WILTSHIRE COUNTY COUNCIL **AGENDA ITEM NO. 9**

WILTSHIRE PENSION FUND COMMITTEE
28 February 2007

CONSULTATION ON LOCAL GOVERNMENT PENSION SCHEME REGULATIONS 2007

Purpose of the Report

1. The purpose of this report is to update Members on the Government's latest draft regulations in relation to the administration of the Local Government Pension Scheme (LGPS) and to share Officers' proposed responses to two consultations.

Background

2. In recent weeks the Department for Communities and Local Government (DCLG) has issued consultations on two sets of proposed regulations in relation to the LGPS:

   - The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (1st Set)
   - The Local Government Pension Scheme (Amendment) (No 2) Regulations 2007 (2nd Set)

3. The 1st Set of regulations relates to the proposed benefit structure for the LGPS from 1 April 2008, essentially what active members will have to pay into the Fund and what pensioners will get out. The 2nd Set relates to more technical matters about what the Administering Authority (ie. Wiltshire County Council) must do in the governance and management of the Fund.

4. Consultation responses are invited by the Government with closing dates of 28 February 2007 and 23 March 2007 respectively.

Main Considerations for the Committee

Benefits, Membership & Contributions Regulations (1st Set)

5. The simplest way to consider the changes proposed by the 1st Set of Regulations is to compare the resulting Scheme with the current LGPS. This comparison is given in detail in Appendix A, but in summary, the key points are:

   a) The Scheme will retain a final salary basis, but with a new definition of final pay, being the greater of the pay in the final year or an annual average of any consecutive 3 years in the last 10 (plus index-linking). In its response to the consultation document last September, our preference was for a career-average earnings scheme, as being both more affordable and fairer for the average Scheme member.

   b) Benefits will accrue at 1/60th of final pay per year, compared with 1/80th in the current Scheme. Unlike the current Scheme, there will be no automatic lump sum. Instead, the member can commute up to 25% of the value of the benefits for a tax-free cash sum of £12 for each £1 p.a. of pension commuted.

   c) Instead of one employee contribution rate of 6%, employees' contributions will be banded, with 5.5% on the first (full-time equivalent) earnings of £12,000 and 7.5% on earnings above that. The DCLG has calculated that the average contribution rate will be 6.3%.

d) The new-look scheme will have a 3-tiered ill-health provision; members judged to be incapable of local government duties, but capable of other gainful employment, will receive accrued benefits only; those incapable of gainful employment on cessation, but likely to be able to do so before 65 will receive accrued benefits plus 25% of potential membership to 65; those incapable of gainful employment before 65, accrued rights plus 50% of potential membership to 65. The DCLG invites comments on the most appropriate way of defining “gainful employment”.

e) There are improvements in the benefits provided on death-in-service; 3 times pay instead of 2 and a pension guarantee of 10 years’ pension on death-in-retirement instead of 5. Employing authorities can augment membership by up to 10 years instead of the current limit of 6.67 years.

f) All current Scheme members will join the new-look scheme on 1 April 2008. Membership accrued up to 2008 at the 1/80th rate will be “banked”.

6. Appendix B gives my proposed response to the Government on this set of Regulations for Members’ consideration. There appear to be a number of errors and omissions in the draft regulations that need rectifying.

Amendment Regulations (2nd Set)

7. The key provisions of these Regulations are:

a) The requirement for a Governance Compliance Statement to be produced and published by 1 October 2007. This will replace the existing Governance Policy, which in our case was approved by this Committee on 25 May 2006.

b) The requirement for the publication of an Annual Report, including certain key policy documents. The Wiltshire Fund already publishes an annual report and there is nothing in this proposed requirement that would cause additional work for us.

c) The framework for the production and publication of a Pensions Administration Strategy, which would essentially sets down the procedures and performance expectations that the Administering Authority and employer bodies will have in working together on behalf of the scheme members.

d) The power to recover additional administration costs incurred by the Administering Authority as a result of poor administration by employer bodies.

8. Appendix C gives my proposed response to the Government on this set of Regulations for Members’ consideration. I support the principles of these Regulations generally, but they are not well drafted and clearly need further work done on them.

Reasons for Proposal / Environmental Impact of the Proposals / Risk Assessment

9. Members are not asked to make a policy decision as a result of the report.

Proposal

10. The Committee is asked to:

a) note the proposed changes to the Local Government Pension Scheme; and

b) approve (or amend) the Chief Financial Officer's proposed responses to the two consultation documents.

SANDRA SCHOFIELD
Chief Financial Officer

Report Author: Nick Nicholson/David Broome

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

62/2007/WPF/DB

APPENDIX A

Local Government Pension Scheme – Current v Proposed 2008 Scheme

	Current Scheme	Proposed 2008 Scheme
Eligibility	Automatic Membership with ability to opt out for all employees except for casuals who must opt in. Employees of resolution and admission bodies as per their employer's policy.	Automatic Membership with ability to opt out for all employees except for casuals who must opt in. Employees of resolution and admission bodies as per their employer's policy.
Accrual Rate Pension	1/80 x service x Final Pay (best of last 3 years' pay)	1/60 x service x Final Pay (best of final year, or index-linked annual average pay of any consecutive 3 years in last 10)
Accrual Rate Lump Sum	3/80 x service x Final Pay Plus optional commutation of up to a maximum of 25% of total pension benefits for increased lump sum. Commutation factor £1 of pension provides £12 of lump sum **NB** The accrual rates for pension and lump sums equates to 1/64 x service x final Pay	No automatic lump sum: optional commutation of up to a maximum of 25% of total pension benefits. Commutation factor £1 of pension provides £12 of lump sum
Scheme Retirement Age	Age 65 or Rule of 85 date (age 60 + service) if 60 before April 2016	Age 65. Benefits paid before 65, except for ill-health could be actuarially reduced to reflect early payment. Old Scheme protection continues in new Scheme to 2016
Pensionable Pay	Basic Pay Contractual Overtime Other Agreed Emoluments	No change
Employee Contributions	6% of Pensionable Pay 5% for pre-1998 protected manual workers	Up to £12,000* 5.5% Above £12,000* 7.5% *Full-time equivalent pay if part-time The effective rate at the following salary levels is: £10,000 5.5% £15,000 5.9% £20,000 6.3% £25,000 6.5% £30,000 6.7% £40,000 6.9% £50,000 7.0% £75,000 7.25%

	Current Scheme	Proposed 2008 Scheme
Survivor Benefits	Widows, widowers and civil partners* Pension: Short term 100% of pension for three months (6 months if children's pension also), followed by long term 50% of pension payable for life (*based only on post-05/04/1988 membership).	Widows, widowers, civil partners* and nominated unmarried partners* Pension: No short term pension 1/160 x service x Final Pay payable for life (*based only on post-05/04/1988 membership).
Children's Pensions	25% of pension payable to a maximum of two children. Payable to age 17 or 23 whilst in full time education.	25% of post commutation pension payable to a maximum two children. Payable to age 17 or 23 whilst in full-time education.
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.* Payable at any age	3 Tiers: i) Permanently incapable of any "gainful employment" before 65 - *accrued membership plus enhancement of 50% of potential membership to retirement age.* ii) Permanently incapable of any "gainful employment" on cessation, but likely to be able before 65 - *accrued plus 25% of potential membership to retirement age.* iii) Permanently incapable of undertaking duties of own employment - *accrued membership with no enhancement.* Payable any age
Redundancy/ Efficiently	Unreduced benefits from age 55 (50 for current members to 2010)	Unreduced benefits from age 55.
Additional Service Purchase and AVCs	Option to purchase up to 6+2/3 years' membership and/or pay AVCs up to Inland Revenue limits.	Option to purchase additional pension in blocks of £250pa up to a maximum of £5,000 and/or pay AVCs up to Inland Revenue limits.

APPENDIX B

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28 February 2007

Nick Nicholson 01225 756599

Dear Mr. Town,

Consultation on The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007

Thank you for the opportunity to comment on the draft Amendment Regulations containing the proposals for a 'new-look' Scheme from April 2008. The response of Wiltshire County Council, as Administering Authority for the Wiltshire Pension Fund, is set out below.

General

The proposed benefit package follows closely Option B outlined in last summer's consultation document "Where next-options for a new-look LGPS". This is the most costly of the 4 options in that document and it is surprising that this option has been chosen, given that one of the aims in the Minister's Statement of 23 November 2006 is to ensure that the Scheme is affordable and sustainable going forward. This Authority supported Option C (a career average scheme) as being both less costly and fairer to the majority of Scheme members than a final salary package. The formation of the Policy Review Group to consider issues surrounding cost-sharing under Regulation 33 is therefore welcome.

Regulation 2 (Active members)

This appears to suggest that all employees of a body listed in Part 1 of the proposed LGPS (administration) Regulations are automatic entrants unless they opt out. Is this correct, or will those Regulations replicate the conditions in the current Scheme regarding casuals and employees of resolution and admission bodies?

Regulation 3 (Contributions payable by active members)

This gives effect to the proposal for banded employee contribution rates of 5.5% and 7.5% on full-time equivalent (FTE) earnings below and above £12,000, respectively. Basing the rates on FTE pay is welcome, as it ensures that employees in lower-paid jobs will pay less than their higher-paid colleagues, even if one of the latter group is part-time and may be paid the same in actual earnings.

It is questionable, however, whether a reduction of just ½% from the current rate of 6% will attract the lower-paid employee into the Scheme. There is a case for making the lower rate lower still if this aim is to be achieved. There is no reference to any provision to index-link the £12,000. If intentional, this amounts to a steady increase over time in the numbers falling into the higher band.

There is also the practical problem of adapting payroll systems to base the contribution rates on FTE rather than actual pay. Pension software systems will require similar adaptation to be able to hold a pensionable remuneration figure for producing annual benefit statements which is currently based on contributions posted to the member's record. It appears that little consideration has been afforded to these problems.

There is no reference in Regulation 3 to contributions payable during absences (maternity, strike, leave of absence, etc).

Regulation 6 (Calculations)

This Regulation refers to the multiplier being 'total membership', without any adjustment for part-time employment.

Regulation 7 (Final pay)

This allows an employee to have benefits based on an annual average of any consecutive 3 years in the last 10, similar to that in the current regulations with certificates of protection. This is an unnecessary complication, which may create practical problems in that pay records may not be available for a 10-year period for a member who retires, for example, shortly after April 2008.

Regulation 10 (Flexible retirement)

This Regulation repeats the flawed wording in the LGPS (Amendment) Regulations 2006 and should have the words "with his employer's consent" inserted after the words "such benefits may", as in the LGPS (Amendment) (No 2) Regulations 2006.

Regulation 12 (Early leavers: ill-health)

This Regulation introduces 3 tiers of ill-health, rather than just 2, as originally envisaged. The introduction of a middle tier with 25% potential membership enhancement for those incapable of gainful employment at cessation, but expected to obtain such employment before NRD, is likely to increase the numbers entitled to enhancement than would be the case under the existing provisions. The expression "reasonable period" is too vague and likely to lead to an increase in appeal cases, so a clearer definition is required. "Gainful employment" should also be clearly defined. One possibility is a definition linked with entitlement to State invalidity benefits. The 25% and 50% enhancements make no allowance for part-time working.

Regulation 13 (Election for lump sum in lieu of pension)

This Regulation restricts the maximum benefits to the lifetime allowance (LTA), whereas HMRC rules allow excess benefits to be paid with a tax penalty. Paragraph 13(3) is duplicated in regulation 14(1) (Limit on total amount of benefits).

Regulation 15 (Death grants: active members)

This is a welcome increase in death-in-service provision from 2 to 3 years' pay.

Regulation 16 (Elections for early payment of pension)

This repeats the current ill-health criteria rather than the new criteria in regulation 12 (see above).

Regulation 18 (Death grants: pensioner members)

This refers to a deferred instead of a pensioner member.

Regulations 19 (Survivor benefits: active members) & 20 (Survivor benefits: pensioners)

These Regulations have no provision for short-term pensions. This may mean a drastic cut in income at the same time as having to cope with bereavement. As a short-term benefit costs relatively little its removal is unnecessary and unhelpful.

Regulation 23 (Children's pensions)

This refers to the "appropriate fraction of his retirement pension" in the case of a pensioner member and it is unclear whether that pension is pre or post commutation under regulation 13. The same comments apply as on short-term pensions in Regulations 19 and 20 above.

Regulation 32 (Commutation: exceptional ill-health)

This retains the current provision for 5 times annual pension. Should this be increased to 10 to be consistent with Regulation 18?

Yours sincerely

Sandra Schofield
Chief Financial Officer

APPENDIX C

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28 February 2007

David Broome 01225 713620

Dear Mr Town,

Consultation on The Local Government Pension Scheme Amendment (No 2) Regulations 2007

I refer to the consultation letter dated 29 January 2007 and thank you for the opportunity to comment. The response of Wiltshire County Council, as administering authority for the Wiltshire Pension Fund, is set out below.

Governance Compliance Statement (Draft Regulation 3/New Regulation 73A)

This Regulation requires a declaration of the degree of compliance with guidance on governance yet to be issued by the Secretary of State, a statement of reasons of non-compliance on any points (if applicable) and a requirement to send a copy of the Statement to the Secretary of State.

Clearly the final requirement does not raise any concerns. However, it is very difficult to make any informed judgement about the impact of this Regulation in the absence of the Secretary of State's Guidance.

We are concerned about the proposed date of 1 October 2007 for production of the new Statement, given that this is a Triennial Valuation year, but especially in the context of the non-availability of the Guidance, as it is unclear what level of work will be required. We suggest that implementation is put back until 1 April 2008.

Pension Fund Annual Report (Draft Regulation 4/New Regulation 76B)

We welcome the requirement for Funds to publish an Annual Report. The Wiltshire Pension Fund was one of the early Funds to adopt this practice some years ago. However, we do have a number of concerns about the practical detail:

1) Some of the requirements of the regulation are very vague:

   a. Presumably when 76B (1) (a) refers to "financial performance…..of the pension fund" it means both investment performance (ie. assets) and changes in liabilities due to movements in bond yields. But what else does it include? And what is meant by the term "management……of the pension fund" – just investment management? And does the term "report of the arrangements made during the year for the administration of…" at 76B (1) (c) refer to benefits administration? Much more clarity is needed.

b. 76B (1) (a) also requires "a statement of the level of funding of the assets and liabilities of the fund as at the balance sheet date". This is ambiguous and needs clarifying. Presumably a full actuarial valuation every year or even an annual interim valuation is not required? If either are required, there will obviously be significant cost and capacity implications. And in the case of the former, the Regulation requiring the Triennial Valuation would also need amending to provide for an annual valuation.

   Alternatively, perhaps what is meant is the type of quarterly/half-yearly interim monitoring that many Funds are now starting to commission from their actuaries (ie. that takes the previous triennial valuation results and adjusts them for major factors such as investment returns, gilt yield movements affecting liabilities and major regulatory change)? If so, there will still be additional costs for Funds not already commissioning such work.

2) The proposed requirement to include the Governance Policy Statement, the Funding Strategy Statement, the Statement of Investment Principles and the Communications Policy Statement in the Annual Report is likely to prove counter-productive. The resulting document could easily run to 150+ pages and is likely to deter readers from attempting to read it, thus losing the accountability benefits of publishing the Annual Report.

   Our vision would be that the Annual Report should do what it says, report on the past year in an interesting, informative and succinct way. Of course, it should refer to the four policy documents mentioned in the draft regulation and how they can be obtained, but they certainly should not be part of the Annual Report. The existing requirement to "publish" these documents is sufficient, or at best, should be extended to require publication on a "public website".

<u>Local Pension Administration Strategy Document (Draft Regulation 4/New Regulation 76C)</u>

We find these proposals incoherent. The Government needs to decide whether or not it is committed to the principles of the Pensions Administration Strategy, and if so, the requirement should be mandatory. If the conviction is not strong, it should be voluntary guidance and not included in the Regulations.

It is incoherent to let Administering Authorities decide whether or not to produce such a Statement, but then legislate precisely for the content and publication date if they do. The effect will be that well-run funds will produce a Strategy in accordance with the Regulations, but less well-run Funds, who presumably most need such a Strategy, would be likely to take the easy option and not produce one. The whole purpose of the Regulation is thus defeated.

Further to this general principle, the proposed Regulation is also unworkable in that an Authority may decide after 31 December 2007 (or just before) to develop a Strategy and would therefore immediately become non-compliant until such time as their Strategy had been prepared and published. A fixed implementation date can only work with a mandatory requirement to implement the Strategy.

Notwithstanding these comments, we support the principles that the Regulation is trying to achieve, given the not infrequent problem of inefficient employer bodies. However, we would prefer to see it addressed through guidance.

On a point of drafting, we strongly disagree with 76C (9), as it blurs the distinction between the Administering Authority (acting under LGPS Regulations) and the same Authority acting as an employer (under Local Government Acts, etc). We spent a lot of time trying to establish this distinction to avoid potential conflicts of interest. The Regulation should read – "In this regulation, a reference to employing authorities includes, where applicable, the Administering Authority acting in its distinct and separate function as an employing authority".

Administration Costs (Draft Regulation 5/New Regulation 81A)

We support the flexibility that this regulation gives to recover unreasonable costs incurred as a result of the failure of employers to fulfil their obligations.

Yours sincerely,

Sandra Schofield
Chief Financial Officer