

LGPS 2014

EMPLOYER OVERVIEW

This brief overview sets out the main features of the proposed LGPS 2014 which commences from 1st April 2014. This new scheme has resulted from the first phase of the LGPS 2014 project - a process of negotiation between the Local Government Association (LGA) and the local government unions in consultation with government. Full details of the LGPS 2014 proposals including proposed member contributions and examples of benefits are available on the LGPS website (www.lgps.org.uk).

COSTS OF THE LGPS 2014

The design of the LGPS 2014 has been costed by the Government Actuary's Department (GAD) at 19.5% of pensionable payroll. As the employee contribution yield is proposed to remain at 6.5% this gives a notional employer Future Service Rate (FSR) of 13%. This compares with the most recent GAD costs of 21.7% for the current scheme (15.2% employer FSR).

Each LGPS fund will have different individual circumstances for fund actuaries to take in account when determining the FSR. However we would expect to see an average reduction in the FSR in the region of 2%, across the 89 funds in England and Wales. That translates to around £600m per annum across the 89 funds.

This reduction in the FSR would be largely achieved by the link between Normal Pension Age and State Pension Age for all membership in the LGPS 2014 as contained in the design of the LGPS 2014.

An automatic link between State Pension Age and longevity will be announced by the Office of Budget Responsibility later in the summer. This link between longevity and pension age will negate a significant degree of the risk (and potential future cost) currently associated with increasing longevity.

However, the FSR is only one element which goes toward the total employer contribution rate. The other major factor is the past service cost.

The revised scheme design will have no impact on past service costs which will continue to be managed via existing deficit reduction strategies and employer contributions. If assumptions in relation to fund performance prove to have been optimistic at the 2013 valuation then any improvements to the overall employer rate due to the revised design may well be wiped out.

Given the difficult market conditions currently in effect many employers may see the impact of the new scheme design reflected in total contribution rates being not as high as they would otherwise have been rather than seeing a reduction.

FUTURE COST MANAGEMENT

A revised scheme design is just the first part of the process contained in the LGPS 2014 project. A mechanism to manage future costs is still to be agreed. This mechanism will impose a cap and collar on future costs, modifying the scheme design should costs move outside of a tight set of parameters.

The mechanism will operate within the provisions of the upcoming Public Service Pensions Bill and will be included in scheme regulations in place for the 2013 valuation.

Future costs will also be managed by the link between Normal Pension Age and State Pension Age for all membership in the LGPS 2014.

In order to ensure that this link continues to effectively manage risk in the scheme we propose working with fund actuaries to develop an LGPS longevity index. Such an index would enable fund actuaries to track the match between increases to SPA and longevity within the scheme and recommend action should they diverge.

These measures combine to ensure that in future not all of the risk falls on the employer but is shared with employees.

NEW SCHEME BENEFITS

The table below shows the main provisions of the proposed new Local Government Pension Scheme (LGPS 2014) for membership from 1st April 2014.

	LGPS 2014
Basis of Pension	Career Average Revalued Earnings (CARE)
Accrual Rate	1/49th
Revaluation Rate	Consumer Price Index (CPI)
Normal Pension Age	Equal to the individual member's State Pension Age (minimum 65)
Contribution Flexibility	Members can opt to pay 50% contributions for 50% of the pension benefit

Definition of Pensionable Pay	Actual pensionable pay - to include non contractual overtime and additional hours for part time staff
Vesting Period	2 years

LGPS 2014 contains some new features. All other benefits remain the same as in the current scheme.

Although some other changes were discussed, including to the ill health tiers, no agreement was reached at this point. However the door remains open to a future review of the ill health provisions.

MAJOR CHANGES FROM THE CURRENT SCHEME

CAREER AVERAGE

The shift to a career average or CARE basis for calculating benefits with a 1/49th accrual rate will be broadly cost equivalent to the current final salary with a 1/60th accrual rate basis of calculation. This is because CPI (Consumer Price Index) is proposed to be the revaluation rate used to increase each year's pension for inflation. CARE pensions are calculated each year then revalued rather than being based on the final year's pensionable pay.

THE 50/50 OPTION

LGPS 2014 is proposed to contain an option for members to pay 50% of the contributions for a 50% pension whilst retaining the full value of other benefits of the scheme. This is intended to attract non-members on low pay to the scheme and retain members who suffer periods of financial difficulty.

This will be a useful tool in encouraging younger employees to join the scheme thereby managing the risk of increased employer rates brought about by an increased maturity in membership.

Although not having any immediate effect on employer rates (i.e. the employer rate is the same for all members regardless of whether they pay full or 50/50 option) it will have an effect at valuation. For example, a significant take up of this option by existing members would result in a lower employer rate at subsequent valuations. Although an increase in participation by existing non members may result in increased cash costs in the short term these should be mitigated by the resulting impact on overall rates brought about by improvements in membership profile.

However the option is not designed to replace long term membership of the full scheme but is intended to provide a short term alternative to those considering opting out of the scheme.

CONTRIBUTIONS BASED ON ACTUAL PAY FOR PART-TIME STAFF

In LGPS 2014, all members are proposed to have contribution rates determined by reference to their actual – rather than full time equivalent - pay which is not the case in the current scheme. This will mean that some part-time workers will pay a lower contribution rate than in LGPS 2008. It should also result in a simpler definition of pensionable pay for the new scheme that will be easier to calculate and remove many of the current complexities for employers.

However employers will still be required to hold and supply the data necessary to calculate pensionable pay on the current basis for pre 2014 membership.

NEW SCHEME CONTRIBUTIONS

The average member contribution to LGPS 2014 will remain at 6.5% as now. However, it is proposed there will be changes to bands and some rates. The lowest paid would pay the same or less and the highest paid would pay higher contributions on a more progressive scale after tax relief.

The bands and rates will be reviewed prior to the introduction of LGPS 2014 to ensure they obtain a yield of 6.5% of pensionable payroll taking into account any movements in pay up to the review. Please note that the rates quoted after tax relief are indicative and will depend on members' individual circumstances.

PROPOSED CONTRIBUTION BANDS AND RATES FOR APRIL 2014

Pensionable Pay	Headline/Gross Contribution	Contribution After Tax Relief
Up to £13,500	5.5%	4.40%
£13,501 - £21,000	5.8%	4.64%
£21,001 - £34,000	6.5%	5.20%
£34,001 - £43,000	6.8%	5.44%
£43,001 - £60,000	8.5%	5.10%
£60,001 - £85,000	9.9%	5.94%
£85,001 - £100,000	10.5%	6.30%
£100,001 - £150,000	11.4%	6.84%

More than £150,000	12.5%	6.88%
---------------------------	--------------	--------------

This is a major shift from the government's initial reference scheme which proposed a 3% increase in the average employee contribution rate i.e. up from 6.5% to 9.5%. At the same time a commitment to protect all members below £15,000 (a third of the membership) from any increases and those below £21,000 (another third) to a maximum increase of 1.5% was given by the government. This would have resulted in rises significantly above 3% for the remaining third of the membership.

A very strong message from members that any increases would result in damaging levels of optants out was very much in mind when reaching this agreement. However forthcoming cost control mechanisms mean that future rises in employee contributions are not ruled out.

PROTECTION OF CURRENT BENEFITS

The new LGPS will start on 1st April 2014. Only membership after that point will be in the new scheme, under the new LGPS 2014 rules.

Existing pensioner and deferred members will not see any change to their benefits.

Employees with membership in the current final salary scheme will retain the link to final salary for all membership built up before 1st April 2014 and the Normal Pension Age as under the current rules for membership up to that date.

Previously agreed protection will continue, including the provisions for those members who were protected against the removal of the Rule of 85 in 2006. There will also be additional protection for members within 10 years of age 65 as at 1st April 2012.

PENSION PROTECTION ON TRANSFER

It is proposed that the provisions of the current scheme are extended to ensure that all staff whose employment is compulsorily transferred will still be able to retain membership of the LGPS when transferred.

This is an undertaking given by government in all of the public service pension scheme Heads of Agreement. However as many of these schemes do not have the Admitted Body Status provisions of the LGPS the exact impact of this undertaking is still to be determined.