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New Look LGPS – Discussions Begin

Branches have been invited to send delegates to a pensions seminar in Glasgow on 13 February 2007. This seminar will be an opportunity to consider in detail the key issues. This bulletin aims to outline the main issues that will be considered at this seminar.

Timetable

Discussions have now started over the 'New Look' Local Government Pension Scheme in Scotland. At its last meeting the tripartite (trade unions, CoSLA, Scottish Executive) Scottish Local Government Pensions Advisory Group (SLOGPAG) agreed a timetable for the discussions. The trade unions and CoSLA will work up the details of the new scheme over the next six months with the aim of reaching agreement by June. There will then be a consultation period whilst the trade unions ballot members on the proposals. Draft regulations will be the subject of formal consultation in the autumn with the intention that the new regulations will be laid before the Scottish Parliament for approval by April 2008. Then there will be a year to prepare the new scheme for implementation with effect from 1 April 2009.

Scottish Executive View

The Minister for Finance has set out some of the issues he would like SLOGPAG to consider during these discussions and these have been noted by the parties. He confirms that all savings released from removing the Rule of 85 and the Finance Act changes will go towards meeting the cost of the new scheme that itself must be affordable. He would wish to see a level of consistency with other Scottish public sector pension schemes including the principle of cost sharing and more effective targeting of ill-health provisions.

In addition CoSLA has commissioned actuaries to undertake some initial costing of options and this report has been shared with SLOGPAG. UNISON has commissioned its own actuaries to comment on this report. The actuaries report is important because it sets out assumptions that should underpin the discussions over the new scheme. This is the basis for costing any options we may wish to consider.

What You Put In

The starting point for any discussion over pension schemes is the amount contributed to the scheme – what you put in. The value of the pension you receive depends on how much has been contributed to the pension fund over the period between starting the scheme and withdrawing your pension in retirement. In addition employer contributions and fund investment performance determines the overall funding available to meet pension liabilities.

Scheme Funding
As highlighted in P&I Briefing No. 146 although there has been a drop in the average funding value of Scottish LGPS funds since the last valuation in 2002 (from an average of 101% to 89%), in general the Scottish funds are relatively healthy in comparison to the LGPS in England and Wales and to private sector pension schemes. In addition, each fund has plans in place to increase their funding levels, for instance Strathclyde Pension Fund (which has 88,000 active members – almost 41% of all LGPS members in Scotland) is aiming to reach a funding value of 104% by March 2007. UNISON Scotland has pointed out that while employees have continually contributed to the LGPS, employers have taken contribution holidays. Any current under funding in the LGPS should be met by those employers making back payments to cover their contribution holidays.

Contributions
A key issue for the new LGPS will be changes to the contribution rates of both employees and employers. Currently employees pay 6% of their salary (with some manual workers paying 5%) while the employers contribution varies to ensure that the fund remains in balance. Employer contributions across Scotland are currently at a higher level to address deficits and actuarial valuations of future pension costs. One proposal for the new look LGPS suggest that, to ease the burden on employers and share the costs of the scheme, contributions should be split on a 2:1 ratio. That could result in contributions set at 14% for employers and 7% for employees. This could go up or down in future but with improved benefits and longevity the current pressure on all pension schemes is upward.

The Scottish Public Pension Agency (SPPA) also raises the issue of introducing a graduated contributions scale for employees. This would link member's contributions to their salary, with an average rate of 7% but with variable bands to reflect member's ability to pay. The following provides an illustration of how employee contributions could be varied in bands, with the relevant contribution rate levied on the members' total pensionable pay. It reflects the fact that an increase in contributions for higher paid staff will be largely offset by tax relief.

Illustrative Banded Employee Contributions

Salary	Total Employee Contribution	Tax Relief	Actual (Net) Employee Contribution	Actual Employee Contribution (%)	Gross Employee Contribution Rate (%)
3000	60	0	60	2.5	2.5
6000	330	33	297	4.95	5.5
12000	840	185	655	5.46	7
24000	1680	370	1310	5.46	7
30000	2100	462	1638	5.46	7
36000	3240	1296	1944	5.4	9
72000	6480	2594	3886	5.39	9
144000	14400	5760	8640	6	10

The SPPA also suggested an alternative where consideration could be given to having a tiered arrangement of contributions so that members would pay a proportion of the earnings up to each limit and then higher contributions on earnings above each limit. In England & Wales the draft regulations propose a variable contribution rate of 5.5% on the first £12,000 of pensionable pay and then 7.5% on earnings above £12,000. The underlying average employee contribution would be 6.3% under these proposals. The underlying rate for the NHS scheme is 6.6% and 6.4% for teachers. There are also issues for part time staff if pay is calculated on an actual or whole time equivalent basis.

Governance
UNISON Scotland has also pointed out to the Scottish Executive and CoSLA that any introduction of cost sharing, with or without a 2:1 ratio, could change the whole basis of the governance of the LGPS.

At present there is no direct representation on the funds (like Trustees in private sector schemes) because the liability to ensure the scheme is funded rests with the local authorities. If scheme members have to make increased contributions to meet future costs then there is an argument that they should be entitled to a greater say in the running of the funds.

What you get out

What you receive in your pension depends on a number of factors. These include the type of pension scheme you are in, the accrual rate, other benefits such as early retirement and access to a lump sum.

Although the corresponding consultation in England and Wales offered a variety of options including a defined benefit (final salary) scheme, a career average scheme and a hybrid version of both of these two options, in Scotland the intention is to retain a defined salary scheme. This means that your pension will be related to the salary you were paid before your retirement, i.e. your final salary. The scheme retirement age is set at 65 and any retirement before the age of 65 (except under special circumstances such as ill health or redundancy) would result in a reduction in your expected pension.

Currently the LGPS includes a number of restrictions on the period of total membership a person may count under the Scheme. However, under the new tax regime there will be no requirement to retain such limits in the Scheme. The removal of the current restrictions would ensure that members continue to accrue membership for any period they remain in employment and continue to contribute to the Scheme, and would remove the current disincentive for longer serving members to continue in service after attaining 40 years membership.

The accrual rate determines how fast your pension pot increases by every year of membership. Currently the LGPS accrual rate is $1/80^{th}$, meaning that for each reckonable year of membership you would receive $1/80^{th}$ of your final or pensionable salary. For the new LGPS discussions actuaries have costed different accrual rates from $1/60^{th}$ to $1/64^{th}$. This means for a similar length of membership your total pension pot would be higher under the new proposals.

Another issue in determining your final pension is whether or not you receive a lump sum and the impact this may have on your pension. Currently the LGPS provides for an automatic lump sum of 3/80ths of your pensionable pay. The new LGPS in line with the Finance Act changes will not include an automatic lump sum. However, it will be possible to commute (or transfer) part of your final salary towards a lump sum up to a maximum of 25% of your total pension. The commutation rate is likely to be 12:1, meaning that for each £1 given up in your pension you would receive a lump sum of £12. Thus, there is a trade off between a higher lump sum and a smaller pension or vice-versa. It would be up to individual LGPS members to decide what is best for their personal circumstances.

Other Benefits

As well as paying in and receiving a pension out of the LGPS there are a number of the current scheme's benefits which may be altered in the new look LGPS.

Ill Health Provision

At present you qualify for an enhanced pension paid early if you leave employment because you are permanently incapable of doing the duties of your employment. Proposals in the new scheme could see the introduction of a two or more tiered system. This would split ill health retirees into different groups such as those who are permanently incapable of performing any gainful employment by reason of ill-health and those who are incapable of continuing in their current role, but who are capable of undertaking other employment.

There is clearly a need to consider these provisions in light of other legislative changes such as the Disability Discrimination Act and changes in employer practice that has apparently led to a significant reduction in the number of scheme members leaving on ill health retirement in recent years. However, we will need to be satisfied that the new arrangements are overall to the benefit of scheme members in both the regulations and the application of the scheme in practice.

Partners Pensions
Currently the LGPS provides partners pensions only to those who are married or are in a civil partnership. The new scheme is being costed on the basis that this will be extended to unmarried partners.

Death in Service
The new scheme is likely to increase a lump sum death grant from two times final salary to three times final salary.

Flexible Retirement
It has been suggested that provision could be made for a more flexible retirement to ensure that members could choose to make arrangements for a more gradual approach to retirement, adjusting their work/life balance by reducing their hours or stepping-down to a less onerous job but, at the same time, able to draw some of their pension and accruing further pension rights.

Discretionary Payments
In England & Wales there was a proposal to remove employer discretion to award compensatory added years for those who are made redundant or retired on the grounds of efficiency over the age of 50, from the Discretionary Payments Regulations. The current draft regulations for E&W propose employer discretion to reduce pensions by an early retirement factor for early payment.

In Scotland the Finance Minister has published his approach to the proposed Discretionary Payments Regulations. Following representations from UNISON the Minister has decided not to publish similar proposals in Scotland. Instead, he has indicated that he may consider the issue again once the UK review of premature retirement and severance arrangements in the Teachers Pension Scheme has been completed.

Other issues
Other issues that may be considered in the discussions include early retirement factors, survivors pensions, additional voluntary contributions and employers powers to increase pensionable service.

Conclusion

This bulletin is intended only as a background to the issues that will be considered in the forthcoming discussions. There will be more detailed consideration at the pensions seminar and members will of course be advised of progress with the discussions and balloted on the final proposals, probably during the summer.

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