WILTSHIRE COUNTY COUNCIL **AGENDA ITEM NO. 8**

WILTSHIRE PENSION FUND COMMITTEE
23 February 2004

UPDATE ON THE LOCAL GOVERNMENT PENSION SCHEME STOCK-TAKE

Introduction

1. The Government initiated a Stocktaking exercise on the Local Government Pension Scheme ("LGPS"/"the Scheme") in September 2001. In November 2002 the Committee considered the implications of the proposals in Phase 1 of the exercise, due to be implemented in April 2004. A brief outline of the draft regulations is attached in Appendix 1 for reference.

2. On 7 November 2003 a consultation document was issued by the ODPM on proposed changes to the scheme under Phase 2 of the Stock-take, due to be implemented in April 2005. I did not reply directly to the consultation, but was consulted on the collective responses put forward by the Society of County Treasurers and the Local Authority Pension Fund Forum. The results of the consultation will become clear when the draft regulations are issued later this year.

3. Phase 2 is intended to take forward a series of amendments to the existing LGPS regulation framework. Collectively these reflect the recent pension policy changes to apply to all occupational pension schemes as set out in the White Paper *Simplicity, Security and Choice: Working and Saving for Retirement,* together with the Inland Revenue's proposals to simplify the taxation of pensions.

4. The policy context of the consultation is that the LGPS cannot remain as it is. The increasing costs of the scheme, due largely to reducing investment returns, increased longevity, and in some cases the infamous contributions holiday, has led to increasing employers' costs. At the same time, the Government is committed to maintaining a final salary scheme which is responsive to changes in local government and remains affordable and sustainable. In the longer term, proposals may be developed into a single scheme, which will remove the historical complexity of the existing scheme, whilst protecting the value of existing pension rights.

Purpose of the Report

5. The purpose of this report is to update Members on the proposals included within Phase 2 of the Stock-take.

What changes are proposed in Phase 2?

6. The consultation exercise focuses on the proposed amendments to the Scheme, which will come into force from April 2005. The main changes to the present arrangements are set out in subsequent paragraphs, together with a commentary.

Removal of the 'Rule of 85' for all new members after April 2005

7. The LGPS already has a normal retirement age of 65, but only for those members who joined after 31 March 1998. Other members generally have a retirement age between 60 and 65.

8. The 'Rule of 85' is a provision that determines the earliest age at which a member can retire before normal retirement age (other than on ill health grounds) and receive a pension that has not been reduced on account of early payment. The rule applies where age plus years' service equals 85. The same formula is applied where a member leaves between ages 50 to 59 with their employer's consent.

9. The proposal is that all new members after April 2005 have a common retirement age of 65 and any benefits paid before that date (other than for ill health and possibly redundancy) would be reduced.

10. *Comment - This proposal will lead to lower future service costs in relation to new members and is to be welcomed. As life expectancy increases the sensible reaction to avoid an increase in the cost of pensions is to delay retirement.*

An 'equitable' phasing out of the 'Rule of 85' for existing members

11. The Government will impose a normal retirement age of 65 for all benefits accruing from April 2005 and is consulting on the best way to implement this change, whilst ensuring protection for benefits accrued before April 2005.

12. *Comment - This change is to conform with the Government's intention to raise the normal pension age in all public service pension schemes to 65. A similar change has already been proposed for teachers and NHS workers. The proposals are to be welcomed as they will help to ease the future burden on the Fund in the light of increasing life expectancy in retirement. Having said that, it is a not insubstantial "reduction" in benefits for those whom it would affect.*

Increasing the earliest age when benefits may be paid (other than on ill health grounds) from age 50 to 55

13. At present the Regulations allow a member to elect (with their employer's consent) to receive benefits at any age from age 50. Benefits are also paid automatically in the event of redundancy on or after age 50. The Government intends to increase the minimum age at which pension benefits can be drawn from 50 to 55 by 2010 for all pension schemes, but it is likely that it will be introduced in April 2005 for LGPS. It is assumed that this will affect all current and new members and all accrued service.

14. *Comment - This proposal increases the age at which unreduced pension must be paid if retirement is on the grounds of efficiency or redundancy. This will generate savings and is to be welcomed, but its effectiveness as a cost control measure will depend on the successful control of ill-health early retirements.*

Flexible retirement dates/incentives to remain in employment

15. At present, the benefits of a member who remains in local government employment beyond age 65 are actuarially increased for each day for which payment is deferred, but generally speaking years of service after age 65 do not accrue extra years' service. In addition, current Regulations do not generally allow a person to remain in employment whilst drawing on their pension. The Government intends to allow flexible retirement in the LGPS, subject to the Inland Revenue's tax simplification proposals.

16. *Comment - Flexible retirement and incentives to assist in retaining scheme members in employment are a future aim in the proposed changes. This proposal will give employers discretions that will assist in the on-going management of staff and will allow members to take a gradual approach to retirement where such an approach will support the business needs of the employer. This proposal is to be welcomed and for those continuing beyond 65, membership should be available to improve their potential long term benefits.*

Simplifying the LGPS Regulatory Framework

17. The Government will implement a new simplified regime for taxing pensions from April 2005. The Inland Revenue indicated in their consultation paper that all pension schemes can look ahead to the prospect of a common set of taxation rules for all members in the future.

18. *Comment - Any simplification of the LGPS regulatory framework is to be welcomed.*

Employees' Contribution Rate

19. The employee's contribution rate is fixed at 6% of pay, except for those manual workers who continue to pay 5% as a result of transitional provisions introduced in 1997. Because of the

increase in pension costs over the past 10 or more years and to reflect longer life expectancy, an increase in employees' contributions is proposed.

20. *Comment – The existing employee rate of 6% was set many years ago when things were very different. It would seem reasonable to increase the employee rate now and this would, in the absence of an increase in benefits, lead to an equal reduction in direct costs for employers. However, this could have two potential adverse effects that need to be acknowledged:*

    - *The risk of upward pressure on pensionable pay, with members possibly not perceiving the benefits of the scheme as justifying pay restraint. Any increase in pay also increases Employers' National Insurance liability for members and non-members.*

    - *More employees, particularly the lower paid and part time staff, may opt out of the scheme or not come-in in the first place. In addition, higher paid staff may perceive possible salary linked increases as making good past service underfunding, rather than covering the cost of increasing life expectancy.*

    Perhaps a more fundamental redesign of employee contributions and scheme benefits is required to link contributions paid on an earnings related basis (as for National Insurance) to a basic retirement package, with options to purchase additional benefits (eg. partners' pensions) for additional contributions.

    Partners' benefits

21. LGPS Regulations provide survivor benefits to a married spouse or dependent children on the death of a member. Employers have previously supported pensions for unmarried partners, but so far ODPM have refused to put them into the Regulations as Government policy is only to support this if the general membership wants it and are prepared to meet the additional costs. Separately, the Government have consulted on proposals to create a status of civil registered partnerships for same sex couples. One of the proposals is to provide survivors' benefits from pension schemes and any change in legislation must be reflected in LGPS (this change will not be extended to opposite sex partners as they already have the option of marriage acknowledged by law).

22. *Comment - The current regulations are inequitable and discriminatory. Partners' benefits need to be updated to incorporate unmarried partners and same sex partners. However, an overall increase in the costs of members' benefits is not acceptable, unless paid for by the members themselves.*

    Redundancy

23. Currently a member who is made redundant aged over 50 is entitled to immediate payment of unreduced benefits, but, as mentioned earlier, other changes will increase this age to 55. However, the employer's organisation has proposed that payment of benefits on redundancy before age 65 should be at the employer's discretion rather than as an automatic right. Benefits, if paid before 65, should be subject to reduction with an employer's option to waive or reduce the reduction. The cost of waiving the reduction would have to be met by the employer.

24. *Comment **-** The proposal to actuarially reduce pension benefits paid early on the grounds of redundancy is to be welcomed, but with the ability to retain flexibility to waive such a reduction in exceptional circumstances. The suggestion that the scheme member be given the choice to take his/her benefits on redundancy (or not) is also welcomed.*

Financial Implications and Risk Assessment

25. One of the key purposes of the Stock-take exercise is to reduce the cost on employers of the LGPS. However, it is inevitable that reductions in benefits and potential higher costs for employees will meet with some resistance. Some of the direct savings that might be achieved, which cannot yet be quantified, may cause upward pressure on pay levels.

Environmental Impact of the Proposal

26. There are none.

Recommendation

27. The Committee is asked to note the proposed changes to the Local Government Pension Scheme as outlined in Phase 2 of the Stock-take.

MIKE PRINCE
County Treasurer

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

48/2004/PENS/JS

APPENDIX 1

LOCAL GOVERNMENT PENSION SCHEME STOCK-TAKE PHASE 1
Draft Regulations effective from 1 April 2004

1. Aggregation of periods of Local Government (LG) employment on re-employment

- Current position – those members who have a previous deferred benefit and take up further LG employment may elect to aggregate the two periods of membership to provide a single benefit. If the election is not made at the date of re-employment it may be made: (1) in the case of someone whose new employment started before 1 April 1998, on retirement, or; (2) where the new employment started after that date, at any time during the new employment.

- *Amendment – An election to combine benefits must be made within 12 months of the start of new pensionable employment. Existing members who have not yet made an election must do so within 12 months of the date of Regulations, 31 March 2005 (or such longer period as the new employing authority may allow).*

2. Refunds of contributions (Immediate vesting)

- Current position – A member who leaves pensionable employment with less than 2 years' pensionable membership (and has not transferred-in any previous pension rights) may take a refund of contributions (less statutory deductions) or a transfer of pension rights.

- *Amendment – The period will be reduced to 3 months. After that period a deferred benefit would be awarded. Any refunds due will be made from the appropriate pension fund.*

3. Short service ill health grant

- Current position - A member who leaves pensionable employment with at least one but less than two years' membership had a right to a short service ill health grant in lieu of a refund of contributions.

- *Amendment – This right is removed.*

4. Second ill health retirement

- Current position – A member, who leaves LG employment due to ill health with an enhanced pension, takes up a further LG employment and retires again due to ill health, may be entitled to a further enhancement on the second retirement.

- *Amendment – There will no longer be a right to a further enhancement, only accrued benefits.*

5. Definition of permanent ill health

- Current position – Independent medical advisers must certify that a person must be "permanently incapable" until age 65 in order to qualify for ill health retirement.

- *Amendment – Makes clear that the decision is made on 'the balance of probabilities'.*

6. Review of ill health retirement

- Current position – A person awarded an enhanced pension on retirement due to ill health is awarded the pension for life (subject to restrictions on further LG employment).

- *Amendment – In all cases of ill health retirement the employer will be required to hold a review every 5 years (or such shorter period as the doctor specifies) until age 65, to assess the extent to which the incapacity may remain and whether there should be a reassessment of the pension. (i.e. should the pension be reduced or stay the same). Will only apply to retirements after 1 April 2004.*

7. Annual Benefit Statement

- Administering authorities will be required to provide an annual benefit statement to all active and deferred members, showing value of accrued benefits and an indication of benefits at normal retirement age. The first statement for each person should be sent within 12 months of 1 April 2004 and thereafter at some time within the intervening 12 months.

8. Augmentation (Granting of additional service within the pension scheme)

- Current position – The Regulations allow an employer to augment service (within limits) on appointment or retirement.

- *Amendment – Employers may augment service at any time during pensionable employment.*

9. Internal Dispute Resolution Procedure – IDRP

- Current position – Any person who is dissatisfied with a decision under the Regulations may refer the matter to the appeal procedure. Stage 1 is to a local referee and if still dissatisfied stage 2 of the appeal procedure is to Secretary of State at Office of Deputy Prime Minister. The arrangements are determined by the administering authority.

- *Amendment – The Secretary of State is removed from the process. Scheme employers will now determine who will consider stage 1 appeals and, and any stage 2 appeals will be determined by the administering authority who may delegate the function. Appeals submitted to the appointed person before 1 June 2004 will continue under the existing arrangements.*

10. Agreement to exclude elements of pay from pensionable pay

- Current position – Scheme employers may by agreement with employers representatives determine that certain elements of pay are not to be counted for pension purposes (This is pay which would otherwise be treated as pensionable)

- *Amendment – This provision is removed, although existing agreements are protected.*

11. Funding strategy statement

- By 31 March 2005 the authority shall publish a Funding Strategy Statement in accordance with guidance to be set out by CIPFA. This is to take a longer term view of the pension fund funding strategy and the actuary must have regard to the principals contained therein when issuing the actuarial valuation certificate.