

WHERE NEXT? – OPTIONS FOR A NEW-LOOK LOCAL GOVERNMENT PENSION SCHEME IN ENGLAND AND WALES

WHAT TOPICS ARE COVERED BY THIS BRIEFING?

This briefing is a jargon-free, non technical briefing for scheme members and other LGPS interests about the consultation on options for a new-look LGPS, which the Government launched on 30 June.

It aims to explain the reasons for the consultation, and its contents, clearly and free of technical jargon. It also responds to some of the claims about the scheme that have been circulating in recent months, leading up to the removal of the 85 year rule from the scheme.

The consultation document *Where next? – Options for a new-look Local Government Pension Scheme in England and Wales* contains further information. This can be accessed via the DCLG website at www.communities.gov.uk/consultations

The following areas are covered:

- 1. The basics:** **What is the consultation, and why does the scheme need to be changed?**

- 2. The stewardship of the LGPS:** **Who runs the LGPS, how is it being reformed and who can be a member?**

- 3. Further details of the Options:** **What are the Options for the new-look scheme, how much do they cost, when and how will a decision be made?**

- 4. The 85 year rule:** **What is it, why has it been removed and what transitional protections are there for existing scheme members?**

- 5. Your contribution** **How to find out more and how to respond**

1. THE BASICS

What is the latest LGPS consultation?

- A consultation began on 30 June on four options for a new-look scheme for existing members and new entrants from 1 April 2008

Is there a preferred option?

- No specific option is being recommended - the consultation is informal and aims to promote debate and to build consensus around the best way forward for the scheme in the future
- Both final salary and career-average options are considered, and each option also includes increased death in service benefits, cohabitees pensions, as well as new, two-tier ill health pension provisions.

Why is the scheme being changed?

- Half of LGPS members are now estimated to work part-time and 72% of members are female.
- The diversity of the workforce and extended and more flexible working lives require a modern, equality-proofed pension scheme which is attractive to employees and employers across the range of the workforce and in and around local government
- It must also remain affordable to employers and employees, and to the taxpayers who underwrite its pension promise.

2. THE STEWARDSHIP OF THE LGPS

Who is responsible for the LGPS?

- The Secretary of State for Communities and Local Government, Ruth Kelly MP, is responsible for the regulation of the LGPS to ensure its on-going solvency and viability.
- The Department for Communities and Local Government has departmental responsibility for the LGPS.

Why is the reform of the LGPS not covered by the PSF Agreement?

- The PSF Agreement provided a framework of principles for the civil service, teachers and NHS pension schemes. Their reforms are now subject to separate scheme specific negotiations and consultations.
- It was made very clear from the outset that the PSF Agreement did not apply to the LGPS. The LGPS is different from the other public service pension schemes for the following reasons:
 - The civil servants, NHS and Teachers had a normal retirement age of 60 and can stay in work beyond 60
 - The LGPS already had a normal retirement age of 65 since the 1920s with a facility to retire early
 - This facility (the 85 year rule) is age-discriminatory
 - The other public sector schemes do not have this
 - The LGPS is a funded pension scheme with real funds and investment strategies, different financing arrangements
 - The other public sector schemes are unfunded, pay-as-you-go schemes which can manage short, medium and long-term costs in a different way from the LGPS, whose costs are annually managed and reflected in local authority budgets.

Who can be a member of the LGPS?

- The LGPS is available to all employees in Local Government, or in other organizations that have chosen to participate in it.
- Employees of Local Government (other than Town and Parish Councils, to which special arrangements apply), automatically become members of the LGPS unless they opt not to join or have previously opted out, or are a casual employee.
- Teachers, police officers, firefighters and employees eligible to join another statutory pension scheme are not allowed to join the LGPS.

Aren't LGPS members being treated unfairly?

- The LGPS is a good quality pension scheme offering stable and attractive benefits to Local Government workers. Although in some instances average pensions appear low, this is a reflection of the relatively short periods of membership of the Scheme, now less than 8 years in average.
- All public service schemes are subject to reform, not just the LGPS.

3. FURTHER DETAILS ABOUT THE OPTIONS

What are the options?

- **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
- **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
- **Option C1** is a new career-average scheme, with an accrual rate of 1.85% and RPI re-valuation
- **Option C2** is a new career-average scheme, with an accrual rate of 1.65% and wage inflation revaluation
- **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 in order to receive final salary linked benefits.

What is the difference between a final salary scheme and a career average scheme?

- Both provide defined benefits in retirement, which are not dependant on the returns of the pension fund's investments. They are both good quality, attractive options.
- A final salary scheme awards benefits on the basis of the scheme member's final salary on retirement.
- A career-average scheme builds up entitlement to a pension in retirement based on the scheme member's salary *in each year of membership*, not just on their final salary.

Why have you included a lower cost Option (Option A)?

- A good quality, final salary low cost option is provided to add range to the consultation exercise
- It is based on the current scheme, but also includes some new benefit improvements
- It does not recycle all the available savings
- Some LGPS interests might see advantages in it compared with the other options. It would be likely to lead to lower costs for employees and / or employers and so help to sustain a final salary scheme at less cost.

- Including such an option widens the response base to this critical exercise for the Scheme's future.
- This is a consultation on options, not on proposals. We want to build a consensus around the best way forward for the LGPS.

What other improvements are there?

- All the options also improve the scheme's **death in service benefits** from two to three times pay and provide **partners' pensions for cohabitants**, as are currently provided for civil partners and married partners.
- It is important to support extending working lives by giving employees the opportunity to wind down towards retirement by gradually reducing their working hours and / or responsibilities. The consultation therefore also considers **extensions to the flexible retirement provisions** which were introduced in April this year.
- The current **ill health provisions** in the scheme award, in most cases, enhanced retirement benefits for life, regardless of future health and employment prospects. The LGPS, along with other public service schemes, is now required to move to a *two-tier* arrangement, which will better target benefits to those who are permanently unfit to perform the duties of their current employment, and are unlikely to secure regular or gainful employment again. A second tier of lesser benefits would cover those who cease employment on grounds of incapacity, but who are judged to be capable of undertaking other regular employment.

EMPLOYEE AND EMPLOYER CONTRIBUTIONS

What will all of this cost?

- Each option has a different cost, and will therefore have different implications for employees' and employers' contribution rates.
- Specific contribution rates are not proposed, but the consultation does seek views on what the employee and employer rates should be in order to ensure affordability.
- We also consider whether employees could pay lower rate contributions on their pay below a certain cut-off point, in order to make the scheme more attractive for those people with less disposable income, and especially those who are low paid, or who work part time.

Will the employee rate rise?

- Employees currently pay 6% although some members have a protected right to pay 5%. The average rate is therefore about 5.8%.
- As all of the Options include benefit improvements, it might be reasonable for the employee contributions to rise, in order that the scheme remains affordable for employers and fair to taxpayers.
- However, this will depend on what option is chosen. Option A is a low-cost option, and Option B is a high cost option. Options C and D are middle cost options but Option D would also require employees to pay about an extra 3% if they chose to receive final salary benefits, rather than career average benefits.
- No specific employee or employer rate is proposed. The consultation seeks views in order to build consensus around a new-look scheme for April 2008.

Will there be cost sharing like with the other public service schemes?

- The benefits of introducing a future cost sharing mechanism to the LGPS are raised in the context of all four options.
- However, because the LGPS is regulated nationally - but managed and funded locally in 89 separate funds in England and Wales – a nationally implemented cost sharing mechanism would need to reflect the fact that local employers' costs and funding circumstances vary considerably.
- The consultation is therefore supportive of the **principle** of a future cost sharing mechanism, but seeks views from consultees as to how such a mechanism might best be implemented in practice.
- Chapter 12 and Annex 3 of the document discuss these important issues.

Which is the best option?

- That is for each consultee to decide. Other options can also be put forward as part of the consultation.
- No option is recommended at this stage. Each option has pros and cons, which are evaluated in the consultation paper. Each option will be fully equality-proofed, to provide fairly and attractively across the diverse workforce.

- The Options can be assessed according to the following criteria:
 - **Cost:** is the option affordable for employees and employers?
 - **Effect on existing members**
 - **Attractiveness to employees:** Does the Option encourage saving and working later in life?
 - **Design:** Is the option fit for the modern and future workforce in and around local government?
 - **Attractiveness to employers:** Would the Option help employers to recruit and retain staff?

When will an Option be decided?

- This consultation closes on 29 September. Ministers will then consider responses to it, and decide which Option, or variation on an Option, to take forward.
- A statutory consultation on draft regulation will then begin in late autumn, which will allow new Scheme regulations to be in place in April 2007.
- The new-look scheme will apply to existing members and new entrants from 1 April 2008.

AFFORDABILITY

- Public sector workers deserve good quality pensions - but these must be affordable and fair to the taxpayers who underwrite their benefits

Isn't the LGPS unaffordable?

- No – the Government is committed to ensuring the scheme remains affordable for employers and fair to the taxpayers who underwrite its pension promise
- The development of a new-look scheme takes this forward from the removal of the 85 year rule from 1 October 2006.
- An increase in employee contributions may be required in the new-look scheme, alongside the improvements in the benefit package
- Funds and employers have been asked to tell the Government what the cost of the four Options will be for them locally. This information will be taken into account before a decision is taken.

Won't the proposals for additional protections from the removal of the 85 year rule put extra pressure on local authority budgets?

- No – these have been taken into account in the costing of the new-look scheme options.
- No decision has yet been taken on these extensions, as they are subject to a statutory consultation exercise which closes on 3 July. However, the Government's view is that they are both affordable and legal.

What justification is there for a final salary pension scheme for local government?

- Both final salary and career-average options are included in the consultation on the new-look scheme.
- The Government is committed to decent and secure pensions for local government employees, whether these are on a final salary or career average basis.
- These must be affordable, viable and fair to taxpayers, who guarantee their security.
- They must also be equality-proofed, and provide fairly for the diverse workforce in and around local government

4. THE 85 YEAR RULE

Isn't this about the 85 year rule?

- No – as first explained in October 2004, this is the next stage in the development of a new-look scheme for the existing and future workforce.
- The 85 year rule has already been removed from the scheme, with effect from 1 October 2006
- Transitional protections are already in place for existing scheme members who will be 60 and satisfy the 85 year rule by 31 March 2013

Why was the 85 year rule removed?

- The 85 year rule is directly age discriminatory and therefore had to be removed from the Scheme by no later than 1 October 2006 to comply with a European Directive¹. This established a general framework for equal treatment in employment and occupation.
- The rule therefore had to be removed from the Scheme, in order to ensure it was equality-proofed for the future.

¹ Council Directive 2000/78/EC

- The 85 year rule costs an estimated 2 – 2.5% of pensionable pay each year. The cost of the scheme is also rising as people live longer in retirement.
- The removal of the rule (originally from 1 April 2005, but now again from 1 October 2006) has helped to ensure that the scheme remains affordable and fair to employers and taxpayers.
- This has already helped to secure its status as a good-quality, defined benefit scheme.

What is the 85 year rule?

- The normal retirement age for LGPS members is 65, rather than 60 as in other public service schemes. Any scheme member can choose to retire from 60 but their pension may be subject to an actuarial reduction to offset its coming into payment early.
- The 85 year rule, which has been removed from the Scheme with effect from 1 October 2006, allowed Scheme members, from aged 60, who choose to retire on an unreduced pension where the sum of their age plus service equals 85 years.

Aren't there also new proposals for protections?

- Yes – a separate consultation on affordable and legal extensions to these protections took place between 26 May and 3 July. These proposals would:
 - Extend the protection for existing scheme members who satisfy the rule of 85 and are 60 by 31 March 2013 to 31 March 2016
 - Provide an extra 18 months service under the 85 year rule for existing scheme members from 1 October 2006 until 31 March 2008, to provide continuity for the new-look scheme.
 - Smooth the current cliff-edge at the end point of the protections, by applying tapering reductions for existing scheme members until 1 April 2020.
- Subject to the outcome of the consultation exercise, amendments will be made by 25 July to implement the extensions.

What about the savings from the removal of the 85 year rule?

- The local government employers and the trades unions agreed, in their joint statement of 11 April, to recycle 50% of savings from a) the removal of the 85 year rule and b) the provision introduced in April to allow scheme members to take a greater tax-free lump sum on retirement, into benefit improvements in an affordable new-look scheme.
- The Government agreed that three options be designed to recycle around 50% of these savings, in line with this agreement.
- One option (Option A) is a lower cost option, which does **not** recycle 50% of the savings, although it does provide some benefit improvements. This low-cost option would be likely to cost employees and/or employers less than the other options.
- No option is preferred at this stage. Other options can also be put forward as part of the consultation.

What about the Judicial Review of the removal of the 85 year rule?

- A Judicial Review of the consultation on draft regulations to remove the 85 year rule is to be heard in the Courts.
- DCLG will be defending its position in Court.
- These legal proceedings do not have direct bearing on the development of the new-look scheme

5. YOUR CONTRIBUTION

Where can I find out more?

- The consultation document *Where next? – Options for a new-look Local Government Pension Scheme in England and Wales* contains further information. This can be accessed via the DCLG website at www.communities.gov.uk
- It is also available on request from Nicola Rochester at lgpensions@communities.gsi.gov.uk or DCLG, Zone 2/E8, Ashdown House, 123 Victoria Street, London SW1E 6DE.
- Requests for clarification or further information in relation to the consultation paper can be directed to Myfanwy Taylor at the above address, or at myfanwy.taylor@communities.gsi.gov.uk

How can I contribute to the debate?

- Responses to the consultation should be sent to Nicola Rochester, using the contact information above, by 29 September 2006.
- DCLG are also holding three workshops from 9.30am to 1pm on 13, 21 and 28 July 2006. These workshops aim to engage all interested parties in the objectives and scope of the proposed development of a new-look LGPS for April 2008.
- They are open to all. Places will be allocated on a first come first served basis. If you would like to attend these sessions, please contact Nicola Rochester.

How will this consultation affect me?

- If you are a scheme member, this won't affect you at all until the new-look scheme comes into effect in April 2008.
- No option is recommended at this stage, so you can respond to the consultation and tell DCLG which option you would prefer and why.
- The new-look scheme will apply to existing members and new entrants from April 2008, but it has not yet been decided how your accrued service in the current scheme will be treated when you retire. This specific issue is addressed in the consultation document, and Ministers will take account of responses to the consultation before deciding how to proceed.
- Your pension manager should be able to provide you with further information about your own personal circumstances.

LGFPS Division, DCLG
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