# Town and Parish Councils Considering Joining the Local Government Pension Scheme: Funding concerns and risks

Parish and Town Councils are entitled to join the Local Government Pension Scheme (LGPS) of the area in which they are physically based as a Designation Body (formerly called a Resolution Body), subject to having first agreed an appropriate resolution at their relevant Council meeting. **Note that actuarial costs of approximately £1000 plus VAT are charged to joining Councils to calculate their starting position in the fund.**

Within the LGPS benefits are guaranteed and set by Statutory Instruments, and the employee contribution is also defined within Statutory Instruments – currently employee contributions vary between 5.5% and 12.5% of pensionable pay and are tiered within pay bands. The only other sources of 'income' from which benefits can be met are investment returns and employer's contributions. Put plainly, the employer will be responsible to meet any cost that is not met by the combination of employee contributions and investment returns.

The impact of the structure of the LGPS is that the employer bears all the risks. Almost all the risks are 'double-sided', in that they can work in favour of the employer or against it from a financial perspective, but it is important that Parish and Town Councils understand the risks that they are taking on before they pass the appropriate resolution to become a scheme employer.

## Examples of these risks

- The actuary makes an assessment of the level of future investment returns when setting contribution rates – the higher the assumption, the lower the required employer contribution as investment returns will pay a higher proportion of the benefits. Lower-than-expected actual investment returns will lead to upward pressure on employer's contribution rates;
- The actuary makes an assessment of how long a pension will be payable for, based on life expectancy tables that are relevant at each actuarial valuation. Increased life expectancy – a common factor in almost all recent actuarial valuations – will lead to upward pressure on employer's contribution rates;
- Ultimately life expectancy is forward-looking and allows the actuary to put an estimated value on the cost of benefits for an individual in advance of them being payable. The actuary is effectively looking to build up a pot of money that is sufficient to pay the benefits due from the sub-fund of the Parish/Town Council. How long someone actually lives for (and how long any surviving dependant receives a pension after the death of the former employee) dictates the actual costs. A single member living considerably longer than expected may have a very meaningful impact onto the liabilities of the sub-fund of a Parish/Town Council, and hence onto the level of its employer's contribution rate;
- All LGPS benefits are linked to inflation, so periods of higher-than-expected inflation will put upward pressure onto employer's contribution rates;

- The employer's contribution rate required will generally increase as an employee gets older – there is less time to earn investment returns on any employee/employer contributions before benefits become payable. For larger employers this is not a major issue as they tend to have younger members replacing older ones that retire or leave for other reasons, and hence the impact of an aging workforce onto their contribution rate is not meaningful because the average age of the workforce stays relatively stable. For small employers with a relatively low turnover of staff, there tends be a gradual 'creep up' in the average age of active members and this puts upward pressure onto employer's contribution rates;
- When the last active member of an employers' sub-fund leaves the LGPS, a termination valuation is required. **Note that the current actuarial charge for this valuation is approximately £3,000 plus VAT.** This termination value will be carried out on a different basis to the on-going valuations that set employers' contribution rates (ongoing valuations for employers that are open to new membership assume that there will continue to be active membership within the sub-fund) and a termination valuation will always give a much higher level of liability. This is necessary because the termination valuation produces a one-off lump sum that is payable by the former employing body, and after this payment has been made the Fund has no ability to return to the employer in the event that the assets of the sub-fund prove to be insufficient to meet the liabilities (if individuals live for much longer than expected or if investment returns are lower than anticipated, for example). To protect the other employers within the Fund, termination valuations are carried out on a more prudent basis and will often give a deficit position (which the employing body needs to pay), even when there is no deficit on an on-going basis. **The Leicestershire Fund has recent experience of two deficits of around £30,000 that have been paid by Parish/Town Councils, and both Councils had a single member of the LGPS and had been employing bodies for relatively short periods of time.**

## Understanding the risks

The above is not a definitive list of the risks borne by employers, and I would reiterate that most of the risks can work either in favour or against the employer. But it is important that the employer understands that they bear all of the risks from a financial perspective, as employee contributions and benefits are set by Statute.

**In order to ensure that the Parish/Town Council fully understands the risks, and has the ability to ask relevant questions about them, the Pension Fund will have requested the contact details of the Leader/Chair of the Council in order that we ensure that a copy of this note reaches both the Clerk and the Council.**

## Further Information

Should you wish to discuss any aspect of funding issues in detail, please contact the Pensions Manager Ian Howe who will be able to help you. Please email: ian.howe@leics.gov.uk

This document was prepared by the Leicestershire County Council Pensions Section on 22nd February 2021.