

Local Authority (Scotland) Accounts Advisory Committee [LASAAC]

## **The Scottish Local Government Pension Scheme: Using the Financial Statements**



August 2012



**SCOTTISH LOCAL GOVERNMENT PENSION SCHEME (LGPS)**

**USING THE FINANCIAL STATEMENTS**



**The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) is constituted of volunteer members representing the Chartered Institute of Public Finance & Accountancy (CIPFA), the Association of Chartered Certified Accountants (ACCA), the Institute of Chartered Accountants of Scotland (ICAS), Audit Scotland and the Scottish Government. LASAAC is primarily concerned with the development and promotion of proper accounting practices for Scottish local authorities. A key task in achieving this is LASAAC's contribution to the development of the 'Code of Practice on Local Authority Accounting in the United Kingdom' ('the Code').**

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**LASAAC**  
**[Local Authority (Scotland) Accounts Advisory Committee]**  
**SCOTTISH LOCAL GOVERNMENT PENSION SCHEME (LGPS):**  
**USING THE FINANCIAL STATEMENTS**

**EXECUTIVE SUMMARY**

**Objective**

This paper is intended to assist users of Scottish Local Government Pension Scheme (LGPS) financial statements, including elected members. It supports, but does not replace, specific training for elected members with LGPS responsibilities.

**Role of Financial Statements**

The financial statements form an important part of financial discipline and corporate governance. They may be used as a basis for question and challenge to support:

- Stewardship of the LGPS fund
- Risk management of the LGPS fund

**The Scottish LGPS**

The LGPS is based on specific legislation. LGPS funds primarily exist to:

- Administer the payment of promised pension benefits and the collection of funding contributions
- Strategically manage LGPS fund assets with due regard to liabilities

**Key Aspects in Understanding the Financial Statements**

Readers of the financial statements are likely to be assisted by some knowledge of the following key areas:

- LGPS Pension Benefits
- Estimation of LGPS Promised Retirement Benefits
- LGPS Investments
- Funding Arrangements



## CONTENTS

	<u>PAGE</u>
<b>CHAPTER 1 - THE LGPS FINANCIAL STATEMENTS.....</b>	<b>4</b>
About this Document.....	4
Role of Financial Statements.....	5
The Financial Statements and Governance of the LGPS .....	5
Stewardship .....	6
Risk.....	6
Use and Interpretation of the LGPS Financial Statements .....	7
Fund Account and Example Questions.....	7
Net Assets Statement and Example Questions .....	9
<b>CHAPTER 2 - THE ROLE AND BASIS OF THE LGPS .....</b>	<b>11</b>
The Purpose of the LGPS and the Role of Elected Members.....	11
Operation of the Scottish LGPS and the Legislative Framework .....	12
Specific Guidance for LGPS Funds.....	12
Overview of LGPS Operation.....	13
Key Areas Supporting Interpretation of the Financial Statements .....	13
<b>CHAPTER 3 - LGPS PENSION BENEFITS .....</b>	<b>14</b>
Overview of LGPS Pension Benefits.....	14
Key Aspects Relating to LGPS Pension Benefits .....	15
<b>CHAPTER 4 - ESTIMATION OF PROMISED RETIREMENT BENEFITS .....</b>	<b>16</b>
Overview of Estimation of LGPS Promised Retirement Benefits.....	16
Key Aspects Relating to the Estimation of Promised Retirement Benefits .....	18
<b>CHAPTER 5 - LGPS INVESTMENTS .....</b>	<b>20</b>
Overview of LGPS Investments .....	20
Key Aspects Relating to LGPS Investments.....	22
<b>CHAPTER 6 - LGPS FUNDING ARRANGEMENTS .....</b>	<b>23</b>



Overview of Funding Arrangements .....	23
Funding Level Assessment: Estimation of Promised Retirement Benefits .....	24
Employers' Contributions.....	24
Demographics of LGPS Membership.....	25
Changes to Employing Organisations Participating in an LGPS Fund .....	25
Key Aspects Relating to Funding Arrangements.....	26
<b>APPENDICES .....</b>	<b>28</b>
Appendix A - Fund Account: Outline of Contents .....	28
Appendix B - Net Assets Statement: Outline of Contents .....	30
Appendix C - Scottish LGPS Administering Authorities & Funds .....	32
Appendix D - Selected Reference Material for the LGPS.....	33
Appendix E - Overview of Current Common Pension Benefit Entitlements .....	34
Appendix F - Estimation of Promised Retirement Benefits: Common Assumptions Required .....	38
Appendix G - LGPS Investments: Overview of Myners Principles .....	39

## **CHAPTER 1 - THE LGPS FINANCIAL STATEMENTS**

### **CHAPTER SUMMARY**

#### **Role of Financial Statements**

The financial statements form an important part of financial discipline and corporate governance. They may be used as a basis for question and challenge to support:

- Stewardship of the LGPS fund
- Risk management of the LGPS fund

#### **Use and Interpretation of the LGPS Financial Statements**

An understanding of the main content of LGPS financial statements, especially the Fund Account and the Net Assets Statement, can help elected members to identify questions relating to corporate governance. Key elements of the statements include:

- Fund Account
- Net Assets Statement
- Notes to the Financial Statements

#### **Example Questions**

Some typical example questions are suggested in this chapter.

### **About this Document**

1. This guide is intended for use as an initial reference point for those with an interest in Scottish LGPS (Local Government Pension Scheme) financial statements. This includes elected members with governance responsibilities. The guide supports, but does not replace, specific training of elected members with LGPS responsibilities. It provides a brief overview of the financial statements with supporting chapters seeking to provide basic information about the LGPS so that informed use may be made of the financial statements.
2. Example questions for those interested in governance are provided. It is not suggested that these questions always need to be asked, nor that they are the only questions which should be asked. They are provided as examples of the scrutiny and challenge that can arise from a review of the financial statements. In doing so they illustrate that sometimes it is the simple and obvious questions that should be asked.

## **Role of Financial Statements**

3. LGPS financial statements are included within the Pension Fund Annual Report<sup>1</sup>. The annual report includes a requirement for the LGPS to specifically report on key aspects of LGPS management. In particular a Governance Compliance Statement is required which details how the LGPS fund is governed and controlled.
4. The financial statements are a formal record and report of the financial activities, assets and liabilities of the LGPS fund. They are intended for use by a potentially wide variety of readers including LGPS members, elected members, participating employing organisations and entities to which the fund owes money.
5. Information in the financial statements is expected to show certain characteristics, usually required by accounting standards, such as being understandable, relevant, material, reliable and comparable. An item is material to the financial statements if its omission or misstatement would influence the decisions or assessments of users of the statements. Materiality can depend on either, or both of, the size and nature of the item.
6. LGPS members, or their representatives, may use the statements to question and challenge how well their interests have been managed. The LGPS Committee may use them to review, question and challenge the management of the LGPS fund. Constructive challenge of past decisions and the financial situation should improve assumptions used for future decisions and forward plans.
7. The preparation of the financial statements supports good governance and control. This is evidenced by the internal discipline required to identify assets and liabilities; account for the use of resources; and ensure management accountability for LGPS assets and liabilities. This internal discipline will normally also be supported by internal audit processes.
8. The need for rigorous internal discipline is reinforced by the existence of an annual external audit and reporting process.

## **The Financial Statements and Governance of the LGPS**

9. In relation to the governance of the LGPS the key areas suggested for particular focus when using the financial statements are:
  - Stewardship of the LGPS fund resources
  - Risks to which the LGPS fund resources are exposed

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<sup>1</sup> As required by SSI 2010 / 234 and explained in Finance Circular 1 / 2011. See:

SSI 3010/234: [http://www.legislation.gov.uk/ssi/2010/234/pdfs/ssi\\_20100234\\_en.pdf](http://www.legislation.gov.uk/ssi/2010/234/pdfs/ssi_20100234_en.pdf)

Finance Circular 1/2011: <http://www.scotland.gov.uk/Resource/Doc/1070/0112302.pdf>

10. It should be noted that, for governance purposes, the financial sustainability of an LGPS fund is primarily addressed through the actuarial funding valuation report. The funding arrangements for the LGPS are discussed in Chapter 6.

### **Stewardship**

11. 'Stewardship' refers to the care and concern a person or organisation should have for another person's resources entrusted to their responsibility. Those responsible for LGPS governance may reasonably be anticipated to exercise their stewardship responsibilities by using the financial statements as a basis to question and challenge decisions and actions relating to the physical and financial resources of the LGPS fund, held on behalf of its beneficiaries.
12. Questions and challenge in relation to stewardship will therefore include queries on the policies and processes in place for the control, use and protection of resources. The appropriateness of, or basis for, past decisions may also be reviewed.

### **Risk**

13. Risk is an inherent aspect of life, and LGPS funds are subject to events that can affect their assets and liabilities, impacting on the ability to provide benefits for the LGPS members in line with their statutory entitlement and the level of contributions required from employers and employees. From a governance and management perspective the challenge lies in understanding the risks and opportunities that can arise and in managing, mitigating and controlling these appropriately. Risk elimination is almost certainly not achievable and would not necessarily represent the best interests of the LGPS fund and its members. Financial statements can provide an initial basis for considering the risks, or opportunities, to which LGPS resources are subject.
14. The wide variety of risks and opportunities to which LGPS resources are exposed includes:
  - market risks: such as changes in interest rates or exchange rates
  - demographic / demand risks: such as changes in life expectancy and behavioural changes in terms of exercising 'lump sum' withdrawal options
  - investment risk: such as the risk that investments perform poorly or not as expected
  - physical risks: such as flood, fire and damage (e.g. to investment property or administration facilities and equipment)
  - misappropriation risks: such as theft, fraud and embezzlement
  - legislative or compliance risks: such as adhering to pensions statutes or data security requirements
  - opportunities: these may arise from a variety of situations including: the choice of investments available; shared services; potential use of new technology and/or process redesign to reduce administrative costs; accommodation choices; and strategic decisions regarding funding arrangements / employer organisations
15. Questions in relation to risk will include those relevant to the potential impact of events on the provision of benefits to the LGPS members. Aspects that may be specifically queried or challenged could include how risks are identified, the extent



of exposure to those risks, the capacity to respond to specific scenarios and any risk-related management decisions.

### **Use and Interpretation of the LGPS Financial Statements**

16. LGPS financial statements form part of the 'pension fund annual report', which is required by legislation. The annual report is also likely to include other reports such as a funding strategy statement, a statement of investment principles and a governance compliance statement.
17. LGPS financial statements are prepared according to the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom'. This generally requires adherence to recognised accounting standards. This primarily relates to International Financial Reporting Standards, particularly International Accounting Standard 26 'Accounting and Reporting by Retirement Benefit Plans'.
18. LGPS financial statements consist of three main elements:

Fund Account	This details the transactions during the year that have changed the value of the LGPS Fund.
Net Assets Statements	This details the assets held in the fund, as well as its liabilities, at the 31 <sup>st</sup> March. The value of pension benefits which will be payable in the future are not shown as liabilities until they actually become payable.
Notes to the Financial Statements	The notes provide more detail on the information provided in the Fund Account and the Net Assets statement and how the LGPS fund's finances are managed.

### **Fund Account and Example Questions**

19. The Fund Account is split into two main sections:
  - Dealings with members, employers and others directly involved with the scheme: this section relates primarily to the payment of benefits and the operation of the funding arrangements.
  - Returns on investments: this section relates to the performance of investments in providing a return, any gains or losses for the year on the investments held and the cost of undertaking investment management.
20. Additional explanation of the items shown in each section is provided in Appendix A.

21. Questions relating to the stewardship and risk management of the LGPS for the year in question, as reported in the Fund Account, could include the following examples:

**Stewardship of administration activities:**

- How did employer and employee contributions for the year differ from those originally anticipated?
- What are the trends that are emerging in terms of LGPS membership changes?
- What significant 'transfers in' occurred during the year?
- Were all benefits paid on time?
- How is the accuracy and timeliness of membership information from employers monitored and controlled?
- How is the value for money of administration costs established, and how does this compare to other LGPS funds?

**Risks of administration activities:**

- What are the major risks that could affect timely and accurate payment of pension benefits?
- Has the financial stability of employing organisations been reviewed recently?
- What error and fraud prevention and / or detection controls are in place?

**Stewardship of investment activities:**

- How is the performance of investment managers measured, monitored and compared to other managers?
- How have voting and other rights been used during the year?
- How is the value for money of investment management costs established?
- Are performance bonus and investment management fee arrangements clear and transparent?

**Risks of investment activities:**

- What would have happened to the returns for the year if UK interest rates had increased by 0.5%?
- Are derivatives used only for the elimination of risk (e.g. 'hedging') and, if not, to what material risks is the LGPS fund exposed?
- Where the LGPS elects to 'self-manage' some investments (i.e. investment managers are not appointed) has a risk assessment been undertaken and how are the risks managed?
- The financial statements detail the risks to which financial

instruments are exposed and how they are managed. What controls are in place to ensure that the processes described are followed?

### **Net Assets Statement and Example Questions**

22. The Net Assets Statement shows the assets that the LGPS fund has. More detail on each item included in the statement is provided in Appendix B.
23. Pension benefits which are payable after the 'Net Assets Statement' date are not usually shown as liabilities in the Net Assets Statement. The value of these is normally disclosed separately in the financial statements (see Chapter 4 for more details on the estimation of the value of promised retirement benefits).
24. It would be expected that the most significant element in the statement is 'Investment Assets'. These will normally be valued at 'fair value' (market value, which will normally be based on 'bid price' i.e. the price a buyer is willing to pay) and will therefore reflect the trading and stock market condition for each type of asset as at the 'net assets statement' date.
25. Consequently the reported value of fund assets may show some volatility on an annual basis. Given the long-term nature of LGPS pension obligations the long-term performance of the investments will normally be a key concern. The extent of short-term volatility may be taken to reinforce the importance of appropriate diversification and risk-management.
26. Questions relating to the stewardship and risk management of the LGPS assets and liabilities, as reported in the Net Assets Statement, could include the following examples:

#### **Stewardship of investments:**

- Has the fund complied with the legislative limits restricting the proportion of the fund that can be invested in particular investment categories?
- How is each investment holding verified, both at the year end and throughout the year, so that the LGPS fund's claim to the asset is evidenced and legally supported?
- How do investment managers demonstrate that they are adhering to the LGPS fund's Statement of Investment Principles?

#### **Risks to investments:**

- What risks are the property holdings exposed to, and how are they managed?
- How do the investment managers evidence that they have assessed the advisability and suitability of investments?
- If any 'non-hedging' derivatives are held what risks are the LGPS exposed to, and how material are they?
- How has the security of cash deposits, including 'term deposits', been assessed?

- What are the key market risks that the investments are exposed to, and what sensitivity analysis has been undertaken?

## **CHAPTER 2 - THE ROLE AND BASIS OF THE LGPS**

### **CHAPTER SUMMARY**

#### **The Role of Elected Members on LGPS Committees**

The role of elected members in relation to the LGPS may be regarded as equivalent as that of a trustee.

#### **The Scottish LGPS**

The LGPS is based on specific legislation. LGPS funds primarily exist to:

- Administer the payment of promised pension benefits and the collection of funding contributions
- Strategically manage LGPS fund assets with due regard to liabilities

#### **Key Aspects in Understanding the Financial Statements**

Readers of the financial statements are likely to be assisted by some knowledge of the following key areas:

- LGPS Pension Benefits
- Estimation of LGPS Promised Retirement Benefits
- LGPS Investments
- Funding Arrangements

These areas are considered in later chapters.

#### **The Purpose of the LGPS and the Role of Elected Members**

27. An LGPS fund exists to meet the future pension obligations arising on the fund to discharge the pension responsibilities of the participating employing organisations. While elected members on LGPS Committees are not trustees in legal terms their role may be regarded as equivalent to that of a trustee.
28. LGPS funds are normally 'multi-employer' schemes. For each fund one Scottish local authority is specified as the 'administering authority'. Participating employers in an LGPS pension fund may be 'scheduled bodies', specified in legislation as participating, or 'admitted bodies', which have applied to participate in an LGPS fund under the terms of an 'admission agreement'. A list of administering authorities in Scotland, and the LGPS funds they administer, is provided in Appendix C.

## **Operation of the Scottish LGPS and the Legislative Framework**

29. The operation of the Scottish LGPS can be regarded as falling into two key areas<sup>2</sup>:

- The management of the administration of the benefits payable to scheme members and the collection of funding contributions (for example employers' contributions and employees' contributions remitted by the employing organisations)
- The strategic management of fund assets with due regard to liabilities. This can be regarded as including consideration of the funding arrangements.

30. The legislative framework within which the Scottish LGPS operates is complex and is subject to frequent changes. This is not an appropriate document for providing comprehensive details. Understanding LGPS financial statements will be assisted by an awareness of the statutory basis of the LGPS.

31. The Scottish Public Pensions Agency (SPPA) is responsible for LGPS regulations in Scotland. The underlying primary legislation for most of the regulations is the Superannuation Act 1972. The SPPA website contains details of the current regulations and other statutory instruments governing the Scottish LGPS<sup>3</sup>. These include:

- Statutory Instruments (UK)
- Scottish Statutory Instruments
- Scottish Statutory Guidance and Circulars

## **Specific Guidance for LGPS Funds**

32. Due to the nature of the LGPS, specific guidance and support is necessary. In particular the unique legislative basis of the LGPS generally specifies the extent of pension benefits, the administration of the fund and the management of its assets.

33. While key elements of generic pensions fund guidance will apply, additional interpretation or adaptation is often required for the LGPS. The CIPFA Pensions Panel has undertaken significant work in this respect, producing a variety of guidance to assist those who are responsible for LGPS funds, such as the 'Code of Practice on Public Sector Pensions Finance Knowledge and Skills'. A list of selected reference material is provided in Appendix D.

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<sup>2</sup> As indicated in 'Delivering Good Governance in Local Government Pension Funds' (CIPFA, 2009) paragraph 18 (a)

<sup>3</sup> The website of the 'Scottish Public Pensions Agency' provides a significant amount of detail concerning the legislative basis of the Scottish LGPS. See

[http://www.sppa.gov.uk/index.php?option=com\\_content&view=article&id=428&Itemid=7](http://www.sppa.gov.uk/index.php?option=com_content&view=article&id=428&Itemid=7)

## Overview of LGPS Operation

34. The LGPS is a 'funded' scheme. This means that contributions from employers and employees are held as assets in a fund to support, or pay for, future promised retirement benefits. Consequently at least part of the future cost of pensions is being paid for now, by both employees and employers, as the pension benefits are actually being earned.
35. This contrasts with most of the other public sector pension schemes<sup>4</sup> which are 'unfunded'. For such schemes current employers and employees contributions are used to pay current pension benefits. The cost of future pensions, being earned now will therefore need to be funded in full in the year in which the benefits are actually payable. This funding will be from future employer and employee contributions.

## Key Areas Supporting Interpretation of the Financial Statements

36. Understanding the following key aspects of the LGPS scheme will assist with the interpretation of the LGPS financial statements:

- **Pension benefits** – what benefits LGPS members are entitled to
- **Actuarial estimation of promised retirement benefits** – how the benefits are assessed and expressed as a future obligation
- **Investment of fund assets** – how the fund's assets are managed to ensure that future obligations are met
- **Funding arrangements** – how the comparison of the promised retirement benefits and the available assets affects employer and employee contributions

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<sup>4</sup> The main unfunded public sector pension schemes are: Teachers' Pension Scheme; NHS Pension Scheme; Principal Civil Service Pension Scheme, Armed Forces Pension Scheme; Police Pension Scheme; Firefighters' Pension Scheme;

## **CHAPTER 3 - LGPS PENSION BENEFITS**

### **CHAPTER SUMMARY**

#### **LGPS Pension Benefits Payable to LGPS Members**

Generally benefits will become payable on retirement. Benefits may also be payable to surviving relatives after the death of an LGPS member.

#### **LGPS Fund Administration of Pension Benefits**

Administering pension benefits will require the LGPS fund to undertake a variety of activities, not limited to but including:

- communication with members
- payment processes
- implementation of changes to the pensions which are payable (including the impact of changes in LGPS legislation)
- the exercise of discretionary powers in relation to pension benefits.

#### **Overview of LGPS Pension Benefits**

37. This overview is not a comprehensive or detailed analysis of LGPS pension benefits. LGPS pension benefits may be subject to change in the future.
38. The LGPS is categorised as a 'defined benefit scheme'. This means that the benefits that a member is entitled to are defined by the scheme rules. If scheme assets are insufficient to meet the pension benefits payable then future contributors, potentially both employers and employees, will be required to pay a higher level of contributions.
39. This contrasts with 'defined contribution schemes' where the scheme rules define the employer's and employee's contribution obligations, but the amount that this may result in as a pension is not specified or guaranteed. This type of pension therefore sees the individual employee adopt the risk of any shortfall in anticipated pension or investment return.
40. For the LGPS the pension benefits are normally defined with reference to the LGPS member's salary on retirement i.e. it is a 'final salary' based scheme. Generally pension benefits become payable on retirement of the LGPS member.



41. Situations where current employees may be entitled to benefits include:

- normal retirement at age 65 [LGPS membership up to 31 March 2009]
- normal retirement at age 65 [LGPS membership after 31 March 2009]
- early retirement (voluntary)
- early retirement (voluntary – rule of 85 / protected member)
- early retirement (redundancy / business efficiency) – may also include 'added years' at the employer's cost
- early retirement (ill-health)
- flexible retirement
- late retirement
- leaving before retirement (e.g. leaving LGPS related employment)
- family protection (e.g. survivor's pension etc)

42. Appendix E provides an overview table with more details of the normal benefit entitlements. Generic details of Scottish LGPS benefits are available from the LGPS website<sup>5</sup>. More specific details should be available from each individual LGPS fund. It should be noted that benefit entitlement can be affected where an employee moves from one LGPS fund to a different LGPS fund.

### **Key Aspects Relating to LGPS Pension Benefits**

43. Actions for LGPS funds in relation to pension benefits will normally include:

- Informing LGPS members of the benefits they are entitled to
- Implementing changes to LGPS benefit entitlements (for example legislation amendments, changes in personal circumstances, cost of living increases etc.)
- Ensuring that benefits are not over nor under paid to members
- Ensuring that only LGPS members (or related beneficiaries) receive benefit payments
- Implementing policies where the LGPS fund has discretionary powers in relation to pension benefits awarded
- Ensuring that appropriate controls, processes and records are in place for the proper administration and payment of benefits
- Ensuring that the administration costs represent value for money for the LGPS fund

<sup>5</sup> See <http://www.lgps.org.uk/lge/core/page.do?pageld=157964>

## **CHAPTER 4 - ESTIMATION OF PROMISED RETIREMENT BENEFITS**

### **CHAPTER SUMMARY**

#### **The Estimation of Retirement Benefits**

Use of LGPS financial statements can be assisted by an understanding of the estimation of promised retirement benefits. This includes an awareness of the importance of the 'discount rate' rate used, and other factors which can significantly affect the estimation of the benefit obligations.

#### **LGPS Fund Actions in Relation to the Estimation of Retirement Benefits**

LGPS funds will normally wish to ensure that the estimation of retirement benefits is reasonable and appropriate by undertaking various actions. These could include:

- ensuring the accuracy of the data provided to the actuary
- ensuring the appropriateness of the assumptions used
- awareness of the sensitivity of the estimate to key factors and assumptions
- an assessment of the skills and expertise required in all stages of the estimation process.

#### **Overview of Estimation of LGPS Promised Retirement Benefits**

44. The estimation is intended to reflect the benefits that have been earned by current employees, deferred members and pensioners up to the valuation date. The estimation of promised retirement benefits is a complex process, normally undertaken by actuaries who specialise in this area.
45. As a starting point an actuary will request information from the LGPS fund about its existing membership, normally analysed between the following groups:
- Existing pensioners – pensioners who have retired and are currently entitled to benefits
  - Deferred pensioners – LGPS members no longer actively contributing to the scheme but who will be entitled to pension benefits in the future on reaching retirement. Typically this would arise where a person leaves LGPS related employment but does not transfer their benefits to another scheme.
  - Active members – LGPS members currently employed by an LGPS employer and currently contributing to the LGPS fund

46. In addition to this the actuary will need to be informed of known or anticipated future events which could affect the estimation of pensions payable, for instance:
- significant redundancy schemes (voluntary or statutory)
  - workforce growth / reduction plans
  - significant service restructuring (e.g. outsourcing) or pay re-grading
  - changes in the employers participating in the LGPS fund
  - future planned pay awards
47. The estimation of the promised retirement benefits is required to allow for the 'time value of money'. This reflects the fact that £1 received today is worth more than £1 received in a year's time, since it could be invested and earn interest for the year. Therefore the estimated future cash flows are 'discounted' to arrive at the present value of the promised retirement benefits.
48. The discount rate used to arrive at the 'present value' is an important factor in estimating the promised retirement benefits because the future cash flows can extend more than 70 years into the future. The cumulative effect of the discount rate over this timescale means that even a small change in the assumed (or required) discount rate can lead to large changes in the estimated promised retirement benefits. Using a lower discount rate will increase the estimated present value of the promised retirement benefits, even without changing the anticipated cash flows.
49. It should be noted that different discount rates may be used by actuaries as follows:
- when recommending the employers' (and/or employees') contribution rates actuaries may apply a discount rate that reflects the expected rate of return of investments for the LGPS fund (i.e. anticipated 'market rate of return')
  - when preparing estimates for the financial statements the accounting requirements specify the use of a discount rate based on yields on high quality corporate bonds (i.e. returns on relatively 'secure' investments)
50. Normally anticipated market rates will be higher than those for high quality corporate bonds. This will usually mean that the estimate of promised retirement benefits used for the setting of contribution rates and funding arrangements will often be lower than the estimate published in the financial statements.
51. The estimation of the promised retirement benefits also involves other assumptions and predictions about the future which can significantly affect the pension liability from one period to the next. . For triennial valuations which are used to decide contribution levels the actuary will normally determine the assumptions used. For the preparation of the financial statements the actuary may make suggestions about reasonable assumptions, including the discount rate, however it is normally the responsibility of the administering authority's

Chief Financial Officer (section 95 officer)<sup>6</sup> to ensure that the assumptions are reasonable and appropriate for its circumstances. Appendix F contains more detailed comments on the following assumptions:

- Discount rate used to determine 'present value'
- Life expectancy / mortality rates
- Future pay awards
- Future pay increases due to promotion
- Inflation / cost of living increases

52. A critical point when considering estimated promised retirement benefits is to be aware of the various factors that can influence the estimation of the liability to be funded and how changes to these will impact on the sustainability of the fund. As stated in Audit's Scotland's report "The Cost of Public Sector Pensions in Scotland"<sup>7</sup> :

"The volatility in the level of reported assets and liabilities of the LGPS funds [.....] underlines the unavoidable yet substantial element of uncertainty and risk associated with pension provision in the long term. Significant swings in value can and have produced significant changes in the funding level, which in turn may affect the required contributions in the long term. This reinforces the importance of having thorough financial knowledge and expertise available to assist each fund in its operations and decisions."

### **Key Aspects Relating to the Estimation of Promised Retirement Benefits**

53. Actions for LGPS funds in relation to the estimation of promised retirement benefits will normally include:

- Ensuring the data supplied to the actuary on current LGPS members and their benefit entitlements is correct
- Ensuring the actuary is fully informed of any factors which will potentially influence the extent of future pension benefits that will be payable by the LGPS fund
- Ensuring the assumptions used by the actuary in the estimation of the present value of promised retirement benefits are reasonable and appropriate for the circumstances of the LGPS fund

<sup>6</sup> Per 'Local Government (Scotland) Act 1973' section 95, see <http://www.legislation.gov.uk/ukpga/1973/65/contents>

<sup>7</sup> See paragraph 99 : [http://www.audit-scotland.gov.uk/docs/central/2010/nr\\_110210\\_public\\_sector\\_pensions.pdf](http://www.audit-scotland.gov.uk/docs/central/2010/nr_110210_public_sector_pensions.pdf)

- Ensuring that the factors influencing the estimation of benefits are understood with a clear explanation of the sensitivity of the estimate, or risk to the LGPS, relating to each factor
- Ensuring that there are sufficient skills and expertise available to the LGPS fund, both in house and externally, to support appropriate estimation of the promised retirement benefits

## **CHAPTER 5 - LGPS INVESTMENTS**

### **CHAPTER SUMMARY**

#### **Governance Consideration of LGPS Investments**

Use of LGPS financial statements can be assisted by an understanding of the management of LGPS investments. This includes an awareness of the statutory and best practice requirements of investment management.

#### **LGPS Fund Actions in Relation to Investment Management**

Action by LGPS funds in relation to investments may include ensuring that:

- LGPS fund objectives are met
- Statutory requirements are complied with
- Risk and return are appropriately balanced
- Investment performance is measured and managed
- Investment performance is communicated

#### **Overview of LGPS Investments**

54. The strategic management of fund assets is a key role of the LGPS Committee. Undertaking this role for the benefit of the LGPS fund is a considerable responsibility. While advice may be sought from management or external advisors this responsibility remains with the LGPS Committee. In effectively acting as trustees, the role of elected members in the stewardship of scheme assets may be regarded as non-political in nature.
55. An LGPS Committee may delegate the development and monitoring of the investment strategy to an Investment Sub-Committee, or advisory panel which reports to, and is held accountable by, the LGPS Committee.
56. 'The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010'<sup>8</sup> directly affects Scottish LGPS investment responsibilities and powers. In particular it includes the following:
- a legal definition of 'investment' for the Scottish LGPS
  - details of debits and credits that should be made to the pension fund
  - a limit on the ability of the pension fund to borrow monies

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<sup>8</sup> Scottish Statutory Instrument (SSI) 2010 / 233 – see <http://www.legislation.gov.uk/ssi/2010/233/contents/made>

- a requirement for the pension fund to operate its own bank account
- the management of investment managers – including choice, terms of appointment and performance review
- a requirement to have an ‘investment policy’ covering the advisability and suitability of investments
- a requirement to publish a ‘Statement of Investment Principles’ (SIP) to include coverage of:
  - types of investments to be held
  - the balance between investment types
  - risk, including risk measurement and management
  - expected return on investments
  - the realisation of investments
  - social, environmental or ethical factors in investment decisions
  - the use of rights (e.g. voting rights) attached to investments
  - stock lending
- restrictions on the proportion of fund assets which can be invested in particular types of investment instruments

57. Additionally the LGPS Committee will normally be expected to adopt good practice on behalf of the LGPS fund. This would require adherence to the Myners Principles, as adapted for the LGPS<sup>9</sup>. The principles, with brief examples of adherence, are detailed in Appendix G. In summary they are:

- effective decision making
- clear objectives
- risk and liabilities
- performance assessment
- responsible ownership (e.g. responsible action as an institutional investor in public companies)
- transparency and reporting

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<sup>9</sup> “Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles” –see <http://secure.cipfa.org.uk/cgi-bin/CIPFA.storefront/EN/product/PUBLG062>

**Key Aspects Relating to LGPS Investments**

58. Actions for LGPS funds in relation to LGPS investments will normally include ensuring that:

- Investments are made in the best interests of the LGPS fund
- Investments are made in compliance with legislation and good practice
- There is an appropriate balance between risk and return
- Investment performance is measured and managed
- The Statement of Investment Principles specifies how voting and other rights are to be used
- Controls are in place to ensure that the LGPS Committee's strategy decisions and the Statement of Investment Principles are complied with
- There is open and transparent communication with LGPS members and other stakeholders



## **CHAPTER 6 - LGPS FUNDING ARRANGEMENTS**

### **CHAPTER SUMMARY**

#### **Legislative basis for LGPS Funding Arrangements**

The funding arrangements for the LGPS are primarily set by legislation. Managing the funding arrangements, within the legislative framework, to maintain the sustainability of the LGPS fund is a fundamental responsibility of the LGPS fund.

#### **LGPS Fund Actions in Relation to the Funding Arrangements**

In considering its funding requirements the LGPS fund may give particular attention to a variety of aspects, including:

- The assessment of the level of funding required
- The setting of contribution rates
- The demographics of the LGPS membership
- Changes in employer organisations

#### **Overview of Funding Arrangements**

59. The ability of an LGPS fund to meet its liabilities is based on the funding arrangements established under legislation. Contributions are provided from two sources: employers' contributions and employees' contributions, both based on current pay.
60. At present employee's contribution rates are set through regulation by the Scottish Government. A 'tiered' approach for employee contributions now exists<sup>10</sup>, with higher earnings subject to higher employee contribution rates. The employer is responsible for correctly setting the employee's contribution rate.
61. Employer's contribution rates are varied, according to the 'rates and adjustments certificate' provided by the appointed actuary, as required to ensure that future benefits can be paid.
62. An LGPS fund is required to undertake an actuarial assessment of the funding level at least every three years. The appointed actuary will compare the estimated present value of promised retirement benefits to the market value of the pension fund assets. This is normally expressed as a percentage.

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<sup>10</sup> As implemented by Scottish Statutory Instrument 2008 / 230 section 4. See <http://www.legislation.gov.uk/ssi/2008/230/regulation/4/made>

63. Key aspects affecting the funding arrangements, discussed in more detail below, include:

- **Funding Level Assessment:** The use of a 'market based' discount rate for the estimation of promised retirement benefits can significantly impact upon the apparent level of funding required by the fund.
- **Employers' Contribution Rates:** Decisions on the level of employers' contribution rates can have significant implications for employing organisations and their stakeholders. While primarily focused on the interests of the LGPS fund itself, the LGPS Committee may also consider the impact of funding arrangements on employing organisations.
- **Demographics of LGPS Membership:** The age profile of the LGPS membership and the relative number of pensioners (current and deferred) compared to active (employed) members is a major factor in the long-term sustainability of the LGPS fund.
- **Changes to Employing Organisations:** The admittance, or exit, of employing organisations to the LGPS may be significant occurrences requiring actuarial valuations and potentially large funding transfers in or out of the fund. Additionally changes in the circumstances of employing organisations can affect the stability of the funding arrangements.

#### **Funding Level Assessment: Estimation of Promised Retirement Benefits**

64. The estimate of promised retirement benefits used is likely to differ from that presented in the financial statements. When recommending the employers' contribution rates actuaries may apply a discount rate that reflects the expected rate of return of investments for the LGPS fund (i.e. anticipated 'market rate of return'). For the financial statements however the accounting requirements specify the use of a discount rate based on yields on high quality corporate bonds (i.e. returns on relatively 'secure' investments). Other assumptions, not just the discount rate, may also differ between the estimation undertaken for the financial statements and that for the assessment of funding levels.

65. A 'market based' discount rate is usually used for the funding assessment since the LGPS investments are normally expected to out-perform high-quality corporate bonds. Use of the 'accounting standards' based estimate could have a significant impact on the level of employer contributions required to achieve a 100% funding level. It is important that the discount rate used for determining contribution rates is unbiased and is reasonable and appropriate.

#### **Employers' Contributions**

66. The actuary will normally specify the employers' contribution rates for the next three years ahead. Not all employers will necessarily have the same contribution rate. The actuary may provide an analysis of the common contribution rate between:

- The contribution level required to ensure that the estimated future pension benefits that will be earned in the next three years are paid for at the time

- A 'past service adjustment' (or deficit recovery) rate which may be required to ensure that the estimated pension benefits up to the valuation date are fully funded. In some situations this may be expressed as an actual amount, with the potential for affected employers to pay over a lump sum amount or series of lump sums, rather than a contribution as a percentage of employee pay. (Where a surplus on past service pensions is deemed to exist a reduction in future contributions may be calculated).

67. While the LGPS Committee will be primarily concerned with the best interests of LGPS members, consideration may potentially be taken of the impact of the funding arrangements on the participating employers. Consequently some stability of contribution rates may be sought, for example by gradually phasing in increases in contribution rates over the three year period, rather than facing a significant increase in the first year.

68. Increases in an employer's contribution rate will naturally mean that it is more expensive to employ staff, potentially placing employers under financial pressure.

69. Maximising the returns on pension fund investment, within the determined level of acceptable risk, will tend to minimise the funding required from employing organisations.

#### **Demographics of LGPS Membership**

70. The employers' contribution rates will be affected by the demographics of the LGPS membership. In particular if the proportion of pensioners (current and deferred) increases compared to employee members, the common contribution rate will become more significantly influenced by the level of funding of previously earned retirement benefits, rather than the cost of new benefits that will be earned by the employee members.

71. Where the LGPS membership is largely composed of older members, nearing retirement or already retired, the scope for requiring future contributors (employers and/or employees) to increase contributions to make up for any shortfall in resources required to pay for previously earned pension benefits may be constrained.

72. It is therefore necessary to be aware of the age profile of the LGPS membership when considering how to address an identified funding deficit, and when considering the risks to which the LGPS fund is exposed.

#### **Changes to Employing Organisations Participating in an LGPS Fund**

73. The legislative framework of the LGPS means that, should one employer default on its obligations, the remaining employers may be obliged to fund any shortfall in the LGPS fund. Consequently there will normally be a clear focus on assessing the financial stability of any employer applying for admittance to the scheme. In some cases a 'financial guarantee' or equivalent may be required before admittance is permitted.

74. Where an employing organisation joins the scheme, an actuarial review will normally be required to determine the new organisation's contribution rate and this may also include a review of the contribution rate of any associated employer.

75. Where an employing organisation leaves the scheme, another actuarial review will be required in order to determine whether the organisation is required to make a final contribution in respect of its pension obligations. For some admitted bodies the scale of contribution assessed may make it difficult to exit the LGPS scheme. This highlights the importance, for all parties, of the impact of LGPS admittance being appropriately considered from the outset.
76. Changes in the participating employers may result in significant transactions for the LGPS fund. The scale of such transactions may warrant specific oversight by the LGPS Committee to ensure that LGPS members' interests are properly represented and that any transfer values are fair and appropriate.
77. In addition significant changes which affect employing organisations, such as restructuring plans, staff workforce changes or a change in the financial stability of employing organisations will also be relevant for the LGPS committee in terms of the funding of an employer's LGPS commitments.

### **Key Aspects Relating to Funding Arrangements**

78. The relative timing, or profile, of benefits payable and future assets available is extremely important, particularly given the long-term nature of benefit obligations, which can project over 70 years into the future. Maintaining the liquidity of the LGPS fund to ensure that current liabilities can be met is a fundamental requirement.
79. This is particularly relevant given that in many cases workforce numbers are reducing. This not only reduces the cash inflow to the fund but also, where retirement or early retirement has occurred, increases the cash outflow. In this situation careful monitoring and forecasting of cash balances is required. This can help to minimise the forced or untimely sale of assets.
80. Awareness of risk is likely to include a focus on the current financial position with reference to potential future scenarios. Typically areas to be considered could include reliance on key funding sources; the impact of critical cost changes; the assumptions used; and the extent to which future benefit obligations are coordinated with anticipated financial resources. The impact of the current economic climate, especially where workforce numbers, and therefore current contributions, are reducing may be a specific consideration.
81. The estimate of promised retirement benefits used for determining contribution rates is likely to differ from the estimate presented in the financial statements. The use of a 'market based' discount rate ensures that the estimate of promised retirement benefits, and the current level of pension fund assets that it is compared with, are valued on the same basis i.e. based on 'market' conditions.
82. As noted earlier (paragraph 49), the 'market based' discount rate used for the funding assessment and the 'corporate bond' discount rate used for the financial statements are based on different requirements and so may be different in most cases. However, the actuary should be able to provide sufficient explanation and evidence to justify the difference.

83. Actions for LGPS funds in relation to funding arrangements will normally include ensuring that:

- Actuarial valuation of the funding level of the LGPS is undertaken at least every three years
- The estimation of the funding level is reasonable, appropriate and unbiased
- The key factors and risks influencing the funding level, both now and in the future, are clearly explained and understood
- Employer's contributions are appropriately set, potentially balancing the short-term and long-term interests and stability of the LGPS fund on behalf of its members
- Actuarial valuations relating to the admittance or exit of employer organisations are undertaken and that any related transactions are in the interests of the LGPS fund and its members
- Adequate monitoring of assets and liabilities between valuations is in place

## APPENDICES

### **Appendix A - Fund Account: Outline of Contents**

The level of detail presented in the Fund Account may differ between LGPS funds. Where summarised information is presented more detail would normally be expected to be provided in the notes to the accounts.

<b>Dealings with members, employers and others directly involved in the fund</b>	
<b>Sub-Heading</b>	<b>Typically will include</b>
Contributions	<p>Contributions (Employers') for example</p> <ul style="list-style-type: none"> <li>○ the employer's contribution based on the LGPS member's pay and the rate for that employer set by the LGPS committee</li> <li>○ contributions for 'strain on fund' where an employer has made an employee redundant with no loss of benefits</li> <li>○ lump sum 'deficit recovery' payments, where not incorporated into the employer's contribution rate</li> <li>○ contributions for augmentation of benefits (e.g. the awarding of additional years of benefit)</li> </ul> <p>Contributions (employees)</p> <ul style="list-style-type: none"> <li>○ the employee's contribution, normally remitted by the employer, based on the statutory percentage of the LGPS member's pay</li> </ul>
Transfers In	Funds transferred into the scheme by individuals, or groups (eg a new employer), joining the scheme
Benefits	<p>Benefits payable to pensioners and beneficiaries for the year including pensions, lump sums on retirement (included commuted sums) and death benefits</p> <p>See Chapter 3 for more details on benefits</p>
Payments to and on account of leavers	Any funds being transferred out to other pension schemes and any refund of contributions made (eg where the member leaving has less than two years' membership).
Administration Expenses	All expenses relating to administration of the LGPS fund such as staffing costs or charges, IT system costs, office accommodation, committee costs, external audit fees etc. Investment management expenses are not included.
<b>Returns on Investments</b>	

Sub-Heading	Typically will include
Investment income	Dividends receivable, interest earned.
Taxes on income	Tax withheld by another country on investment income earned in that country.
Profit and losses on disposal of investments and changes in the market value of investments	<p>Any gain or loss in the value of investments that has occurred during the year. This includes situations where the investment was realised (sold /disposed of).</p> <p>Since LGPS investments are held with the purpose of generating a return, investments are normally valued at 'market value'(based on bid price – i.e. what a buyer is willing to pay).</p> <p>Therefore even if the investment has not been disposed of in the year the change in market value is normally still recognised.</p>
Investment management expenses	All expenses related to investment management and performance including: management fees; the cost of monitoring investment performance; investment consultancy and advice.

**Appendix B - Net Assets Statement: Outline of Contents**

The level of detail presented in the Net Assets Statement may differ between LGPS funds. Where summarised information is presented more detail would normally be expected to be provided in the notes to the accounts.

<b>Investments</b>	
<b>Sub-Heading</b>	<b>Typically will include</b>
Investment Assets	<ul style="list-style-type: none"> <li>• Equities (shares or equivalent): UK or foreign equities</li> <li>• Fixed interest securities: An investment (e.g. a bond) where the rate of interest earned by the LGPS fund is set and does not vary</li> <li>• Index linked securities: An investment where the return is linked to an index (often an inflation index eg RPI) thereby ensuring that income returns are (generally) protected against inflation.</li> <li>• Pooled investments: A means of seeking economies of scale and some risk diversification through a variety of investors 'pooling' their investment. Typically this may be a managed fund or a unit trust.</li> <li>• Property: Property held (UK or foreign). May be held with long-term appreciation as an objective.</li> <li>• Derivative Contracts: derivatives are contracts that specify conditions for future payments. The conditions are often related to specific dates, specific indexes (eg RPI), exchange rates or other specified factors. Derivatives can be used for risk management (eg 'hedging') to limit the exposure of the LGPS fund to future events (e.g. to mitigate unexpected changes in foreign exchange rates). Derivatives may also be used for speculation by taking on risk, however this may be rare for LGPS funds. Forms of derivative contract include               <ul style="list-style-type: none"> <li>○ Futures / forwards: an agreement to pay (eg buy or sell an asset) at a future date at an agreed price</li> <li>○ Forward foreign currency: an agreement to buy or sell foreign currency at a future date at an agreed exchange rate</li> <li>○ Options: an agreement which allows the option (but not an obligation) to buy (call) or sell (put) an asset at a future date at an agreed price</li> </ul> </li> </ul>



Cash deposits	Monies held in bank deposit accounts. The terms and conditions of deposits may differ. Often the investment will be for a specified period of time and the cash will only be available to the fund at the end of this period.
Investment Liabilities	<p>Derivative contracts: See Investment assets for a description of derivatives. The value of derivatives is measured at the 'net assets statement' date. Where circumstances have changed since the contract was initially signed this may mean that the derivative effectively has a 'negative' market value i.e. it is a liability. This may arise for various reasons. In some cases it will have protected the fund from the risk of unexpected changes (for instance in currency exchange rates).</p> <p>Creditors – amounts payable for investment assets purchased (not yet paid as at 31 March)</p>
Current Assets	<p>Contributions due: contributions owed by employers and employees to the LGPS fund.</p> <p>Transfer values receivable</p> <p>Other debtors</p> <p>Cash balance: cash and bank accounts that are readily convertible to cash that can reliably be used to settle immediate liabilities.</p>
Current liabilities	<p>Transfer values (or refunds) payable to leavers</p> <p>Benefits payable: benefits that were payable as at 31 March which have not yet been settled in cash</p> <p>Other Creditors</p>

### **Appendix C - Scottish LGPS Administering Authorities & Funds**

Scottish LGPS Financial Statements are included within each fund's LGPS Annual Report. The following is a list of the main Scottish LGPS funds with a link to their annual report downloads.

<b>Administering Authority</b>	<b>Scottish LGPS Fund</b>	<b>Web Link for Annual Report</b>
Aberdeen City Council	North East Scotland Pension Fund Aberdeen City Council Transport Fund	<a href="#">Annual Reports page</a>
Dumfries & Galloway Council	Dumfries & Galloway Council Pension Fund	<a href="#">Annual Reports page</a>
Dundee City Council	Tayside Superannuation Fund Tayside Transport Superannuation Fund	<a href="#">Annual reports page</a>
City of Edinburgh Council	Lothian Pension Fund Lothian Buses Pension Fund Scottish Homes Pension Fund	<a href="#">Annual Reports page</a>
Falkirk Council	Falkirk Council Pension Fund	<a href="#">Annual Reports page</a>
Fife Council	Fife Council Pension Fund	<a href="#">Annual Reports page</a>
Glasgow City Council	Strathclyde Pension Fund (includes No. 3 Fund as a sub-fund)	<a href="#">Annual Reports page</a>
Highland Council	Highland Council Pension Fund	<a href="#">Annual Reports page</a>
Orkney Islands Council	Orkney Islands Council Pension Fund	<a href="#">Annual Reports page</a>
Scottish Borders Council	Scottish Borders Council Pension Fund	<a href="#">Annual Reports page</a>
Shetland Islands Council	Shetland Islands Council Pension Fund	<a href="#">Annual Reports page</a>

## **Appendix D - Selected Reference Material for the LGPS**

### **Audit Scotland**

- 1 The Cost of Public Sector Pensions in Scotland (2011)  
[http://www.audit-scotland.gov.uk/docs/central/2010/nr\\_110210\\_public\\_sector\\_pensions.pdf](http://www.audit-scotland.gov.uk/docs/central/2010/nr_110210_public_sector_pensions.pdf)
- 2 Public Sector Pension Schemes in Scotland (2006)  
[http://www.audit-scotland.gov.uk/docs/central/2006/nr\\_060620\\_publicsector\\_pension.pdf](http://www.audit-scotland.gov.uk/docs/central/2006/nr_060620_publicsector_pension.pdf)

### **SPPA (Scottish Public Pensions Agency)**

- 1 Local Government Pension Scheme – web page  
[http://www.sppa.gov.uk/index.php?option=com\\_content&view=article&id=428&Itemid=7](http://www.sppa.gov.uk/index.php?option=com_content&view=article&id=428&Itemid=7)
- 2 LGPS Regulations (New Scheme):  
[http://www.sppa.gov.uk/index.php?option=com\\_content&view=article&id=107&Itemid=253](http://www.sppa.gov.uk/index.php?option=com_content&view=article&id=107&Itemid=253)
- 3 LGPS Regulations (Old Scheme):  
[http://www.sppa.gov.uk/index.php?option=com\\_weblinks&view=category&id=305&Itemid=1327](http://www.sppa.gov.uk/index.php?option=com_weblinks&view=category&id=305&Itemid=1327)

### **CIPFA (Chartered Institute of Public Finance and Accountancy)**

CIPFA, through its Pensions Panel, has produced a number of guidance and framework publications to support LGPS governance and management. Details are available at: <http://www.cipfa.org.uk/panels/pensions/publications.cfm>

A list of selected items is provided:

- 1 Delivering Good Governance in Local Government Pension Funds: A Guide to the Application of the CIPFA/SOLACE Code of Corporate Governance in Local Authorities to their management of LGPS Funds
- 2 Code of Practice on Public Sector Pensions Finance Knowledge and Skills
- 3 LGPS Fund Accounts 2011/12: Example Accounts and Disclosure Checklist
- 4 Buying Time: A CIPFA Pensions Panel Guide to Procuring efficiency in Public Sector Pensions Administration
- 5 Narrative Reporting in Public Sector Pension Schemes
- 6 Investment Decision Making and Disclosure in the LGPS: A Guide to the Application of the Myners Principles

**Appendix E - Overview of Current Common Pension Benefit Entitlements**

Benefit Scenario	Overview
<p>Normal Retirement (age 65)  <b>[For any LGPS membership up to 31 March 2009]</b></p>	<p>Pension benefits fall into two parts:</p> <p>A) Annual pension            = (x years of LGPS membership to 31 March 2009 / 80) x final salary</p> <p>plus</p> <p>B) Lump sum            = annual pension x 3</p> <p>Notes:</p> <p>a) Where desired (subject to some limitations) a retiree can opt to reduce their annual pension in return for a larger lump sum payment (often referred to as commutation or commuted sums). This is generally limited to 25% of the capital value of the pension.</p> <p>b) Small pensions may be settled (i.e. paid in full in one payment) as a 'lump sum' by the LGPS (subject to some restrictions)</p>
<p>Normal Retirement (age 65)  <b>[For any LGPS membership after 31 March 2009].</b></p> <p><i>Note: where a member has pre &amp; post 31 March 2009 membership, a separate calculation is made for each period (i.e pre 31/3/09 and post 31/3/09).</i></p>	<p>Pension benefits consists of:</p> <p>Annual pension            = (x years of LGPS membership since 31 March 2009 / 60) x final salary</p> <p>Notes:</p> <p>a) There is no automatic lump sum payable.</p> <p>b) Where desired (subject to some limitations) a retiree can opt to reduce their annual pension in return for a larger lump sum payment (often referred to as commutation or commuted sums). This is generally limited to 25% of the capital value of the pension.</p> <p>c) Small pensions may be settled (i.e. paid in full in one payment) as a 'lump sum' by the LGPS (subject to some restrictions)</p>

<p>Early Retirement (voluntary)</p> <p>See also 'Rule of 85 / Protected Member' below</p>	<p>Subject to the criteria below an employee may choose to retire early with a corresponding decrease in pension benefits to reflect the fact that the pension will be paid for longer.</p> <p>Criteria: From age 55-60 employer agreement is required that the pension can be drawn early. From age 60 employer's consent is not required.</p>
<p>Early Retirement (voluntary - rule of 85 / protected member)</p> <p>Applies only to those who were LGPS members at 30 November 2006</p>	<p>Where an LGPS member qualifies voluntary early retirement may be possible (employer agreement required) with no (or restricted) reduction in benefits payable.</p> <p>The rule of 85 is met if</p> <p>[Age at start of pension payment + years of scheme membership ] equals or is greater than 85</p> <p>In addition the following applies</p> <ul style="list-style-type: none"> <li>a) If age 60 or over at 31/3/2020 then benefits up to 31/3/2020 are not reduced where the rule of 85 is met</li> <li>b) If age under 60 at 31/3/2020 then benefits up to 31 March 2008 are not reduced where the rule of 85 is met</li> </ul>
<p>Early Retirement (redundancy / business efficiency)</p> <p>[Strain on Fund / Pension Strain]</p> <p>[Added Years at employer's discretion and cost]</p>	<p>Where aged 55 or over benefits are payable without reduction.</p> <p>For those who were LGPS members at 5 April 2006 benefits may be payable from the age of 50, but possibly without a cost of living increase until age 55 is reached.</p> <p>Where such early retirement occurs the additional costs arising, often referred to as 'strain on the fund' or pensions strain, will normally be paid by the employer through either a lump sum contribution to the LGPS fund or a series of annual payments.</p> <p>Employers, at their discretion, may provide a retirement enhancement of up to 10 years of additional LGPS membership and/or up to £5,000 extra annual pension. The cost of this is normally borne by the employer, not the LGPS fund.</p>

<p>Early Retirement (Ill Health)</p>	<p>If there is no reasonable prospect of being capable of future gainful employment then benefits are payable based on membership that the employee would have had up to age 65.</p> <p>If there is a reasonable prospect of being capable of future gainful employment then benefits are payable based on membership to the date of leaving plus 25% of the prospective membership between that date and age 65.</p> <p>Note: Protection of benefits applies to those LGPS members who were in the scheme as at 1 April 2009 so that such members are not worse off than under the previous benefits structure.</p>
<p>Flexible Retirement</p>	<p>With their employer's consent an LGPS member may, from age 55, elect to work reduced hours or at a lower post, and draw some of their pension early. Pension benefits are reduced to reflect the impact of the longer payment period.</p> <p>Employer agreement is required for those aged under 60 as the employer may have to pay an additional amount [strain on fund] into the pension fund.</p>
<p>Late Retirement</p>	<p>Where an employee continues to work after age 65 (up to age 75) their pension is delayed but is increased to reflect the shorter expected payment period.</p>
<p>Leaving Retirement before</p>	<p>On leaving employment under an LGPS scheme before retirement a member may normally:</p> <ul style="list-style-type: none"> <li>a) Transfer their benefits to another pension scheme (lump sum cash payment / settlement by the LGPS for all benefits earned)</li> <li>b) Defer their benefits until retirement (i.e. leave their funds in the LGPS). [Deferred benefits / Deferred Pensioner]</li> </ul> <p>Note that those with less than 2 years LGPS membership cannot defer their benefits and have some options to consider.</p>

<p>Family Protection [related beneficiaries]</p>	<p>The following may be payable to non-LGPS members:</p> <p><u>Death Grant</u> Where the LGPS member dies in LGPS employment a lump sum is payable up to 3 times the annual pay.</p> <p>Where the LGPS member dies within 10 years after retirement any dependants may receive a lump sum.</p> <p><u>Survivor's Pension</u> A recognised partner can receive an on-going pension after the LGPS member's death. Specific calculation is required.</p> <p><u>Children's Pension</u> Eligible children (criteria apply) may also receive an on-going pension after the death of the LGPS member.</p>
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**Appendix F - Estimation of Promised Retirement Benefits: Common Assumptions Required**

<b>Factor / Assumption</b>	<b>Comments</b>
Discount rate used to determine present value of promised retirement benefits	<p>The estimation of promised retirement benefits can be significantly affected by the discount rate used. A lower discount rate may significantly increase the estimate of the promised retirement benefits.</p> <p>It should be noted that different discount rates may be used for:</p> <ul style="list-style-type: none"> <li>• the actuary's assessment of future contribution rates that need to be set. This will often reflect the expected market rate of return on the LGPS fund assets.</li> <li>• the estimate of promised retirement benefits for the financial statements. The accounting requirements specify the use of a discount rate based on yields on high quality corporate bonds. This may be lower than the expected market rate of return on LGPS fund assets.</li> </ul>
Life expectancy / mortality rates	<p>This is a significant factor for defined benefit schemes where benefits are generally payable from retirement until death. Improvements in life expectancy naturally increase the liability that the LGPS is exposed to, and therefore the funding that is required to support the benefits. This is a major factor affecting the estimation of future retirement benefits.</p>
Future awards pay	<p>Benefits are generally based on final salary so forecasting of expected salary on retirement is undertaken.</p>
Inflation	<p>Pension benefits are normally inflated for cost of living increases and therefore estimation of future cash flows payable requires an allowance for this.</p>



**Appendix G - LGPS Investments: Overview of Myners Principles**

	<b>Principle</b>	<b>Examples of Adherence</b>
1	Effective Decision Making	Decision makers appropriately skilled, knowledgeable and resourced.  Appropriate evaluation and challenge of advice received
2	Clear Objectives	Overall investment objective(s) set for the fund, based on the fund's unique specific situation and requirements
3	Risk and Liabilities	Investment strategy should consider the form and structure of fund liabilities and funding arrangements
4	Performance Assessment	Formal measurement of the performance of investments, investment managers and advisers  Periodical review of the decision-making effectiveness of the LGPS fund
5	Responsible Ownership	Adoption of the Institutional Shareholders' Committee Statement of Principles  Statement on responsible ownership in a Statement of Investment Principles  Periodical reports on the adherence to these responsibilities
6	Transparency and Reporting	Transparent actions and clear communications with stakeholders  Regular communication with scheme members