HEREFORDSHIRE COUNCIL

LOCAL GOVERNMENT PENSION SCHEME – RESPONSE TO INITIAL CONSULTATION ON FOUR OPTIONS

PORTFOLIO RESPONSIBILITY: CORPORATE AND CUSTOMER SERVICES AND HUMAN RESOURCES

CABINET **28TH SEPTEMBER, 2006**

Wards Affected

None

Purpose

To endorse the proposed response to an initial consultation exercise being undertaken by the Department for Communities and Local Government (DCLG) in respect of four options for the Local Government Pension Scheme (LGPS).

Key Decision

This is not a Key Decision.

Recommendation

THAT the response to this initial consultation exercise be endorsed.

Reasons

To provide a prompt and comprehensive response to this initial consultation exercise in order to influence the subsequent proposals and ensure that we retain a LGPS that is affordable to Herefordshire, as well as remaining valued by current and prospective employees.

Considerations

1. In 2001 the Government initiated a review of the Local Government Pension Scheme with the aim of safeguarding the scheme and ensuring its affordability for the future.

2. This current consultation process is in advance of a statutory consultation period, which is due to take place from November 2006, through to February 2007. The Government's intention is for final regulations to be laid before Parliament in April 2007 and the new-look LGPS to be in place from April 2008.

3. For information, approximately 64% employees in Herefordshire, who are eligible to join the LGPS, are currently members of the scheme. The employer's contribution rate is currently 17.6% for Herefordshire.

4. The current consultation exercise is seeking views on four costed options (see below), employee and employer contribution rates, and ways of making the current scheme

Further information on the subject of this report is available from
David Johnson, Head of Human Resources, on (01432) 383055.

more flexible by extending the opportunities for employees to access their pension whilst continuing to be employed.

5. The four costed options are summarised below. Where an indication of cost is shown, it should be noted that this is an estimate provided by the DCLG and will vary between employers, depending upon the make up/career patterns of its workforce. We have requested that the Actuary for the Pension Fund carry out an assessment of the cost implications of each option in relation to Herefordshire. To date this information is not yet available.

6. The four costed options are,

A. An updated current scheme, with additional benefit improvements

This scheme would be very similar to the existing scheme i.e. a final salary scheme, based on an accrual rate of 1/80th of final salary per year of membership, with a 3/80ths tax-free lump sum payment. There would be an increased lump sum death in service benefit, partners pensions for cohabitees and targeted ill health provision on a two-tier basis.

This option has the benefit of retaining a final salary scheme, which is considered attractive to current and prospective employees. It is estimated by the DCLG that this would be the lowest cost-option. We are awaiting confirmation of this from the Actuary for the Pension Fund in Herefordshire. The reduction in costs is generated by the introduction of two-tier ill health pension provision. This option is also an arrangement that most employees are familiar with. Should this option be implemented consideration will need to be given to a tiered employee contribution rate.

B. A new final salary scheme with an improved accrual rate

The improved accrual rate is proposed to be 1/60th of final salary per year of membership, but no lump sum. As it increases the sum of the annual pension paid, it may be of benefit to those whose period of retirement subsequently proves lengthy. This option is estimated to cost more than options A & C. It would therefore be likely that an increase to the employee contribution rate (currently at 6%) is considered necessary. The option does, however, retain the final salary scheme, which is valued by employees.

C. A new, career-average scheme

This is a significant change as it moves away from a final salary scheme to a pension based on a career-average salary. The DCLG state that this structure ‘would better meet the needs of the whole modern local government workforce, with high numbers of short serving, part-time employees on low salaries…as it tends to redistribute benefits towards shorter serving staff, in comparison to a final salary scheme’.

Two options have been proposed, based on different accrual rates. A move away from the final salary scheme could prove unpopular with employees and trades unions and a career-average scheme is considered complex to communicate. A tiered employee contribution rate would also need to be considered.

D. A new hybrid arrangement, based on a career-average core with a final salary option

The new hybrid option would be based on c) above (i.e. career average) but enable employees make extra contributions to ensure they obtain final salary linked benefits in retirement. The final salary choice means that those existing employees who wished to continue in a final salary scheme could do so without reducing the quality of the career average scheme which would be provided for the majority.

7. The DCLG will look to set an appropriate employee contribution rate so as to ensure affordability for scheme employers and employees. The employee contribution rates that have been used for illustrative purposes by the DCLG vary between 6.6% and 8.1%. These rates maintain or reduce the employer rates.

8. Based on the information currently available, we would recommend Option A as it is likely to be the least costly of the options and retains a final salary scheme which is valued by current and prospective employees. Further details are included in the Appendices.

9. During this initial consultation period we have sought the views of trade unions and The Pensions Administering Authority in Worcester. We have also considered detailed guidance produced by a working party of the Local Government Pensions Committee, and advice from both the LGE and the West Midlands Local Government Association (WMLGA). Employees will be consulted during the statutory consultation period, to commence later this year.

Risk Management

There is a risk that the assessment carried out by the Actuary for Pension Fund for Herefordshire, finds that Options A is not the least costly option for Herefordshire. If this is the case, a modified response will be provided during the statutory consultation period. There is a further risk that the option finally selected proves unacceptable to employees and that employee relations significantly worsen as a consequence. Clearly a key issue for each authority responding to the consultation exercise will be cost and acceptability. The Herefordshire Council will continue to lobby for a scheme that is not only attractive to employees but is affordable. We are liaising with the WMLGA to ensure that, in addition to an individual response, a co-ordinated and robust regional response is provided to the current consultation exercise.

Alternative Options

The alternative option is not to respond and to wait for the statutory consultation period. This is not a recommended option as it is important that the views of all employers are made known to the DCLG and inform the content of the subsequent consultation and new-look scheme.

Consultees

Pensions Administering Authority - Worcester

Trade Unions

Appendices

Proposed Herefordshire Council response to the DCLG's consultation exercise – 'Where next? – Options for a new-look Local Government Pension Scheme in England and Wales'

Background Papers

None identified.

Appendix 1

Proposed Herefordshire Council response to the DCLG's consultation exercise – 'Where next? – Options for a new-look Local Government Pension Scheme in England and Wales'

C1 – Which of the four options, or variations on them, would you support and which would you oppose? Why?

We would support Option A as it:

- Represents the least costly of the options, according to the DCLG, although we are awaiting confirmation of this from the Actuary of the Pensions Fund for Herefordshire;
- Is most similar to the current scheme;
- Retains the final salary scheme;
- Is considered to be a valuable recruitment and retention tool as it tends to focus benefits on longer-term employees, who seek to pursue a career within local government by progressing through the grades;
- Is straightforward to manage in terms of transferring existing scheme members to the new-look scheme. Conversion issues would arise with each of the other options.

We would oppose Option C as it:

- Represents a move away from the final salary scheme, which is valued by existing and prospective employees;
- Is more costly that Option A;
- Would result in conversion issues in respect of transferring existing members to the new look scheme;
- Does not give provision for employees to make an additional contribution in order to obtain final salary linked benefits.

C2 – Bearing in mind the criteria for evaluation, and Chapters 1-4, which Options would you recommend be taken forward for the new-look scheme?

We would recommend that Options A, B & D be taken forward for the new-look scheme.

C3 – Which of the five possible extensions to the current flexible retirement provisions, or variations on them, would you support and which would you oppose? Why?

a) *Allow scheme members to make extra contributions to offset any reduction in their pension in the case that they wish to retire early. These extra contributions could be calculated according to cost neutral buy-back factor –*

   We would support this facility, however, it must be a system that is easy to administer, and for employees to understand.

b) *Extend flexible retirement from age 60 to the scheme's minimum retirement age (currently 50, but this will need to increase to 55 by 2010)*

   There is no need to change this, as the LGPS rules already allow flexible retirement from age 50.

c) *Remove the requirement for employees to obtain employer consent for flexible retirement*

Whilst this is cost-neutral, we would wish to retain the requirement for employer consent in order to maintain some element of management control over staffing arrangements.

d) *Remove the requirement for employees to take a reduction in hours or grade in order to take flexible retirement*

Provided this is cost-neutral, we would support this.

e) *Benefits accrued after age 65 also to be increased by cost-neutral uplift factors when a member elects to take payment of them after age 65.*

We would support this, as it is an incentive for employees to work longer. In keeping with the spirit of the forthcoming age discrimination legislation we would wish to remove any disincentive to employees working beyond age 65. Due to demographic trends, the workforce is an ageing one and we would seek to encourage the recruitment and retention of people of all ages in order to maintain effective service delivery.

C4 – What should the average employee contribution rate be in the new-look scheme?

This would depend upon the scheme chosen, but would need to reflect the view (see C6 below) that the standard employer contribution be no greater than 13%. Hence for Option A, if the overall cost for existing members is estimated at 19.4%, the employees average contribution rate would need to be 6.4%.

C5 – Should the employee contribution rate be tiered, so that a lower contribution rate would be payable on pensionable pay below a certain cut off point? Would this depend on which Option was implemented, and if so, how and why?

We have the following concerns in relation to tiered contribution rates:

- The LGPC point out that it is not necessarily a financial benefit for the lower paid to join the LGPS, and a lower contribution rate may encourage them to join, when it is not in their interest to do so.

- There is some evidence to suggest that the, relatively, small changes to the employee contribution rate for lower paid, will be such that it would be unlikely to encourage the lower-paid to join the scheme, as studies have shown the majority of the ‘unpensioned’ have urgent calls upon their money.

- Lower/higher contribution rates for the lower/higher paid may be subject to challenge in terms of sex and age discrimination i.e. it may have an indirect disproportionate impact upon employees of a certain age and/or gender.

- Approximately 36% of eligible employees in Herefordshire (i.e. excludes teachers who have separate pension arrangements) have not joined the LGPS. If a lower contribution rate were to encourage a large number of these employees to join, this is likely to have significant cost implications, as the Council would need to meet the cost of the employer contribution. The higher contribution rates paid by the higher paid may not offset the cost of those increased numbers of people joining at the lower contribution rate. An assessment would need to be carried out.

- Decisions would need to be taken as to the appropriate employee contribution rate for employees with multiple jobs, of which there are many in schools.

C6 – What would an affordable employer contribution rate be in the new-look scheme, in relation to the employer rates being paid by scheme employers for future service costs under the current scheme?

We would support the LGA position, which is that the standard employer contribution rate should be no more than 13%.