WILTSHIRE COUNCIL

WILTSHIRE PENSION FUND COMMITTEE

25 July 2012

LOCAL GOVERMENT PENSION SCHEME REFORMS UPDATE

Purpose of the Report

1. This report updates Members of the latest developments on the proposed reforms to the Local Government Pension Scheme (LGPS) following negotiations and the subsequent announcement by the Local Government Employers (LGE) and the Unions, supported by the Government on 31 May 2012.

Background

2. The New LGPS 2014 project was set up in December 2011 following acceptance by the Government of a set of principles for scheme reform submitted by the LGE. This was to incorporate the recommendations of the Hutton Review and required Government cost savings.

3. The first phase was to agree the "big ticket" items as outlined in this most recent announcement with the finer detail of the scheme being agreed later in the year. Unions will consult their members over the proposals and the LGE will consult employers. Government has confirmed that a favourable outcome of the consultations will enable them to move directly to a statutory consultation later in the autumn.

4. The timeline requires the reformed scheme to be agreed and regulations put into statute prior to 31 March 2013 so the revised basis can be used within the 2013 triennial valuation process in order to achieve the required cost savings.

Key Considerations for the Committee

Proposals

5. These changes will apply from April 2014 but all pensions in payment or built up before this date will be protected. Members that are in receipt of a pension or have left with deferred benefits will not be affected, all members currently contributing will have all pre 2014 benefits accrued protected.

6. The main provisions proposed for the LGPS 2014 scheme are:

   a) Career Average Revalued Earnings (CARE) scheme using CPI as the revaluation factor (uplift) – the current is a Final Salary scheme.

   b) An accrual rate of 1/49th – the current is a 1/60th scheme

   c) There would no longer be a Normal Retirement Age (NRA) that covers all scheme members. Instead each individual member's retirement date would be the same as their State Pension Age (SPA) – the current scheme has a NRA of 65

   d) Average member contributions would remain the same at 6.5% but the rate would be determined on actual pay – the current scheme determines part-time contribution rates on full time equivalent pay. Although there would be no change to average contributions, the lower paid will pay the same or less and the higher paid will pay higher contributions on a more progressive scale after tax relief

e) Members that have, or are, considering opting out of the scheme can elect to pay half contributions for half the pension while still retaining full value of other benefits. This will be known as the 50/50 option. Members can opt back into the main scheme at any time and this option will be seen as a short term solution where members will be opted back into the scheme under the new auto-enrolment provisions.

f) For current scheme members benefits accrued prior to April 2014 will be protected including any outstanding 'Rule of 85' protection. Protected pre 2014 service will continue to be based on Final Salary and the current NRA.

g) Where scheme members are outsourced they will be able to elect to stay in the scheme on first and subsequent transfers – currently this is at the discretion of the employer.

7. All other benefits remain as in the current scheme, namely death in service grant, spouses' pensions and ill health provision.

8. The Appendix shows at a quick glance the changes between the current and proposed scheme.

What does this mean for members?

9. The original Government's Reference Scheme design, which was the starting point for negotiations, had already highlighted the move from Final Salary to CARE; retirement age linked to SPA, and protections for those within 10 years of retirement so this was no surprise. However, the accrual rate change and 50:50 option was unexpected.

Benefits

10. The higher accrual rate (1/49th) combined with a lower expected revaluation based on CPI is a significant change from (1/60th). The claim is that the new basis is the equivalent of the old $1/60^{th}$ Final Salary benefits.

11. This change will impact different members in different ways. A high accrual rate is generally better for those close to retirement and for those with short service at the expense of younger members who will have a full career membership of the LGPS.

12. The following examples (courtesy of Hyman Robertson) compare projected LGPS 2014 scheme pensions at SPA with those from the existing LGPS 2008 scheme (if it had continued). The figures assume accrual from 1 April 2014 and ignore protections and pension accrued prior to this. In the example, pensionable pay is £20,000 at 1 April 2014 and all pensions are in today's money.

13. An employee with a full working lifetime in the LGPS 2014 scheme would receive a significantly reduced pension compared to the current LGPS scheme. Despite the higher accrual rate in the LGPS 2014 scheme this is offset by a lower revaluation over the long term.

14. However, an employee closer to retirement in the LGPS 2014 scheme will benefit more from the higher accrual rate despite the lower level of revaluation. There is a tipping point

for members aged mid to late-forties where the benefits from the two schemes are broadly equivalent.

Case study	LGPS 2008	LGPS 2014
Employee currently age 25, retirement age of 68	£15,900	£11,300 (71% of LGPS 2008)
Employee currently age 45, retirement age of 67	£7,700	£7,100 (92% of LGPS 2008)
Employee currently age 58, retirement age of 65	£2,300	£2,600 (113% of LGPS) 2008)

These figures are based on HMT/GAD assumptions of 4.25% per annum salary escalation and 2% per annum CPI increases. For comparison purposes pensions in the LGPS 2008 scheme are assumed to be payable from SPA and allow for an uplift per day of 0.014% simple.

50/50 scheme

15. Another significant proposal is the 50/50 option that allows employees to elect to pay 50% of their normal contribution rate in return for 50% pension accrual although most other benefits would remain as they currently are.

16. The 50/50 scheme may be attractive to a wide range of scheme members, such as:-

- Scheme members who may be experiencing short term financial difficulties and who might otherwise have been tempted to opt-out of the scheme instead.

- Higher earners wishing to avoid the possible tax charges associated with the annual and lifetime allowances, but who wish to retain ancillary benefits such as survivor and death benefits.

- The lower paid, who might otherwise have considered opting-out of the scheme where accrual in the full scheme would have a detrimental impact on existing State benefit provision.

17. This option is meant to be a short-term alternative to opting out of the scheme but not envisaged to be undertaken on a long term basis (although the detail of how this would work is not yet known). Members who do opt out of the scheme altogether will be automatically enrolled back into the main scheme every three years anyway.

Contributions

18. The new contribution scale has been designed to be more progressive after allowing for tax relief. It aims to meet the Government's objectives of protecting the lower paid and limiting increases to all but the higher earners.

19. The proposed employee contribution rate structure is as follows:

Pensionable pay	Gross contribution rate	Net contribution rate
Up to £13,500	5.5%	4.4%
£13,501 - £21,000	5.8%	4.64%
£21,001 - £34,000	6.5%	5.2%
£34,001 - £43,000	6.8%	5.44%
£43,001 - £60,000	8.5%	5.1%
£60,001 - £85,000	9.9%	5.94%
£85,001 - £100,000	10.5%	6.3%
£100,001 - £150,000	11.4%	6.84%
More than £150,000	12.5%	6.88%

20. Many part time employees will be paying a lower percentage of pensionable pay than would be the case under the previous structure, given that the bandings will be assessed against actual pay and not full time equivalent.

21. A significant number of employees will see little or no increase in their contribution rate and some will see an effective reduction. The announcement states that the average member contribution to LGPS 2014 will remain at 6.5% gross yield. However, the increases for the higher paid are greater e.g. the rate for someone earning £80,000 increases from 7.2% to 9.9% and the new net contribution rate in this case will now be around 5.9% after higher rate tax relief. This compares to a contribution rate of 4.6% after basic rate tax relief for someone earning £20,000.

22. Pensionable pay will now include elements such as non-contractual overtime, which are currently treated as non-pensionable. This also adds additional administration issues for employers and administrators as in addition to redefining the pensionable pay elements within payroll/HR systems it will still be necessary to record pensionable pay in accordance with the current LGPS in order to calculate benefits from membership accrued to 31 March 2014.

23. The implementation of the 50/50 schemes will also provide additional challenges for systems in addition to employers' additional requirements for the recording pay for auto-enrolment.

Member communication

24. There is generally a lack of awareness and understanding of existing pension arrangements before the 2014 scheme is even implemented. Clear communication will be vital especially as many members could end up with different tranches of benefits (pre-2008, post-2008 and post-2014).

25. Plans will need to be implemented on how to communicate to members. This will be achieved through the following:-

- annual benefit statements;
- presentations / pension clinics / roadshows;
- the fund website;
- online modellers

What does it mean for employers and taxpayers?

26. The announcement states the new scheme is based on a notional employer future service contribution rate of 13% of pay (the “cost ceiling” of 19.5% less employee contributions of 6.5%), which is an increase on the original figure of 10.9% suggested at the start of negotiations.

27. The cost ceiling should only be used for benchmarking alternative scheme designs. Although linking retirement age to SPA will help control future costs, the expected savings for employers at the moment are modest. Initial calculations indicate a saving in the region of 1.5% - 2% of pay but any savings for individual funds could vary significantly depending circumstances.

28. As accrued rights prior to April 2014 are protected, existing deficits are unchanged by the reforms and will still need to be repaired. Any potential saving from the future cost of post-2014 benefits are likely to be offset by upwards pressure on employer contributions due to current low interest rates and bigger deficits compared to the 2010 valuations. Therefore, total employer contributions (including those to repair existing deficits) are unlikely to fall at the 2013 actuarial valuations despite the proposed benefit changes.

29. The benefit for employers is that contribution increases will be less than would otherwise have been the case. However, there has been a great deal of negotiations to reach this point and the outcome is still to be concluded.

What does it mean for Administering Authorities?

30. The timescale for implementing is very tight and requires co-operation by employers and unions to ensure this timescale can be met. The Wiltshire Pension Fund is implementing its restructure agreed in December 2011 and resources will be monitored to ensure capacity exists to address the issues which include:-

    - Developing or updating communications plans to both employers and employees
    - Considering what changes may be required to systems and processes in light of the new scheme design
    - Understanding and implementing changes to governance arrangements (once they have been published)
    - Identifying changes to year end processes and other accounting issues.

Other observations

31. One other interesting observation is that under the 2014 scheme outsourcing employees will be able to decide if they wish to remain in the LGPS. This is different to the current situation where the employer is able to provide a “broadly comparable” scheme instead of becoming an admitted employer within the Fund.

32. The detail of how this would work in practice is still to be published as it suggests a potential conflict between the administrating authority’s ability to decide whether an employer can join the Fund and the employee’s rights.

What will happen next?

33. These proposals have to be communicated to employers and scheme members. The various local authority unions will ballot their members on what has been proposed and the LGE to consult LGPS employers (responses due by 27th July 2012).

34. Assuming the proposals are accepted, the next stage will be a statutory consultation later this year to allow the necessary regulations to be in place for the next actuarial valuations in 2013.

Conclusions

35. Overall the new scheme has a number of features that are good for members and for taxpayers. The positives include:

- protection of accrued rights;
- career average benefits which are fairer and better suited to the lower paid and those with broken careers, often women;
- the link between retirement age and State Pension Age since this will provide the scheme with greater protection from increased cost as longevity continues to improve; and
- measures to help keep people in the scheme who might otherwise have left.

36. There are concerns that some features of the new scheme will create greater complexity for the Fund and its employers and the task of implementation should not be underestimated.

37. Although it is likely the cost of benefits will fall in the long term compared to the current scheme, the extent of savings may be modest (around 1.5% - 2% on average employer contribution rates). The reforms reduce future benefit costs but leave existing deficits unchanged. The increase in deficits since the last valuation will wipe out any savings from the reforms and any employers hoping for a reduction in contributions at the next valuation are likely to be disappointed.

38. A concern that may not be alleviated until the proposed cost management system and governance arrangements are known (due to be issued later in the year) is how costs can be controlled over the longer term (it will be only 6 years since the 2008 changes when the new scheme is implemented). Here "cap & collar" arrangements will be implemented to limit increases in employer costs and share the burden with scheme members. As stakeholders will have to go through significant pain to implement these changes it's hoped this will deliver a more long term sustainable scheme and not require further savings to be found in the near future.

Risks Assessment

39. The proposed reforms will potentially impact on risk *PEN003: Insufficient funds to meet liabilities as they arise* in terms of the impact of the future accruals from 2014 while systems and administration processes will have to be reviewed to mitigate the risk *PEN008: Failure to comply with LGPS & other regulations* both highlighted on the Risk Register elsewhere on this agenda.

Financial Implications

40. The financial implications of these proposed reforms are considered in the main body of this report.

Proposals

41. Members are asked to note the proposed changes to the LGPS reforms.

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Director of Finance

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Unpublished documents relied upon in the production of this report:

Hymans Robertson – Proposed LGPS 2014 benefit design announced June 2012

APPENDIX

<table>
<tr><th></th><th>LGPS 2014</th><th>LGPS 2008</th></tr>
<tr><td>Basis of Pension</td><td>Career Average Revalued Earnings (CARE)</td><td>Final Salary (FS)</td></tr>
<tr><td>Accrual Rate</td><td>1/49th</td><td>1/60th</td></tr>
<tr><td>Revaluation Rate</td><td>Consumer Price Index (CPI)</td><td>Based on final salary</td></tr>
<tr><td>Pensionable Pay</td><td>Pay including non-contractual overtime and additional hours for part time staff</td><td>Pay excluding non-contractual overtime and non-pensionable additional hours</td></tr>
<tr><td>Employee Contribution Rate – Average 6.5% in both LGPS 2008 and LGPS 2014</td><td>
<table>
<tr><th>From</th><th>To</th><th>Gross Rate</th></tr>
<tr><td colspan="2">Up to £13,500</td><td>5.5%</td></tr>
<tr><td>£13,501</td><td>£21,000</td><td>5.8%</td></tr>
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<tr><td>£15,801</td><td>£20,400</td><td>5.9%</td></tr>
<tr><td>£20,401</td><td>£34,000</td><td>6.5%</td></tr>
<tr><td>£34,001</td><td>£45,500</td><td>6.8%</td></tr>
<tr><td>£45,501</td><td>£85,300</td><td>7.2%</td></tr>
<tr><td colspan="2">More than £85,300</td><td>7.5%</td></tr>
</table>
</td></tr>
<tr><td>Contribution Flexibility</td><td>Yes members can pay 50% of the pension benefit</td><td>No</td></tr>
<tr><td>Normal Pension Age</td><td>Equal to the individual member's State Pension Age (minimum 65)</td><td>65</td></tr>
<tr><td>Lump Sum Trade Off</td><td>Trade £1 of pension for £12 lump sum</td><td>Trade £1 of pension for £12 lump sum</td></tr>
<tr><td>Death in Service Lump Sum</td><td>3 x pensionable pay</td><td>3 x pensionable pay</td></tr>
<tr><td>Death in Service Survivor Benefits</td><td>1/160th accrual based on Tier 1 ill health pension enhancement</td><td>1/160th accrual based on Tier 1 ill health pension enhancement</td></tr>
<tr><td>Ill Health Provision</td><td>Tier 1 – immediate payment of pension with service enhanced to Normal Pension Age
Tier 2 – immediate payment of pension with 25% service enhancement to Normal Pension Age
Tier 3 – temporary payment of pension for up to 3 years</td><td>Tier 1 – immediate payment of pension with service enhanced to Normal Pension Age
Tier 2 – immediate payment of pension with 25% service enhancement to Normal Pension Age
Tier 3 – temporary payment of pension for up to 3 years</td></tr>
<tr><td>Indexation of Pension in Payment</td><td>CPI</td><td>CPI
(RPI for pre 2011 increases)</td></tr>
<tr><td>Vesting period</td><td>2 years</td><td>3 months</td></tr>
</table>