

TECHNICAL BULLETIN

NO.15

FEBRUARY 2006



TO ALL EMPLOYERS WITH MEMBERS IN THE LOCAL GOVERNMENT PENSION SCHEME. PLEASE ENSURE COPIES ARE PASSED TO RELEVANT STAFF.

Changes to the Local Government Pension Scheme including the removal of the Rule of 85

Introduction

There is currently an unprecedented level of interest from all quarters - including employers, scheme members, trade unions and the press – in the Local Government Pension Scheme, its costs and benefits, and potential changes. Much of this has focused recently on the renewed proposal to remove the Rule of 85 from the Scheme. We would stress that nothing has been finally agreed at this stage – all proposals remain subject to consultation. Nevertheless, given the level of interest, we thought it would be helpful to issue a Technical Bulletin to provide an objective analysis of the current situation.

1. Context

The Local Government Pension Scheme (LGPS) has been under review for some time. Ultimately the review is likely to result in a new scheme, and various proposals in this regard have already been brought forward. Some amending regulations have been made, though the most contentious of these – the removal of the Rule of 85 in England & Wales – was subsequently revoked. The controversy surrounding the Rule of 85 was re-ignited in early December 2005 when a further set of draft regulations was published by the Office of the Deputy Prime Minister (ODPM) for consultation. The draft regulations would again remove the Rule of 85 provisions from the Scheme. The draft regulations were accompanied by various supporting documents from ODPM. Their publication was announced in a formal statement in the House of Commons by the Minister for Local Government, Phil Woolas, and a letter and briefing note issued by the Deputy Prime Minister to all Labour Groups.

2. Purpose

The purpose of this note is:

- to provide some additional briefing regarding the proposed changes to the LGPS;
- to provide an update as regards the LGPS in Scotland; and
- to consider the implications of the changes for Local Authorities in Scotland.

3. Background

3.1 Retirement

The Normal Retirement Age in the LGPS is 65. But, under the existing Scheme rules, LGPS members are able to take early retirement (from age 60 of their own choosing, or from age 50 to 60 with their employer's consent). There is currently no proposal to change this.

3.2 Actuarial Reduction

Where a member opts to retire before age 65 an actuarial reduction is applied to his pension and retirement lump sum unless he satisfies the Rule of 85.

3.3 Rule of 85

Put simply, the Rule of 85 means that when a member's age plus years of service equals 85 no actuarial reduction is applied to any early retirement. Removal of the Rule of 85 would mean that in future all members opting for early retirement would suffer a reduction to their pension and retirement lump sum.

3.4 Application of the Rule of 85

The Rule of 85 does not apply to ill health retirals. Nor does it apply in redundancy situations or in respect of retirals in the efficiency of the service: both of these are commonly dealt with instead by means of award of compensatory added years. For other retirals at less than age 60, it is understood that the Rule has been little used as, by granting consent, the employer would immediately incur a "strain on the fund" charge. The Rule has mostly applied in relation to retirals at age 60 or over where no employer's consent is required. In practice the incidence of application of the Rule of 85 will have varied from Council to Council. Administering Authorities or their actuaries should be able to supply details.

3.5 Review of the LGPS

A review of the LGPS was initiated by the ODPM in 2001 in response to the ongoing increase in average life expectancy and its impact on the cost of the Scheme. The review has gone through various stages and has progressively extended its scope from issues of cost to broader issues of scheme sustainability. These include governance, and compliance with wider government policy on pensions and with various other pieces of legislation which have appeared in the interim including the Pensions Act 2004, the Finance Act 2004 and the Employment Equality (Age) Regulations 2006.

4. Removal of the Rule of 85 (England & Wales)

4.1 Removal of the Rule of 85 - 1

Removal of the Rule of 85 from the LGPS was one of the early proposals to emerge from the review initiated by ODPM. Regulations were duly made in December 2004 which removed the Rule of 85 with effect from 1st April 2005. This materially reduced the assumed future cost of scheme provision and this was taken into account by LGPS funds in England & Wales in completing their 2004 actuarial valuations which set employer contribution rates for the 3 years from 1st April 2005.

4.2 Transitional Provisions

When the Rule was removed, transitional provisions were put in place to protect all pensions rights accrued to the date of abolition and afford further protection for those nearing retirement age.

The transitional provisions:

- provided full protection to members who would be aged 60 by 31st March 2013; and
- for all existing members, provided protection in respect of service prior to 31st March 2005.

4.3 Re-instatement of the Rule of 85

The trade unions took the view that, even with the transitional provisions, removal of the Rule of 85 represented a breach of the “pensions promise” between employers and local government employees as it meant that some members would not be able to retire at the date which they had planned and for which they had paid. The issue became extremely vexed in the early months of 2005 and widespread industrial action was only narrowly avoided in March when the government agreed to reconsider. This produced 2 outcomes:

- the Deputy Prime Minister convened a Tripartite Committee, involving representatives of government, employers and the trade unions to take the review of the LGPS forward; and
- the December 2004 Regulations were subsequently revoked, effectively re-instating the Rule of 85 as if it had never been removed.

4.4 Removal of the Rule of 85 – 2

On 2nd December 2005 a written statement laid in the House of Commons announced the Government’s intention to circulate further draft amending regulations. The regulations which were subsequently issued would (again) remove the Rule of 85, this time with effect from 1st October 2006. The various statements accompanying the draft regulations have made clear the Government’s view that the Rule of 85 is age discriminatory and would become unlawful on 1st October 2006 when the Employment Equality (Age) Regulations 2006 – which are necessary for the UK to comply with European Union Employment Directive 2000/78/EC - come into force. The Rule of 85 may also be sex discriminatory. Transitional provisions have been proposed similar to those which accompanied the original removal.

4.5 Consultation

The draft regulations were issued to interested parties for comment. The consultation period closes on 28 February 2006.

4.6 Trade Unions

The Deputy Prime Minister’s briefing note concedes that *“while both the employers and the trade unions agree that the 85 Year Rule should be removed from the Scheme, they cannot agree on the timing and process of its removal or the issue of protection for existing members of the Scheme. If necessary, these particular issues can continue to be discussed beyond the end of the consultation period initially set.”* This may be something of an understatement. Unison’s immediate response to its members reads as follows. *“Despite positive proposals from the Trade Union side to the employers and Government, which would have provided for negotiations up to June 2006 on the whole future of the LGPS, they have decided to reinstate*

the key proposals of the amendment Regulations and remove the 85 Rule without a fair replacement, with very limited protection up to 2013 only. This is entirely unacceptable to UNISON and the whole Trade Union Side which is made up of Amicus, CYWU, FBU, GMB, Napo, TGWU and UCATT, alongside UNISON. "Each of the unions is committed to hold an industrial action ballot if the Government and the employers pursue these proposals after the end of the consultation period."

5. Scotland

5.1 The Local Government Pension Scheme (Scotland) – LGPS(S)

The LGPS is commonly regarded as a single UK-wide scheme. In legal terms however, the Scheme in Scotland is separate. LGPS(S) Regulations are separate Scottish Statutory Instruments made by the Scottish Parliament and issued by the Scottish Public Pensions Agency (SPPA), an agency of the Scottish Executive. The normal procedure is for amending regulations to be made first in England & Wales and then, with some delay, to be adopted via the Scottish legislative process.

5.2 Review of the LGPS(S)

In broad terms, the current review of the Scheme has followed the normal pattern, being initiated south of the border then mirrored in Scotland with a 12-month delay. Discussions on the future of the LGPS(S) are being progressed in a manner similar to the Tripartite Committee via a joint forum involving SPPA, COSLA and the Trade Unions.

5.3 Removal of the Rule of 85 - 1

Happily, the 12 month delay meant that Scotland was spared the original revocation and re-instatement of the rule of 85, and has escaped the associated administrative and financing problems which accompanied this episode in England & Wales.

5.4 Removal of the Rule of 85 – 2

Following the December 2005 announcement of the renewed removal of the Rule in England & Wales, SPPA informally indicated their intention to revoke the Rule of 85 in Scotland with effect from 1st October 2006. Their rationale is identical to that in England & Wales – i.e. that the rule falls foul of the Employment Equality (Age) Regulations. It is worth noting that whilst power to make LGPS(S) regulations is devolved to Scotland, matters of pensions policy remain reserved to Westminster. SPPA indicated that draft Regulations will be issued for consultation in Scotland but that this will not be before April 2006. Transitional provisions similar to those in England & Wales will be proposed and the SPPA, like ODPM, has expressed its wish to discuss these proposals further with employers and trade unions during the consultation period.

5.5 Removal of the Rule of 85 – Latest Developments

In January 2006 the situation in Scotland was clarified when, in response to a question in the Scottish Parliament, finance minister Tom McCabe confirmed that *"the Scottish Executive has given careful consideration to the legal opinion presented by COSLA on the question of the removal of the Rule of 85 and also that presented to the UK government by UNISON. The Executive has concluded that retaining the rule would be incompatible with the Directive on age discrimination and therefore it will require to be removed from the LGPS with effect from October this year."*

Subsequent press reports accused the Scottish Executive of a “Pensions Con Trick” on the grounds that they were using EU legislation as a smokescreen for the fact that they want to cut back pension rights on financial grounds. But both ODPM and the Scottish Executive remain very firmly of the opinion that the Rule will become unlawful and must be removed.

6. Implications for Scottish Local Authorities

6.1 Cost

Whatever rationale is used to support the removal of the Rule of 85, the main impact from the perspective of local authorities would be a material pension cost saving in future years which, all else being equal, would result in a reduction in the contribution rate paid by participating employers into their pension fund. The Government’s partial regulatory impact assessment estimates the cost of the Rule of 85 to be between 2.0% and 2.5% of payroll per annum.

There is considerable real pressure to control pensions costs and ensure the sustainability of the LGPS, so any reduction in overall cost which might result from abolition of the Rule of 85 would be very welcome. However, the figures above must be qualified by the following caveats.

- The savings would be reduced initially by the transitional provisions; the currently proposed transitional provisions would reduce the saving by around 0.5% (of payroll) per annum until 2013; any extension of the transitional provisions would reduce the savings further.
- Whilst the Rule may be abolished in 2006, in the normal course of events employer contribution rates would not be re-assessed until the next actuarial valuations in 2008 with revised rates being introduced in financial year 2009/10. Given all the variables it might be viewed as imprudent to crystallise any savings at an earlier date.
- The LGPS(S) remains under review. The review is certain to bring further changes, some of which may increase future costs, thus further offsetting the savings from removal of the rule of 85. This should be much clearer by the date of the 2008 actuarial valuation.
- The review of the LGPS has already had one dramatic change of direction with the re-instatement of the Rule in England & Wales after it was initially abolished. Further unexpected developments cannot be ruled out.

6.2 Industrial Relations

Implicit in the reduced pensions cost which might be achieved through removal of the Rule of 85 is a reduction in the value of the benefits to members. The transitional provisions (arguably) ensure that all benefits paid for up to the point of removal will be protected, and those nearing retirement at that time will be afforded additional protection. Nonetheless, employees and trade unions can be expected to continue to take issue with the proposals and industrial relations difficulties may ensue.

The actuarial factors used in the Rule of 85 together with a worked example of one specific case are included at Appendix 1 to illustrate the potential impact of removal of the Rule and of the transitional provisions. It should be stressed that there are many other varying scenarios and that the example is illustrative only.

7. Next Steps – LGPS(S) Consultation Response

The next formal step in the process will be the opportunity for councils in Scotland to respond to the draft Scottish regulations which are not expected to appear before April. It might be expected that the detail of the regulations will be further informed by the outcome of the consultation process in England & Wales, and the ongoing discussions between SPPA, COSLA and the Trade Unions in Scotland which are taking place in the interim.

8. Conclusions

With respect to removal of the Rule of 85 there is a difficult balancing act to be achieved between pension cost savings and equitable treatment of Scheme members. The likelihood continues to be that the Rule will be removed, so the balance is likely to be struck within the transitional provisions, but there may be considerable further debate between the various parties before this is achieved.

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