MEETING	**PENSIONS COMMITTEE**
DATE	**25 NOVEMBER 2011**
PURPOSE	**Decide on the Pension Fund's response to the CLG Consultation on achieving a saving of £900m within the local government pension scheme by 2014-15 by proposed increases to employee contribution rates and changes to scheme accrual rates, effective from 1 April 2012 in England and Wales**
TITLE	**CLG CONSULTATION ON CHANGES TO THE LOCAL GOVERNMENT PENSION SCHEME**
AUTHOR	**DILWYN WILLIAMS, CORPORATE DIRECTOR**

1. Background

The Government is proposing changes to the Local Government Pension Scheme (LGPS) in order to achieve short term savings of £900m across LGPS funds by 2014-15. The proposals which were published on 7th October 2011 are currently out to consultation until 6 January 2012.

These proposals follow the recommendations of Lord Hutton's interim report on the future of all public service pensions. He recommended that the most effective way to achieve short term savings would be to raise employee contribution rates.

The Government is also considering longer term changes to public pensions and recent proposals regarding accrual rates and protection for those expecting to retire within 10 years from 1 April 2012 relate to the longer term considerations. It is not clear how the short term proposals to achieve the £900m savings required by the Government will fit with the longer term scheme proposals still being considered.

2. Government Proposals

2.1 The Government set out some requirements for the proposed changes in July 2011 as follows:

- There should be no increase in employee contributions for those earning less than £15,000.
- There should be no more than a 1.5% increase in total by 2014-15 for those earning up to £21,000. This amounts to a 0.6% increase in 2012-13 on a pro-rata basis.
- High earners in the LGPS should pay progressively more than those in lower salary bands, but no more than 6% (before tax relief) of salary.

2.2 The consultation paper outlines two options for achieving the £900m savings by 2014-15 (3% of forecast pensionable paybill).

2.3 Option 1 comprises two separate elements as follows:

- An increase in the employees contribution tariff from April 2012, to raise an additional £450m (1.5%)
- A change in the scheme's accrual rate from April 2013 from the current 60ths to 64ths in 2013/14 and 65ths in 2014/15, to raise an additional £450m (1.5%)

2.4 Options 2 comprises two separate elements as follows:

- An increase in employees contribution tariff from April 2012, to raise an additional £300m (1%)
- A change in the scheme's accrual rate from the current 60ths to a 67ths from 1 April 2014 so as to raise an additional £600m (2%)

2.5 In addition, Lord Hutton recommended that the pension age in public sector schemes could be linked to the State Pension Age. According to the Government Actuary this would deliver annual savings of £330m if implemented for future service accruals. Measures to achieve the remaining required savings could include a combination of changes to accrual rate and employees contributions.

2.6 The Government is proposing to make statutory amendments to the current pensions regulations to allow a downward revision of employer contribution rates between three-yearly actuarial valuations in order to ensure that LGPS employers and taxpayers benefit from the savings achieved.

3. Other Proposals

3.1 The Local Government Group submitted their proposed package of savings to the Secretary of State in September 2011.

3.2 Their proposals are summarised as follows:

- Increasing retirement age for all by one year.
- A combination of accrual and contribution rate changes.
- Protection or reduction in contributions for lower paid members.
- A change in contributions over the existing employee contribution structure with lower additional contributions for higher paid than in the Governments' proposals.
- An option for employees to reduce their accrual rate for a reduced contribution rate.

4. Issues arising from the proposals

4.1 The proposals outlined above would have a significant effect on individual LGPS Funds.

4.2 Any increase in employee contributions and reduction in benefits would result in an increased opt-out rate. Whilst proposals that avoid the full 3.2% average increase in employee contributions should help reduce the number of people opting out it is likely that significant numbers would consider the scheme to be too expensive or unaffordable. Any increase in opt-out levels will affect the cash flow and the costs to be borne by the employers.

4.3 The proposals seek to protect the lower paid, but any change in the accrual rate will directly affect this group even though their contribution rates are not affected.

4.4 The proposals will also put significant additional strain on scheme administrators. They will have to implement short term changes in contributions and accrual rate, auto-enrolement and the final Hutton report reforms in 2015.

4.5 The interim changes will increase complexity for administrators and members and it therefore would be ideal if these changes could dovetail with the final Hutton reforms.

4.6 Effective communication to members is essential to ensure that they understand that even with complex changes, public service pensions remain among the best in the UK and that they have a lot to lose if they opt out.

4.7 Whilst the Government is proposing a change to the legislation to allow a downward revision of employers contributions before the next triennial actuarial valuation it may not be appropriate for funds to do this especially given the deterioration in market conditions since the 2010 valuation. Even if contributions remain at current levels until the next valuation, the proposed changes will save employers and taxpayers money in the long term and will help avoid bigger increases in future contributions.

5. Consultation Responses

5.1 Consultees' views on the proposals outlined above are formally sought by 6 January 2012.

5.2 The consultation paper invites consultees views and any evidence relating to all aspects of this statutory consultation and in particular to the following questions:

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

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

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

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?

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

6. Gwynedd Pension Fund Consultation Response

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

Any savings will be dependent on changes to the opt-out rate following the increase in employees contributions. This relates to opt-out by existing members who see the future contributions as unaffordable and the decision of new employees not to join the scheme. This could have major implications for the realisation of expected savings.

Increased opt-out rates would have an impact on cash flow for the Fund with early management of investments and returns to ensure that cash is readily available to bridge any shortfall of contributions to pay retirement benefits.

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

Opt-out / non joining rates as per response to question one.

Additional administration burden of maintaining information based on 11 contribution bands rather than 7 (for Pension Funds and employers).

The significant increase in the complexity of the scheme for a short interim period would attract disproportionate cost and communication issues.

Additional administration and cost of between valuation exercise to establish revised employer rates across each fund following implementation of any increased employee contributions.

Will it be mandatory for Pension Funds to pass the reductions on to employers?
Would it only be mandatory for employers directly funded from Government or for all employers?

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

Effective communication with members and employers in the Funds is essential to ensure that they understand the benefits available and to reduce anxiety about the changes.

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?

The question of equality between different public sector schemes arises – will employees on similar salary levels face similar employee contributions across all schemes? e.g. teachers and social workers especially in light of the higher level of salaries below £15k and £21 in the LGPS which will place a disproportionate level of pressures on mid to high earners in comparison to demographics of other public sector schemes e.g. teachers scheme?

Any link to state pension age should also be consistent with other public sector pension schemes

The option for mixing reductions in accrual and increases in contributions rates will have an disproportionate effect on low earners in that the effect of accrual rate reductions will have an impact compared to the protection they receive from increases in contributions.

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

Given that longevity is increasing it appears to be logical to link the LGPS retirement age with state pension age going forward. Any link to state pension age should also be consistent with other public sector pension schemes.

General comments

As increasing longevity impacts on the cost to pension funds it would be appropriate to reduce the accrual rate in conjunction with linking the normal retirement age to state pension age – members are likely to be working longer and therefore will have the opportunity to increase the number of years they are contributing which would offset the reduced accrual rate. This would enable lower increases to employee contributions which should reduce the level of opt-outs from the changes.

The proposal made by the Local Government Group to allow members to opt for a lower accrual rate for lower contributions would create significant administration and communication issues. There is already a heavy burden of administration for employers and the quality of information received by the Pension Fund varies between employers. Giving employees choices about how much to pay makes the job even more complex.

It also assumes that the additional employee contributions would always cover the cost of the additional accrual rate – additional employer costs would result if that was not the case.

The option of different contribution rates would create additional data capture issues for actuarial valuations and annual actuarial reports for accounting purposes (IAS19 / FRS17 reports).

The proposals also include the possibility that some low paid workers could end up paying a lower rate than at present if they opt for a lower accrual rate. Whilst lower paid workers should be protected is it equitable that they could reduce their contributions?

7. Recommendation

The Committee is requested to approve the Pension Fund's consultation response to be submitted by the deadline.