

## **"WHERE NEXT? - OPTIONS FOR A NEW-LOOK LOCAL GOVERNMENT PENSION SCHEME"**

### **LPFA SUMMARY**

The above publication was produced by the Department for Communities and Local Government at the end of June. Responses from interested parties are required by 29<sup>th</sup> September 2006.

The paper sets out various options for a new-look Scheme from April 2006, insisting that the scheme be

- A **affordable** and **viable**;
- B **fair** to taxpayers, who ultimately guarantee its pension promise;
- C **attractive** to existing and future scheme members, and to employers;
- D regarded and valued as **an integral part of the overall remuneration package** for employees in an increasingly diverse workforce; and
- E able to deliver an appropriate **defined benefit, index-linked income** in retirement for its members.

The options have been costed on the basis that 50% of the assumed savings from the removal of the 85 year rule, and the introduction of increased commutation are re-cycled into the Scheme.

The four basic options for the Scheme are

- A An updated current scheme, with additional benefit improvements;
- B A new, final salary scheme with an improved accrual rate;
- C A new, career-average scheme; and
- D A new, hybrid arrangement, based on a career-average core with a final salary **option**.

### **SCHEME IMPROVEMENTS**

All of the options include the following scheme improvements

- Increase of lump sum death grant for death in service from 2 x Final Pay to 3 x Final Pay
- The introduction of two tiered ill health benefits
- The improvement of partners pensions as a result of a higher basic pension (options B, C and D only)

These options are considered in more detail later in this summary

NB It has been suggested that the introduction of two tiered ill health benefits could be introduced as early as April 2007, twelve months before the launch of the new-look Scheme.

**OPTION A    *An updated current scheme, with additional benefit improvements***

This is a final salary scheme with an accrual rate of 1/80 of final salary with a tax free lump sum of 3/80 of final salary. The total cost of this scheme is estimated to be 19.4% of payroll (17.3% for new members).

**OPTION B    *A new, final salary scheme with an improved accrual rate***

This is also a final salary scheme but with an accrual rate of 1/60 of final salary, and with no automatic lump sum. The total cost of this scheme is estimated to be 20.9% of payroll (18.6% for new members).

**OPTION C    *A new, career-average scheme***

This is a career average scheme with two alternative methods for calculating benefits. The first would be to revalue each years pay in line with the Retail Price Index(RPI) and apply an accrual rate of 1.85%. Alternatively , each years pay could be increased by RPI plus 1.5% with an accrual rate of 1.65%. The first option is estimated to cost 20.6% of payroll (17.7% for new members) whilst the second would be marginally less costly at 20.5% (but 18.1% for new members).

**OPTION D    *A new, hybrid scheme***

This would be similar to Option C, but would provide members the opportunity to pay additional contributions to obtain final salary linked benefits. The basic cost would be the same as for Option C, however scheme members electing to receive final salary based benefits would need to pay around 3% additional contributions.

***Other possible developments for the new Scheme***

***Partners Pensions***

The consultation paper does not advocate the immediate introduction of co-habitee's pensions, though it recognises that these may need to be considered following conclusion of the government sponsored Law Commission consultation: "Cohabitation: The Financial Consequences of Relationship Breakdown". It is pointed out that under Options B, C and D, where basic individual pensions are higher, current partner pensions are subsequently increased.

***Increased Flexibility for early retirement***

Proposals include

Allowing members to pay additional contributions to offset the reductions in benefit resulting from early retirement.

Extend Flexible Retirement from age 60 to age 50 (increasing to 55 by April 2010)  
(Although this appears to have been included already in 2006 Amendment Regulations – KG)

Remove the requirement to obtain employers consent for flexible retirement

Remove the requirement for employees to reduce hours or grade for taking flexible retirement

Benefits accrued after age 65 to be uplifted

### ***Two tier ill health retirement***

Aimed to widen the range of ill health benefits an employing authority is able to award, the top tier would cover members permanently unable to perform the duties of their local government employment and unlikely to secure gainful or regular employment again. The second tier would cover members judged capable of undertaking other regular employment.

Those covered by the top tier would receive immediate benefits with membership enhanced by 50% of potential membership to age 65 (possibly higher if justified on compassionate grounds). Employers would be given the ability to review and if appropriate to withdraw the enhanced benefits

Those covered by the second tier would receive immediate unreduced benefits, but these would not be enhanced. It is expected that 85-95% of ill health retirees would fall within the second tier. A consideration is that the second tier could be broken onto several categories each offering a different level of benefit ranging from immediate payment of enhanced benefits to immediate payment of deferred benefits for a fixed period only (eg 2 years).

### ***Employer and Employee Contribution Rates***

In order to “equality-proof” the new Scheme, tiered employee contributions could be considered. These would be particularly appropriate to Options A and B, as final salary schemes tend to disproportionately reward high earners.

It may also be appropriate to consider future cost sharing between employers and employees. Effectively this means introducing some mechanism by which variations in the ratio between employer and employee contributions are limited.

### ***Existing Members in the new-look Scheme***

It is intended that the new Scheme be available to all new and existing scheme members from 1<sup>st</sup> April 2008. All membership from April 2008 would be accrued under the terms of the new-look scheme. Three methods have been proposed for treating pre April 2008 membership

- A Award an actuarially calculated period of membership to existing members
- B Award a period of membership greater than that calculated in A to existing members
- C Treat pre April 2008 membership as a deferred benefit under current scheme rules, but based on final pay at retirement.

### ***Scope of Scheme Employers discretions***

It is suggested that employers could be enabled to provide specific additional benefits over and above the main Scheme benefit package, where this would not conflict with other equality and discrimination requirements

### ***Consultation Responses***

Responses are required by 29 September 2006.

Two templates for responses have been suggested, a core response template and a technical response template. Consultees who wish to respond to the core issues raised in this paper are encouraged to refer to the core response template in Annexe 2 of the consultation paper. A technical response template is at Annex 3 for those who wish to respond to the more technical aspects of the paper.

These templates provide a list of questions which the Department believes to be particularly relevant to the successful development of a new-look scheme. The use of these templates is not compulsory and nor are respondents limited to commenting on the specific issues they raise.

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This document is a summary of the consultation paper "Where next? - Options for a new-look Local Government Pension Scheme" as understood by the London Pensions Fund Authority.

For detailed explanation of the issues involved you should refer directly to the consultation paper.