

SURREY COUNTY COUNCIL

SURREY PENSION FUND BOARD

DATE: 22 MAY 2015

LEAD OFFICER: SHEILA LITTLE, DIRECTOR OF FINANCE

SUBJECT: FREEDOM AND CHOICE



SUMMARY OF ISSUE:

The report explains the statutory changes to pension fund scheme rules that will allow LGPS members over the age of 55 to transfer their LGPS benefits to defined contribution (DC) arrangements, or take advantage of the new trivial commutation limits.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board note the report.

REASON FOR RECOMMENDATIONS:

The Pension Fund Board must be aware of the changes implemented by the Government with regard to freer access of members' pension assets by those approaching retirement.

DETAILS:

Background

- 1 In a written statement on 21 July 2014, the Chancellor announced Government proposals to give more "freedom" to defined benefit (DB) pension scheme members. This appeared to have the private sector largely in mind as it was expressly stated not to extend this freedom to the unfunded public service schemes (because of the potential significant impact on public finances). However, it has since been confirmed that the proposals would include the funded public service schemes, principally the LGPS, with safeguards required that are similar to those in the private sector.
- 2 On 24 November 2014, the Department for Communities and Local Government (DCLG) published a paper on the proposed safeguards that will apply to public service pension schemes, following Government amendments to the Pensions Schemes Bill. From 6 April 2015, LGPS members have the flexibility to take their benefits as up-front cash, via a transfer to a defined contribution (DC) arrangement. However, this flexibility comes at the expense of the remaining life-long pension, and it will not always be obvious whether this will be in a member's best interest. Furthermore, it is acknowledged that this may have a positive or negative material impact on LGPS funds' financial positions.

Safeguards

- 3 To take advantage of the new flexibility, a member would need to transfer their LGPS benefits into a DC arrangement before retirement. The chosen benefit payments would then come from that arrangement, with no further input or administration by the LGPS fund. As a result, the following safeguards apply to the transfer from the LGPS fund to the DC arrangement:

Financial Advice: A fund will need to clarify and check that a member has received appropriate independent advice before being allowed to transfer to a DC arrangement. However, members with 'pension wealth' below £30,000 will be exempt from having to take advice. LGPS members will have to pay for their own independent advice.

Cash Equivalent Transfer Value (CETV) Reductions: The DCLG will have the right to arrange for reductions in CETVs from funded public service pension schemes, in the event that there is the need to protect the taxpayer (and the pension scheme).

- 4 There is also an existing safeguard that allows schemes to apply to the Pensions Regulator to delay the payment of transfers. This power however is only likely to be of use in limited circumstances. Both main safeguards are potentially problematic.

Financial Advice

- 5 Initially, the only exception to the requirement for advice will be for those with pensions wealth below £30,000. The Government has since decided that this limit will apply to the member's cash equivalent transfer value (CETV) and therefore LGPS funds will not need to consider the value of any benefits the member has in other registered pension schemes. However, it is not clear if the LGPS counts as one 'scheme' for these purposes. If it does, account would have to be taken of service in other LGPS funds that has not been consolidated in the LGPS fund handling the transfer request.
- 6 Government statistics show that a typical employee has, on average, 11 jobs during his or her working lifetime. One consequence of this is that a member with deferred pensions in a number of previous pension schemes, LGPS or otherwise, could have several transfer values below the advice requirement limit. This would result in significantly more than £30,000 being transferred into a DC arrangement without the member receiving any advice.
- 7 LGPS funds will not be required to review whether or not the financial advice is "correct", just that it exists. The LGPS will need to check that a member has received independent advice and that the advice is from a reputable source e.g., an adviser authorised by the Financial Conduct Authority (FCA). The rules around this check will be set out in secondary legislation. Inappropriate financial advice could leave members with much poorer retirement incomes. The potential for member poverty as a result of incorrect advice should not be underestimated.

- 8 Even if appropriate independent advice is received, there is no obligation on the member to act upon that advice. This could lead to members taking CETV transfers when it is in their best interest to remain in the LGPS (which is likely to be the case for most LGPS members). If a member has provided evidence of taking advice then, in general, the fund must pay the transfer value. The advice cost is to be borne by the LGPS member and must be paid even if the transfer does not proceed.
- 9 LGPS administrators will need to be sure that their processes are robust enough to ensure that transferring members have received advice from a properly qualified financial adviser that complies with all the requirements of the legislation. If this is not properly evidenced and recorded, funds will be open to challenge in future. Information about the increased options now available at retirement will need to be clearly communicated to employers and members before any financial advice is sought to avoid any unnecessary expense being incurred. Equally, LGPS funds will also need to avoid the situation where members retire while unaware of the new flexibility, after which it would be too late to do anything.

The approach to Freedom and Choice of the Surrey Pension Service

- 10 The Pension Service team has established new processes to enable the education of scheme members and ensure the efficient and compliant administration of Freedom and Choice.
- 11 Information about Freedom and Choice, including the necessity or recommendation to take independent financial advice has been included in a member newsletter, a revision to the scheme guide and as part of notifications to deferred members.
- 12 For those members who request a transfer a compliant new suite of documents have been produced which include the following risk warnings:
- Discharge forms will include new questions to confirm whether the member has other LGPS rights (to determine whether a transfer out is permitted. Also, to establish whether the CETV in all LGPS funds is over £30,000) and whether the transfer is to a scheme which offers flexible benefits;
 - Where the CETV is over £30,000 and the new scheme offers flexible benefits, members will be supplied with a Confirmation of Advice Form to be completed by the qualified adviser.
- 13 In addition to these safeguards members who enquire about transfer options will be warned of the dangers of pension liberation fraud and provided with contact details of the Pensions Regulator.

Cash Equivalent Transfer Value (CETV) Reductions

- 14 The method of calculating any reduction in CETVs will be set out in secondary legislation. This will be subject to consultation in due course. There are a number of other factors, including how the trigger for any reduction will be managed and quantified. The proposal to reduce CETVs in certain circumstances raises a number of issues:

- There is a question mark over whether CETVs should be reduced at all. LGPS benefits are guaranteed and paid under statute and therefore members have every reason to expect full payment of those benefits. The introduction of reduced CETVs could be inconsistent with this.
- Requiring funds to reduce CETV payments becomes a paradox where the payment of the full CETV is a lower cost to the fund, and payment of the CETV will actually reduce pension risk, as the fund no longer has to meet that future liability.
- An approach adopted to reduce CETVs could result in very different reduced transfer payments for (say) two members with identical benefits in two separate funds. The impact could vary between different employers within the same fund, potentially resulting in added cost and administration.
- Any reduction reduces the amount of cash available to members, and thus reduces the likelihood that the member will be advised that a transfer is in his or her best interests, resulting in a waste of advice fees incurred by the member.

Take Up Rates in the LGPS

- 15 The degree of any potential CETV reduction will affect the likelihood of members exercising the option and the profile of payments which, in turn, will affect the funding and investment impacts. The temptation of a lump sum payment, even if subject to a large reduction, may still be enough to ensure some transfers occur, especially where the value is less than £30,000.
- 16 A more generous approach (little or no reduction to the CETV) could result in more members exercising the option across the pension spectrum. In any event, financial advisers may find it difficult to recommend that a transfer is in the best interests of members based on the level of the transfer amounts available using current CETV factors.
- 17 The Government's initial estimate was a take-up rate of around 10% of those approaching retirement. It was suggested this would depend on, amongst other things, whether transfers are actively promoted by employers/funds, what is available in the DC market, and the quality of financial advice. Income tax may also affect the take-up rate, with any cash taken above HMRC tax-free pension limits subject to the individual's marginal rate of tax. LGPS members tend to be cautious when transferring pension rights, and perhaps this will mean that the new rules will be used less widely in the LGPS than elsewhere. It is difficult at this stage to predict what will happen with any certainty. Employer engagement and education with members may increase take-up levels.

Impact of Increased Transfer Activity

- 18 There could be a material impact on LGPS funds, particularly for the more mature ones due to cash flow implications or for those that are badly funded. For funds and employers that are in deficit, it is possible that the underlying asset share is lower than the corresponding CETV. This would mean that, although a liability gain generally arises if a CETV is paid, the asset share (or funding level) would be lower for those benefits left behind in the fund.

Conversely, a well-funded employer where the asset share is bigger than the CETV would see both the deficit reduce and the funding level improve.

Effect on Cash Flow

- 19 Transfer values will crystallise liabilities as a result of being settled up-front rather than being spread as pension payments over many years. This can affect investment strategy and impact cash flow. Larger one-off cash payments may mean that funds need access to more liquidity, to avoid disinvestment costs if assets have to be sold to meet liabilities. The impact of up-front settlement will also accelerate negative cash-flow positions. Funds may need more readily available income from existing assets. But transfers out will remove some key risks, such as investment, inflation and longevity, in respect of the liabilities transferred.

Effect on the Surrey Fund

- 20 Further analysis concerning the effect on the Surrey is attached as Annex 1 (Freedom and Choice in the LGPS), involving the following:
- Identification of active and deferred members due to reach age 55 or above (and their split of liabilities above and below the £30,000 'pension wealth' advice threshold) over the short to medium term.
 - Comparison of CETVs versus funded pension liabilities and assets actually held.
 - Investigation of the impact on funding level, cash flows and pension cost of different percentage levels of assumed transfer to DC at retirement.
 - Calculation of liquidity levels required to meet the increased level of transfer payments.
 - Impact on individual employers, focusing on particular employers that are mature, or are badly funded.

Conclusion

- 21 The new freedoms are more aimed at members of the private sector rather than public service schemes. They have extended to funded public service pension schemes because of the existence of a separate pool of assets to pay transfer values. The Government has felt the need to put in place protection in the form of CETV reductions to ensure there will never be the need for future taxpayer support.
- 22 Of more concern is the fund's responsibility for ensuring that a member has received appropriate independent advice. There is clearly the potential for members receiving the wrong advice and future mismanagement of DC monies, resulting in pensioner poverty.
- 23 The Surrey Fund has communicated the new rules to members and employers. In particular, retirement packs have been adapted to reflect the new flexibility as an extra option for members approaching retirement to consider.

CONSULTATION:

- 24 The Chairman of the Surrey Pension Fund Board has been consulted on the report.

RISK MANAGEMENT AND IMPLICATIONS:

- 25 Risk related issues are contained within the report, most notably the effect on cash flow, funding levels and the need to check and monitor the provision of independent financial advice to members.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

- 26 Financial implications for the Surrey Fund are included in the Hymans Robertson study shown in Annex 1.

DIRECTOR OF FINANCE COMMENTARY

- 27 The Director of Finance is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed within the report and attached Annex 1.

LEGAL IMPLICATIONS – MONITORING OFFICER

- 28 Following the enactment of the Pension Services Act 2015, all LGPS Funds (as 'defined benefit' schemes) are required to implement these changes with effect from 6 April 2015. As further Regulations and statutory guidance are published in due course, these changes will need to be reviewed to ensure continued compliance by the Surrey Fund.

EQUALITIES AND DIVERSITY

- 29 There are no equalities or diversity implications associated with this report.

OTHER IMPLICATIONS

- 30 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

- 31 The following next steps are planned:
- Further updates on outcomes will be presented at future Board meetings.

Contact Officer:

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Consulted: Surrey Pension Fund Board Chairman

Annexes: Hymans Robertson study on the Surrey Fund.

Sources/background papers: None