Pension Fund Sub Committee
25 September 2012

Report from the Director of Finance and Corporate Services

For Information

Wards Affected: ALL

Report Title: Proposals for the Local Government Pension Scheme 2014

1. SUMMARY

In November 2011 officers reported on the consultation for cost saving measures for the Local Government Pension Scheme (LGPS). Those proposals were that from April 2012, under the current scheme, increased employee contributions and reduced accrual would be the mechanisms used to achieve savings of £900 million by April 2015 – the proposed date of the new scheme. The consultation resulted in amended proposals to consolidate scheme design and cost savings in a new scheme in 2014. This report provides a summary of the proposals and officers' response to the recent consultation regarding them.

2. RECOMMENDATION

2.1 Members are asked to note this report.

3. DETAIL

3.1 The Independent Public Service Pension Commission delivered its final report in March 2011. The fundamental aim of the report was that all public sector pension schemes would move from a final salary to a Career Average Revalued Earnings (CARE) scheme. Employer cost savings were proposed including higher employee contributions, a later retirement age (in line with the state retirement age) and a cost sharing mechanism that would help to ensure that risk is proportionately shared between scheme members and employers.

3.2 The Government identified the importance of making immediate cost savings and in relation to the Local Government Pension Scheme the aim was to ensure savings of £900 million. Critics felt that the proposed solution of stepped employee contributions and lower accrual rates were likely to make the LGPS less attractive, encouraging members to opt out, worsening cash flows and compounding funding difficulties. It was also felt that it was more beneficial to combine the cost saving measures and the new scheme in one piece of legislation to be enforced with effect from April 2014.

3.3 Employers, employee unions, and the Government reached outline agreement of a potential new scheme and issued a joint statement in March 2012 stating the broad terms of the new scheme. The main components are as follows:

- Career Average Revalued Earnings (CARE);
- 1/49th accrual rate with revaluation based on Consumer Prices Index (CPI);
- Retirement linked to State Pension Age (SPA);
- Contributions based on actual pay (including part time employees) with the average employee contribution remaining at 6.5%. No change to the expected overall net yield from employee contributions;
- Retention of banded employee contributions where employees pay a rising percentage depending on their pay band, but with an extension to the number of bands with little or no increase in the employee rate at the lower bands but more significant increases at higher pay bands, even after allowing for tax relief;
- 50/50 scheme option enabling members to pay half contributions for half the pension, with most other benefits remaining as they are currently;
- Benefits for service prior to 1 April 2014 are protected, including remaining ‘Rule of 85’ protection which allows members to retire early if their age in years and LGPS service total at least 85 years (e.g., age 55 with 30 years’ service). Protected past service continues to be based on final salary and current retirement age;
- Outsourced scheme members will be able to stay in the scheme on first and subsequent transfers;
- Vesting period when members can get a refund on their contributions if they leave the scheme will be increased from 3 months to two years.

Benefit to Scheme Members

3.4 It is the opinion of officers that the proposed scheme is likely to remain relatively attractive to employees as it will continue to offer good quality salary related benefits. The introduction of a CARE scheme also means that there will be better equality proofing - the benefits would be more fairly distributed between higher and lower earning members. The proposed scheme offers an attractive accrual rate and the final salary link to previous service means there will be no reduction to benefits already accrued up to March 2014.

3.5 The negative employee aspects are that the scheme will become significantly more difficult to understand. For example, existing members will require three calculations for the 1997, 2008 and 2014 elements of the scheme in order to determine their benefits. Increases in employee contributions and the scheme retirement age will also make the scheme less attractive. More stringent tax penalties brought about by the reduction in the Annual Allowance combined with the scheme changes may also cause more high earners to opt out from the scheme in the future.

Sustainability

3.6 A key objective of the review of public sector pension schemes was that of sustainability. Whilst full details of the new scheme are not currently available, early indications are that the proposed scheme is not likely to offer the cost savings employers had hoped for. Although linking retirement age to the State Pension Age will help control future costs, the expected savings for employers at the moment are modest. The fund actuary indicates a saving in the region of 1.5% - 2.0% of pay on HM Treasury financial assumptions but any savings for individual funds could vary significantly depending on their own particular circumstances. Since accrued rights to April 2014 are protected, existing deficits are locked in. Any potential saving from the future cost of post-2014 benefits is likely to be offset by upward pressure on employer contributions due to current low interest rates and larger deficits compared to the 2010 valuations. Total employer contributions (including the extra amount required to address past service deficits) are unlikely to fall at the 2013 actuarial valuations despite the proposed benefit changes. One minor consolation for employers is that contribution increases will be less than would otherwise have been the case. In the absence of cost savings for future service and no redress for past service deficits, employers may need to consider radical action to ensure adequate funding. This could, for example, require greater endeavours towards pooled or regionalised pension funds where concentrated resources could potentially achieve better investment returns.

3.7 The move from a final salary to a career average scheme addresses the issue of fairness – an aim of the Commission. CARE does not alleviate the potential costs and risks of the LGPS. The scheme will continue to offer high quality guaranteed benefits with improved accrual rates, there will be a final salary link to pre 2014 membership (with 85 year rule protections built in) and there will be an underpin of 2008 benefits for members within 10 years of retirement. All of these issues lock in employer risk and associated costs. As such, it is probable that the Council will be required to make similar investment choices to those made under the 2008 scheme. Risks still in existence and employer affordability considerations remain an area of concern.

Administration

3.8 Together with the introduction of auto enrolment, the proposals present a challenge to existing administration systems. These will require significant amendment in a relatively short time frame. The new regulations must also be in place in time for the next valuation in order that the changes in scheme design can be fully incorporated. Experience from previous regulatory change has shown that progress tends to be slow. Late changes to legislation will have a negative impact on resources and may adversely affect the 2013 valuation.

Consultation

3.9 In June 2012 the Local Government Association issued a consultation document to employers asking whether they supported or did not support the proposals of the new scheme. Brent officers have responded with a marginally negative view due to the fact that whilst the Council recognises the importance of a scheme that is attractive for members, there remains concern that the scheme will not be sustainable in the longer term. The proposals do not offer the cost savings hoped for by the Council and other employers and the structure of the new scheme is likely to mean that it will be more complex to administer and communicate to members.

3.10 However, at a national level there has been overwhelming support as councils have joined trade unions in backing the Government's proposed reforms to the Local Government Pension Scheme, clearing the path for the changes to be introduced in April 2014. The outcome of the consultation of local government employers by the Local Government Association and results of the unions' proportion voting yes was issued in a joint statement on 30 August 2012 as follows:

	Proportion voting in favour of the proposals
Local government employers	93%
Unison members	90%
GMB members	95%
Unite members	84%

4. FINANCIAL IMPLICATIONS

4.1 The 2010 valuation of the pension fund indicated that it remained in relatively poor financial health. Between the 2007 and 2010 valuations, the fund had declined in value (from £499m to £456m), the deficit had grown (from £193m to £295m) and the funding ratio had fallen from 72% to 61%.

A number of factors had contributed to the deterioration in the fund's position including:

- Poor investment returns resulting from a combination of asset management strategy and the poor performance of some fund managers;
- Increased longevity;
- Reducing payroll – there are less employees contributing to the fund to help reduce fund deficits.

However, there were some positive funding points which worked in the fund's favour:

- The revaluation of pensions (annual uplift) was changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) – this is less beneficial for pensioners;
- The discount rate for scheduled bodies was increased to reflect recovering markets.

4.2 On the whole the impact of the points above reduced overall future service contribution rates slightly but increased the deficit, resulting in a significant increase in employer rates and an extended recovery period of 25 years. The actuary was concerned that progress in reducing the deficit would have been impeded by falling payrolls as the Council managed the harsh economic environment and falling revenues from Government. The current employer rate, set to cover both future service contribution and past service deficits, equates to 26.9% and is set to rise to 27.4% in 2013/14.

4.3 In 2010, it was hoped that the results of the review in public sector pensions would deliver a more favourable valuation in 2013 due to the intended cost saving measures. Unfortunately the proposed changes are unlikely to reduce fund deficits to any material degree due to the various protections proposed for scheme members. Any potential saving from the future cost of post-2014 benefits are also likely to be offset by upward pressure on employer contributions due to current low investment returns and larger deficits compared with the 2010 valuation.

4.4 It remains possible that there could be the need for further increases in employer contributions following the 2013 valuation unless investment performance is able to outstrip the increase in pension liabilities. The new LGPS proposals may mean that the increases will be less than they would have been due to factors such as the increase in the retirement age and the increases in employee contributions.

5. LEGAL IMPLICATIONS

5.1 There are no legal implications arising from this report.

6. DIVERSITY IMPLICATIONS

6.1 The details of this report have been subject to screening and officers believe that there are no diversity implications arising from them.

7. STAFFING/ACCOMMODATION IMPLICATIONS

7.1 It will be important that there is effective communication of the new pension scheme once the legislation has been agreed in order that employees understand the changes. This may include publishing information on the Council’s website, employee newsletters, and/or the provision of staff induction programmes.

8. CONTACT OFFICERS

8.1 Persons wishing to discuss the above should contact the Pensions Manager on 0208 937 3190 at Brent Town Hall.

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