

Pension Fund Committee

30 April 2007



Final regulations for 'new-look' Local Government Pension Scheme

Report of Stuart Crowe, County Treasurer

Purpose of the Report

- 1 The purpose of the report is to inform Members of the recently-issued regulations that will introduce a 'new-look' Local Government Pension Scheme (LGPS) from 1 April 2008.

Background

- 2 Communities and Local Government (CLG) issued draft benefits, membership and contributions regulations for the 'new-look' LGPS on 22 December 2006 with comments invited by 28 February 2008. The final regulations were published on 4 April 2007 and they are broadly similar to the draft regulations. The letter accompanying the final regulations is attached at Appendix A.
- 3 Two further sets of regulations are due shortly – the administration regulations and the transitional regulations. Once these are finalised all the regulations necessary to administer the LGPS from 1 April 2008 onwards will be available.
- 4 CLG has emphasised that the long-term policy objective for LGPS reforms is to ensure that the "Scheme reforms should be affordable, viable and fair to taxpayers" and that the key intention throughout the reform process has been "to ensure that no additional costs are imposed on taxpayers" who ultimately guarantee the LGPS benefits.

The benefits, membership and contributions regulations

- 5 The regulations set out the following LGPS benefit structure from 1 April 2008 onwards:
 - Pension accruing at 1/60th final pay for each year of service when retiring at age 65.

- Earlier retirement possible from age 55 onwards (from age 50 onwards up until 31 March 2010 for employees in the Scheme before 1 April 2008). Employer consent is needed to retire before age 60.
- Employee contribution rates of between 5.5% and 7.5% of pay depending on which of seven different bands an individual's pay for the previous financial year falls into. Part-time employees will have their full-time equivalent salary used for determining their contribution percentage, except for term-time only employees who will be treated as full time.
- Two different tiers of ill-health benefits:
 - Scheme members judged on health grounds to be have no reasonable prospect of obtaining gainful employment before age 65 to be awarded accrued benefits plus benefits based on prospective service to age 65
 - Scheme members judged on health grounds to be unable to undertake gainful employment on leaving but likely to be able to do so before age 65 to be awarded accrued benefits plus augmentation of 25% of prospective service to age 65
- The letter accompanying the regulations states that employers will be given the power to pay the equivalent of a pension based on accrued service to those members who leave employment on health grounds but are judged to be likely to obtain alternative employment within a reasonable period of leaving. However, these payments would come from an employer's revenue account not from the Pension Fund.
- Option on drawing benefits to take 25% of the value of pension benefits as a lump sum.
- Lump sum death benefit of three times actual salary if member dies in service.
- Lump sum death benefit of ten times pension (less any pension payments already made) if member dies while in receipt of a pension.
- Lump sum death benefit of five times deferred pension if member dies in deferment.
- Survivor benefits accruing at 1/160th for spouses, civil registered partners, co-habiting partners and children.
- A facility for employers to augment membership or annual pension.
- A facility for members to buy extra Scheme pension in steps of £250 a year up to a maximum of £5,000 a year.
- The continuing facility to have Scheme Additional Voluntary Contribution (AVC) providers. The continuing ability to take AVC funds as tax-free cash (within an individual's overall tax-free cash limit)
- A facility to access pension benefits whilst continuing in employment by reducing hours or grade (a continuation of the 'flexible retirement' option introduced to the current scheme)

- 6 The main changes from the draft regulations issued earlier in the year are in the banded employee contribution rate and the ill-health provisions. Introducing seven different employee contribution rates with the rate being determined by an individual's rate of pay in the previous financial year will create challenges for employers' payroll systems. This will be further complicated by CLG's decision to gradually phase out the 5% manual worker contribution rate (further details on this will be included in the forthcoming transitional regulations). Careful communication will be needed to ensure scheme members know what contribution rate they can expect to pay. The ill-health provisions appear to be less expensive and complicated than those proposed in the draft regulations.
- 7 One other notable change from the draft regulations issued earlier in the year is the confirmation that individuals will still be able to use their AVC funds to provide tax-free cash on retirement (provided this comes within the individual's overall tax-free cash limit). This clarifies the position on the use of AVC funds. However, there is still uncertainty about the level of contributions that will be allowed going forwards as CLG has previously consulted on a proposal to restrict maximum contributions to AVC funds to 50% of pay but has not yet issued final proposals on this issue.

Next steps

- 8 CLG expects to issue the administration regulations for the new-look LGPS during May and has provided a list of areas it expects to address in the transitional regulations that are also due to be published soon.
- 9 CLG has confirmed that the transitional regulations will continue the arrangements in the current regulations which protect certain categories of member from the removal of the 'rule of 85'. This means that anyone who was in the Scheme before 1 October 2006 who meets the 'rule of 85' and reaches age 60 by 31 March 2016 will still be able to retire from age 60 on unreduced benefits. Anyone reaching age 60 between 1 April 2016 and 31 March 2020 will have a phased level of reduction applied to their post-31 March 2008 benefits if they retire before age 65. All other members will have any benefits earned after 31 March 2008 reduced if they take payment of them before age 65 (even if their age plus service when they draw their benefits equals 85 or more). CLG has confirmed that all Scheme members will earn benefits in the new-look Scheme at the 1/60th accrual rate – even if they benefit from protections against the removal of the 'rule of 85'.
- 10 CLG has announced the establishment of a Policy Review Group to assist in the on-going stewardship of the Scheme's regulatory and policy development. The Group's membership is drawn from all Scheme interests and the Group will "focus on strategic issues, establish common ground between stakeholders and monitor closely longevity trends ill-health and flexible retirement trends and other

demographic experiences in the Scheme as a basis for co-operative decision-making on Scheme developments, considering proposed regulatory changes to the Scheme's legal framework and developing essential cost-sharing requirements." One of its initial tasks will be to develop a cost-sharing mechanism by 31 March 2009 – this will be a mechanism whereby certain future increases in pension costs will be shared between employer and members – for example a future improvement in longevity above current expectations could result in an increase in member contributions as well as an increase in employer rates.

Conclusion

11 Members are asked to note this report.

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Dear Colleague

**THE LOCAL GOVERNMENT PENSION SCHEME (BENEFITS,
MEMBERSHIP AND CONTRIBUTIONS) REGULATIONS 2007.**

With the agreement of Ministers, I enclose Regulations made on 3 April under powers contained in sections 7 and 12 of the Superannuation Act 1972 and laid before Parliament on 4 April. The regulations amend the Local Government Pension Scheme Regulations 1997 (the "1997 Regulations") with effective dates as set out in regulation 1. These regulations deal specifically with rights accruing and benefits based on membership from 1 April 2008 and events linked to that membership which subsequently occur.

Background

The basis of the Government's reforms for the Scheme were initially announced on 23 November 2006 in a written Ministerial statement to Parliament. It emphasised that the long-term policy objective for the Scheme reforms should be affordable, viable and fair to taxpayers. The key intention throughout this reform process has been to ensure that no additional costs are imposed on taxpayers who ultimately guarantee its security.

The statement also emphasised the central importance of the reforms having to meet the challenge of being attractive to existing and future employees, and to their employers, both in and around local government in England and Wales. Flexibility and accessibility are seen as important components, as is the need to provide a range of modern, equality-proofed, defined benefits. However, central to the reform process has been, and will continue to be, the objective of ensuring an equitable and proportionate balance between the actual level of pension benefits provided by the Scheme for its members, and the costs of providing those benefits incurred by employers.

Draft amending regulations, to give effect to the 23 November statement, were circulated to Scheme interests in England and Wales on 22 December 2006. The consultation period closed on 28 February 2007. The assessment of the responses indicated broad support for the vast majority of the proposals. A summary of responses can be found on the LGPS website at www.communities.gov.uk/lgps. The consultation period provided the opportunity for interested parties to discuss several detailed areas which required clarification and adjustment, within the required cost envelope for the new Scheme, in order to fulfil the key policy objectives for reform outlined above.

The 2008 Local Government Pension Scheme

The principal features of the new Scheme, to be effective from 1 April 2008 (annex A sets out the full package), include:-

- The retention of a guaranteed, final salary pension scheme;
- A 1/60th accrual rate for **all** new and existing and members, including those with a rule of 85 protection;
- Flexible retirement provisions;
- Improved death-in-service terms;
- The ability for members to commute part of their pension into a lump sum;
- Retention of provision for early payment of pension in cases of redundancy at certain ages;
- Better targeted ill health provisions;
- Introduction of tiered employee contribution rates to benefit the low paid and to assist in equality proofing the Scheme;
- Extension of partners' pensions;
- Retention of AVC rights;
- Averaging of employees' contributions yield at 6.3% of payroll (up from 5.8% in the existing Scheme);
- Average employers' costs for existing members and new entrants is 13.1% of payroll.

New arrangements for employees, whose contributions will yield on average 6.3% of pensionable pay, are in the package. By linking pay to the rate of contribution payable, members from 1 April 2008 will contribute 5.5% of annual pay of the first £12,000 of salary and 7.5% on any excess. Bandings above £12,000 will ensure an equitable level of graded contributions, linked to pay. The contribution rates and bands are based on whole time equivalent pay levels. The arrangements help considerably to equality-proof the new Scheme and have been welcomed because they focus favourably on part-time, low-paid workers, mostly female, who form a highly significant proportion of the Scheme's current and likely future membership. Higher earners will contribute proportionately more in their contributions under the terms of the bandings set out in the regulations. The transitional position of current members who pay contributions at the rate of 5% of pensionable pay are to

be dealt with on a phased basis and will be set out in related but separate provisions, described in Annex C, on which consultations will begin shortly.

Ill-health provisions in the regulations provide new levels of protection for eligible Scheme members. Those who are totally incapacitated will receive their accrued pension entitlements plus a service enhancement of all their prospective membership to their normal retirement rate, and those with a lower level of incapacity will receive 25% of that prospective membership along with their accrual pension entitlements. For other cases, if a scheme member leaves employment because they are assessed by an occupational health doctor to be permanently incapable of their current job but medical evidence indicates that alternative gainful employment could be obtained within a reasonable period of leaving, an employer is to be provided with the appropriate powers to pay a benefit at an accrued membership equivalence for the interim. These payments would need to be subject to review as they could not continue if alternative employment is found. Costs arising from these payments would fall to employers' revenue accounts and not, as in the other levels where membership is enhanced, to the appropriate pension fund. Draft regulations to give effect to this new arrangement will be circulated shortly to stakeholders for comment.

Equality-proofing

The regulations comply fully with the necessary gender equality requirements which come into force on 6 April for all public bodies. They also meet appropriate race equality and health impact assessments. The successful provision of equality-proofed regulations for the new-look LGPS is a critical policy success of the reform programme.

Benchmark costs

The final benefit package has been revised since the December statutory consultation proposals. Adjustments to the benchmark costs have had, first, to deal with a technical re-balancing between current and future members, and second, to deal with issues raised, discussed and subsequently amended as a result of the consultation process with stakeholders. The consultation package was provided on the basis of the cost-envelope made up of an employee contribution yield of 6.3% of pay, plus an employer benchmark cost of 13.2% of payroll. The final package, set out in the regulations, has been adjusted marginally so that the total benchmark cost for existing members is 20.6% (less 6.3%) and 18.2% (less 6.3%) for future members. This provides employer benchmark costs of 14.3% and 11.9% respectively, or an average at 13.1% of payroll.

The reason for the revision is due entirely to the decision to restructure the ill-health provision in the new Scheme from three levels to two levels. A third level of benefit is now to be provided by employers, paying from their revenue budgets, rather than through pension funds. In essence, the equivalent sum totals are the same, although they are now differently disposed among employers.

Scheme Governance

To assist in the on-going stewardship of the Scheme's regulatory and policy development, a Policy Review Group of key stakeholders is being established. Its membership is drawn from all Scheme interests and has been approved by the Minister Phil Woolas. The Group will focus on strategic issues, establish common ground between stakeholders and monitor closely longevity trends ill-health and flexible retirement trends and other demographic experiences in the Scheme as a basis for co-operative decision-making on Scheme developments, considering proposed regulatory changes to the Scheme's legal framework and developing essential cost-sharing requirements.

The establishment of the Policy Review Group is a major step forward and a genuine measure to enhance the governance of the Scheme by involving key stakeholders in a constructive forum about its future. Its constituent membership is being announced today and the organisations who have been invited to be represented on it are listed in Annex B. Arrangements have been made for a first meeting in early May.

The Group's most immediate task will be to develop, with the full involvement of the LGA, other employers and trades unions, a shared approach towards meeting the new Scheme's future service costs and so limiting employers' and taxpayers' liabilities for the future. Regulation 40 includes a requirement that guidance be issued by the Secretary of State by 31 March 2009 regarding the handling of future costs. Efforts take this forward will feature prominently as the Group's work programme develops. The outcomes of the Scheme's 2007 valuation exercise will provide a benchmark for more immediate cost experience, which in turn will be reflected in subsequent cost-sharing arrangements.

The work of the Group will be reported regularly to Ministers. It will complement the extensive statutory and non-statutory consultation arrangements which already exist within the current framework of the Scheme. Other working groups associated with CLG's responsibilities for the LGPS will continue and, where appropriate, their findings can inform the Group.

Conclusion

The reform package, as a whole, is workable and affordable. It recognises the importance of delivering pension reforms and, at the same time, recognises the need to protect providers and taxpayers from increases in future costs. It positively addresses the balance of responses received from stakeholders to recent consultation exercises. It delivers the Government's policy objectives for the Scheme's reform, particularly in terms of equality-proofing, viability, affordability and fairness to taxpayers, and provides good quality, secure pensions for eligible workers in and around local government in England and Wales.

Transitional protections

Annex C sets out the provisional items so far identified which CLG intends should be included in addressing transitional protections. A consultation exercise will begin shortly.

Local Government Pension Scheme (Amendment) Regulation 2007

Scheme interests will be aware of recent consultations on draft regulations about the administration aspects of the new Scheme. Their closing dates for consultation responses was 23 March. An update on the progress towards introducing final provisions will be issued shortly. The current intention is to bring the final regulations forward next month.

Contacts

The LGPS website is located at www.communities.gov.uk/lgps.

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Yours sincerely

T B J Crossley

ANNEX A

LGPS BENEFIT PACKAGE

The main benefits of the new-look Local Government Pension Scheme are set out below:

- Normal Retirement Age (NRA) of 65 for release of unreduced benefit
- Pension to be indexed in line with the Retail Price Index and must come into payment before the 75th birthday
- Earliest age for release of pension is 55 by 2010 for current members except on grounds of ill-health
- Early release from age 55 on grounds of redundancy or business efficiency and on objective justification basis
- Augmentation of membership/benefits
- Final Salary Pension based on 1/60th of salary for each year of pensionable service, with the flexible option to commute pension at the rate of £1 of annual pension for £12 of lump sum up to a maximum tax free lump sum of 25% of capital value of accrued benefit rights at date of retirement
- The best actual pensionable pay in the last three years or an averaging of 3 years (financial) within the last ten before early retirement
- Survivor benefits for life, payable to spouses, civil partners and “nominated” dependant partners (opposite and same sex) at a 1/160th accrual rate
- Survivor benefits payable to children, and the accrual rates vary relative to status
- Revised permanent ill-health retirement package with no review system within the Scheme – two levels with a higher enhancement of benefits for total incapacity; 25% (with degree of protection) enhancement with prospect of return to gainful employment
- A death-in-service tax-free lump sum of 3 times salary
- Post-retirement lump sum death benefit up to a maximum of 10 years before age 75
- Phased retirement arrangements that would enable LGPS members under specified circumstances to draw down some or all of their accrued pension rights from the scheme while still continuing to work
- Actuarial enhancement for those who continue in work beyond NRA 65 without accessing their pension benefits
- Tiered employee contribution rates with 5.5% payable on the first £12,000 of pensionable pay, and 7.5% paid on the excess over £12,000 to be increased in line with RPI
- A facility to purchase up to £5,000 of added annual pension
- Facility to contribute to AVC arrangements in conjunction with an external provider

ANNEX B

LOCAL GOVERNMENT PENSION SCHEME

POLICY REVIEW GROUP

Representative Organisations

Society of County Treasurers

Association of Consulting Actuaries
(Local Government Sub-Committee)

Society of London Treasurers

Society of Metropolitan Treasurers

UNISON

GMB

TGWU

Universities and Colleges Employers Association (UCEA)

Association of Colleges (AOC)

Environment Agency

Association of Professionals in Education and Children's Trusts (ASPECT)

Society of Local Authority Chief Executives (SOLACE)

Public Sector People Managers Association (PPMA)

Welsh Assembly

Local Government Employers

Local Government Association

**Communities and Local Government
April 2007**

ANNEX C

Transitional Arrangements

Following the introduction of the new LGPS Benefit provisions we will shortly carry out a brief consultation exercise which will confirm the process of closing off the 1997 Regulations. None of the rights, qualifying conditions or processes linked to service and membership up to and including 31 March 2008 will be lessened in any way by these particular provisions. Nor can there be any substantive changes to those provisions dealing with pension sharing on divorce. The finalised SI will either be in the form of a stand alone instrument or inserted as a transitional schedule to the regulations.

As previously advised to pension fund administrators it will need to cover the following issues

- i. For a member who was an active member on 31 March 2008 who continues to be a member by virtue of regulation 2, all membership accrued on a 1/80th and 3/80th basis under the 1997 Regulations up to that date will be calculated using final salary on leaving with or without immediate entitlement to pension or where a flexible retirement occurs.
- ii. The old provisions defining pay which have not been replicated in the 2007 Regulations will be protected and continue for those affected individuals under the 2008 regime;
- iii. A member who joins the LGPS on or after 1 April 2008 with preserved rights under the 1997 Regs which have not come into payment will be treated as if regulation (2) and (i) above applied. Such a member must make an choice within 12 months of rejoining in order to qualify.
- iv. Subsequent to the separate calculation of benefits under above regulations 6, 10, 11, 12 and 16 of the 2007 Regulations the two amounts shall be added and treated as a single BCE for the purpose of calculating benefits under 13 and 14.
- v. Retaining the facility to pay the lump sum death benefit to a deferred member for pre 2008 membership, this is to be paid along with any lump sum payable under regulation 17.
- vi. In the case of survivor benefits as well as rights accruing under these regulations, and to be paid under regulation 20 or 21, in the case of survivor continue the provision that only membership between 1988 and 2008 counts for calculating that part of the pension for civil registered or cohabiting partners.
- vii. Consider in connection with (vi), whether a provision be inserted which allows reduction in pre 2008 membership or payment for this period for those wishing to count pre-1988 membership.

- viii. In the case of deferred member, continue right of child of such a member to receive survivor pension under 1997 Regulations.
- ix. In the case of a pensioner at 1 April 2008, continue right to pay survivor benefits as under the 1997 Regulations.
- x. Continue to commute trivial pensions as accrued under 1997 Regulations.
- xi. Added years contracts entered into before 31 March 2008 will be honoured and will be credited as pre- 2008 membership.
- xii. Any augmented membership awarded under the 1997 Regulations will be credited as pre-2008 membership.
- xiii. Continuous membership before 1 April 2008 will count towards the 3 month qualifying condition if 1997 qualifying condition is not completed as at 31 March 2008.
- xiv. The schedule to SI 2006/966, which deals with protection linked to the removal of the rule of 85, will continue to apply irrespective of different accrual rates, as will the guidance issued by GAD.
- xv. A phasing of increases to the 5% contribution rate of pre-1998 manual workers, bringing their contributions in line with all other Scheme members after the 2010 actuarial valuation and with effect from 1 April 2011. To achieve this, it is proposed that the phased rates will be 5%/6.5% in 2008/09; 5%/7.5% in 2009/10; 5.25/7.5% in 2010/11.

It is CLG's intention that where a person was a deferred member on 31.3.08, returns post 1.4.08. and aggregates membership (see (iii) above, or was an active member on 31.3.08., leaves post 1.4.08. and subsequently rejoins and aggregates then there is no justification to treat them differently. The same would need to be replicated under the current LGPS Regulations

It is not CLG's current intention to proceed with modifications dealing with elected members. Rather than transposing the extant provisions of Schedule 8 of the LGPS Regulations 1997, this provides the opportunity to recast the provisions relating to a CARE scheme with a 1/60th accrual and indexed at RPI plus 1.5%.