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Committee and date	Item
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PUBLIC SECTOR PENSION REFORM

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Summary

This report updates Members on the public sector pension reforms, particularly reforms across the Local Government Pension Scheme (LGPS). It summaries the consultation paper issued on 7 October on the short term measures on proposed increases to employee contribution rates and changes to scheme accrual rates, effective from 1 April 2012 and puts forward suggested responses to the questions raised. It also summarises the long term position including the recent improved 2015 Scheme offer tabled by the Government on 2 November.

Recommendation

That a full response to the Government's consultation be prepared by the Scheme Administrator and sent on behalf of the committee reflecting the suggestions set out in the report, which takes into account any additional comments.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1 Risk Management is part of the Pension Fund's structured decision making process. Engagement with Government consultations ensures Shropshire views can be taken into account in shaping future regulations.

3.2 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.3 There are no direct environmental, equalities or climate change consequence of this report.

4. Financial Implications

4.1 There are no direct financial implications arising from this report as this is only a consultation, however as any outcome of this process is known there may be financial implications which will be reported in subsequent reports to members.

5. Background

5.1 Following Lord Hutton's Independent Public Service Pensions Commission review, March 2011, the Chancellor announced that employees in the unfunded public service pension schemes, civil servants, teachers, etc., would be required to pay increased contributions averaging 3.2%. This would raise £2.8bn a year by 2014/15 and would be phased in from April 2012.

5.2 The Government has accepted the 'funded' nature of the LGPS would allow separate discussions to identify whether alternative ways could be found to achieve the equivalent savings of £900m for the LGPS in England and Wales.

5.3 The Government has set out certain requirements that any proposals must meet:

i) There should be no increase in employee contributions for those earning less than £15,000 pa (full time equivalent) ;

ii) There should be no more than a 1.5% increase in pension contributions by 2014-15 for those earning between £15,000 and £21,000 pa full time equivalent);

iii) High earners should pay progressively more than lower earners but no more than 6% in additional contributions.

5.4 The Department for Communities and Local Government (DCLG) issued a consultation paper on 7 October 2011 on proposals to achieve these savings in the LGPS by 2014/15. The deadline for responses is 6 January 2012. The consultation paper is attached at Appendix A.

5.5 There are two proposals for achieving the savings of £900m for the LGPS. Both options require a combination of increases in employee contributions and a worsening of the accrual rate.

5.6 The Local Government Group has discussed with trade unions how the savings of £900m could be achieved, although no agreement has yet been reached. Instead, the Local Government Group has submitted its own proposals to the Government which would provide a degree of choice for employees between increased contribution rates and worsened accrual rates, as well as an increase in the normal retirement age for the scheme from 65 to 66. The Local Government Group's proposals are included in Appendix A and will be considered by the Government as part of its consultation process.

6. The Proposals

6.1 The Government's two proposals are summarised in the following table. The full details of the proposals are included in the Government's consultation paper attached as Appendix A.

	Option 1			Option 2		
Employee contributions	To save £450m per annum Average increase of 1.5% phased in from 1 April 2012 Contributions for the highest salary band would increase from 7.5% to 12.5%			To save £300m per annum Average increase of 1% phased in from 1 April 2012 Contributions for the highest salary band would increase from 7.5% to 12.5%		
Accrual rates	To save £450m per annum 2012/13 1/60th as now 2013/14 1/64th 2014/15 1/65th			To save £600m per annum 2012/13 1/60th as now 2013/14 1/60th as now 2014/15 1/67th		
Savings	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
	£m	£m	£m	£m	£m	£m
Contributions	180	360	450	95	220	300
Accrual rates	-	360	450	-	-	600
Total	180	720	900	120	240	900

6.2 The following table shows the impact of the proposals on the mid to higher salary bands.

Government's proposals for employee contribution bands

Tariff band	Current	Option 1			Option 2		
		2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
	%	%	%	%	%	%	%
£0 – 12,900	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
£12,901 – 15,100	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%
£15,101 – 19,400	5.9%	5.9%	6.0%	6.0%	5.9%	6.0%	6.0%
£19,401 – 21,000	6.5%	6.7%	7.2%	7.7%	6.5%	6.8%	6.8%
£21,001 – 32,400	6.5%	7.2%	8.0%	8.3%	6.8%	7.2%	7.5%
£32,401 – 43,300	6.8%	7.5%	8.3%	8.7%	7.1%	7.8%	8.2%
£43,301 – 60,000	7.2%	8.2%	8.7%	9.0%	7.8%	8.4%	8.8%
£60,001 – 81,100	7.2%	8.7%	9.2%	10.0%	8.7%	8.8%	9.5%
£81,101 – 100,000	7.5%	9.0%	9.8%	11.0%	9.0%	9.8%	10.5%
£100,001 – 150,000	7.5%	9.5%	11.0%	12.0%	9.3%	10.8%	11.5%
£150,001+	7.5%	10.0%	12.0%	12.5%	9.5%	11.8%	12.5%

6.3 The Governments proposals are intended to address a number of issues:

i) the need for immediate savings, from increase in employee contributions;

ii) a concern to protect lower paid staff from increased contributions, but not from worsened accrual rates. This is intended to reduce the number of staff opting to leave the scheme because they consider it too expensive;

iii) a view that all employees might prefer a reduction in the level of their future benefits through the worsened accrual rates, to a full increase in their contribution rates, again with a view to limiting opt-outs from the scheme.

6.4 The Government also raises the prospect of employers benefitting from the effect of the changes via reductions in contributions in advance of the next actuarial valuation. Mercer, the Fund's Actuary, advise that in current market conditions this could prove challenging as funding positions have generally fallen over the last few months. Mercers said it is difficult for them to advise Funds to allow contribution reductions if given a choice, as the majority of savings would appear to be planned for 2014/15 which is when the rates from the 2013 valuation would come into effect. They feel a more general power to amend contribution rates in-between actuarial valuations would be more appropriate than a specific one targeted at these particular changes.

7 The Local Government Group's proposals

7.1 The Local Government Group has proposed that the first £300m of the £900m savings required by the Government should be met from an increase in the scheme's normal retirement age from 65 to 66 for benefits earned from April 2014.

7.2 The Group suggest the remaining £600m could be met by offering employees earning more than £15,000 a choice between:

an increase in their contribution rates; or

a worsening in the accrual rates from April 2014.

7.3 In addition, the Group propose that employees earning less than £15,000 could be given the option of reducing their existing contribution rates in return for a worsened accrual rate.

7.4 The Group's costings include a number of options for these choices, including phasing the implementation, as set out in Appendix A.

8. **Responses to Consultation Questions**:

8.1 **Question 1** – Do the proposals meet the policy and objectives to deliver the necessary level of savings?

Suggested response – *Yes we believe all three sets of proposals have been constructed to ensure the necessary savings are met across the LGPS as a whole. However individual funds within the whole may have very different experiences. Shropshire has a larger percentage of its workforce in the lower pay bands so will not make the savings suggested at Fund level.*

Percentage of membership in each pay Band

Tariff band	CLG LGPS as a whole %	SCPF %	Difference %
£0 – 12,900	8.67	15.16	6.49
£12,901 – 15,100	10.61	8.72	-1.89
£15,101 – 19,400	25.20	36.85	11.65
£19,401 – 21,000	7.47	5.45	-2.02
£21,001 – 32,400	31.34	25.35	-5.99
£32,401 – 43,300	11.16	6.09	-5.07
£43,301 – 60,000	4.18	1.73	-2.45
£60,001 – 81,100	0.91	0.38	-0.53
£81,101 – 100,000	0.25	0.19	-0.06
£100,001 – 150,000	0.16	0.08	-0.08
£150,001+	0.05	0.01	-0.04

8.2 **Question 2** – Are there any consequences or aspects of the proposals that have not been fully addressed?

Suggested response – *The areas of communication, administration and change management have not been fully explored in the consultation, and will require considerable work to enable any resulting changes to be implemented successfully. Also the fact that the short term and long term measures are not being consulted on together- should this be reconsidered. The long term changes need to be made from a robust starting point and the short term* *measures could weaken that starting point, especially if they lead to members opting out. It should also be remembered that this message will have to be delivered alongside that of Auto-enrolment.*

8.3 **Question 3** – Is there a tariff of alternative measures which consultees think would help to further minimise any opt outs from the scheme?

Suggested Response – *Increases in member contributions should be kept to a minimum to avoid the financial impact on members, and changes in benefits kept as simple as possible to aid member understanding.*

8.4 **Question 4** – Are there equality issues that could result in any individual groups being disproportionately affected by the proposals? If so, what are considered to be the nature and scale of that disproportionate effect? What remedies would you suggest?

Suggested response – *One of the original aims stated was that lower paid staff should be no worse off, but by reducing the accrual rate their benefits would be reduced. Some lower paid may opt out, particularly part-time staff, as their contribution band is set by their full-time equivalent pay rather than actual pay. This may be detrimental for them in their retirement and put more strain on government resources long term. Middle and higher earners could decide to opt out because of the disproportionate increase in their contribution rates whilst at the same time reducing their benefits. Short term affordability may well outweigh long term pension provision. As in Q3 increases in member contributions should be kept to a minimum and changes in benefits kept as simple as possible taking into account any long term changes from 2015.*

8.5 **Question 5** – Within the consultation period, consultees' views are invited on the prospects of introducing into the LGPS a link with the state pension age as recommended to the Government in Lord Hutton's report.

Suggested response – *The Government are proposing further changes to state pension age and there are the existing pension age protections in the LGPS, only introduced in 2008, to introduce further changes in the short term could further confuse members by introducing even more complexity and could lead to opt-outs. The linking with State Retirement age should be considered with the long term changes to the Scheme from 2015. The flexibility around personal choice of retirement age, with benefits amended accordingly, should be kept in the scheme and built on.*

8.6 Every effort is being put in to communicating the message to members that whilst changes to the LGPS are being proposed, nothing has been decided yet, the scheme is, and will continue to be, a valuable part of their pay package. This was a key message delivered at the recent Annual Meeting and an Employee newsletter is due to go out shortly.

9 2015 Longer Term Changes

9.1 The Government's proposals for the longer term LGPS have been emerging gradually since the summer. On 7 October HM Treasury wrote to the TUC with final details of the proposed reference scheme, against which the long term costs would be benchmarked.

9.2 The main features for the four largest public sector pension Schemes are a Career Average Revalued Earnings (CARE) pension scheme with an accrual rate of 1/65ths and a normal pension age linked to State Pension Age.

9.3 On the 2 November HM Treasury announced an enhanced offer in relation to the cost ceiling and the long-term changes from 2015. The highlights are:

Accrual rate of 1/60ths leading to an increase in the cost ceiling for employers of 1.6% of pay in the LGPS;

Protection for anyone within 10 years of their pension age on 1 April 2012, meaning "they will see no change in when they can retire, nor any decrease in the pension they will receive at their normal pension age". The cost of this protection falls outside of the cost ceiling;

Others who are very close to being 10 years from retirement age may also see some additional protection, subject to further discussions.

9.4 These proposals are conditional upon agreement being reached in the ongoing scheme by scheme talks and does not change the short term measures being consulted on.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Pensions Committee, 15 September 2011, Item 14, Pensions Administration Monitoring,
Cabinet Member (Portfolio Holder) NA
Local Member NA
Appendices Appendix A – CLG Consultation document of 7 October 2011.