK. Because of the defined benefit nature of these schemes and the increasing cost of funding them, the Independent Public Service Pensions Commission had been set up to review the situation. The remit given to the Commission was to conduct a fundamental structural review o public service pension provision and to make recommendations to the Chancellor and Chief Secretary on pension arrangements that were sustainable and affordable in the long-term, fair to both the public service workforce and the taxpayer and consistent with the fiscal challenges ahead, while protecting accrued rights. The local government scheme (LGPS) was included in the brief of all public sector pensions. He noted that the LGPS was a funded scheme, whilst the majority of other schemes were unfunded with the contributions received being used in order to pay current pensions. There was no intention to change this situation. The interim report had been published on 7 October 2010. The final review was expected next year to coincide with the 2011 budget.

He noted that the proposal recognised the importance of pensioning the public sector and the original intention when such schemes had been established many years ago. The cost had increased because life expectancy was longer, there had been an increase in the number of pensioners and because pension rights had been extended to all employees. The requirement to provide comparative pensions was a barrier for providers outside the public sector and it could make working arrangements with the private/voluntary sector more difficult. The discount rate used to set employer contributions in actuarial valuations was key and it should be reviewed. Current and past reform measures had helped to reduce the long-term cost of funding public sector

pensions. The Commission had concluded that further reform of the current schemes was necessary. Some short-term reforms were recommended in the interim report. The Commission would be consulting further with relevant organisations and would submit a range of options to the Government. The final report would set out in more detail the broad range of radical solutions in an attempt to seek to ensure a balance between fairness to the taxpayer and to the members of the scheme. The accrued rights of employees would be protected against any reforms.

In relation to the short-term reforms, there was a need to amend the public sector pension schemes, however, accrued benefits needed to be protected properly. Further work was required on this, therefore, it was not a viable option in order to achieve short-term savings. The Commission agreed that the most effective way of achieving short-term savings was to increase employee contributions and the Government was responsible for deciding upon the level of increases that should protect those on low salaries and be introduced in stages. The Government published in the Comprehensive Spending Review that employee contributions would increase 3% on average by 2014/15. The increases would be introduced gradually from 2012 onwards. Because this was the average for all public sector schemes with varied employee contribution rates, it was not known how much the increase would be for LPGS members.

In relation to the long-term reform, the interim report noted that the current system could not respond in a flexible enough way to demographic changes seen in recent years and the need for more mobility between the public and private sectors. It had also led to unequal benefits for high flyers in comparison to low flyers and an unfair distribution of costs between the employer and the employee. The Commission believed that a long-term structural reform was required to the current final salary provision of benefit, but that an individual defined contributions model for employees was not appropriate for public service pensions. It was noted in the report that another model was required for the scheme, which distributed the risk fairly between the employer and the employee and that provided a sufficient pension for the members. An alternative range of benefits would be considered, such as career average arrangements and hybrid schemes combining defined benefits and defined contribution models. The final report would consider the administration costs of pension schemes and the opportunities to rationalise and reduce costs. This would include possible simplification and consolidation of some functions across various schemes and units within schemes. The report noted, as a specific example, a number of LPGS funds, how the costs varied between them and the possible efficiency should the number of funds be reduced.

He noted that the final report would include the options for long-term reform and recommendations and that it would be published for the 2011 budget.

RESOLVED to accept the report.

6. RATIONALISATION OF PENSION FUNDS IN WALES

Submitted – the report of the Corporate Director noting that it had been reported to this Committee in June 2009 that the Treasurers to Pension Funds in Wales had considered whether or not there would be advantages in pursuing greater collaboration or even merging funds in Wales. As there was very little hard evidence available on which a rational decision could be based, the Committee had agreed to participate in a joint exercise with other pension funds in Wales to commission an outline business case to establish whether there would be financial advantages in having fewer funds in Wales. In March of this year, the Pensions Sub-group of the Society of Welsh Treasurers commissioned a study by Price Waterhouse Coopers (PwC). The study had been

completed and the final report was awaited. The report would suggest that there would be room to create more efficiency savings along with achieving greater consistency by reducing the number of funds in Wales. The potential savings were substantial enough to merit further more detailed work.

He noted that the study recognised that any change would take time to be implemented and that it could be complex and that there would be costs that would repay themselves over a period of time, subject to the decision made. In addition, as the employer contributions were changed every three years, namely at the time of the valuation every three years, the earliest that any savings would be available, even after taking immediate action, would be 2014/15. Managerial issues would also be a substantial issue in the context of any further work to be achieved. However, the study set out a strong foundation to suggest that further detailed work should be undertaken, and the Treasurers for Pension Funds were currently considering that further work should be done to establish the outline business case based on reducing the number of Welsh pension funds. The objective was to establish the ideal model for Wales, namely a single fund, or two, three or four sub-regional funds. The Pensions Sub-group of the Society of Welsh Treasurers would proceed with the work with appropriate assistance. The group was of the opinion that this was important work in order to establish the prima facie case to rationalise the number of funds in Wales which would improve efficiency and make the standards of the service more consistent.

RESOLVED to note the conclusions of the report and agree to continue to participate in the further work that is to be achieved.

The meeting commenced at 10.00am and concluded at 11.00am