Agenda Item No. 8

Pension Fund Committee

28 January 2008

Rule of 85 Protections - Update

Report of Stuart Crowe, County Treasurer

Purpose of the Report

1 The purpose of the report is to advise Members of the latest position in the Government's consultation on extending the 'rule of 85' protections.

Background

2 The 'rule of 85' is the feature of the Local Government Pension Scheme (LGPS) that allowed those retiring before age 65 whose age plus service (both in whole years) equalled at least 85 to have no early retirement reductions applied to their benefits on retirement.

3 The 'rule of 85' has been removed for all new entrants to the LGPS from 1 October 2006 and will not apply for service after 31 March 2008 for other active members.

4 However, there are protections in place to ensure that those nearing retirement do not suffer too harsh a reduction to their expected retirement benefits. The current protections mean anyone who is aged 60 before 1 April 2016 will be protected against the removal of the 'rule of 85' and anyone who is aged 60 after 31 March 2016 and before 1 April 2020 will have a degree of protection against the removal of the 'rule of 85' (known as 'tapered protection').

Ongoing Consultation

5 Communities and Local Government (CLG) issued a consultation document asking for views on replacing the 'tapered protection with an extension to the full protection against the removal of the 'rule of 85' to cover all members who are 60 before 1 April 2020. The consultation document was issued in July 2007 and responses were asked for by 1 October 2007. A copy of the Council's response is included at Appendix A.

6 CLG issued a letter in December 2007 enclosing a copy of a statement from the Minister for Local Government announcing that he had taken

"no final decision on the outcome of the statutory consultation exercise". The letter and statement are included at Appendix B.

7. CLG has committed to undertake a fresh costings exercise (with the help of the Government Actuary's Department) using emerging data from the 2007 LGPS actuarial valuations. The Minister's statement concludes "This will allow a new assessment of the current cost position and also provide an opportunity for all the interested stakeholders to engage fully in the review process. The exercise for updating of costs is expected to be completed early in the New Year. A final decision on the proposed amendment and within the policy parameters of affordability and legality will then be made, taking full account of any further representations which may be made by stakeholders."

Next steps

8. CLG approached the Council on 21 January to ask for permission to view valuation data previously supplied to the Scheme Actuary. I have granted this request.

9. Members will be advised of the outcome of the consultation and the probable impact on the Fund in due course.

Recommendation

10. Members are asked to note this report.

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Appendix A

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Nick Orton

Ms N Rochester
CLG

By email

28 September 2007

Dear Ms Rochester

Local Government Pension Scheme – Rule of 85 Protections
Consultation response on behalf of Durham County Council

I am writing in response to Mr Crossley's letter dated 5 July 2007, which asked for comments on a formal proposal to extend the current protections against the removal of the 'rule of 85' from the Local Government Pension Scheme (LGPS). We welcome the opportunity to comment on this proposal.

Durham County Council is the largest local authority in the North East of England with a population of 499,800. It is also a major employer within the Local Government Pension Scheme with over 10,000 current employees contributing to the Scheme. The Council also has a key role to play as an administering authority within the Local Government Pension Scheme and is responsible for the administration (including investments) of the Durham County Council Pension Fund.

Please find enclosed a response sent on behalf of Durham County Council both as an employer and as an administering authority within the Scheme.

I hope this is useful, please contact me if you need to discuss any of the issues raised in this response.

Yours sincerely

Nick Orton
Head of Pensions

Local Government Pension Scheme – Rule of 85 Protections

Consultation Response from Durham County Council as an Administering Authority and as an Employer within the Durham County Council Pension Fund.

Background

The normal retirement age in the Local Government Pension Scheme (LGPS) is age 65. Anyone retiring from the LGPS before age 65 (except on ill-health, redundancy or efficiency grounds) has their benefits reduced to take account of the fact they are being paid early. Until recently no benefit reduction would apply if the individual met the ‘rule of 85’, that is their age plus service (both in whole years) added up to at least 85.

The ‘rule of 85’ was removed from the LGPS with effect from 1 October 2006 for any new entrants to the scheme on or after that date. Existing members have certain protections against the removal of the ‘rule of 85’:

(i) all members of LGPS 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.

The proposal

The proposal being consulted on is to extend the full protection provided against the removal of the ‘rule of 85’ so that all qualifying members who are aged 60 by 31 March 2020 will have no actuarial reduction applied should they choose to retire at the age they satisfy the ‘rule of 85’. There would be no tapered reduction applying for those aged 60 after 31 March 2020. Under the terms of the proposal there also needs to be an explicit adjustment made to the Scheme to directly meet the cost of the extended protections.

Durham County Council’s response

Durham County Council does not support the proposal to extend the existing protections for the following reasons:

Fairness – cross-subsidy:

Extending the protections initially appears an attractive option as it would improve the benefits offered to members. However, the number of members affected would be comparatively small. In the Durham County Council Pension Fund only around 8% of the current active membership could potentially benefit from this improvement. The proportion that actually would benefit if the proposal was carried out is likely to be lower still as some of these individuals may be eventually work to age 65 anyway.

Within the parameters set out in the consultation, in order to meet the cost of the improvement without increasing the cost to the employers (and hence taxpayers), either employee contributions would have to increase or future benefit accrual would have to be reduced in some way. Whilst recognising that a certain level of cross-subsidy is a feature of defined benefit pension schemes, this usually relates to members accessing benefits as a result of circumstances that could potentially affect any member (such as death in service or ill-health benefits). With this proposal the proposed improvement can only ever benefit around 8% of the members. It is not equitable to ask 100% of the active members to pay for an improvement that only around 1 in 12 of them could ever benefit from.

Fairness: need to avoid 'cliff edge'

Extending the 'full' protection would remove the existing tapering arrangement. This was introduced to ensure there was not a 'cliff edge' whereby an individual born one day would be fully protected but someone born the next day would have no protections. If this proposal was carried out the 'cliff edge' would be reintroduced and, for example, someone retiring at age 60 with 25 years service on 1 April 2020 would get a pension 13% lower than they had been born (and retired) a day earlier. This is inequitable and harder to justify than the existing tapering arrangement.

Existing position broadly accepted (and understood) by membership

The consultation also asked for consideration of how retaining the existing protections would impact on labour relations. The existing protections have been in place for some time now and have been publicised to our membership through a recent pensions newsletter. There is now recognition that the 'rule of 85' is being removed from the scheme from April next year and an understanding of who is protected against its removal. If the current protections remain in place, whilst there may be disappointment amongst the 8% of members who would benefit from an extension to the protections, this will not cause widespread unrest. Recruitment and retention should not be affected.

Appendix B

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T B J Crossley
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13 December 2007

TO: LOCAL GOVERNMENT PENSION SCHEME INTERESTS IN ENGLAND AND WALES

LOCAL GOVERNMENT PENSION SCHEME
RULE OF 85 EXTENDED PROTECTIONS

With the agreement of Ministers, I am writing to advise Local Government Pension Scheme (LGPS) interests in England and Wales of the position about proposals to extend the protections in the Scheme involving the rule of 85, following the statutory exercise conducted between 5 July and 1 October 2007.

The responses to the consultation exercise have been considered carefully by Ministers and the wide range of comments received has been analysed against the criteria set out in the department's consultation letter of 5 July 2007. A summary of the responses received so far will be placed on the department's website as soon as possible.

The principles underlying the statutory consultation exercise were set out in the department's letter of 5 July, and those particularly relating to affordability were based on costed estimates provided by the Government's Actuary Department (GAD) which in turn were sourced on data extracted from the 2004 LGPS actuarial valuation exercise.

In terms of affordability, the consultation letter indicated that the capital cost of removing the current level of tapered protections between 2016 and 2020 was some £0.35 billion - £0.4 billion. In payroll terms, this figure equates to some 0.1% of payroll or, in total, about £25 million annually, for 20 years. Responses to recent consultation exercises have broadly confirmed that order of magnitude, with some local variations associated with the number of Scheme members in the workforce able to qualify, and their specific age and service characteristics.

It was made clear also, as an integral part of the consultation package, to comply with the well-established principles regarding the Government's position to ensure that no additional costs arising from Scheme reforms or amendments should pass on to taxpayers and that the costs of implementing any amendments to improve the current level of protections needed to be provided from within the Scheme and its existing cost-envelope. It was also emphasised that adjusting assumptions, or forecasts of data change, would not be regarded as satisfactory ways to deal with the costs incurred of introducing the rule of 85 additional protection benefit, as this could be seen as foregoing a saving which would otherwise be available to employers.

No final or immediate decision has yet been made by Ministers regarding the outcome of the statutory consultation exercise. Their intention, as confirmed by John Healey in a Ministerial Written Statement to Parliament on 13 December, is to consider a fresh assessment of costs and experience, using the 2007 actuarial valuation data, which will shortly start to become available, and to take into account any other relevant information and experience which emerge from that process.

Ministers are aware from the responses to the consultation exercise and other sources that there are strong views among stakeholders about the rule of 85 and its associated protections, and its affordability. If interested parties now wish to make any further representations, at the same time as the assessment work is undertaken, they are invited to contact the department in the usual way.

Ministers have requested, to take the new assessment forward, that the LGPS Policy Review Group, involving the Government Actuary's Department, the Association of Consulting Actuaries, the LGA / LGE and trades union interests are invited to assist in the consideration of fresh data from the 2007 valuation Ministers have requested that the results of the exercise should be available as soon as possible in the new year. The necessary arrangements for an initial meeting of stakeholders, in January, are now being made.

T B J Crossley

Written Ministerial Statement

COMMUNITIES AND LOCAL GOVERNMENT

Local Government Pension Scheme

The Minister for Local Government (Mr. John Healey): The Government's commitment to provide decent final salary pensions for those employed by local authorities and other organisations associated with local government is matched by the need to ensure that Members' pensions are secure, affordable and viable, and fair to taxpayers who guarantee their security.

The Government see it as critical to maintain stability of costs in the Scheme over the years ahead, particularly in the new-look Local Government Pension Scheme (LGPS) in England and Wales from 1 April 2008. The intention remains to ensure that no additional costs are imposed on taxpayers or employers. This objective is central to any considerations involving amendments to the Scheme's regulatory framework.

A statutory consultation with all Scheme stakeholders in England and Wales on proposals to extend the current levels of protection in the Scheme for older employees began on 5 July 2007 and ended on 1 October 2007. The protections were originally introduced by the local Government Pension Scheme (Amendment) and (Amendment No. 2) Regulations 2006 and took effect from 1 October 2006. The draft proposals would involve amending the regulations to provide a full, rather than a tapered, protection for the period 2016 to 2020, together with appropriate offsetting savings for the estimated cost of this benefit improvement.

To ensure the continuing solvency of the Scheme and to meet the Government's standing policy on ensuring no adverse effects on taxpayers, the costs of implementing any Scheme amendments to improve the level of protections would need to be provided from within the Scheme.

The costings for the additional rule of 85 protections were provided by the Government Actuary's Department (GAD), based on the data provided for the 2004 LGPS actuarial valuation exercise. GAD estimated that the capital cost of removing the current tapered protections between 2016 and 2020 was some £0.35 billion - £0.4 billion. In payroll terms, this equates to about 0.1% or some £25 million annually for 20 years.

If no agreed means of providing the necessary resources to extend the proposed level of protection emerge from the consultation, then it will be necessary to retain the present level of protection.

The responses received to the recent consultation exercise have been considered carefully and analysed against agreed criteria regarding affordability and legality, as set out in the department's consultation letter of 5 July.

The consultation has demonstrated strong views from all stakeholders in terms both of the level of protections and affordability. I wish, however, to be clear about the most recent position in the Scheme regarding costs, the likely numbers of potentially affected older Scheme members, and the range of other cost-influencing variables.

In the light of these representations, I have taken no final decision on the outcome of the statutory consultation exercise and, in view of the data from the 2007 LGPS actuarial valuations which are due to become available early in the New Year, I have decided to ask the Local Government Pension Scheme Policy Review Group, with the assistance of GAD, to undertake a fresh costings exercise using emerging data from the 2007 LGPS actuarial valuations. This will allow a new assessment of the current cost position and also provide an opportunity for all the interested stakeholders to engage fully in the review process.

The exercise for updating of costs is expected to be completed early in the New Year. A final decision on the proposed amendment and within the policy parameters of affordability and legality will then be made, taking full account of any further representations which may be made by stakeholders.