AUDIT AND PENSIONS COMMITTEE

8 December 2011

CONTRIBUTORS

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Consultation on proposed increases to employee contribution rates and changes to scheme accrual rates

WARDS
All

This report sets out the contents of a current Government consultation on proposed increases to employee contribution rates and changes to scheme accrual rates to the LGPS, which are intended to be effective from 1 April 2012 in England and Wales. The Committee is asked to give its views on the draft response attached.

RECOMMENDATION:

That the Committee recommend that the response attached as appendix 1 be submitted as the Council's response to the consultation document

LOCAL GOVERNMENT ACT 2000
LIST OF BACKGROUND PAPERS

No.	Description of Background Papers	Name/Ext. of Holder of File/Copy	Department/ Location
1.	Consultation Document	Les Green, ext 1878	FCS, Hammersmith Town Hall

1 Context

1.1 The Independent Public Service Pensions Commission review chaired by Lord Hutton set out a range of reforms aimed at making public sector pension schemes sustainable and affordable in the long term, while being fair to scheme members and taxpayers. These reforms have been accepted by the Government who intend to introduce these reforms in 2015.

1.2 Lord Hutton also published an interim report recommending to the Government that if it wanted to relieve short term costs pressures before the long term reforms begin in 2015 the most effective way would be for increases to be made to employee contribution rates.

1.3 This consultation paper sets out two options for a range of increases to employee pension contributions and revised accrual rates, responses to CLG are to be submitted by 6 January 2012. Details of the proposed changes can be found at

http://www.communities.gov.uk/documents/localgovernment/pdf/2004147.pdf

2 Proposals for the Local Government Pension Scheme

2.1 The Communities and Local Government Department has set out two options for amendment to the LGPS with the aim of achieving short term savings of £900M by 2014-15, the equivalent of 3.2 percentage point contribution increases in the unfunded public service pension schemes.

2.2 These options are aimed at relieving the current pressures caused by increased longevity and achieving a fairer balance between how much is paid by employees and how much by taxpayers.

2.3 The consultation paper asks for comments to the following five questions with regard to each of the two options

Question 1 – Do the proposals meet the policy and objectives to deliver the necessary level savings?

Question 2 – Are there any consequences or aspects of the proposals that have not been fully addressed?

Question 3 – Is there a tariff or alternative measures which consultees think would help to minimise any opt outs from the scheme?

Question 4 – Are there equality issues that could result in individual groups being disproportionately affected by the proposals? If so, what are considered *to be the nature and scale of that disproportionate effect? What remedies would you suggest?*

Question 5 – Within the consultation period, consultees' views are invited on the aspect of introducing a link to state pension age as recommended to the Government in Lord Hutton's report

2.4 The options are

Option 1

1) an increase in the employees' contribution rate from April 2012, to raise an additional £450M (1.5% of pensionable paybill), and
2) a change in the LGPS accrual rate from April 2013, to raise an additional £450M (1.5% of pensionable paybill)

Option 2

1) an increase in the employees' contribution rate from April 2012, to raise an additional £300M (1.0% of pensionable paybill), and
2) a change in the LGPS accrual rate from April 2014, to raise an additional £600M (2.0% of pensionable paybill)

2.5 A draft response to these questions is set out in Appendix 1.

3. Local Government Group offer

3.1 Following an invitation from the Secretary of State for Communities and Local Government, the Local Government Group has conducted discussions with local government trades unions with a view to establishing a package of measures to achieve the required savings, taking into account the funded nature of the LGPS which makes it unique from the other public sector schemes.

3.2 The Local Government Group proposal is as follows:

Normal pension age to be increased from 65 to 66 in respect of future membership from 1 April 2014 – to generate savings in the range of 1.0% to 1.5% of pensionable pay, equating to £300M per year

The balance of £600M savings would be delivered via an increase to employee contribution rates with a protection for anyone earning less than £15,000 pa, either from 1 April 2014 or on a phased basis from 1 April 2012 – but due to the pressures on personal finances, members should be given the option of having a reduced accrual rate rather than face increased contributions.

3.3 This solution allows fund actuaries to assess the effects and reflect the results in the next triennial fund valuation on 31 March 2013, with new employer rates applying from 1 April 2014. The Secretary of State for Communities and Local Government has not acted on this proposal by the Local Government Group.

4. Industrial action 30 November 2012

All of the main local government and teaching unions have been balloted and voted in favour of industrial action on 30 November which may cause widespread disruption to services.

5. Improved offer from Government

Shortly before the results of union ballots were announced, the Government made an improved offer aimed at protecting workers who are within 10 years of their normal retirement date; although no formal scheme specific offers have been made.

6. Summary

The case for requiring increased employee contributions to maintain funding levels in the short term is clear, but will inevitably cause hardship to a large number of members. Effectively it will be a cut in net wages at a time of high inflation and local government pay freezes.

The case for reduced accrual rates in the short term is difficult to comment on until the long term position the LGPS from 1 April 2015 is known, and in particular the new accrual rate to be applied.

APPENDIX 1- Draft Consultation response

<u>Question 1 Do the proposals meet the policy objectives to deliver the necessary level of savings in the LGPS</u>

The proposals will meet the policy objectives provided that the increase employee contribution rates and reduced accrual rates do not cause large scale opt-outs from the LGPS

<u>Option 1 and 2 – Increased employee contribution rate</u>

Prior to 1 April 2008 most employees contributed at the rate of 6% of pensionable pay with some protected manual workers retaining a 5% contribution rate. Following the LGPS stocktake, effective from April 2008, employee contribution rates were revised based on a tariff whereby the employee contribution rate was in the ranges from 5.5% to 7.5% of pensionable pay depending on the employee's full time equivalent annual salary. This new tariff was introduced with the intention of achieving a fairer share between employee and employer, of the costs of providing benefits.

The revised tariffs set out in Option 1 are aimed at further sharing of the costs of providing benefits in recognition that improvements in life expectancy have meant that pension benefits are being paid for longer than ever before, with protection given to any employee earning less than £19,401 pa which will mean that they do not have an increase to their rate until 1 April 2013 if they earn more than £15,100 pa.

The revised employee contribution tariffs under both options will achieve the aim of a much higher income of contributions by 2015 but only if the higher contribution rates do not lead to a large scale movement of employees opting out of the LGPS. A high number of opt outs will lead to a corresponding increase in the number of members with deferred benefits held in the pension fund, so it will not result in a lessening of administration costs and may restrict the amount of savings.

Also, the requirements of the Workplace Pensions legislation which begin to take effect in 2012 will require employers to automatically enrol their employees into a qualifying workplace pension scheme, even those who have previously opted out of their pension scheme.

This will lead to employees who have opted out of the pension scheme, possibly because of the increased cost of membership and reduction to the accrual rates, being re-admitted on the relevant staging date with the option to opt out again. This may lead to higher administration costs to local authorities and the prospect of financial penalties because of non compliance with the strict processing deadlines.

Revised accrual rate beginning April 2013- Option 1

There will be no change to the accrual rate in 2012/13 but it will change from 60ths to 64ths in 2013/14 and to 65ths in 2014/15.

The new accrual rates will result in a reduction of 6.25% in 2013/14 and 7.69% in 2014/15, the amount of annual pension earned for one year of full time membership, as follows:

Grade		2011/12	2012/13	2013/14	Lower pension value compared to 1/60th accrual	2014/15	Lower pension value compared to 1/60th accrual
		1/60th accrual	1/60th accrual	1/64th accrual		1/65th accrual	
MEG	17,298	288.30	288.3	270.28	6.25%	266.12	7.69%
SO1	29,571	492.85	492.85	462.05	6.25%	454.94	7.69%
PO4	40,506	675.10	675.10	632.91	6.25%	623.17	7.69%
SMG3	71,193	1,186.55	1,186.55	1,112.39	6.25%	1,095.28	7.69%

These changes will produce savings, but in view of the changes to public sector pensions schemes which will take effect from 1 April 2015 following Lord Hutton's review and the prospect of LGPS becoming a Career Average Revalued Earnings (CARE) scheme much will depend on the accrual rate that is to be used in the CARE scheme from 1 April 2015, making it difficult to comment on these proposals to change accrual rates in the short term.

Option 2 - Revised accrual rate beginning 1 April 2014

No change to the accrual rate until 1 April 2014 when it will change from 60ths to 67ths

The new accrual rates will result in a reduction of 10.45% in 2014/15, to the amount of annual pension earned for one year of full time membership, as follows:

Grade		2011/12	2012/13	2013/14	2014/15	Lower pension value compared to 1/60th accrual
		1/60th accrual	1/60th accrual	1/60th accrual	1/67th accrual	
MEG	17,298	288.30	288.3	288.3	266.12	10.45%
SO1	29,571	492.85	492.85	492.85	454.94	10.45%

PO4	40,506	675.10	675.10	675.10	623.17	10.45%
SMG3	71,193	1,186.55	1,186.55	1,186.55	1,095.28	10.45%

These changes to accrual rates will produce savings, but in view of the changes to public sector pensions schemes which will take effect from 1 April 2015 following Lord Hutton's review and the prospect of LGPS becoming a Career Average Revalued Earnings (CARE) scheme much will depend on the accrual rate that is to be used in the CARE scheme from 1 April 2015, making it difficult to comment on these proposals to change accrual rates in the short term.

A progressive change to accrual rates as outlined in Option 1 has the advantage of producing savings in year one, rather than delaying the change until 1 April 2014 when it produces a much more dramatic effect on member's entitlements and by which time more members may have decided to opt out, thereby reducing the savings which would follow from the lower accrual rate.

<u>Question 2 – Are there any consequences or aspects of the proposals that have not been fully addressed</u>

Option 1 and 2

There will be a significant reduction in amount of contributions being paid into the scheme if large numbers of members choose to opt out, with a resultant drop in funding levels. The prospect of large scale opt-outs is very likely as there has been a pay freeze in local government for three years at a time when cost of living and inflation are high.

A consequence of these proposals may be that large scale opt outs will increase the burden on the state pension and ultimately on the benefits system if more people do not have sufficient retirement income. The LGPS provides a wide range of benefits including death benefits, dependents pensions and ill health retirement benefits, which members will jeopardise by opting out.

<u>Question 3 – Is there a tariff or alternative measures which consultees think would be help to minimise any opt outs from the scheme</u>

Option 1 and Option 2

The reduction in the Lifetime Allowance and the Annual Allowance is already making higher earners review their LGPS membership, if they opt out there is a large financial loss to the scheme in terms of future income from contributions. If these limits were increased it would assist in retaining these members in the scheme.

<u>Question 4 – Are there equality issues that could result in any individual groups being disproportionately affect by the proposals? If so, what are considered to be the nature and scale of that disproportionate effect? What remedies might you suggest?</u>

Option 1 and Option 2

There is a large number of lower paid staff who are from ethnic minorities, lone parents or disadvantaged backgrounds, any increase in the cost of the pension scheme will cause them hardship, even if they opt out in the long term their pension will be reduced. An increase in the threshold at which increased contributions are introduced may encourage lower earners to remain in the scheme.

The average pension in local government is £3,800 pa and any reduction in accrual rates will reduce this further, meaning lower retirement income for many more people, especially women who are more likely to be employed in part time and low paid jobs.

<u>Question 5 – Within the consultation period, consultees views are invited on the aspects of introducing into the LGPS a link with state pension age as recommended to the Government in Lord Hutton's report</u>

Option 1 and Option 2

A link to the state retirement age, which is being progressively increased, would increase the amount of contributions to pension funds so further reducing the fund deficit. A later retirement age would also reduce the term of pensions paid. Such an increase to the normal retirement age in the LGPS is justifiable on the grounds of increased longevity.