CABINET
15 FEBRUARY 2005

ITEM NO. ....17................

CHANGES TO THE LOCAL GOVERNMENT PENSION SCHEME - CONSULTATION

Responsible Cabinet Member(s) – Councillor Don Bristow,
Resources Management Portfolio

Responsible Director(s) – Paul Wildsmith, Director of Corporate Services

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Purpose of Report

1. To agree a response, via the Employers' Organisation, to consultation by the Office of the Deputy Prime Minister (ODPM) on proposed changes to the Local Government Pension Scheme (LGPS).

Information and Analysis

2. The Government recognises that people are living longer and that there is a need to deal with the changing ratio of the economically active population to those in retirement. The Government seeks to meet the social and economic challenges of these demographic changes by encouraging people to work longer, to help stabilise the affordability of pension provision and to improve the retention and transfer of knowledge and skills in the workforce.

3. In the context of the LGPS, this forms an essential element in moves to ensure the long-term sustainability of the Scheme and to stabilise costs over the longer term.

4. There is widespread concern about the increasing cost of the LGPS to employers and council tax payers. The Council's contribution rate has risen from 12.8% of pensionable pay in 1998-99 to 16.5% in 2004-05. Following the triennial revaluation in 2004, the employer's contribution rate is set to increase in annual steps to 18.9% from April 2007. The annual cost of the scheme to the Council is currently £6.3M.

5. The Government started a stocktake of the LGPS in 2001. As a result of this, significant changes to the LGPS will take effect from 1 April 2005 (unless the regulations are challenged by Members of Parliament in the forty day period starting from 10th January, 2005) and further changes are proposed, to take effect on 1st April, 2008. It is the second set of changes in 2008 which is the subject of the current consultation.

Changes to LGPS - April 2005

6. The changes being implemented from April 2005 aim to safeguard the scheme and to ensure that it remains affordable and sustainable to scheme employers and local taxpayers. The resulting cost savings have been factored into the 2004 Durham pension fund valuations and employer contribution rates are 1.5% to 2% less than they would otherwise have been in the long-term. Stabilising costs to safeguard the Scheme will pave the way for the next stage of

review to modernise the scheme so that it meets the needs of the current local government workforce.

7. The main changes to take effect in 2005 are summarised in **Appendix 1**. All public sector schemes will be making similar changes to their scheme rules.

Changes to LGPS - April 2008

8. In October 2004 ODPM issued a Green Paper 'Facing the Future – Principles and Propositions for an Affordable and Sustainable Local Government Pension Scheme in England and Wales.' This sets out a range of principles and proposals for a new-look LGPS from 2008.

9. The paper sets out the Government's commitment to introducing new pension arrangements for local government.. Ministers have expressed their commitment to retaining a defined benefit final salary arrangement that is relevant to the local government workforce, provided that it remains both affordable and sustainable.

10. A summary of the proposed changes is given in **Appendix 2**.

11. The Employers' Organisation/Local Government Pensions Committee (EO/LGPC) have prepared a draft response to the consultation exercise. The EO/LGPC require responses from individual authorities by 28th February, 2005 to enable them to finalise their reply to ODPM by 31st March, 2005. A draft response to EO/LGPC on behalf of the Council has been considered by CMT and is attached at **Appendix 3**. CMT are in general agreement with the EO/LGPC draft response.

12. In responding to the consultation, the Council needs to be conscious that the LGPS is part of the overall remuneration package. There is a balance between pensions and other elements of the package (pay and conditions). Reduction in the value of the LGPS to employees is likely to cause pressure to increase the value of other parts of the overall package. The Council may need to increase pay to maintain the value of total remuneration in a generally competitive labour market.

13. An important issue to consider is whether the pension element, which over time has increased in cost to employers and in value to employees as life expectancy has increased, currently represents the most appropriate proportion of total remuneration. A relatively small change in the balance away from pension towards pay may provide better value through improving recruitment and retention within similar overall cost to employers.

Outcome of Consultation

14. The issues contained within this report do not require formal consultation.

Legal Implications

15. This report has been considered by the Borough Solicitor for legal implications in accordance with the Council's approved procedures. There are no issues which the Borough Solicitor considers need to be brought to the specific attention of Members, other than those

highlighted in the report.

Section 17 of the Crime and Disorder Act 1998

16. The contents of this report have been considered in the context of the requirements placed on the Council by Section 17 of the Crime and Disorder Act 1998, namely, the duty on the Council to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. It is not considered that the contents of this report have any such effect.

Council Policy Framework

17. The issues contained within this report do not represent change to Council policy or the Council's policy framework

Decision Deadline

18. For the purpose of the 'call-in' procedure this does not represent an urgent matter

Key Decisions

19. This report does not represent a key decision.

Recommendation

20. It is recommended that: -

    (a) The changes to the Pension Scheme to be introduced from 1st April 2005 be noted;

    (b) The response at Appendix 3 be forwarded to the Employers' Organisation.

Reasons

21. The recommendations are supported to enable this Council's views on the proposed changes to the LGPS to be taken into consideration in the Employers' Organisation's response to the ODPM.

Paul Wildsmith
Director of Corporate Services

Background Papers

(i) ODPM Consultation Paper "Facing the Future – Principles and propositions for an affordable and sustainable Local Government Pension Scheme in England and Wales".

(ii) Employers Organisation Circular No 168 – January 2005

David Hall : Extension 2303

CHANGES TO LGPS TO TAKE EFFECT APRIL 2005
- SUMMARY OF MAIN CHANGES

***Minimum age of retirement* -** will increase from 50 to 55. This will apply for retirements on redundancy or efficiency grounds and for voluntary retirement with the employer's consent before age 60.

The change will not apply in the case of Scheme members who will be aged 50 or over on 31 March 2005 age (e.g. those born before 1 April 1955), who will retain 50 as their earliest retirement date.

It will also not apply to scheme members who are retired on the grounds of permanent ill health (as ill health retirements do not have a minimum age criterion).

The '85 year rule' will also be removed from the Scheme for service from 1st April 2005. The '85 year rule' is where the employee's age (in whole years) plus their LGPS membership (in whole years) equals at least 85 years. Under the current Scheme, if an employee asks for their pension to be paid before they reach age 65, it is reduced to reflect the cost of paying it early unless the employee satisfies the '85 year rule'. As such, if an employee meets the '85 year rule' and leaves employment before they reach 65, their pension is not reduced.

The removal of this rule means that all benefits from membership of the Scheme after 31 March 2005 will be reduced if an employee chooses to have their pension paid before age 65 (although the Council can continue to waive the actuarial reduction on compassionate grounds). As such, the normal retirement age will effectively be 65 for all members.

However, removal of the '85 year rule' will not apply for certain 'protected' members until 1 April 2013. If an employee will be aged 60 or over before 1st April 2013 (e.g. born before 1 April 1953) and will satisfy the current 85 year rule by then, the benefits that the employee accrues up to that date will not be affected by the changes.

The increase of the minimum retirement age from age 50 to age 55 and the removal of the 85-year rule for all future service will reduce the flexibility that the Council currently has in terms of managing change. These areas currently give the Council a tool for managing people out of the Council, where this is of mutual benefit to the Council and the employee. As such, the changes may also have an adverse impact on sickness absence levels (however, the Green Paper proposal for flexible retirement could help to address these issues).

The Council's Early Retirement Policy will need to be amended in due course to take account of the changes to the Scheme.

PROPOSED CHANGES TO LGPS TO TAKE EFFECT APRIL 2008
- SUMMARY OF MAIN CHANGES

Contribution Rates

Currently, the Scheme regulations require members to contribute 6% of their gross pensionable pay, with a declining number of defined 'manual workers' having a protected right to contribute 5%.

The paper states that the various propositions it contains for a new LGPS would, if taken together, result in a total future Scheme cost of about 21% of payroll.

It proposes that employer contributions should be stabilised at current levels (after the April 2005 changes) by increasing employees' contributions to an average 7% of gross pensionable pay.

Employers' views are sought whether this is sustainable, or whether reductions in employers costs should be achieved by reducing benefits, further increasing employee contributions, or both? This is in response to the fact that authorities are increasingly concerned about the costs on the pension scheme, but also aware of the value of the scheme as part of the remuneration package.

The Green Paper also proposes banded employee's contribution rates: -

Salary	Contribution Rate
< £5k	2.5%
> £5k but < £7k	5.5%
> £7k but < £38k	7%
> £38 but < £80k	9%
> £80k and over	10%

The rationale for this proposal is to provide equitable access to the LGPS and address some of the anomalies of the current inter-face with the state benefit provision. These are whole-economy issues that would be better dealt with by changes to the state benefit and tax systems. This proposal is not well thought through. It should certainly not be supported in its present form, which would, in some circumstances, cause small increases in gross pay to result in reductions in net pay.

Defined Contribution Top-Up Scheme

Consideration could be given to the option of the Scheme providing a defined contribution top-up arrangement. This would negate the need for the Scheme to maintain the current Additional Voluntary Contribution or added years provisions. Scheme members could pay additional contributions into the top-up arrangement on their basic pay and on any pay received in excess of basic pay (and potentially could transfer the value of pension rights in other Schemes into the top-up arrangement).

The paper also asks whether such an arrangement should be offered to employees as an alternative to the defined benefit scheme, with an appropriate level of employer contribution, in order to provide further flexibility and choice to employees.

Eligibility
The Scheme would cover the same range of employers as now, including contractors who wish to participate in the Scheme under an admission agreement following outsourcing.

Employees could participate at any age and would be deemed to have opted into membership of the Scheme (apart from employees employed on fixed term contracts of less than three months who would have to elect to joining the Scheme, as would employees of admitted bodies.

Pensionable Pay
Pensionable pay could be limited to basic salary. All other payments, such as bonuses, fees, overtime and allowances, would be excluded. The basic salary on which contributions would be paid could be that at the start of the financial year or, if the employment commences or changes during the period, the salary on commencement of the job.

Accrual Rate
Benefits could be linked to final basic salary and could accrue on the basis of 1.6% per annum. For example, after 10 years' service, a member would receive a pension based on 16% of their basic salary. After 40 years' service, a member would receive a pension based upon 64% of their basic salary. This is a slightly better accrual rate than at present.

Taking account of this accrual rate, it is not intended that the Scheme would provide an automatic lump sum. Instead, it could allow members to commute up to 25% of their pension for a tax-free lump sum at a rate of 12:1. In other words, for every pound of pension foregone, £12 of lump sum would be awarded.

Scheme Retirement Age
Any new arrangements will have a normal scheme retirement age of 65. Where benefits are paid before this age (except on ill health grounds) they would be actuarially reduced. Benefits paid after age 65 would be actuarially increased.

Flexible Retirement
Provision could be made for flexible retirement to ensure that members could choose to make arrangements for a more gradual approach to retirement, where this meets the business needs of the employer. This would allow employees to adjust their work/life balance by reducing their hours or moving to a less demanding/onerous job, but, at the same time, able to draw some or all of their accrued pension whilst continuing to accrue further pension rights.

Inland Revenue Changes
The Finance Act 2004 establishes a new tax regime for all pension schemes and comes into effect on 6 April 2006. The current LGPS regulatory framework will need to be amended to take account of this. Changes will be needed in the following areas: - lifetime allowance, annual allowance, tax-free lump sum, flexible retirement, total membership, members contributions and high earners.

Ill Health Retirement
Tiered ill-health retirement benefits could be introduced, with improved enhancement for members whose employment is terminated on grounds of being permanently incapable of performing any gainful employment due to ill health. Their benefits would be paid based on potential membership to age 65, although a review mechanism could be considered to take account of future improvements in medical science.

A second tier of un-enhanced ill retirement benefits could be available to those who are incapable of continuing in their role, but capable of undertaking other employment. This could be subject to review and could cease or be reduced if the member took up subsequent employment.

Alternatively, the second tier could take a more radical form. Instead of the Scheme paying an ill health pension, employers could enter into income protection policies which are commercially available, with the LGPS benefits only becoming payable when a member will not be, or will not be capable of, working again.

Death in Service Lump Sum
This could be increased to three times pensionable pay.

Survivor Benefits
As well as providing survivor benefits to widow(er)s, children and to registered civil (same sex) partners, it is proposed that survivor benefits could be extended to unmarried partners where the co-habitees are financially dependant or inter-dependant, have been in an exclusive, long-term relationship established for a minimum of two years, and the member has completed a valid partner's pension nomination form.

The maximum spouse's / partner's pension could be 50% of the member's post commutation pension (i.e. the amount of the member's pension after any lump sum has been taken by the member), although the survivor benefits could be less where there is a considerable age difference between the spouses/partners.

Children's pensions would be 25% of the member's post commutation level of pension and would cease at age 18.

There would be no enhanced short-term survivor benefit provisions (i.e. a benefit paid at a higher rate for the first 3 – 6 months following death).

Transitional Arrangements
To ensure a simplified, single framework for the future, the Green Paper states that any new look Scheme could provide that every person who is contributing to the current LGPS on the date the new scheme commences would be automatically transferred to the new arrangements and awarded a period of membership in the new scheme that is of equal value. Deferred and pensioner members, at the date the new scheme commences, would be entitled to retain benefits in the current LGPS.

Compensation Arrangements
The Scheme could continue to offer unreduced benefits to early leavers aged 55 or over whose departure is outside their control (e.g. redundancy). The existing compensation arrangements (allowing the award of compensatory added years or a one-off lump sum of up to 66 weeks pay) could be revoked and replaced with a provision allowing the payment of a one-off lump sum payment. This could be extended to cover, for example, not just redundancy cases but cases involving compromise agreements. The recipient could even be allowed to exchange the cash payment for LGPS pension benefits of equivalent value.

Other Matters

The paper also proposes that a new LGPS would, like the current Scheme, contain provision related to the proper governance of the LGPS Funds. It also discusses:

- the need for high quality scheme administration and information / data flows, and questions whether there are any regulatory approaches that can be adopted to improve these, and
- considers the options for simpler, clearer regulation possibly linked to a greater use of codes of practice.

It also comments on best practice issues such as joint working, e-government and the importance of good communication strategies.

Questionnaire for employers on key points in the EO/LGPC draft response to the Green Paper: Facing the future – Principles and propositions for an affordable and sustainable local government pension scheme

Introduction

The purpose of this questionnaire is to obtain employers' reactions to the key points being made in the Employers' Organisation for local government (EO)/Local Government Pensions Committee (LGPC) draft response to the Green Papers issued by the Office of the Deputy Prime Minister (ODPM) and by the Scottish Public Pensions Agency (SPPA) in 2004.

It would be helpful if, having fully considered the Green Paper and the individual elements of, and reasoning behind, the **draft response in Annex B,** employers could indicate their agreement, or otherwise, to the main points being made in that response. Employers are asked to complete and return this questionnaire to: The Local Government Pensions Committee, Employers' Organisation for local government, Layden House, 76-86 Turnmill Street, London, EC1M 5LG by **28 February 2005**.

Based on the views presented in Annex B please indicate your agreement or otherwise with the following key points being made in the EO/LGPC draft response to the Green Papers

	Please tick one	
	Agree	**Disagree**
Q.1. The Scheme forms part of the overall remuneration package and there is a balance to be struck within that overall package between pay and pensions (deferred pay)	✓	❑
Q.2. The LGPS should have a benefit structure broadly in line with that in other comparator public sector schemes	✓	❑

	Agree	Disagree
Q.3. With regard to the cost of the Scheme, please indicate which of the three options below you most support. Within your preferred option please indicate your preferred sub-option (where appropriate):		
Q.3. Option 1 We are supportive of targeting an employer contribution rate in respect of future service accrual that is equivalent to that under the current Scheme (after the effects of the removal of the 85 year rule from the current Scheme have been taken into account); or	❑	✓
Q.3. Option 2 We are cautious about targeting an employer contribution rate for future service accrual that is equivalent to that under the current Scheme (after the effects of the removal of the 85 year rule from the current Scheme have been taken into account). Targeting a slightly lower employer rate (of, say, a reduction of 1%) would be justified, would be more acceptable to employers (and to Council tax payers) and would be more likely to ensure the longer term affordability and sustainability of the Scheme. This could be achieved by:	✓	❑
• **Sub-Option 2A**: reducing the value of the benefits package outlined in the Green Paper by a target figure of 1% whilst retaining an average employee contribution rate of 7%; or	✓	❑
• **Sub-Option 2B**: retaining the value of the benefits package outlined in the Green Paper but increasing the average employee contribution rate by 1% (i.e. from 7% to 8%)	❑	✓
Q.3. Option 3 As per option 2 but with a larger reduction in employer contribution to be achieved via:	❑	✓
• **Sub-Option 3A**: target a larger reduction in the benefit package (to save more than 1%), or	❑	❑
• **Sub-Option 3B**: target a larger increase in the employee contribution rate (beyond 8%)	❑	❑
• **Sub-Option 3C**: target both a larger increase in the employee contribution rate and a larger reduction in benefits	❑	❑

	Agree	Disagree
Q.4. A new-look LGPS should be a final salary Defined Benefit scheme. This should be open to:	✓	❑
a) employees and	✓	❑
b) councillors	❑	✓
• There should be no Defined Contribution scheme as a top-up to the main scheme	✓	❑
• There should be no Defined Contribution scheme as an alternative to the main scheme	✓	❑
• There should be no facility for members to purchase added years	✓	❑
• There should be a facility for members to purchase additional scheme benefits based on an actuarially set charge for purchasing £100 of annual pension	✓	❑
Q.5. The Scheme should cover the same range of employers as now	✓	❑
Q.6. Employees should be allowed to contribute at any age (subject to the Inland Revenue limit of age 75)	✓	❑
Q.7. The employee/councillor contribution rate should be the same[1] for all scheme members (not a graded/banded contribution rate dependent on the level of earnings)	✓	❑
Q.8. We are inclined to retain the current definition of pensionable pay	✓	❑
Q.9. The accrual rate per year of membership and the commutation rate should be no less favourable than the other main comparator public sector pension schemes	✓	❑
Q.10. The Scheme should have a Scheme Retirement Age (SRA) of 65. Benefits taken before SRA should be subject to an actuarial reduction, other than in the case of ill health retirement, whilst benefits drawn after SRA should be subject to an actuarial increase	✓	❑
Q.11. Flexible retirement, linked to down-shifting (i.e. moving to a lower graded post) or a reduction in hours, should be permitted from April 2006 and members availed of this facility should be allowed to continue paying into the Scheme in their remaining employment	✓	❑

[1] The actual level to be set out in your answer to Q. 3 above.

	Agree	Disagree
Q.12. The new Inland Revenue flexibilities should be built into the LGPS from April 2006.	✓	❑
• No special provisions should be made for members whose benefits exceed the new lifetime or annual allowances	✓	❑
• Nor should a Scheme specific earnings cap be retained in respect of the future membership of those employees currently subject to the earnings cap of £102,000 per annum (although a fair and equitable solution will need to be found in respect of their accrued membership)	✓	❑
Q.13. Benefits payable on redundancy/efficiency retirement prior to Scheme Retirement Age (SRA) should be payable at the employee's choice, at an actuarially reduced rate.	✓	❑
• The employer should have the option to waive or reduce the actuarial reduction at the employer's cost	✓	❑
Q.14. We are in favour of a two tier ill health system ***[If you disagree with the above statement, go to question 15]***	✓	❑
• We agree that the benefits of those who are certified as being permanently incapable of any gainful employment should be based on their prospective service to age 65	✓	❑
With regard to the second tier, please tick the box which represents your favoured option:		
Q.14. Option 1 We are generally in favour of a second tier of un-enhanced ill health retirement benefits payable for life, but we are not convinced of the equity of a review system; or	❑	✓
Q.14. Option 2 We are generally in favour of a second tier of un-enhanced ill health retirement benefits but believe these should only be payable for a limited period of time, say 2 years; or	✓	❑
Q.14. Option 3 We believe there should be no second tier of ill health retirement benefits. Instead, the member would be provided with a deferred pension and the employer could make a one off lump sum termination payment	❑	✓

	Agree	Disagree
Q.15. The death in service lump sum should be 3 times final pensionable pay	✓	❑
Q.16. There should be no short term survivor pensions	✓	❑
Q.17. We are supportive of the introduction of partners' pensions (particularly if, as seems likely, the other public sector schemes are moving towards their introduction)	✓	❑
• But we feel there are a number of equity issues surrounding the proposals contained in the Green Paper which need to be considered	✓	❑
Q.18. A surviving spouse's/partner's pension should not be reduced if there is a large age differential between the couple	✓	❑
Q.19. Unless a child is disabled, a child's pension should cease at age 18	✓	❑
Q.20. We are not in favour of adjusting a person's period of accrued membership if they move between jobs in local government, or if they move into a different salary band (if tiered employee contributions are introduced), in order to take account of the differences in pay levels	✓	❑
Q.21. The transfer of pension rights from other (non-club) pension schemes into the LGPS should purchase a period of membership in the Scheme or,	✓	❑
• The Scheme should provide that transfers purchase additional benefits based on an actuarially set charge for purchasing £100 of annual pension	❑	✓
Q.22. Transferring existing scheme members from the current Scheme to a new-look LGPS has merit, as all contributors would then be in a single Scheme, but only if the service conversion is workable, fair and equitable	✓	❑
Q.23. On the wider front, we see merit in there being one set of Scheme rules covering, for example, local government, teachers and the NHS	✓	❑
Q.24. We are in favour of revoking the current Compensation Regulations and replacing them with a general power for employers to make a one off payment of up to 2 years pay	✓	❑

	Agree	Disagree
Q.25. If you do not agree with the first statement in **Q.4.** above (i.e. the LGPS should be a final salary Defined Benefit scheme for both employees and councillors) what alternative would you prefer? (please tick as appropriate)		
• A final salary Defined Benefit scheme for employees plus a career average Defined Benefit scheme for councillors, or	❑	❑
• A career average Defined Benefit scheme for all employees and councillors, or	❑	❑
• Defined Contribution scheme for all employees and councillors, or	❑	❑
• Other (please specify)	❑	❑

Additional comments:

Signed ……………………………………………. Date ………………………

Designation (in capital letters) …………………………………………………..

For and on behalf of (name of employer in capital letters)

………………………..……………………………………………………

Please return the completed questionnaire by **28 February 2005** to:
LGPC
Employers' Organisation for local government
Layden House
76 – 86 Turnmill Street
London
EC1M 5LG
Fax: 0207 296 6739