Agenda Item No. 6

Pension Fund Committee

30 July 2007

Rule of 85 Protections

Report of Stuart Crowe, County Treasurer

Purpose of the Report

1 The purpose of the report is to advise Members of a consultation exercise on the detail of early retirement provisions within the Local Government Pension Scheme (LGPS)

Background

2 The LGPS has a normal retirement age of 65 which means that benefits drawn earlier than that age are usually reduced to take account of early payment. The ‘rule of 85’ was a feature of the LGPS which meant that no early retirement reductions would apply if an individual’s age plus service (both in whole years) added up to at least 85.

3 The rule of 85 was removed from the LGPS regulations with effect from 1 October 2006 but certain protections have been put in place for existing LGPS members, these protections are currently as follows:

- i) all members of the LGPS on 1 October 2006 will continue to build up membership under rule of 85 terms until 31 March 2008
- ii) if a qualifying member (someone who was an active LGPS member as at 1 October 2006) is 60 by 31 March 2016 and would have satisfied the rule of 85, no actuarial reduction will apply should they choose to retire at the age they satisfy the rule of 85; and
- iii) if a qualifying member is 60 between 1 April 2016 and 31 March 2020 and would have satisfied the rule of 85, if they choose to retire at the age they satisfy the rule of 85, an actuarial reduction will apply on a tapered basis on all service earned from 1 April 2008.

4 Communities and Local Government (CLG) have started a consultation on a formal proposal to extend the protections against the removal of the rule of 85 to give full protection to any qualifying member who is 60 by 31 March 2020. A copy of the consultation letter is included at Appendix 1. The proposal specifies that this extension of protections should be at no net cost to the LGPS and so should be balanced by either reductions in benefits elsewhere or increases in employee contributions.

5 CLG has asked for a response to the consultation by 1 October 2007.

Implications of extending the protections

6 The Government Actuary's Department (GAD) has estimated that nationally, the cost of removing the current tapered protection and replacing it with full protection for those who are 60 between 1 April 2016 and 31 March 2020 is around 0.1% of payroll or £25m a year for 20 years. This suggests that one way of paying for this improved protection would be to increase employee contribution rates by 0.1%. Employee contribution rates are changing anyway as a result of the introduction of the new-look scheme from 1 April 2008 so it would be relatively straightforward to include this additional increase within the new rates. Alternatively, the proposed benefits from the new-look scheme could be adjusted to take account of this additional cost – for example the improvements to death benefits could be reduced.

7 There are obvious problems with increasing contributions or reducing benefits for everyone in return for improved protections which will only benefit a small proportion of scheme members. Within the Durham Fund only around 8% of current members would potentially benefit from the proposed improved protections. Although final salary pension schemes have built into them a degree of cross-subsidy between classes of members, asking all members to pay for something that will only benefit around 1 in 12 members would be controversial.

8 The current protections include a degree of tapering. This means that the level of protection currently offered to those aged 60 between 1 April 2016 and 31 March 2020 gradually reduces with younger members being offered steadily less protection against the removal of the rule of 85. Extending the protections to give full protection to those aged 60 by 31 March 2020 could cause problems by introducing a 'cliff edge' whereby a scheme member born on 31 March 1960 would be fully protected from the removal of the rule of 85 but someone born the next day would have full reductions applied to any service they had from 1 April 2008 onwards. This could mean an individual retiring at 60 with 25 years service getting a pension 13% lower than if they had been born a day earlier.

9 One alternative way of extending the protections would be to provide a lesser degree of tapered protection to more people. So for example instead of just giving tapered protection to those aged 60 between 1 April 2016 and 31 March 2020, tapered protection could be given to those aged 60 up to 31 March 2024. However, to make this cost-neutral the level of protection would have to be adjusted resulting in a lower level of protection to those currently covered by the tapered protections.

Recommendation

10 Members are asked to authorise me to consider, in consultation with the Chairman and Vice-Chairman, what response to make to the consultation on behalf of Durham County Council as the administering authority of the Fund, taking into account the issues highlighted in this report. I will also consult with representatives from the HR Committee to consider producing a response on behalf of Durham County Council as a Scheme employer as well.

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Appendix A

Communities and Local Government

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TO: LOCAL GOVERNMENT PENSION SCHEME INTERESTS IN ENGLAND AND WALES

5 July 2007

LOCAL GOVERNMENT PENSION SCHEME
RULE OF 85 PROTECTIONS

With the agreement of Ministers, I am writing to invite your comments on the terms of a formal proposal to extend the current protections in England and Wales provided in the Local Government Pension Scheme (LGPS) within the existing cost envelope of the Scheme. This would affect older Scheme members following the removal of the rule of 85 with effect from 1 October 2006, providing certain statutory conditions are met. Responses **are requested please by Monday 1 October.**

Policy context

As explained in the Ministerial Written Statement to Parliament on 15 June, this statutory consultation exercise takes place following the recently concluded informal consultation with Scheme interests between 16 May and 13 June. Ministers were grateful for the range of responses provided and wish it to be known that they intend to take further account of those responses as part of this exercise when it concludes.

Those responses build helpfully on the representations made previously on this matter and provide support now for a further assessment of the current levels of protection in the Scheme which apply between 2016 and 2020 and a specific proposal to provide full protection to 2020.

Ministers believe that this formal consultation, for a full twelve weeks, will provide an extended opportunity for Scheme stakeholders to consider the terms of a set of specific propositions outlined below. This has to be done within the clear policy context that the full costs of implementing any benefit changes which would involve an extension of the current level of rule of 85 protections, can only be provided from within the Scheme's **existing** cost-envelope. The department's letter of 4 April explains that this amounts to 19.4% of payroll for future LGPS service only and is formed of a yield of 6.3% of pay from employees, plus 13.1% of payroll from Scheme employers.

Appendix A

Existing protections

Following the final removal of the rule of 85 from the LGPS with effect from 1 October 2006, the present protections, which then came into force, currently provide that: -

(i) all members of the Scheme on 1 October will continue to accrue membership under rule of 85 terms until 31 March 2008;

(ii) if a qualifying member is 60 by 31 March 2016 and would have satisfied the rule of 85, no actuarial reduction will apply should he choose to retire at the age at which he satisfies the rule of 85; and

(iii) if a qualifying member is 60, would have satisfied the rule of 85 between 1 April 2016 and 31 March 2020 and chooses to retire at the age at which he satisfies the rule of 85, an actuarial reduction will apply on a tapered basis, with effect from 1 April 2008.

Cost estimates

The Government Actuary's Department has estimated that the capital cost of removing the current level of tapered protections between 2016 and 2020 is some £0.35 billion - £0.4 billion. GAD further estimates that, in payroll terms, this figure equates to some 0.1% of payroll, or in total about £25 million annually, for 20 years.

Responses to the recent informal consultation exercise have verified that order of magnitude, with some variations associated with the number of Scheme members in the local workforce able to qualify, and their specific age and service characteristics. For example, one LGPS administering authority estimated £730,000 as the cost of change, while two others, with smaller workforces and varying membership demographics, estimated £330,000 and £210,000 respectively.

The basis upon which the Statement was made to the House of Commons regarding the affordability of any uprated level of protection is well established. The Government's intention remains to ensure that no additional costs arising from LGPS reforms or amendments are imposed on taxpayers, or employers. This objective is central to any considerations surrounding amendments to the Scheme's regulatory framework and is reinforced by the Government's intention only to consider amendments from within the established Scheme cost-envelope.

To ensure the continuing solvency of the Scheme, therefore, and to meet the Government's longstanding policy on affordability, the costs of implementing any amendments to improve the level of protections need to be provided from within the Scheme. Adjusting assumptions or forecasts of data change would not be regarded as satisfactory ways to deal with the costs incurred of introducing this benefit improvement. Instead, there needs to be an explicit adjustment, within the Scheme's cost-envelope, to directly meet the cost of the new benefit.

Consultees will wish to note that Ministers have confirmed that, if no statutory and agreed means of providing the necessary resources to extend the proposed level of protection emerge from this consultation exercise, the present level of tapered protections, set out in the Local Government Pension Scheme (Amendment) (No.2) Regulations 2006, will remain.

Appendix A

Specific proposals

Consultees are invited to consider their response to the elements of a possible future Scheme amendment which would involve

(i) an amendment to the Schedule to the Local Government Pension Scheme (Amendment) Regulations 2006 (Transitional provisions and savings) as follows: for "2016" in paragraph 2, in both places where it occurs, substitute "2020"; and

(ii) a deletion of paragraph 6 in the Schedule; and

(iii) the introduction of further, specific regulatory amendments to ensure that the terms of the Government's Statement of 15 June regarding affordability and the cost-envelope limit are fully met.

Considerations for consultees

Ministers' policy remains that any changes to the present level of Scheme protections can only occur on the basis of legality and affordability. The terms of the recent Statement made in Parliament on 15 June confirm that position for this current consultation exercise.

Consultees in their responses are invited to focus on whether there are employment policy or labour market objectives which could be applied in order to objectively and reasonably justify an extension of the current standard of protections. In considering the standard of objective evidence around these issues, consultees are encouraged to comment on and, where possible, provide actual incidences of issues arising from cross-border transfers of staff if no change occurs, and if any retention of staff concerns arise as a consequence in England and/or Wales. Comments are invited also on what would be the future consequences for labour relations if the existing level of protection was retained.

Consultees to express a preference for a specific way of offsetting the costs of extending transitional protection, if they wish to support such an extension. This means considering whether, for example, if increases in employee contributions, or further amendments, to reduce a specific element of the new 2008 benefit structure to provide a saving could be applied to produce the necessary offset. Alternatively, some other Scheme change could be provided, but from within the existing Scheme regulatory framework, to expressly offset the specific additional costs arising to pay for the improved protections, as estimated by the Government Actuary's Department.

Consultees are invited also to address the equity arguments, raised by some consultees in their responses to the recent informal consultation exercise where it was pointed out that the improvements being considered for what appears to be a minority of Scheme members, could only be achieved if the full Scheme membership either paid higher contributions, or had the terms of the new 2008 benefit package reduced for all members in order to provide affordable and improved levels of protection for a specific group.

Consultees are invited finally to consider how the membership at large is affected (or not) by the creation if a cliff-edge at 2020? For example, what would be the local consequences of taking away the equity-basis of the 2016-2020 taper? Would a full 2020 protection standard be beneficial? In addition, local authority and other employers may be in a position to provide data on the numbers of Scheme members who would benefit from a move to full protection in 2020, and to show how this number sits in proportion to the rest of the local workforce membership.

Next steps

Your responses to this consultation exercise are requested **no later than 1 October 2007** and should be sent to:-

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Zone 2/F7 Ashdown House
123 Victoria Street
London SW1E 6DE

or e-mailed to nicola.rochester@communities.gsi.gov.uk

A summary of responses to this consultation will be published within 3 months of the close of consultation at www.xoq83.dial.pipex.com.

Information about the Government's code of practice on consultations is at Annex A.

TBJ Crossley

Appendix A
ANNEX A

Government Code of Practice on Consultations

This consultation follows the Government code of practice on consultations, which is attached.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a Statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, in itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

As there are intended to be no direct financial implications arising from these amendments, or impacts on business, charities or the voluntary sector, a Regulatory Impact Assessment has not yet been prepared. In due course, once the outcome of the consultation exercise has been assessed, and Assessment may need to be prepared.

Appendix A

ADDRESSEES

The Chief Executive of:

- County Councils (England)
- District Councils (England)
- Metropolitan Borough Councils (England)
- Unitary Councils (England)
- County and County Borough Councils in Wales
- London Borough Councils
- South Yorkshire Pensions Authority
- Tameside Metropolitan Borough Council
- Wirral Metropolitan Borough Council
- City of Bradford Metropolitan District Council
- South Tyneside Metropolitan Borough Council
- Wolverhampton City Council
- London Pension Fund Authority
- Environment Agency
- Police Authorities in England and Wales
- Fire and Rescue Authorities in England and Wales.
- National Probation Service for England and Wales

Town Clerk, City of London Corporation
Clerk, South Yorkshire PTA
Clerk, West Midlands PTA

The Secretaries of:

- Local Government Association
- LGPC
- Employers' Organisation for Local Government (LGE)
- PPMA
- SOLACE
- ALACE
- CIPFA
- New Towns Pension Fund
- ALAMA
- UCEA
- NALC
- SLCC
- Society of County Treasurers
- Society of District Council Treasurers
- Society of Welsh Treasurers
- Association of Metropolitan Treasurers
- Society of London Treasurers
- Association of Consulting Actuaries
- Northern Ireland Public Service Alliance

Trades Union Congress
UNISON
UNITE
GMB
UCATT
Aspect
NAPO
Association of Educational Psychologists
Audit Commission
Other Government Departments with public service pension interests:
GAD
DoE (NI)
SPPA