REPORT NO 371/05

ANGUS COUNCIL

RESOURCES & CENTRAL SERVICES COMMITTEE

17 MARCH 2005

LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND): OPTIONS FOR A NEW SCHEME: CONSULTATION PAPER BY SCOTTISH PUBLIC PENSIONS AGENCY

REPORT BY CHIEF EXECUTIVE AND DIRECTOR OF FINANCE

ABSTRACT

The Scottish Public Pensions Agency has issued a Consultation Paper about the future of the Local Government Pension Scheme (Scotland). The purpose of this report is to advise members of the main elements of a proposed new Scheme to be implemented as of 1 April 2008 and of the main principles behind the proposed Scheme. The report also outlines a suggested response to the Consultation Paper's proposals.

1. RECOMMENDATION

The Committee is asked to:

i Note the proposed changes to the Local Government Pension Scheme (Scotland) as outlined in a Consultation Paper from the Scottish Public Pensions Agency.

ii Authorise the Chief Executive and Director of Finance to respond to the Consultation Paper on the basis of the comments as outlined in this report.

2. BACKGROUND

With the approval of Ministers the Scottish Public Pensions Agency has issued a Consultation Paper about the future of the Local Government Pension Scheme (Scotland) [LGPS(S)]. The Pensions Agency is seeking views on 'how best to take forward the development of the Scheme to make it more attractive, affordable and sustainable for those who are members of it, for those who provide its benefits and for taxpayers who ultimately guarantee its security'.

Against a backcloth of fundamental questions being raised over the affordability of public sector pension schemes the Agency argues that to ensure the retention of the Scheme as a funded, final salary public service pension scheme it is essential that it is kept under regular review to ensure it continues to demonstrate to providers and to taxpayers in particular good value for money.

The Consultation Paper outlines the main elements of, and principles behind, a new-look LGPS(S) which it is suggested be effective from 1 April 2008.

Responses to the Consultation Paper are sought by no later than 20 May 2005. This report highlights the main principles behind, and the main elements of, the proposed new-look LGPS(S. It also contains the basis of a suggested response by the council to the Consultation Paper.

3. PROPOSED NEW-LOOK LGPS(S)

The Consultation Paper indicates that in designing a new look Scheme the Scottish Public Pensions Agency's aims are to ensure that the new Scheme arrangements are:

- Comprehensive in their overall provision;

- Flexible and responsive to the need of stakeholders;

- Equitable from the points of view of all stakeholders, in terms of the balance between provision and cost;

- Efficient and cost effective in terms of delivery;

- Provide fully transferable rights; and,

- Provide the security of a guaranteed pension promise for all Scheme members.

It is argued in the Consultation Paper that the proposed LGPS(S) is designed to:

- Be attractive to prospective and current employees.

- Recognise the broader employment context of local government in the 21st century.

- Build on the best elements of the current Scheme.

- Balance stakeholders' interests by providing reasonable levels of benefit and at an affordable cost to employers, members and taxpayers ensuring value for money and financial sustainability.

- Safeguard the LGPS(S) as a funded final salary pension scheme whilst ensuring its affordability for the future.

The Paper suggests that the new-look Scheme would become effective as at 1 April 2008 with existing Scheme members transferred into the new Scheme.

In responding to the Consultation Paper it is suggested that the council support the principles behind the design of the proposed LGPS(S) and in particular highlight that:

- The LGPS(S) forms part of the overall remuneration package and there is a balance to be struck within that overall package between pay and pensions (deferred pay).

- The Scheme needs to remain as attractive to prospective and current employees as possible.

- With regard to the cost of the scheme the Council is supportive of targeting an employer contribution rate that would result in an underlying rate of 14% of future service accrual plus an employee rate of 7% (+1%). This would result in the underlying cost of the scheme to employers being approximately the same as the long term cost of the current scheme after the removal of the Scheme's 85 rule takes full effect. It is estimated that the abolition of the 85 rule will eventually reduce the employers contribution rate by approximately 2%.

- The Scheme should as far as is possible, match the provisions in the other main comparator public sector pension schemes.

- The Scheme should remain a final salary pension scheme.

It is further suggested that while transferring existing Scheme members from the current Scheme to a new-look LGPS(S) has merit, as all contributors would then be in a single Scheme, service conversion needs to be workable, fair and equitable.

Employee Contributions

Currently the Scheme's regulations require members to contribute 6% of their gross pensionable pay with a declining number of defined manual workers having a protected right to contribute 5%.

One of the underlying propositions of the Consultation Paper is that the average employee contribution rate across the Scheme would be 7% with variable levels applying to reflect the member's ability to pay, the benefits accruing and the tax relief that members receive in relation to their income tax banding

The Consultation Paper argues that variable levels of contribution would recognise the need for equity across the Scheme, and deal with some of the issues relating to low pay and the interface with the provision of State benefits.

The illustration given in the Consultation Paper is:

< £5k	Contribution rate of	2.5%
> £5 but < £7k	Contribution rate of	5.5%
> £7k but < £38k	Contribution rate of	7%
> £38k but < £80k	Contribution rate of	9%
> £80k	Contribution rate of	10%

The Consultation Paper suggests that the salary used in calculating the contribution rate could be that at the start of the financial year or, if employment commences or changes during the period, the salary on commencement of the job.

The Paper argues that implementing variable levels of employee contributions would help secure a modernised and attractive final salary related pension scheme.

It is suggested that responding to this aspect of the Consultation Paper the following concerns be highlighted:

- A variable employee contribution rate is anomalous to proposals for all of the other public sector schemes under review.

- Encouraging the lower paid to join the Scheme by offering a reduced contribution rate could well result in employees joining the Scheme who may not be best served by doing so, due to the impact of the Pension Credit.

- There is little evidence that offering employees a lower contribution rate would necessarily encourage the vast majority of current non-joiners to join the Scheme. The Institute for Fiscal Studies have shown that the bulk of the 'unpensioned' are not paying into a pension scheme because of other urgent calls on their money.

- A banded contribution structure as described in the Consultation Paper would mean that an employee earning £4,999 per year (on which he/she pays a contribution of 2.5%) would, if he/she received a £1 pay rise, pay contributions of 5.5% on the full £5,000. This would be inequitable in the extreme.

- A banded contribution structure as described in the Consultation Paper would have implications for promotion, regrading, annual pay increases, incremental progression, etc. It would, in effect, have implications for the whole of the employer's pay strategies. Offering a lower contribution rate to lower paid staff would clearly be of benefit to such staff but it is difficult to justify this when the Local Government Pay Commission has commented that "those at the bottom of the earnings distribution [in local government] are better paid, in general, that their whole economy counterparts while those at the top of the distribution are lower paid than their counterparts."

- Higher contribution rates for higher paid staff could lead to salary drift in respect of those staff which would, of course, lead to increased employer costs – not only in terms of additional salary but also in terms of the additional pension and national insurance on-costs on that additional salary.

- Decisions would need to be taken as to whether the pay of employees with multiple jobs should be aggregated to determine which contribution band they fell into. Morally, a person with the same overall income from two local government jobs should pay the same contribution rate as a person receiving the same income from one job. However, there would be difficulties in aggregating pay figures if a person has more than one job and these are with different employers.

- Around one third of local government employees do not presently join the Scheme. These tend to be the lower paid workers and younger members of staff. It is not certain that the higher contribution rates for those on higher salaries will offset the increased numbers of people encouraged to join by a lower contribution rate (to achieve an overall average of 7%) There will clearly be different impacts on employers depending on the make up and salaries of their workforce and on the number of current lower paid non-joiners who decide to opt into the Scheme. An increase in the number of lower paid staff joining the Scheme paying an employee contribution rate of 2.5% or 5.5% would add additional cost to employers.

On the basis of the above it is suggested that the council favour the same employee contribution rate for all Scheme members rather than a banded contribution rate as suggested in the Consultation Paper.

If banded contribution rates are to be taken forward as a concept then to help address some of the above concerns it is suggested that the banded arrangement be on the basis of eg employees paying 2.5% on the first £5000 of pensionable earnings, 5.5% on the next £2000 etc.

It is appreciated that such an alternative and indeed a standard rate may result in higher percentages in order to achieve an average employee contribution rate of 7%.

__Scheme Benefits in a New Look LGPS__

The proposed benefits in a new look LGPS(S) are contained below in embold followed by a suggested response from the council in plain type.

There would be a Scheme Retirement Age (SRA) of 65. Benefits taken as of choice before SRA would be subject to an actuarial reduction. Benefits drawn post SRA would be subject to an actuarial increase. The actuarial reductions/increases would be cost neutral to the Scheme and reflect the costs/savings of paying pensions before or after SRA. In both instances, members over 55 could be in receipt of pension benefits and continue to accrue further membership whilst they remain in employment which could be on reduced hours or in a lower paid job.

It is agreed that the Scheme should have a Scheme Retirement Age (SRA) of 65. It is also agreed that benefits taken as choice before SRA should be subject to an actuarial reduction, other than in the case of ill health retirement, whilst benefits drawn after SRA should be subject to an actuarial increase.

Flexible retirement, linked to down-shifting (ie moving to a lower graded post) or a reduction in hours, should be permitted and members using this facility should be allowed to continue paying into the Scheme in their remaining employment.

Benefits could be linked to final basic salary.

Whilst basing contributions and benefits on basic pay is favoured in principle, there are reservations over the practicalities of this suggestion:

If existing members are compulsorily transferred to the new Scheme, restricting the definition to basic pay only would represent a significant reduction in pensionable pay for those current members who still receive a large element of their pay (prior to leaving/retirement) via such payments as bonus, shift allowances, or weekend/unsocial hours allowances. A significant element of the local government workforce still receive such payments. Furthermore, if existing members are compulsorily transferred to the new Scheme, we envisage particular difficulties in assessing the service credit in the new Scheme to compensate for the reduction in future pensionable pay.

Benefits could accrue on the basis of 1.6% per year, for example 10 years of membership would equate to a pension of 16% of basic salary.

This equates to $\frac{1}{62.5}$ for each year of service compared to the current Scheme of $\frac{1}{64}$ and therefore represents an improvement providing the employees stays to the age of 65. However, consultation exercises which are currently taken place on changes to the Teachers' Scheme and the Health Service Scheme are suggesting a change to $\frac{1}{60}$ for each year of service and it is suggested that the LGPS (S) should match the provisions in these other public sector pension schemes.

It is not intended that there would be an automatic lump sum in any new arrangement. Individuals could instead be able to commute up to the maximum permissible under Inland Revenue rules, ie 25% of the capital value of the benefits accrued at the point they are paid, up to ten years before or after SRA. The commutation rate could be 12:1; for every £1 of pension surrendered, £12 of lump sum would be awarded, up to the Inland Revenue 25% limit.

At present employees receive a lump sum based on $\frac{3}{80}$ times years of service. The proposal could give employees a bigger lump sum than at present although there would be a compensatory reduction in their annual pension. This approach would provide employees with the flexibility to take their own decisions about the pension benefits that are appropriate to their own needs.

There be no Scheme limit on the period of membership which could accrue in relation to employment.

Employees should be able to contribute at any age (subject to the Inland Revenue limit of age 75).

There would be no facility to buy additional membership of the Scheme but consideration could be given to providing a defined contribution LGPS(S) top-up arrangement.

There would be no requirement for employers to offer an AVC arrangement. However, members would be able to use an external AVC arrangement or take advantage of the Inland Revenue changes which will allow concurrent membership of registered pension schemes.

The Scheme should be a final salary Defined Benefit scheme, there should be no Defined Contribution scheme, either as a top-up to, or as an alternative to, the main scheme and no facility for members to purchase added years: but an option for members to be able to purchase additional scheme benefits based on an actuarially set charge for purchasing £100 of annual pension would be supported. The Finance Act 2004 removes restrictions on the amount of contributions a member may make to registered pension schemes and removal of the current 15% maximum of pensionable pay in the LGPS(S) would be supported.

Death in service benefit could be three times final basic salary, paid as under the current arrangements, in consideration of the member's expression of wish as to who they nominate to receive the payment.

There would be no short-term survivor benefit provisions. Adult survivor benefits could be 50% of the pension after any commutation. Individual child survivor benefits could be 25% of the pension after any commutation and limited to a maximum of 50% where multiple dependants exist. Payment of children's pensions could cease at age 18.

A death in service lump sum of three times final pensionable pay represents an improvement on the current provision of two times final pensionable pay and is supported. It is agreed that there should be no short term survivor pensions.

It is agreed that a child's pension should cease at age 18.

The Consultation Paper also introduces the possibility of partner's pensions, something which has been sought by the trade unions for a number of years.

The introduction of partner's pensions is supported but it is considered that there are a number of equity issues surrounding the co-habiting partner's proposals contained in the Consultation Paper, which need to be addressed particularly if they could leave the Scheme open to legal challenge.

- A married or civilly registered couple do not have to be living together in order for a survivor pension to be paid (they could be living apart).

- A married or civilly registered couple do not have to be in an exclusive, long-term relationship established for a minimum of two years in order for a survivor pension to be paid.

- A married or civilly registered couple do not have to show financial dependence or interdependence.

- A survivor pension would automatically be paid to a married or civilly registered partner, they do not have to have been nominated to receive a pension by their spouse/partner. The lack of a valid nomination form would surely result in disputes where all the other criteria are met.

- The benefits of a married or civilly registered couple would be subject to pension sharing on 'divorce', whereas those of a member with a "common-law" partner would not be, even though the Scheme will have had a prospective partner's pension liability during the period of the "common-law" co-habitation.

- Single members who are not co-habiting are not able to nominate a person to receive a pension upon their death.

Enhanced ill health benefits could be payable only where a member is permanently incapable of any employment, with enhancement up to the scheme retirement age. Consideration could be given to similar enhancement in relation to survivor benefits which are paid following death in service.

The introduction of what would be a two tier ill health system is supported with the benefits of those who are certified as being permanently incapable of any gainful employment being based on their prospective service to age 65 and those certified as permanently incapable of doing their own job but capable of alternative employment only entitled to payment of their accrued pension rights with no enhancement. We do not believe that there should be any review mechanism as suggested in the Consultation Paper given the practical and administrative difficulties or arranging such.

The Scheme could continue to offer unreduced benefits to early leavers whose departure is outside their control, and where termination of employment occurs on or after the member's 55th birthday.

Any provision for the payment of pension benefits on redundancy grounds would not extend to statutory redundancies that would not attract any statutory redundancy payment.

Benefits payable on redundancy/efficiency retirement prior to Scheme Retirement Age (SRA) should be payable at the employee's choice, at an actuarially reduced rate, with the option for the employer to waive or reduce the actuarial reduction at their cost.

Other aspects of the Consultation Paper deal with the Finance Act 2004 which establishes a new tax regime for all registered pension schemes with effect from April 2006, and with the governance of the Scheme.

There are some aspects of the Finance Act 2004 referred to above as they have influenced the Consultation paper's proposals. Other aspects together with the governance of the Scheme are not included in this report as it is considered that these matters would be more properly dealt with in the response by Dundee City Council in its role as Administering Body for the Scheme in Tayside.

4. FINANCIAL IMPLICATIONS

There are no direct short term financial implications associated with the terms of this report. There are however long term financial implications. The proposals in the Consultation Paper are designed to achieve an equitable balance between the provision of reasonable benefits and affordability. Employers contributions to the LGPS(S) as a proportion of total future service costs have increased significantly in the last decade and now employers meet some 70% of costs. The proposals are designed to restore the balance to a 60/40 cost relationship between employer and employee, the original balance when the Scheme was first introduced.

The proposed banded contributions for employees which give an average employee contribution rate of 7% mean that employer contributions would average 14% in respect of future service after the removal of the 85 rule.

5. HUMAN RIGHTS IMPLICATIONS

There are no human rights implications associated with the terms of this report.

6. CONSULTATION

The Director of Law & Administration has been consulted on the terms of this report. The Chief Officers Management Team has been consulted on the proposed response to the Consultation Paper.

A B Watson
Chief Executive

HR/PerServMan

NOTE No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973, (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above Report.