
CONSULTATION ON THE FUTURE OF THE LOCAL GOVERNMENT PENSION SCHEME

Introduction

1. The Government initiated a stocktaking exercise on the Local Government Pension Scheme (LGPS/the Scheme) in September 2001 and has now published a discussion paper outlining ways in which it might be developed, particularly for new entrants.
2. Comments and observations are invited for submission to the Office of the Deputy Prime Minister (ODPM) by 14 February 2003. The intention is that a series of further papers will be published to generate discussion, eventually leading to the introduction of a revised benefit package for new entrants.
3. Existing entitlements will not be adversely affected, although the opportunity may also be taken to consider the possible extension of the current LGPS package including, for example, pension provision for unmarried partners.
4. This report briefly reviews the contents of the discussion paper and seeks initial thoughts from the Committee. The full discussion paper is attached as an appendix to this report.

Why is change considered necessary?

5. The LGPS is a statutory-based, funded, defined benefit final salary scheme whose members generally pay 6% of their pensionable salary to their individual LGPS administering authority. It has its origins in the 19th century and its basic design is for male officers with 40 year career expectations and salaries peaking as a retirement age of 65 is approached.
6. Local government, however, has significantly changed and continues to do so. At present, in the UK, it has around 2 million employees, many of whom are female and part-time. In addition, employment contracts are now often short-term, multiple and flexible employment is increasing, as is outsourcing of services.
7. Recent early retirement patterns, a desire for a more flexible retirement regime, and the need to manage ill-health issues also need to be taken into account.
8. The OPDM also believes, as a result of its stocktake exercise, that the Scheme is perceived as complex, inflexible, and poorly understood, that it is not fully utilised by eligible employees and that private contractors are wary of it.
9. Interestingly, the discussion paper does not make much play on another important factor, that is, an increase in life expectancy and the resulting increased cost involved in pension provision. Presumably, this will be explored in future discussion papers.

What possible changes might be introduced?

10. The OPDM is now looking for feedback on a number of suggestions, together with any supplementary proposals that consultees may wish to make. The possible incorporation of the following components to the Scheme are put forward:
 - 10.1 On an optional basis, and in return for a higher employee contribution, an improved pension package available either universally or selectively compared with that presently available.
 - 10.2 Amendments to the benefit package to improve management of ill-health early retirements, and to provide more flexibility on the issue of work and retirement in relation to age and service through incentives to encourage longer active service. This is taken to mean the option to access pension entitlements whilst being able to continue to work on a part-time basis.

- 10.3 A lower employee contribution rate for new starters for, say, their first five years of service with correspondingly lower benefits but linked to improved entitlements in return for a higher contribution rate and/or a stepped plan linked closer to career progression and length of service.
- 10.4 A “hybrid” arrangement featuring defined contribution arrangements initially but reverting to defined benefit arrangements after a specified minimum period of service.
- 10.5 Pension benefits based on career salary average rather than final salary.
- 10.6 The offer of an improved set of employer-based discretionary benefits, and/or a “cafeteria” style of pension provision with more flexibility on employee contribution rates.
- 11. The OPDM is also testing the waters on two specific suggestions. Firstly, that employees be allowed to purchase additional LGPS benefits up to Inland Revenue limits and, secondly, that employers have powers to provide, by resolution, an enhanced scheme above the national norm subject to employees paying an appropriate contribution rate.
- 12. A number of threads appear to be prevalent in the suggestions:
 - 12.1 An increase in flexibility, to make the Scheme more appropriate to other than those that expect to retire after a lifetime of service in local government.
 - 12.2 The availability of incentives to encourage the take up of pension entitlements and staff retention, and the offering of more flexible options around retirement.
 - 12.3 More flexibility for employers to offer local variations in the Scheme.
 - 12.4 An indication of moves to reduce the ongoing cost of the Scheme to employers.
- 13. An immediate concern is that, rather than reducing Scheme complexity, an influx of local variations will make it harder to administer and will be confusing for staff moving between local authorities that offer differing Scheme elements.
- 14. As indicated in paragraph 9, no direct link is made to increased life expectancy pushing up the cost of the Scheme for employer bodies. This does point to the need for the amount contributed by employees, currently 6%, to be reviewed.
- 15. Another key issue not addressed, although it is hinted at, is whether or not the current balance of risk in terms of the cost of pension provision is appropriately shared between the employing bodies (that currently absorb all the risk) and employees.
- 16. These factors do point, for the future, to a revised Scheme for new entrants that is a hybrid of a pared-down defined benefit scheme based on that currently operated, supplemented (possibly on an optional basis) by a defined contribution element to which the employer also contributes. Discretion might be made available to employers on the amount to which they do contribute to this latter element, over and above a prescribed minimum.

Recommendation

- 17. The Committee is asked if it would like to respond to the ODPM’s discussion paper on the basis outlined in paragraphs 13 to 16.

MIKE PRINCE
County Treasurer

Unpublished documents relied upon in the production of this report: NONE

Environmental impact of these proposals: UNKNOWN

LOCAL GOVERNMENT PENSION SCHEME**RETIREMENT BENEFIT PACKAGE OPTIONS DISCUSSION PAPER****SUMMARY**

While the LGPS is a reasonable pension scheme for career-serving employees able to put in 40 years service, with a degree of salary progression, and so able to retire on a maximum of half their final salary, it is not so well focussed on the pension needs of part-timers, career-break employees, low paid workers, contract workers or term-time employees. Employment trends are seen to be increasingly more fluid, changeable and fragmented between and within sectors. The LGPS was not originally designed to cope with such experiences. This discussion paper seeks to stimulate an inclusive debate and a comprehensive and objective analysis of options. The present Scheme is not under challenge. No-one's rights under the present arrangements are being changed. But the debate on how best to forge some new, flexible and attractive proposals which could be turned into a "new" LGPS, particularly for the future staff of local authorities, needs to begin.

Policy

1. The Local Government Pension Scheme (the LGPS) is a statutory-based, public service, funded, final salary pension scheme, as defined by Section 1 of the Pension Schemes Act 1993.
2. Its rules are set out in secondary legislation made by the Secretary of State under section 7 of the Superannuation Act 1972. The Local Government Pension Scheme (Regulations) 1997 as amended define the current pension entitlements of LGPS members who pay 6% of their pensionable salary to their individual pension authorities; a decreasing number of workers enjoy a protected right to pay 5%.
3. Within the public service, a co-ordinated approach to the level of pension provision is maintained so as to ensure expectations and costs are harmonised. Two important policy principles underpin the government's general approach to all public service pension packages:-
 - (i) retrospective improvements to benefits are not normally introduced; and
 - (ii) improvements must be paid for jointly by contributing Scheme members and employers, or from savings made by the Scheme.

However, current policy in relation to extending eligibility for survivor benefits to unmarried partners, where the general membership want such an improvement is that they should be prepared to meet the additional costs, as set out in Chapter 8 paragraph 60 of *A new contract for welfare: Partnership in Pensions* (Cm 4179, December 1998).

4. Increasingly, changes in public sector employment strategies, organisation, structures and workforce trends are impacting on retirement and pension policies. Retirement income is a highly relevant factor in employment decisions both for employees and their employers who both contribute to their occupational pension schemes. Complex linkages exist between pay, length and type of service, retirement age and longevity in retirement, as well as the wider economic, fiscal and social policy issues.

Context

5. The LGPS, like most final salary pension schemes, has its origins in the 19th century. It is a defined benefit pension scheme, designed, initially, for full-time, male officers with 40 year career expectations, and salaries peaking (due to career progression) as retirement at age 65 is approached.

6. Against that perspective is the fact that local government has significantly changed, and continues to change rapidly, in terms of its structure, management, work patterns, organisation and responsibilities for service delivery. As a result, its workforce is having to adapt and be adapted within and by this process of change. The new local government employment dynamic impacts unavoidably on the pension framework provided through the LGPS, and the other local authority based public service pension schemes.
7. At present, local government in the UK employs about 2 million workers, or 1/12th of the total national workforce. Many are part-time and the majority are women. With currently about 2.7 million members, the LGPS is regarded nationally as an important benefit provider and a key part of local authority employers' human resource strategies, involving the recruitment, motivation and retention of good quality staff. An efficient, cost-effective occupational pension scheme, particularly one the size and nature of the LGPS in England and Wales, has significant advantages for all those interests who have a stake in it. But as the managerial and operational context of local authority employment continues to modernise, there is a demand for more diverse options and outcomes, running alongside the historic pattern of the LGPS's present benefit package.

Findings

8. The 2001 stocktake exercise confirmed, from a wide variety of interests, that a pension response is needed to meet the changing nature of future mainstream local authority employment and employees' likely expectations and needs.
9. Several elements were identified within the stocktake as motivators/influences of change, including:-
 - the increasing incidence of part-time employment;
 - the introduction of employment contracts for relatively short-term, defined periods;
 - the increasing proliferation of multiple employments;
 - a greater incidence of flexible working; and
 - an increasing incidence of external delivery of services and so higher levels of outsourced employment.
10. Associated with these trends are recent patterns of early retirement and a desire for a more flexible retirement regime, and the need to improve and manage ill-health issues within a flexible human resource context.
11. Before considering the potential scope for considering how to revitalise the current LGPS pension package, the inherent benefits of the Scheme should be recognised. Briefly, the Scheme:-
 - meets the pension needs, in broad terms, of those career, full-time local authority employees who are unlikely to be involved in frequent job changes;
 - its benefit structure for that membership group is generally regarded as producing acceptable benefits, linked to final pay;
 - pensions are inflation-proofed for scheme members;
 - inflation-proofed pensions are also available to families in the event of death or ill-health;
 - the LGPS, in effect, is an industry-wide scheme;

- the fact that it is funded assists in defraying employers' costs over acceptable actuarial-linked periods; and
 - the capacity to transfer between Scheme and with other public sector employers is seen as being generally beneficial.
12. By way of contrast, the following shortcomings were identified from a variety of sources during the stocktake exercise:-
- the LGPS benefit package for both employees and most employers tends to be poorly understood and even appreciated due, in particular, to its inherent complexity, over-bearing detail and inflexibility;
 - the direct and indirect benefits of the Scheme in a local authority context are frequently forgotten;
 - those who may change employer (public to private and the reverse) can suffer a diminution in the value of their final pensions;
 - too many new local authority employees opt out of membership for a variety of reasons;
 - not all employees necessarily benefit from the final salary nature of the LGPS;
 - there is a need to address the scope for providing survivor benefits for partners;
 - planning for retirement in local government is said not to be as attractive as other pension arrangements in the public sector;
 - the current benefit structure of the LGPS does not adapt well to the current needs of local authority employment; and
 - private contractors (who can opt to be admitted to the LGPS) are often wary of the Scheme as they have little or no control over costs, and are said to be frustrated and confused frequently by its complex arrangements and structures.

Policy Principles

13. In establishing a discussion framework for any possible future developments to the existing LGPS benefit framework designed to address these shortcomings, some key principles can be identified as to what the Scheme should be seeking to provide. It seems reasonable to suggest that the LGPS should provide benefits which are:-
- adequate for their policy and regulatory purposes;
 - comprehensive in their provision;
 - flexible and responsive to the needs of all members (employees and employers);
 - equitable to members, employers and taxpayers in terms of the balance between provision and cost;
 - efficient and cost-effective in their delivery;
 - be fully transferable; and
 - be secure enough to achieve the long-term statutory-based pension promise.

Scope for Action

14. As a consequence of the stocktake exercise, and against the background of recent reports to government by Ron Sandler and Alan Pickering, and indeed the government's anticipated Green Paper response, it is timely, therefore, to consider the scope for examining the possible form and content of the LGPS pension package.
15. The objective being developed involves trying to make it more appropriate and more relevant to the on-going employment and human resource conditions applying in local government today, and attractive to both existing and, critically, future members.
16. At the same time, the well-established strengths of the current arrangements will be built on, rather than undermined in any way, in order to protect rights already accruing and also to reinforce concepts of security, continuity and familiarity for employee members and employers in the LGPS going forward.

Components for Discussion

17. Given the policy principles outlined in paragraph 13, consultees, therefore, may wish to consider developing in their responses to this invitation to contribute to the development of future components of the LGPS, arguments both for and against introducing any of the following elements in any new package, and for whom and, where appropriate, to add to or to revise them in any way:-
 - for example, in return for a higher employee contribution, would it be sensible to establish, on an optional basis or otherwise, an improved pension package (available universally or selectively) to the one presently available;
 - is there merit in examining the scope for amending the benefit package in the light of the follow-ups to the public sector wide examination of managing ill-health and subsequent early retirements, in particular the use of enhancement/augmentation and possible review procedures;
 - what can be deduced from an assessment of the broader issue of work/retirement balance in terms of age/service; the concept of incentivised employment and flexible ways to encourage a longer active service;
 - what are the pros and cons of providing for a lower employee contribution (possibly restricted to new starters only and, say, only for their first 5 years membership), a limited range of benefits but being service-linked for future entitlements at a higher rate of contribution;
 - should an improved set of employer-based discretionary benefits be offered;
 - should employers be able to offer a stepped pension plan, being linked closer to career/salary progression/length of service than at present for either individuals or groups of employees;
 - what are the costs and benefits of "hybrid" arrangements based, for example, on those already tested in the private sector, featuring defined contribution arrangements initially but reverting to defined benefits after a specified minimum service period;
 - would it be sensible to introduce salary-averaging arrangements;
 - would it be practical to introduce more flexibility in employee contribution rates eg by individuals or groups, by location, or by time period on a "cafeteria" style of provision;

- should mandatory annual benefit statements be provided to assist with long term pension planning;
 - is it necessary to address the difficulties caused for some senior staff by the "earnings cap" imposed by Inland Revenue – as a means to ensure that the best candidates are attracted to apply for the top posts in local government; and
 - how helpful is relevant experience in other EU countries, for example, see www.eapspi.com for details on Member State schemes.
18. Consultees may wish to consider, in more detail and informally with the Department, more further suggestions for change set out below. They take as their starting point two separate needs. On the one hand, to retain the statutory, nationally applicable nature of the LGPS (and its position vis-a-vis government policy towards it and the other public service pension schemes) and on the other, allowing local authorities and other employers in the Scheme an opportunity to devise a pension package with bespoke elements that matched employment, career, salary and personal demands of their employees. These ideas should be considered within the statutory framework of the Scheme as a whole.
19. The suggestions put forward below are for discussion and are not proposals. Do consultees feel attracted in any way by the LGPS having:-
- (i) new powers to widen generally the extant discretionary elements of the 1997 Scheme on the basis that employees could "purchase" additional LGPS benefits up to Inland Revenue limits; and/or
 - (ii) local authority employers, having powers within Inland Revenue limits, to provide, by resolution, authority-wide pension arrangements which may exceed the national norm in some locally-preferred way, provided employees contractually agree to pay appropriate actuarially determined contributions?

Next Steps

20. Consultees are, therefore, invited to contribute to the exploration of the components listed above, and any others with merit. It would be helpful if account could also be taken of relevant actuarial advice and costings when preparing responses. In due course, the Department may wish to undertake further assessments, for example through a specific research contract, in some of the areas covered.
21. The Department will aim to produce a report which analyses these and any other propositions put forward, and to circulate the key conclusions. The findings will be reported to Ministers who may in turn wish to take forward some items as possible future statutory changes to the Scheme through the well-established national consultative machinery with all the interested LGPS parties.

Conclusions

22. The current LGPS pension benefit package is targeted at a specific employment group of public sector career officers who expect to retire after a lifetime in local government, in all probability at the peak of their earnings. This traditional expectation is no longer comprehensively relevant, even though the long established merits of the current LGPS arrangements are sound, well respected and should continue to be protected.
23. For the future, the LGPS, and its benefit structure in particular, needs to be in a position from which to respond to the ever-changing nature of local authority employment and policy initiatives linked to service delivery. If not undertaken, the fundamental attractiveness of the Scheme could diminish as liabilities mature leading to adverse long term resource effects on the Scheme.

24. This exercise seeks some first steps to explore the best means available to begin to modernise the LGPS, particularly for future new local authority employees.

Comments are invited on the paper no later than 14 February 2003 and should be sent to Michael Groves, Local Government Pensions Division, ODPM, at Zone 2/E8, Ashdown House, 123 Victoria Street, London SW1E 6DE, or by e-mail to michael.groves@odpm.gsi.gov.uk

**LOCAL GOVERNMENT PENSIONS DIVISION
OFFICE OF THE DEPUTY PRIME MINISTER
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