**WEST DUNBARTONSHIRE COUNCIL**

**Report by Chief Executive**

**Council : 20 December 2006**

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**Subject: Local Government Pension Scheme Changes and West Dunbartonshire Council's Policy on Discretions**

## 1. Purpose

**1.1** To update Council on the considerable regulatory changes to the Local Government Pension Scheme by virtue of the 'Local Government Pension Scheme (Scotland) Regulations 1998' and the Local Government (Discretionary Payments and Injury benefits) (Scotland) Regulations 1998.

**1.2** As a consequence of the regulatory changes to seek Council approval for the revised Policy on Discretions which identifies Council discretions in respect of early leavers, flexible retirement, augmentation of benefits, shared cost AVCs and election to join the Local Government Pension Scheme.

## 2. Background

**2.1** The LGPS (Scotland) Amendment No 2 Regulations came into place in early October 2006 to:-

- formalise HMRC (tax) simplification measures,
- to take account of the removal of the Rule of 85 which has been deemed to be age discriminatory, and
- to incorporate changes to AVC arrangements.

**2.2** There has also been a significant change to the Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 which follow on from the broad consultations which took place as part of "Facing the Future – Principles and Propositions for an affordable and sustainable LGPS in Scotland".

**2.3** The regulations impact on local government employers' discretionary powers to award employees a one off lump sum of up to 66 weeks pay where employment is terminated early either on grounds of redundancy or in the interest of the efficient exercise of the employers' functions. An "age and length of service formula currently determines the level of benefit to be awarded up to the maximum of 66 weeks. The new Age Discrimination Regulations, however, have rendered this methodology to be age discriminatory and consequently the formula driven approach has been reviewed. As of 1 December 2006 employers have freedom and flexibility to set the most appropriate compensation lump sum level for each individual case, up to a maximum of 66 weeks.

## 3. Amended Discretions Policy

**3.1** The current Policy on Discretionary Payments has been reviewed and amended in line with the changes outlined above (Appendix 1). It has been retitled 'Policy on Discretions' to incorporate the wide range of discretions available to the Council. The effect of applying some of the discretions enables flexibility in managing the Council's people resources. The discretions available are broadly as follows:-

Early Leavers

**3.2** Where an employee requests early payment of his/her pension benefits between the ages of 50 and 60, payment can only be made with the consent of the Council. In most cases there is likely to be a "strain on the fund" cost due to the early release of a pension benefit.

**3.3** The Council may decide on compassionate grounds, that the pension and lump sum should be paid without being actuarially reduced for early payment. The effect of allowing payment without reduction will be to increase the "strain on the fund" cost to the Council.

**3.4** An employee who has opted out of the LGPS will only be entitled to a payment of benefits without any reduction to these benefits from normal retirement date if the Council consents to this arrangement. However the new flexible retirement options allows payment of deferred pension benefits while the member is still in employment at normal retirement date. In this case, there is no "strain on the fund" cost as there is no early release of pension benefit.

Flexible Retirement

**3.5** In allowing flexible retirement within pension schemes, the government has had to take account of the demographic changes to the population.

**3.6** The population is ageing and the previous average of 2.4 children per family has now reduced to 1.7 children per family. The Government calculates the ratio of age 20 – 64 against age 65+ population and this is called the "Pensioner Support Ratio". Currently the ratio of population aged 20 – 64 against population of 65+ is 4:1. By 2035 the ratio will by 2.3:1 thus requiring a significantly reduced younger population to be supporting a significantly ageing population through national insurance contributions.

**3.7** The Government's dilemma is acute: whether to increase NI contributions and raise these from 11% - 16%, to pay pensioners less, or to increase the retirement age. It is planned that the state retirement age will rise from 65 to 68 by 2046 thus allaying some of the effects of the changing Pensioner Support Ratio.

**3.8** As of 1 October 2006, an employee may receive payment of their pension and lump sum and continue working in the same employment, as long as they reduce their hours or their grade, and the employer consents. Under the new arrangements, there is no abatement to pension. Under such circumstances, the employee would be able to continue to pay pension contributions to build up a second pension.

**3.9** The Government has not defined a "reduction in hours or grade" and it is likely that a legitimate reduction could be from 35 to 34 hours. Depending on the age and membership of the member, there could be "strain on fund" costs for the employer.

**3.10** If a Council allows flexible retirement then they may choose to waive, in whole or in part, any reduction in the member's benefits. If the Council chooses to do this then they must bear the cost to the fund. This is in line with the above but there would be additional cost to the Council in funding the waiver of the reduction.

Augmentation of Benefits

**3.11** This is not a new discretion but previously an employee's service could only be augmented at the beginning or the end of their service. The Council may now augment the membership of an active member at any time by up to 6 2/3 years or up to the members $65^{th}$ birthday if this is shorter.

In such cases, the Council will meet the full cost of additional membership by payment of a lump sum into the fund, payable within 1 month of a resolution being passed to agree augmentation.

Shared Cost AVCs (SCAVC)

**3.12** This is also not a new discretion. The Council may resolve to establish such an arrangement for its employees and the resolution must specify whether all active members in employment are eligible and, if not, the conditions for eligibility. The resolution must also specify whether SCAVCs may be used to provide death benefits and the amount of contributions which the Council will pay.

Employer's Discretion to reduce members' contribution rate

**3.13** The new tax regime does not restrict the amount of membership which can be accrued and therefore the previous practice of waiving an employee's contributions once they had attained 40 years service, is no longer allowable.

Election to join

**3.14** An employee who has opted out of the Scheme more than once may only rejoin if the Council consents. Where a member has joined the scheme and opted out twice to receive scheme refunds, then the employer contributions remain in the Pension Fund. Councils have been advised to take account of this in reaching a decision on whether to allow re-entry.

## 4. Other Significant Pension Changes

**4.1** There are a number of other significant changes to the Scheme in light of the new Revenue rules.

Reporting Arrangements – Administration and Information

**4.2** There are considerable additional administration, information and administration requirements which must be carried out by the Administering Authority, by the Scheme member and by the employers. SPFO intends to advise all these requirements to employers and scheme members in the near future

Lifetime Allowances

**4.3** The new rules introduce ‘standard lifetime allowances’ under which, no additional tax charges apply. These allowances will generally relate to high earners i.e. over £150,000 per annum. The allowances, however, take account of all pensionable earnings including e.g. AVCs

Active Membership post age 65

**4.4** From October 2006 the age 65 new entrant bar will be replaced with a bar at age 75. Existing members now working beyond 65 can continue to pay into the pension scheme. In accruing further membership beyond age 65, the member will have an actuarially *increased* benefit when the pension is eventually drawn.

**4.5** The scheme rules now require that we identify all staff over the age of 65 who have previously been excluded from the scheme, to be automatically brought into the scheme unless an opt-out form has been signed.

Removal of Contribution Limit

**4.6** An employee can now pay additional contributions into their pension scheme – up to their full salary if they wish. The employee would require to identify to SPFO the number of years they wish to add on and SPFO will calculate the appropriate additional % contributions to be deducted through payroll.

Conversion of Pension into Lump Sum

**4.7** The new rules remove the facility to convert lump sum into pension. However, the rules increase the current limited provisions for converting pension into lump sum and replace this with a standard conversion factor of 12:1 i.e. for every £1 the employee gives up from his pension for the rest of his life, he will receive £12 as an addition to his lump sum.

**4.8** There is however, a maximum commutation amount which is tax free and each individual will have to have this personally checked to ensure they don't fall into the tax bracket. However, members will require to elect to commute before their benefits become payable so timescales will be critical.

In House AVCs

**4.9** If an employee has 'in-house' AVCs (Prudential) then they will now be allowed to take their full AVCs as a non-taxable lump sum. This is a considerable benefit and only applies to a very few 'in-house' schemes, the LGPS AVC facility being one of them. This does not apply to free standing AVCs where only ¼ of the AVC amount is allowed to be taken as a tax free lump sum.

However this tax free cash amount can only be taken if done at the same time as other LGPS benefits, so again timing will be critical for employees.

Removing of the 85 year rule

**4.10** Based on age discrimination, the 85 year rule has now been removed. Protection arrangements have been put in place and members active in the scheme on 30 November 2006 who will be age 60 on or before 31 March 2020 will have no reduction in benefits if 85 year rule is satisfied when benefits are drawn.

**4.11** Some limited protection under certain circumstances apply to members who are active on 30 November 2006 and who will not be age 60 by 31 March 2020.

Children's' Pensions

**4.12** Children's pensions are payable to eligible children in the event of a member's death. The new rules indicate that children cease to be eligible at age 23 in all circumstances other than in incapacity cases.

Purchased Membership

**4.13** Members can pay additional LGPS contributions to purchase additional years of membership. From October 2006 there is a single limit of 6 years and 243 days

Renewal of Earnings Cap

**4.14** As of October 2006 the earnings cap for payment of contributions has gone. Previously the cap was £105,600 but now all earnings are subject to pension deductions.

## 5. Personnel Issues

**5.1** SPFO will now require the information on a retiring employee 3 months in advance of their retirement date to allow them to provide the employee with all the benefit options available to them. This is a statutory requirement. If these timescales are not met then members may be denied the right to select the retirement benefit package that best suits their financial needs in retirement.

## 6. Financial Implications

**6.1** There are significant immediate and long term financial costs associated with voluntary severance and early retirement. Early access to pensions incurs additional costs borne by the Council over the long term i.e. strain on the fund, additional lump sum and pension enhancements.

**6.2** The precise scales of costs and/or long term savings in any particular situation can only be determined through systematic and detailed analysis of information provided through the Strathclyde Pension Fund Office.

**6.3** In all circumstances of early or flexible retirement, Directors will require to fully consider all immediate and ongoing costs prior to the Chief Executive authorising all instances of early release.

## 7. Conclusions

**7.1** Due to the significance and relative complexity of these changes it is proposed that we undertake a range of communications with all staff and managers.

**7.2** It will be particularly important for staff within reach of retirement to have a full understanding of the changes to the rules in order that they can undertake decision making in drawing their benefits.

## 8. Recommendations

**8.1 Council is invited to:-**

**a) note the changes to the Pension Scheme; and**
**b) approve the amended Policy on Discretions.**

**David McMillan**
**Chief Executive**
**Date: 12 December 2006**

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**Wards Affected:** All Wards

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| **Appendix:** | Policy on Discretions |
| **Background Papers:** | Policy on Discretionary Payments |
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