report

meeting	**PENSIONS ADMINISTRATION SUB-COMMITTEE**	
date	**31 JULY 2006**	agenda item number

REPORT OF THE DIRECTOR OF RESOURCES

PROPOSED NEW LOCAL GOVERNMENT PENSION SCHEME FROM 2008 CONSULTATION EXERCISE

1. Purpose

1.1 To give the Pensions Administration Sub-Committee the opportunity to discuss the options for change in 2008 identified by the Government.

1.2 To give the Pensions Administration Sub-Committee the opportunity to engage in the consultation exercise, responses to which are required by 29th September 2006.

2. Background

2.1 The Government has always spoken of its support for the provision of good quality, index-linked, pensions for workers in and around local government. On the other hand, affordability, viability, and fairness to tax payers, have also been key drivers to their recent thinking.

2.2 The Government has previously indicated its intention to come forward, with costed options for a new-look LGPS and to seek the views of interested parties. The intention is then to circulate draft amending regulations later in the year for the necessary statutory consultation exercise on specific proposals for a new-look Local Government Pension Scheme to apply in England and Wales from 1 April 2008.

2.3 The programme timetable for these stages is as follows: -

i Costed options consultation 30 June 2006 to 29 September 2006

ii Statutory consultation exercise on specific new-look LGPS proposals November 2006 to February 2007

iii Make and lay new-look Scheme regulations April 2007 iv New-look Scheme to be in force April 2008

3. The options for change

3.1 Option A is an updated version of the current scheme with its current accrual rate of `1/80th and an automatic tax-free lump sum on retirement of 3/80ths of pension

3.2 Option B is a new final salary scheme, with an improved accrual rate of 1/60th, but with no automatic tax-free lump sum on retirement

3.3 Option C1 is a new career-average scheme, with an accrual rate of 1.85% and Retail Price Index (RPI) re-valuation

3.4 Option C2 is a new career-average scheme, with an accrual rate of 1.65% and wage inflation revaluation

3.5 Option D is a new hybrid scheme, in which scheme members would have a one-off choice to either receive career-average linked benefits, or to make extra contributions (possibly 3%) in order to receive final salary linked benefits.

4. Considerations

4.1 It is worth remembering that this is a consultation on options, not on proposals. Further alternatives or variations to the options put forward are welcome as part of this exercise.

4.2 Options A and B retain the final-salary basis of the scheme. Option A retains the same accrual rate (80ths) and RPI linked annual increases as in the current scheme so effectively represents the argument that there is no need for a fundamental change.

4.3 Option C has a career-average structure as in the Councillors' Pension Scheme. Effectively, members build up entitlement to a pension based on their salary in each year of membership, not just on their final salary. Revaluation (inflation-proofing) is applied to each year of service retrospectively from the retirement date.

4.4 The difference between Options C1 and C2 is around the revaluation index. C1 revalues each year's benefits in line with price inflation while C2 revalues each year's benefits in line with a measure of wage inflation. As wage inflation is generally the greater (taken to be RPI plus 1.5% for the purposes of these calculations) the accrual rate for Option C2 is lower than for Option C1.

4.5 Option D builds on C1 and C2 but would also offer scheme members a one-off choice of making extra contributions to obtain final salary linked benefits in retirement albeit without a contribution from the employer.

4.6 Additional proposed benefits that could apply alongside all the options and have been included in the costs in para 6.3 include;

i death-in-service lump sum to be increased from two to three times pay

ii partners pensions for cohabitees

5. Protection for existing members

5.1 The Government are keen not to run two different schemes from 2008 so are looking for comments as part of this exercise on how current members can make the transition into the new scheme.

5.2 Possible methods of transferring accrued rights into the new scheme identified by the Government so far are;

- i calculate and transfer an actuarially equivalent period of service using a GAD formula
- ii calculate and transfer as above but add a little extra service to the calculation
- iii preserve existing, accrued service as a benefit to be paid on retirement under the terms of the current scheme

5.3 The options need to be considered with regard to a number of factors as follows;

- i Cost - which may impact on the terms of the new scheme (ie the more generous the protection terms, the less generous the new scheme can afford to be)
- ii Impact on existing scheme members
- iii Existing protections (e.g. some members still pay 5%, many will have 85 year rule protection etc) will need to be accommodated
- iv Ease of administration

6. The costs of the options

6.1 Actual costings cannot be provided by the Government because of the variety in employer contribution rates, funding positions etc across the 89 administering authorities in England and Wales of which, Nottinghamshire County Council is one of the larger ones.

6.2 They have, therefore, developed a benchmark cost system to enable consultees to compare the costs of the various options and adjustments to them, all other things being equal. There are some significant assumptions involved in developing this system but it has been developed using actual sample data and the involvement of statisticians from the Government Actuaries Dept and from Fund actuaries.

6.3 The average cost of the existing scheme based on this formula is 20.3% of pensionable payroll. The potential average costs from 2008 of the options outlined above for existing and for new (post April 2008) members works out as follows;

	Existing members	New members
Option A	20%	17.6%
Option B	21.5%	18.9%
Option C1	21.2%	18.3%
Option C2	21.1%	18.7%
Option D	As for C plus 3% extra for the final salary option	

6.4 New entrants cost less is because the 85 year rule will not apply to them, it having been removed from 1st October 2006.

6.5 The key question on the cost side concerns what share should be paid by the member. Existing members currently pay an average of 5.8% (most pay 6% but some are protected on 5%) and all new members currently pay 6%. The Government's calculations indicate that, for the average Fund, the employee contribution would need to rise to an average of 6.6% to maintain the employer contribution rates set at the last valuation in 2004.

6.6 The suggestions around employee contribution rates are;

i a two-tier structure where employee contributions are paid at a reduced rate beneath a certain cut-off point; perhaps at the point where earnings begin to be taxed at the basic rate

ii a two-tier structure not linked to tax bands but to any point that would rise with inflation thereafter; say £12000

6.7 The thinking behind adopting a tiered structure is to make the scheme more attractive and affordable to the low paid. The higher paid, therefore, would have to pay a higher rate to cover this.

6.8 The Government has worked out a number of permutations around the potential relationship between lower and higher paid employees' rates plus the total average contribution rate in each example. The higher the total average, the less the employer will need to contribute. A selection from the Government's examples is as follows;

Cut off point	Lower rate	Higher rate	Total average
£12k	3%	8%	4.9%
£12k	5%	7.5%	6%
£12k	6.5%	7.5%	6.9%
£12k	7%	8.5%	7.6%
£7,185	3.5%	6%	5.1%
£7,185	5%	6.5%	5.9%
£7,185	6%	7.5%	6.9%
£7,185	6.5%	9%	8.1%

7. Flexible retirement

7.1 The 2006 Regs have already introduced some cost-neutral provisions to support flexible retirement allowing scheme members to;

i take payment of a reduced pension between ages 60 and 65 while remaining in employment (generally taking on less hours or responsibility than during the main period of service)

ii to continue to accrue pension beyond age 65 at an actuarially increased rate to be taken by 75^{th} birthday

7.2 Proposed potential enhancements to these provisions identified by the Government include;

i an option to pay extra contributions in advance to offset the potential reduction in benefits resulting from taking those benefits early

ii extend the flexible retirement option to include everyone meeting the Scheme's minimum retirement age (currently 50, moving to 55 in 2010)

iii remove the requirement for employees to obtain employer consent before taking flexible retirement

iv remove the requirement for employees to take a reduction in hours or grade in order to qualify for flexible retirement

8. Two-tier ill-health provisions

8.1 At present, the ill-health provisions in the Scheme award enhanced benefits for life regardless of future health and employment prospects. The two-tier idea will offer employers more options in the benefits they provide which be based more specifically upon particular circumstances.

8.2 The differentiation between the tiers would be as follows;

	Qualification	Proposed benefits
Top tier	Those scheme members who are permanently incapacitated from performing their current duties and are unlikely to secure regular or gainful employment again	Benefits would be based on an enhancement of their existing membership by 50% of their prospective service up to age 65
Second tier	Those members who cease employment on the grounds of incapacity but are judged capable of undertaking other regular employment	No enhancement - just immediate payment of unreduced benefits

8.3 It is expected that 85 - 95% of LGPS ill-health retirees would fall in the second tier.

8.4 A review element is also proposed. This would enable employers to adjust entitlements to benefits further to any personal changes in circumstances. For example, an improvement in the health of a top tier ill-health leaver may lead to their enhancement being withdrawn.

8.5 In considering this proposal, a balance needs to be struck between ease of administration of the review process on the one hand and the potential cost savings on the other.

8.6 Cost savings are, according to the Government, not the key driver of this potential change but it is recognised that savings will be one welcome side effect of targeting such benefits more equitably.

8.7 The amount of variation across the country in the award of ill-health benefits to date, however, makes it impossible for a worthwhile estimate of potential savings to be suggested.

8.8 The consultation exercise wishes to focus on the principles of the proposal for a two-tier system and asks questions such as;

i how might we define ‘regular employment’?

ii what percentage of prospective service should be granted as an enhancement - 50% suggested, should employers have discretion to award 100%?

iii should immediate payment of reduced benefits be subject to review and abated in improvement cases?

9. Future cost sharing

9.1 The Government are aware that, when costs of LGPS provision rise, the employer contribution rate rises to meet it while the employee contribution rate stays at a fixed amount whatever the economic conditions. This proposal concerns building some flexibility in so that the employees contribution rate can change as well.

9.2 It is suggested that there could be a requirement for a review of demographic assumptions at every second or third triennial valuation. If significant variation over the period was found, the employer rate would, as under the present system, have to change but the employee rate could change as well - perhaps to meet some previously agreed proportion of total cost.

9.3 The Government understand that a fixed employee contribution rate is a key component of a defined benefit scheme so have asked for ideas on how this suggestion, if it is accepted as desirable, could actually be made to work.

10. Scope of employers' discretions

10.1 The final proposal is that specific optional scope could be provided allowing employers to provide specific, additional benefits over and above the national benefit package.

10.2 Such benefits could be provided where the employer has satisfied itself of its ability to manage any extra liability accruing as a result.

11. Recommendations

11.1 The 'What Next?' consultation document asks a number of questions on both a strategic and technical level. As far as possible, this report has limited itself to the strategic aspects.

11.2 It is recommended that Members consider the future shape and style of the Local Government Pension Scheme at this strategic level and task officers with compiling a response to the proposals accordingly that further takes into account any appropriate technical issues.

11.3 It is further recommended that the response compiled be presented for final consideration at the Pensions Committee meeting in September and submitted to the Department of Communities and Local Government by 29th September 2006.

Background papers

'Where next? - Options for a new look Local Government Pension Scheme in England and Wales'. Dept of Communities and Local Government, June 2006.

A DEAKIN
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Personnel Implications

As detailed in the report.

Equal Opportunities Implications

None.

Crime and Disorder Implications

None.