

PENSIONS COMMITTEE - 20 JULY 2006

LOCAL GOVERNMENT PENSION SCHEME (LGPS) – ANNUAL REPORT ON EARLY RETIREMENT 2005/06

SUMMARY

This report notes the numbers, costs and savings of early retirements for 2005/06 and assesses the effectiveness of the Council's existing early retirement policies.

Instructions are also sought as to whether contributions should be reclaimed from three employees who had their contributions waived after 40 years service. This arises due to changes to the LGPS Regulations.

RECOMMENDATIONS That:

- (1) the numbers, costs and savings of early retirements occurring in 2005/06 be noted;
- (2) the review of the effectiveness of the Council's existing early retirement policies be noted;
- (3) the Director of Finance and Business Services be given authority to agree, with the Chairman of this Committee, the Council's response to the Government's consultation paper 'Where Next? – Options for a new-look Local Government Pension Scheme in England and Wales' as discussed in Section 4; and
- (4) contributions be reclaimed from both employer and employee in respect of contribution holidays as discussed in Section 5. The Director of Finance and Business Services be given authority to agree terms with the individuals on a case-by-case basis taking into account personal circumstances.

1. Introduction

In April 1998 Members agreed changes to the management of early retirements in Bexley following the publication of a national Audit Commission report. The Audit Commission recommended a review of redundancy and early retirement policy and procedures in all local authorities and closer involvement of Members in decision making and monitoring.

One of the changes agreed in 1998 was to report to Members on the numbers, costs and savings from early retirements at the end of each financial year together with an assessment of the effectiveness of the Council's existing early retirement policies.

2. Early Retirements in Bexley – 2005/06

(a) Background

Early retirement from the Council may occur for one of the following reasons:

- redundancy
- efficiency retirement (termination in the interests of the efficient exercise of the authority's functions)
- voluntary resignation prior to age 60
- ill-health retirement

There were 68 retirements in 2005/06 which triggered payments from the pension fund, of which 19 (28%) were early retirements. This compares to a total of 77 in 2004/05, of which 18 (23%) were early retirements.

The Council has discretion regarding the level of payments made in early retirement situations with the exception of ill health. For reporting purposes the numbers, costs and savings of early retirements are therefore divided into the categories of ill-health and other early retirements (excluding ill-health).

(b) Funding of Early Retirements

Ill-health early retirements are non-discretionary, are chargeable to the Pension Fund and are allowed for in the Fund's actuarial valuation. The costs of early retirements (excluding ill-health) are met as follows:

Table 1 – Funding of early retirements (excluding ill-health)

Element of early retirement benefits	Costs of early retirement element charged to:		
	Initial Costs	Annual Costs to Age 60	Annual Costs Age 60 onwards
Redundancy payment	Department	n/a	n/a
Added years lump sum	Department	n/a	n/a
Added years pension	Department	Department	Department
Basic pension prior to age 60	n/a	50% Department 50% Pension Fund	n/a

Charging part of the basic pension to departments was introduced in 1998 in response to the Audit Commission report which encouraged Councils to be more accountable for the strain on pension funds of granting early retirement. In cases of redundancy and efficiency the employee receives unabated pension benefits despite retiring early. This results in a potential strain on the pension fund which is managed on the expectation that employees will remain in the scheme until at least age 60. When the Council considered charging this cost 50% to the pension fund and 50% to the DSB this struck a fair balance between accountability and not constraining departments from making necessary organisational change.

Age 60 was chosen as the cut-off date because it is the age at which employees may elect to retire without requiring employer consent, i.e. any decision to terminate employment and pay benefits early does not represent an additional cost to the pension fund. This remains the case under the various proposals for changing the LGPS referred to later in this report.

All costs of providing added years in the event of early retirement are charged to department staffing budgets as they are not covered by pension contributions.

(c) Numbers, Costs and Savings

- Ill-health retirements

In 2005/06 there were 6 ill-health retirements compared to 5 in 2004/05. It is difficult to predict the number of ill-health retirements that will occur each year. For 2005/06 the numbers in each service area were as follows:

<u>Service Area</u>	
Finance & Business Services/Law & Admin	0
Children and Young People's Services	3
Adult Social Services	1
Environment and Regeneration Services	0
Bexley Trading Services	<u>2</u>
Total	<u>6</u>

Over a three-year period the actuary assumed a yearly average of 23, whereas the Council's average was 7 – well below the assumed level.

- Early retirements (excluding ill-health)

In 2005/06 there were 13 early retirements (excluding ill-health) as in 2004/05. Over a three-year period the actuary assumed a yearly average of 17, the Council's average was 14 – also below the assumed level.

Table 2 - Breakdown of early retirements (excluding ill-health) - 2005/06

Type of Early Retirement	Numbers	
	Senior Posts subject to Member Level Appointment	Other Posts
Redundancy	0	5
Efficiency (termination in the interests of the efficient exercise of the authority's functions)	1	6
Voluntary – prior to age 60	0	1
Total of early retirements (excluding ill-health)	1	12

In addition to those shown above there were four redundancies and one efficiency retirement (termination in the interests of the efficient exercise of the authority's functions) where LGPS benefits were not payable ie. those under 50 or non-members of the LGPS.

Table 3 – Summary of early retirement costs (excluding ill-health) – 2005/06

Early retirements are agreed where there are financial or operational advantages to the Council i.e. savings and/or organisational change can be achieved at the same time as improving service delivery. The table below includes a number of assumptions but does provide a good indication of the financial impact. It shows that such retirements provided the Council with significant annual savings.

	Initial Costs	Annual Costs to Normal Retirement Date	Annual Costs Normal Retirement Date Onwards
	£000	£000	£000
Costs charged to departmental budgets	132	86	18
Costs charged to Pension Fund	0	68	0
Total cost	132	154	18
Savings to departmental budgets	0	255	0
Total cost (+) /savings (-)	132	-101	18

3. Assessment of Existing Policies

With the exception of ill-health retirements, Bexley's policies for managing early retirements are set in the context of managing organisational change. Over the years a number of decisions have been taken which have substantially changed the structure of the authority and methods of service delivery and the Council continues to respond to various pressures and opportunities by reorganising and streamlining services. The Council's policies in these circumstances are designed to maintain employee commitment and motivation by avoiding redundancies and early retirement as far as possible through retraining and redeployment, whilst at the same time ensuring that where redundancy or early retirement is inevitable, a reasonable package of financial benefits exists to help soften the blow of job loss. This approach has met with a measure of success with all organisational changes being implemented smoothly and with a minimum of disruption to services.

In 2005/06, the majority of early retirements (excluding ill-health) resulted from minor reorganisations to effect expenditure reductions. The vast majority of these, even those compulsory ones, were achieved with a reasonable degree of co-operation from those involved. Added years (for those over 50) and enhanced severance payments have been considered to be a valuable tool in the management of the

early retirement process. Redeployment continues to be sought for staff affected by reorganisations and there were at least 2 successful redeployments in this monitoring period.

The Council's policies and procedures therefore continue to be effective in achieving organisational change with the minimum of disruption. There are, however, a number of regulatory changes which will have an impact on the Council's existing financial terms for redundancy and early retirement.

4. Regulatory Changes Affecting the Council's Published Policy on Redundancy and Early Retirement

The Council's Financial Terms for Redundancy and Early Retirement are derived from both the Local Government Pensions Scheme Regulations and the Local Government (Early Termination of Employment) Discretionary Compensation Regulations. These financial terms detail the Council's policy on compensation and the exercise of its discretions that the Council is obliged to publish under the regulations. These financial terms were last published through this Committee in November 2005.

New LGPS Regulations came into force on 1 April 2005 that significantly amended the early retirement provisions of the LGPS. Subsequently these Regulations were retrospectively revoked and a Tripartite Committee consisting of Government, employer and trade union representatives was established to draw up proposals for the ongoing modernisation and development of the Scheme. A particular issue of concern to the Trade Unions was the removal of the Rule of 85 from the Scheme. (This rule allows a member whose age and length of service equals 85 to retire with unreduced benefits). With the revocation of the Regulations this rule was reinstated.

Further amended Regulations have since been introduced with effect from 1 April 2006 which remove the '85 year rule' from 1 October 2006. These have subsequently been further amended to defer removal of the 85 year rule, for existing scheme members, to October 2008 and extend protection arrangements. Consultation on these amended regulations closed on 3rd July 2006.

In addition to the changes to the LGPS Regulations, Government consultation on revised Discretionary Compensation Regulations commenced in May 2006. Changes are proposed, primarily to reflect age discrimination legislation, and are therefore effective from 1 October 2006 when these come into force. The proposed amended Compensation Regulations significantly alter the Council's powers to award compensation (principally by removing the power to award added years) at a time when significant organisational change is envisaged.

It is anticipated that proposals for amending the Council's policy and financial terms for redundancy and early retirement resulting from these Regulations will be put to General Purposes Committee for consideration in September. Amendments to the financial terms are also required to reflect age discrimination legislation (eg. removal of the upper and lower age limits) and consideration needs to be given to the new discretion to allow flexible retirement. These issues will also be included in a report to GP Committee.

A summary of the main changes to pensions and early retirement regulations since 1 April 2006 is attached as Appendix 1.

On 30 June 2006, the Department for Communities and Local Government issued a consultation paper entitled 'Where Next?- Options for a new-look Local Government Pension Scheme in England and Wales'. This seeks views on four possible options for a new look scheme by 2008. It is suggested, as consultation closes on 29th September 2006, that the Director of Finance and Business Services consults with the Chairman of this committee in determining a response to this paper.

5. Contribution Holidays

Under the 1997 LGPS Regulations the service used to calculate pension benefits was capped at 40 years, up to the age of 60. Members had discretion 'to resolve that no employees' contributions, or contributions at a reduced rate, could be paid for service after 40 years had been attained, while allowing the final pay at the time of retirement to be used to calculate benefits and retaining the death-in-service lump sum cover'.

Members resolved to waive employees' contributions in all cases where 40 years' pensionable service, in line with statutory requirements, had been achieved.

Under the April 2006 Regulations this discretion has now been removed and, therefore, employees must now make a contribution regardless of age or length of service.

Three employees are affected by this decision in Bexley. One had a contribution holiday of 2 years and has since resumed making contributions as a matter of course once they reached the age of 60. Two other employees were on contribution holidays when the revised Regulations were issued and their contributions have been resumed as a consequence.

Under the revised Regulations, a decision needs to be made as to whether or not to collect contribution arrears from these employees and, if so, how much and over what period. Payment of Employer arrears needs to be considered in the same way.

A summary of the sums involved is as follows:

Employee	Period of contribution holiday	Employee contribution at 6%	Employer arrears
Employee A (Environmental Health)	6 June 2005 to 5 April 2006	£1,163.08	£2,428.07
Employee B (Democratic Services)	5 July 2005 to 5 April 2006	£1,906.76	£3,981.43
Employee C (Library Service)	8 December 2002 to 7 December 2004	£1,742.17	£3,255.40

Under the 1997 Regulations service was not counted when calculating pension benefits for the duration of a contribution holiday. Under the new Regulations, service will be counted regardless of whether or not contributions are reclaimed.

On the basis that:-

- employees will have the benefit of the service; and
- the department had the necessary funding for their contributions at the time; and
- strain on the pension fund should be reduced where possible;

it is recommended that contributions should be reclaimed from both employer and employee.

Should members agree to this recommendation, it is suggested that the Director of Finance and Business Services be given authority to agree terms with the individuals on a case-by-case basis taking into account personal circumstances. The employer contribution would be met from the appropriate DSB.

6. Equal Opportunities/Access Issues

Bexley's policies and arrangements for early retirements apply to all affected employees regardless of race, gender, age, disability, or level in the organisation. This information is monitored in respect of early retirement situations to ensure that no discriminatory practices exist.

7. Summary of Financial Implications

The funding of early retirements is explained in section 2 above. The implications to the Pension fund and DSB of reclaiming the employee and employer contributions for contribution holidays are detailed in section 5 above.

Local Government Act 1972 – section 100d List of background documents

Pensions Committee November 2005 - Local Government Pension Scheme (LGPS)
– Annual Report on Early Retirement 2004/05

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Summary of recent Changes to the Local Government Pension Scheme in England and Wales

Changes from April 2006

- Employees can join the scheme and remain in the Scheme up to two days before their 75th birthday.
- If a member of the Scheme defers drawing their pension beyond age 65, their pension benefits will be actuarially increased.
- The ability to give up part of their pension to provide a dependant's benefit over and above the standard spouse's, civil partner's or child's pension has been removed.
- Children's pensions coming into payment after 5th April 2006 for non-incapacitated children who are continuing in full time education or training will have to cease by age 23.
- The extra years of membership that can be purchased in the Scheme by paying additional pension contributions is limited to 6 2/3rd years.
- The ability to convert some or all of the tax-free lump sum paid on retirement into additional taxable pension is removed.
- The maximum service limit of 40 years (or, for those who joined the Scheme before 1 June 1989, the maximum of 40 years at age 60 and 45 years at age 65) has been removed.
- Employers can no longer reduce or waive the contributions of scheme members who have been in pensionable local government employment for at least 40 years, and so, from 6 April 2006, if a member has had their contributions waived they will have to start paying full contributions again. Their service in excess of 40 years will now count towards their pension benefits and the employer can, at their discretion, recoup the contributions that would otherwise have paid. The membership will count regardless of whether member contributions are reclaimed or not.
- Flexible retirement is now available for employees from age 50, so that rather than continuing in their job to age 65 a member can, with their employer's consent, reduce their hours or move to a lower grade and draw their pension benefits whilst continuing in employment and building up further benefits in the Scheme. Their pension benefits may be reduced if paid before age 65, but the employer has the discretion (at their cost) to waive these reductions.

- Exchanging part of the pension for extra lump sum – if a Scheme member draws their benefits after 6 April 2006 they can take up to 25% of the capital value of your pension benefits as a lump sum. The current lump sum automatically paid on retirement roughly equates to 15% of the capital value. Any amount taken above the current lump sum would be achieved by exchanging part of the annual pension for a one off tax-free cash payment at a rate of £12 lump sum for each £1 of pension given up.
- If additional voluntary contributions (AVC's) are being paid a Scheme member may elect to take up to 100% of the accumulated fund in their AVC account as a tax free lump sum provided it is drawn at the same time as the LGPS pension benefits and, when added to the LGPS lump sum, it does not exceed 25% of the overall value of their LGPS benefits (including their AVC fund).
- Removal of the Rule of 85 - the normal retirement age for Scheme members is already age 65 but employees can voluntarily retire from age 60 onwards (or from age 50 and before age 60 with their employer's consent). The 85-year rule decides if benefits should be reduced or not if a scheme member chooses to retire early. If they do not satisfy the 85-year rule, then their benefits are reduced if voluntarily drawn before age 65.
- The Government's legal advice is that the '85 year rule' will be in breach of Age Discrimination legislation which comes into force 1 October 2006 and for this reason the 85-year rule has been removed from the scheme, but only in respect of benefits built up in the future. Protection arrangements for existing Scheme members are being finalised.
- The current 15% contribution limit on contributions paid to **all pensions schemes** is removed and thus up to 100% of taxable pay, after National Insurance deductions, can be paid into the Scheme or In-House AVC arrangement with full tax relief. There is however a limit of 6 years 243days on the number of added years you can buy in the scheme and the basic employee % under the Scheme remains at 6%.
- The introduction of a Lifetime Allowance and Annual Allowance by the Government from 6 April 2006 mainly affects high earners. Some of the changes relating to "high-earners" remain unresolved, in particular with regard to issues around enhanced protection and how any adjustment to benefits in excess of the lifetime allowance should be made. Guidance from the Government Actuary's Department has been promised shortly.

Future Changes

- Earliest age pension benefits can be taken (with the exception of ill health retirements) will have to increase to 55 (from 50) by April 2010 to comply with the Government's new Tax Regime for Pension Schemes.

The Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006 - Draft Regulations effective from 1 October 2006

- Proposed regulations that would come into force from 1st October 2006 introduce a maximum severance payment of 104 weeks and reference to age and length of service have been removed. The provision to pay compensatory added years is also to be removed. There are no transitional protection clauses.
- Augmentation under the LGPS regulations (52) is the main way left for employers to enhance pension. An employee cannot have a severance payment if their service is augmented. One of the impacts of age discrimination could also be that if augmentation is used for over 50's it would have to be used for under 50's.
- Bexley currently awards credited service (maximum of 5 added years – 2 months service for each completed year) to eligible employees retired on the grounds of redundancy/efficiency under the previous regulations to those aged 50 or over. This provides both a pension and lump sum and 100% of the cost is paid by the employer for the life of the pensioner.