Appendix 1

LGPS Cost Control Mechanism

1. There are two mechanisms for in the LGPS in England & Wales
    a. the Employer Cost Cap **(ECC)** process of the Treasury
    b. the Future service Cost **(FSC)** process, which has been set up to reflect the specifics of the LGPS experience in assessing the costs of the pension scheme reforms, such as the take up of the 50/50 option or the rate of commutation assumed.
2. Both processes could lead to changes to the scheme design or to the level of members' contributions if the mechanisms demonstrate that the cost of the LGPS has moved sufficiently from the individual targets.
3. The Government Actuaries' Department (GAD) will be responsible to assessing the costs under each mechanism.
4. This cost control mechanism is determined and decided at the national level for LGPS funds. The local funds have no discretion within the process. They will be consulted as part of the process and will have to implement any changes that arise by incorporating the changes to the benefits structure in their valuation process.
5. **Target Costs:**

    The cost cap mechanisms calculate the cost of providing benefits that have been accrued since the career average reforms took effect in April 2014. The total employer contributions targeted are therefore ***notional*** figures, and most employers will find they pay contributions that are different to these notional rates. The mechanisms do not take account of the costs of benefits that have accrued pre 1 April 2014.

    The target costs are:

    a. **For the FSC** is 19.5% as a total of employer and member contributions at a 2:1 ratio (**13% relating to employers' contributions** and 6.5% relating to members').
    b. **For the ECC** process is **14.6% of employer contributions alone**.
6. **Triggers for adjusting scheme structure:**
    a. There are some differences between the mechanisms in how the changes to the Scheme are triggered, but under either process, a movement of 2% or more in either direction will require changes to be made to bring the Scheme cost back to the target.
    b. If either of the processes demonstrate that the cost of the Scheme has increased or decreased to a point that a requirement for reform is triggered, the Scheme must be bought back to its target cost via one of the below two means:
        i. Changes to the design of members' benefits (for example, by changing the accrual rate or the normal pension age), or
        ii. Changes to the member contribution rate.

c. The results of the cost control process could therefore lead to either, changes in the employee contributions which need to be paid into the LGPS, or to changes in the pension benefits eventually payable by the LGPS.

d. The FSC process is designed to be more gradual to take account of the trend in costs over time rather than wait for the ECC's 2% trigger to be breached.

e. For the FSC process the following will trigger adjustments:
   i. A movement of between 0% and 1% from the target in either direction *may* result in agreed recommendations for action to move back to the target.
   ii. A movement of between 1% and 2% from the target in either direction *should* result in agreed recommendations for action to move back to the target.
   iii. A movement of 2% or more from the target in either direction *must* result in agreed recommendations for action to move back to the target.

f. In contrast, no corrective action will be required to move the Scheme back to the target by the ECC process unless there is a movement of 2% or more from the target in either direction.

g. If the ECC process indicates corrective action needs to be taken to bring the Scheme back to its target cost, but the FSC process indicates that no action needs to be taken, **the ECC process takes precedence and changes would need to be made to the Scheme**. In the event that a design change cannot be agreed between the Government and the Scheme Advisory Board to bring the Scheme back to its target cost, an adjustment to the accrual rate for future benefits must be made by DCLG (as the default action).

7. As the cost control processes will estimate the cost of the new scheme across the LGPS, the results are highly unlikely to correlate with the employer contribution rates payable by individual employers. There are two main reasons for this:

   a. Local funding valuations are based on individual fund and employer experience and assumptions are made based on this experience. The cost control processes will be looking at Scheme experience nationally and consequentially making assumptions on that basis.

   b. Local funding valuations will include consideration of all the benefits payable by each fund and employer in their participation in the Scheme - including costs relating to the pre-April 2014 final salary benefits structure.

8. **Process & Timescales:**

   a. The cost control process will be undertaken in tandem with the local triennial valuations and will first impact the scheme (in terms of changes to accrual rates or employee contribution rates) at the 2016 valuation. This means that the first ECC and FSC figures will be based on the same data produced and submitted by funds for the 2016 valuation.

b. Any revisions to contribution rates or the benefits structure as a result of the cost cap mechanism will not be effective until **three years after the valuation**; therefore for the valuation at 31 March 2016 any changes would be effective 1 April 2019. The delay is due to the need to consult with members on prospective changes.