

Reform of Public Sector Pensions: proposals for short term changes

In this leaflet we take a look at what is happening on the reform of the Local Government Pension Scheme (LGPS) and how this may impact on scheme members and their pension provision.

The Public Service Pension Commission, headed by Lord Hutton, made a number of recommendations about the future design of public service pension schemes. As a result, the Government is looking to reform the LGPS, along with other public service schemes, so that the cost of providing these pensions is affordable, not just now but in the decades to come.

The Government's position is that public service pension schemes, including the LGPS, will remain among the very best available, providing a defined benefit pension for all employees. However, as people are living longer, and so drawing a pension for longer, the Government is proposing that changes should be made to the LGPS to ensure there is a fairer balance between what employees pay and the cost to employers and taxpayers.

But before we look at what changes are being proposed and why the unions are balloting for strike action, let's take a quick look at why the LGPS needs to change.

Did you know?

When the LGPS was first set up

- there were restrictive age limits on who could join the scheme
- only certain types of employee were automatically eligible for membership of the scheme
- contribution rates were fixed at 5 or 6%
- to be entitled to a pension on retirement at 60 members had to have at least 40 years service or, for retirement at age 65 they had to have at least 10 years service, and
- a spouse's pension was only payable following a member's death if the member had given up part of their own pension.

Since then, there have been significant improvements to the LGPS.

- a wide range of employers now offer membership of the scheme
- any employee under age 75 can be a member of the LGPS no matter how many hours they are contracted to work
- members only need to have paid into the scheme for 3 months to be entitled to a pension (which can be drawn from age 60, or from age 55 with the employer's consent)
- there's a pension on redundancy aged 55 or over
- a lump sum is payable on death (equal to 3 years pay if a member dies in service), and
- there are automatic survivor benefits payable to a spouse, civil partner, nominated co-habitee and eligible children.

And what's more, life expectancy has increased dramatically. The average 60 year old is living 10 years longer now than they did in the 1970s. More of people's lives are now being spent in retirement – between 40% and 45% of adult life compared to around 30% for pensioners in the 1950s.

But, despite the big improvements in the benefits offered by the scheme and in scheme members' life expectancy, the employee contribution rate is still only, on average, around 6.4% of pay (before tax relief).

And, unlike employees in defined contribution (money purchase) schemes in the private sector, your benefits are guaranteed. The amount of pension from those schemes can be affected by share prices and stock market fluctuations. All the risk falls on the employee. But in the LGPS your benefits are guaranteed and it is the employer who has to pay more into the scheme, when necessary, to ensure the cost of the benefits that have been promised is met. All the risk falls on the employer (and, ultimately, on the tax payer).

So why are the unions balloting for strike action?

One point to clarify first of all is that the unions are in dispute with the Government, **not** with your employer, and are asking their members to vote for strike action over proposed changes to the LGPS which, they say, mean you will have to pay more and work longer to get a pension that is worth less.

But what we need to ask ourselves is "If we're all living longer, and so drawing our pensions for longer, don't those extra years on pension have to be paid for?" The answer, of course, is yes. The question then is "Who should meet that cost?"

Well, taxpayers can't be expected to bear all the cost of increased longevity. There needs to be a fairer balance between what scheme members pay and what other tax payers contribute towards a public service pension. It is only right, isn't it, that if you are the one to benefit from drawing that extra pension you should be the one to meet a fair share of the extra cost? And there are only a limited number of ways that the cost can be met. Members either have to pay more to fund those extra years, or draw their pension later, or draw their pension at the same time as now but at a slightly reduced rate (because it will be paid for longer due to the extra life expectancy), or a combination of these.

What is being proposed?

There are two strands to reform of the public service pension schemes.

In the short term the Government is proposing that public service workers should pay more towards their pensions. **In the longer term**, and in response to the recommendations made in Lord Hutton's report, the Government is proposing to redesign public sector pension schemes.

Let's look at the **short term** changes first. The Government is proposing that employees in the **other** main public service pension schemes (except in the Armed Forces' Pension Scheme) should pay an average 3.2% more in pension contributions, but with protection for the lower paid.

However, unlike the other main public service pension schemes, the LGPS is a funded scheme, backed up by assets and investments, and this puts it in a different position to the other public service pension schemes.

The Government recognises this and it asked the Local Government Association (LGA) and national trade union representatives to enter into discussions to see whether an agreement could be reached on a combination of changes to the LGPS which could achieve the short term measures required other than wholly through an increase in employee contribution rates. Unfortunately, despite constructive discussions between the LGA and the trade unions, it has not so far been possible to reach agreement.

The LGA therefore wrote to the Secretary of State on 21 September 2011 setting out its own proposals as to how the required 3.2% could be delivered in a way which it believes is fair to employees and affordable for the taxpayer. The proposals minimise the impact on the lower paid whilst at the same time giving **choice** to individuals.

The key elements of the changes proposed by the LGA are:

- No increase in employee contributions for scheme members whose full-time equivalent earnings are less than £15,000.
- A moderate increase of 1.5% from 1 April 2014 for those earning between £15,000 and £21,000.
- An increase of 2% to 2.5% from 1 April 2014 for those earning over £21,000.
- Recognising that some employees earning over £15,000 may not be able to afford an increase in their pension contributions, they would have the **choice** to carry on paying contributions at existing levels and have a reduction in the rate that their pension builds up from April 2014 (from the current rate of 1/60th of final pay per year of service to 1/68th per year of service).
- Also, employees with full-time equivalent earnings of less than £15,000 who may be finding it difficult to meet their current level of contribution would have the **choice** to reduce their contribution rate by around 0.6% to 0.7% and instead have a reduction in the rate that their pension builds up for service from April 2014 (from the current rate of 1/60th of final pay per year of service to 1/68th per year of service).
- Increase the normal age of retirement from 65 to 66 for benefits earned after April 2014 with benefits earned before then retaining a normal pension age of 65.

The main thrust of the LGA's proposals is that employees should have choice about how they meet the cost of paying for increased longevity.

You can find more information on the LGA's proposals and examples of the impact of the proposals on the LGA's website at

<http://www.lge.gov.uk/lge/core/page.do?pagelId=13667990>

The Government has subsequently issued its own consultation paper on how the 3.2% could be delivered.

Key elements in the Government's consultation:

The Government has put forward two alternative approaches to that suggested by the Local Government Association.

• **Option 1:**

A phased increase in employee contributions for those with full-time equivalent pay of £15,101 or more, starting from April 2012. There would be no increase in the employee contribution rate for those with full-time equivalent pay of less than £15,101 a year and no more than a 1.2% increase by April 2014 for those earning between £15,101 and £21,000 a year. Higher earners would pay progressively more than those on lower pay (i.e. an increase of between 1.8% for those earning £21,001 up to a maximum increase of 5% from April 2014 for those earning £150,001 or more).

And

A reduction in the rate at which the pension builds up (reducing from the current rate of 1/60th of final pay for each year of service to 1/64th for service between April 2013 and March 2014, and to 1/65th for service after March 2014).

- **Option 2 :**

A phased increase in employee contributions for those with full-time equivalent pay of £15,101 or more, starting from April 2012. There would be no increase in the employee contribution rate for those with full-time equivalent pay of less than £15,101 a year and no more than a 0.3% increase by April 2014 for those earning between £15,101 and £21,000 a year. Higher earners would pay progressively more than those in lower pay bands, but the level of increase for all but the most highly paid employees (those earning £150,001 or more) would be less than under Option 1.

And

A reduction in the rate at which the pension builds up (reducing from the current rate of 1/60th of final pay for each year of service to 1/67th for service after March 2014).

The second option delivers most of the changes via a reduction in the rate at which benefits build up in the future, coupled with a marginal increase in employees' contribution rates. The first option achieves the changes more by way of the increase in scheme members' contribution rates, whilst impacting less on retirement income.

You can find more information on the Government's consultation paper and examples of the impact of the proposed changes on scheme members on the LGA's website at <http://www.lge.gov.uk/lge/core/page.do?pagelid=13931474>

Responses to the Government's consultation have to be submitted by 6 January 2012 and it is expected that a decision will be taken early in 2012 on which of the proposals mentioned above will be taken forward (or any other proposal that interested parties may have put forward to the Government during the consultation period).

Now let's have a look at the longer term.

In the longer term, and in response to the recommendations made in Lord Hutton's report, the Government is proposing to redesign public sector pension schemes, with the reformed schemes being in place from April 2015. The detailed design of a reformed LGPS, how much you will pay, and exactly how your pension will build up in that scheme is still being discussed. However, in general terms, the Government is proposing that, from April 2015, public service workers should:

- **Move to a career average scheme as the fairest basis to calculate pension benefits**
This would give a defined benefit pension based on your average **revalued** earnings over your career rather than one based on your final salary as now. The current final salary scheme tends to benefit certain scheme members more than others, particularly those who get a promotion towards the end of their time in the scheme.
- **Have a later retirement age**
To keep in line with changes to life expectancy, the Government proposes to link the normal retirement age in most public service pension schemes (including the LGPS) to the age you can draw your State pension. The State pension age is currently due to increase in stages to age 66 by April 2020. This means that as the State pension age increases, so would the age you can draw your LGPS pension in full. However, members would, as now, still be able to retire early with a reduced pension.

The Government has confirmed that:

- **The reformed schemes for public service workers will continue to provide defined benefit pensions**
That means that you would, as now, receive a guaranteed amount in retirement – not an uncertain amount based on the value of an investment fund or cash pot.
- **The pension rights you have earned up to the date of the scheme change (i.e. up to March 2015) will be honoured in full**
This means that your current retirement age would still apply in respect of the pension you have built up prior to the move to the new scheme, and those accrued pension rights would still be calculated on your final year's pay. **Only benefits for future service would be based on your career average revalued earnings and have a new retirement age linked to the State pension age.**

And the Government has made an additional commitment that low and middle earners working a full public service career will receive broadly the same pension at normal pension age as they do under their current public service pension scheme.

Remember – the LGPS is still a good quality pension scheme

The Government's consultation on increases in employee contributions is currently underway and discussions on an initial design of a reformed LGPS from April 2015 are ongoing.

So, whilst these discussions are going on, it's important to realise that not only do you have access to a good quality pension scheme at the present time, but you will continue to do so in the future, with a scheme which provides you with a guaranteed level of income when you retire that's not dependent on share prices and not affected by stock market fluctuations.

As well as benefits on retirement, the current benefits of being a member of the LGPS include life cover and family benefits in the event of your death. There's also cover in the event of early retirement on the grounds of permanent ill-health, redundancy or business efficiency. As a member of the LGPS you have the security of these benefits at a relatively low cost to you and, if you pay tax and National Insurance, you get tax relief on your contributions and you pay a lower rate of National Insurance.

The LGPS allows you to save while you are working in order to enjoy a pension once you retire. What's more, the LGPS is offered by your employer who pays part of the cost of the excellent range of benefits, so it's a valuable part of your employment package. If you choose not to join or are thinking of opting out of the LGPS you are, in effect, voluntarily giving up a part of your pay package.

And finally

Whilst we know that there will be changes to the Scheme, we don't yet know exactly what these will be. However, it is reassuring that Government has said it is committed to retaining a defined benefit scheme, with full protection for benefits built up to the date the new scheme is introduced, and that public service pensions will remain among the very best available.

This leaflet provides brief information on developments to public sector pension provisions and how they may impact on employees who are members of the LGPS in England or Wales. It is for general use only and does not cover every personal circumstance. In the event of any dispute as to benefits due under the LGPS the appropriate legislation will prevail. This leaflet does not confer any contractual or statutory rights and is provided for information purposes only.