WILTSHIRE COUNTY COUNCIL **AGENDA ITEM NO: 11**

WILTSHIRE PENSION FUND COMMITTEE
21 February 2005

CONSULTATION ON THE FUTURE OF THE LOCAL GOVERNMENT PENSION SCHEME

Introduction

1. In September 2001 the Government initiated a three phase review of the Local Government Pension Scheme (LGPS) known as the Stocktake together with a wider review of other public sector pension schemes. In November 2002 the Committee considered the implications of the proposals in Phase 1 of the exercise, which were implemented in April 2004.

2. In November 2003 a consultation document was issued by the ODPM on proposed changes to the scheme under Phase 2 of the Stocktake, which this Committee considered in February 2004. A brief outline of the changes that come into effect in April 2005 is attached in Appendix 1 for reference.

3. On 4 October 2004 the 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 paper introduces Phase 3 of the review and sets out a model for a new look LGPS, which could be introduced from 2008. The Government are keen that the document is fully considered, to enable detailed proposals to be published during 2005, and has therefore set the deadline for consultation responses as 31 March 2005.

Purpose of the Report

4. This Committee will need to form an initial view on how the *principles and propositions* in the document will impact on the long term future of the LGPS and the Wiltshire Pension Fund. As Administering Authority, this Committee also has a role to promote discussion and response on this document amongst the Fund's employers, and their employees.

5. Employers will need to comment on issues of the long term future of the scheme, but also on how the changes will impact on the recruitment and retention of staff in their service areas. They will be aware of the trade-off between savings on pensions and pressure on other aspects of the rewards package.

The Needs of the Stakeholders – Government, Employers and Employees

6. The Government is committed to retaining the LGPS as a funded, defined benefit, final salary scheme, **but** only if it can be demonstrated to be affordable and sustainable. The Government is also looking to redress the balance in funding the scheme between the employee and their employer.

7. Employers are increasingly concerned about the costs of the pension scheme and will be looking to exercise greater control over the stability of their contributions. At the same time they are aware of the value of the scheme in providing a competitive remuneration package to recruit, reward, motivate and retain the calibre of staff required to deliver high quality, effective services.

8. Forward looking employers will also be concerned at the expected ageing and decline in the size of the workforce in future. In terms of manpower planning employers are likely to have to encourage more employees to stay in work for longer so flexibility within the scheme is vital.

9. As it currently stands the LGPS appears particularly unattractive to younger employees and is not best meeting the needs of a growing number of part-time employees. The new scheme needs to encourage these groups to recognise the value of membership of the LGPS.

What are the main *principles and proposals*?

10. The consultation document is based on the closing of the current scheme (except for existing pensioners, and those with deferred benefits), and the transfer of all active members to a new look LGPS. The new scheme would contain what is seen as best practice from the old scheme, plus a series of new, relevant and flexible elements. The new scheme would be open to the same staff groups as the existing scheme.

11. The key components of the consultation document are shown in Appendix 2.

General Comments

12. I feel strongly that the proposals for a new look LGPS should acknowledge the fact that it is a funded scheme with national assets of around £90 billion and that the pensions of local government workers are better financed than civil servants, teachers, firefighters and uniformed police officers whose benefits are unfunded and paid from current revenue

13. The first report of the Independent Pensions Commission on the adequacy of pension provision and saving in the UK commented that it is increasingly important not to be drawn into making comparisons with the benefit dilution taking place in the private sector. The key issue is that private sector retirement saving is becoming increasingly inadequate, not that the public sector is too generous.

Key issues

14. In my view there are three key issues that must be addressed in the new look scheme. The first is that changes to the scheme should not increase the overall cost to employers. This exercise should not be an attempt to dilute or improve the benefits offered to members, but to achieve a flexible balance that meets the long term needs of all the key stakeholders – employers, employees and the Government.

15. One of the main features of the proposal is that the new look scheme would remain a final salary scheme which would have considerable support predominately with full time members and those who view their career in Local Government as long term with potential for promotion. However, a possible move towards a career average re-valued earnings (CARE) scheme is worthy of consideration, the argument being that such a change would deliver reductions to the on-going scheme liabilities, whilst also addressing the issue of equity between scheme members. A similar suggestion has been made for the NHS Scheme. An average salary scheme does directly link the benefits received by a scheme member to the contributions they have made to the Fund over the course of their career. In a final salary scheme members' contributions to the Fund have been based on a much lower level through out their membership than the benefits paid out on their final salary. In effect, a significant number of staff, who have little salary increase (apart from the annual cost of living increase) are subsidising those who have been successful.

16. Consideration of the average salary option will need to be in conjunction with the detail of the new flexible retirement arrangements, which allow people to step down from demanding higher paid jobs but preserve their pension entitlement. Further options may also be raised during the consultation which will deliver similar objectives to the average salary approach.

17. The third key issue is the need to reflect increased longevity and redress the 60:40 relationship of contributions between the employers and the employees that existed when the scheme was set up. This will require an average increase in contributions paid by employees from just under 6% to around 7%. Reducing the contributions paid by lower paid members may well encourage more to remain in the scheme but this is not guaranteed and there is a danger that increasing higher rates paid by higher paid members may create more pressure to increase pay which would be counter-productive. A tiered contribution structure is more equitable as higher rate taxpayers enjoy greater tax relief on their contributions than the lower paid and therefore a flat contribution structure is more beneficial to the higher paid. However, in my view pension schemes should not be used as a redistributive mechanism; this is the job of the national tax system.

Other Considerations

18. Having considered the remainder of the new look scheme my views on the proposals are as follows:

    a) that the accrual rate per year should be no less favourable than the other main comparator public sector pension schemes and note the rate being suggested for the National Health Service scheme is 1/60 per year

    b) there should be an actuarial reduction in benefits taken before the scheme retirement age of 65, other than in cases of ill health, together with the actuarial increase of any benefits drawn after age 65

    c) that the current definition of pensionable pay should be retained

    d) partners' pensions should be introduced particularly as other public sector schemes are moving towards their introduction and because it is one of the key features that members representative bodies have been requesting for some time

    e) the death in service lump sum should be three times salary with no short term pensions

    f) that unless a child is disabled, a child's pension should cease at age 18

    g) that a two tier ill health retirement arrangement should be in place but without the addition of prospective service to age 65. I also believe that a second tier of un-enhanced ill health retirement benefit should only be payable for a limited period, say two years

    h) that the current Compensation Regulations should be revoked and replaced with a general power for employers to make a one off payment of up to two years pay

Conclusion

19. The ODPM intends to report on this consultation exercise to Ministers in the early part of the summer of 2005, with the view to publishing specific proposals later in 2005. Draft

regulations would then be circulated for consultation in 2006, with the intention of having the new regulations in place for April 2007, and coming into force in April 2008, alongside the results of the 2007 valuations.

20. The Committee can form a more considered response during 2005 and 2006 as the ODPM develops clearer proposals, and the detailed arrangements for the implementation of any changes.

Reason for Proposal

21. At the beginning of the original Stocktake exercise the Employers' Organisation (EO) asked local authorities whether, together with the Local Government Pensions Committee (LGPC), they should take the lead in assessing the issues raised by the Stocktake and 64% of respondents replied in the affirmative. Based on the views expressed above I hope it is clear to the Committee how I recommend responding to the questionnaire from the EO/LGPC (Appendix 3).

Proposal

22. The Committee is asked to delegate authority to the County Treasurer to respond to the EO/LGPC questionnaire, and direct to the ODPM, having heard the views of this Committee and held further discussions with other employer bodies in the Fund, the Fund's Actuary, other Administering Authorities and the Society of County Treasurers.

MIKE PRINCE
County Treasurer

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

46/2006/WPF/JS

APPENDIX 1
(Extract from booklet provided to members)

LGPS - New rules from 1 April 2005

- The **earliest retirement age is increasing from 50 to 55**, except for those retiring on ill-health and those of you who are protected from the change.

- Although the LGPS already has a retirement age of 65, current rules allow some employees to retire before then with unreduced benefits. By removing the 85-year rule, **if you choose to retire before age 65 your benefits will be reduced to take account of early payment,** unless your employer waives the reduction on compassionate grounds or you are protected from the change.

If you were contributing to the Scheme on 31 March 2005 you are protected from the changes -

- **If you are age 50 or over by 31 March 2005, your earliest possible retirement date continues to be age 50,** but if you are retired because of permanent ill health your benefits can be paid from any age.

- **If you will be age 60 by 31 March 2013, choose to retire before age 65 and satisfy the 85-year rule when you start to draw your pension,** you will have some protection from the removal of the 85 year rule. Your benefits built up before April 2013 will not be reduced.

- **If you will be age 60 by 31 March 2013, choose to retire before age 65, do not satisfy the 85 year rule when you start to draw your pension, but would have satisfied the rule if you had remained in employment until age 65,** you will have some protection from the removal of the 85 year rule. All the benefits you have built up in the Scheme before 1 April 2013 will continue to be calculated in the same way as if the changes had not been made. But any benefits you build up under the new rules (from April 2013) will be subject to a larger reduction than before.

- **If you choose to draw your benefits before age 65 and would not have met the 85 year rule if you had remained in employment until age 65, or if you do not draw your pension until age 65,** the removal of the 85 year rule will have no impact on you. You will receive the same benefits as before.

How do I know if I will satisfy the 85-year rule?

The rule is satisfied if at the time you start drawing your pension your membership and age (each in whole years) adds up to 85. *If you work part time, your membership counts towards the 85-year rule at its full calendar length.*

Remember*: The 85-year rule is a rule to see if your benefits should be reduced or not* ***if you choose to retire early.*** *If you do not satisfy the 85-year rule, then your benefits are reduced if voluntarily drawn before age 65, unless your employer chooses to waive the reduction on compassionate grounds.*

APPENDIX 2

LGPS - Some of the key changes between 2005 and 2008 Schemes

	Current Scheme	**New Scheme**
Eligibility	Automatic Membership with option to opt out for all employees except for casuals who must opt in. Employees of Resolution and Admitted Bodies as per their employers policy	Automatic Membership with option to opt out for all employees except those employed for less than three months who must opt in. Employees of Resolution and Admitted bodies as per their employers policy
Accrual Rate Pension	1/80 x service x Final Pay	1/62.5 (1.6% per year) x service x Final Pay
Accrual Rate Lump Sum	3/80 x service x Final Pay **NB** The current accrual rates for pension and lump sum equate to 1/64	Commutation of up to a maximum of 25% of pension entitlement Commutation factor £1 of pension provides £12 of lump sum
Scheme Retirement Age	Age 65 or Rule of 85 (age 60 + service) if 60 before April 2013	Age 65 Benefits paid before 65, except for ill-health, would be actuarially reduced to reflect early payment
Pensionable Pay	Basic Pay Contractual Overtime Other Agreed Emoluments	Basic Pay only
Employee Contributions	6% of Pensionable Pay 5% for protected manual workers	Varies based on Basic Pay < £5,000 2.5% £5,000-£7,000 5.5% £7,000-£38,000 7.0% £38,000-£80,000 9.0% >£80,000 10.0%
Survivor Benefits Widow/Widower	Payable to Widows and Widowers Pension Short term 100% of pension for three months followed by Long term 50% of pension payable for life	Widow/Widower Civil Partnership Unmarried Partners Pension 50% of post commutation pension payable for life Possible reduction to reflect age difference No short term pension

	Current Scheme	New Scheme
Children's Pensions	25% of pension payable to a maximum of two children. Payable to age 17 or whilst in full time education	25% of post commutation pension payable to a maximum two children. Payable to age 18
Death in Service Lump Sum	2 x Pensionable Pay	3 x Pensionable Pay
Ill-Health Retirement	If permanently incapable of undertaking duties of current or comparable employment - Accrued membership plus, enhancement as per Regulation 28 Payable at any age	Two Tiered - i) Permanently incapable of any employment - Accrued membership plus enhancement to retirement age ii) Permanently incapable of undertaking duties of own employment - Accrued membership with no enhancement Payable any age
Redundancy/Efficiently	Unreduced Benefits paid from age 55	None - direct compensation for severance rather than using the pension scheme as a vehicle for compensation
Additional Service Purchase and AVCs	Option to purchase additional service and AVCs up to Inland Revenue limits	No scheme provision but an option for a Defined Contribution Scheme

Note: In the table above 'Current Scheme' means the Scheme in place at 1 April 2005.

APPENDIX 3

QUESTIONNAIRE FROM EMPLOYERS ORGANISATION AND LGPC

	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	❑	❑
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	❑	❑

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 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	❑	❑
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	❑	❑
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	❑	❑
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)	❑	❑