Local Government Pension Scheme, 2010 onwards

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Author: Djuna Thurley

Section Business and Transport Section

The Local Government Pension Scheme (LGPS) is a funded, statutory, final salary public service pension scheme. The scheme has been reformed in recent years, with a "new look" scheme introduced in England and Wales in April 2008. Steps were also taken towards introducing a "cap and share" arrangement, with the aim of limiting the liability of the taxpayer to future cost pressures.

In June 2010, the Conservative-Liberal Democrat Government announced that from April 2011, public service pensions would be increased in line with the Consumer Prices Index rather, than in previous years, the Retail Prices Index. It also set up the Independent Public Service Pensions Commission to "undertake a fundamental structural review of public service pension provision." In its interim report, published in October 2010, the Commission concluded that an increase in member contribution rates was the most effective way of making short-term savings. In response, the Government said it intended to increase employee contributions from April 2012. Lord Hutton's final report, published in March 2011, recommended replacing existing public service schemes with new ones for future service, with benefits based on career average earnings rather than final salary. Furthermore, it recommended that the normal pension age (other than for the uniformed services) should be linked to the State Pension age (although this link should be regularly reviewed).

Local government stakeholders expressed particular concern about the impact of the increase in member contributions on LGPS funds. In July 2011, the Government said it would discuss whether there were alternative ways to deliver equivalent savings in the LGPS. In October, it launched a consultation on options for achieving short-term savings. In December, it announced that heads of agreement had been established with most of the local government unions. In April 2012, the LGA and trade unions announced the outcome of negotiations for a new LGPS in England and Wales from 1 April 2014.

This note provides an overview of the current debates on LGPS reform. Also relevant are SN/BT 4115, *Local Government Pension Scheme, 2008 reforms* and SN/BT 5768 *Public Service Pension Reform – 2010 onwards.*

Contents

1 Background

1.1 Framework

The Local Government Pension Scheme (LGPS) is a registered, funded, statutory, public service pension scheme. It is contracted-out of the State Second Pension. Its rules are in regulations made under section 7 of the *Superannuation Act 1972*. The scheme is sponsored centrally by the Department for Communities and Local Government (CLG), which is responsible for the scheme's stewardship and maintaining its regulatory framework.[1] The Secretary of State is required to consult before making regulations.[2]

The LGPS is administered, managed and funded at local level.[3] There are 81 funds in England and 8 in Wales.[4] Collectively, it is the biggest pension fund in the UK and the fourth largest in the world. The 89 funds in England and Wales hold some £145 billion in investments and assets, enough to pay benefits for over 20 years. They have four million members, including 1.6 million contribution members.[5]

The Local Government Association (LGA) says:

> Councillors sitting on the Pensions Committee in each of the 8 administering authorities in England and Wales are responsible for the management and investment of Pension Funds. Thus, as well as being funded, and funded locally, the LGPS is governed, administered and invested at individual pension fund level by elected members representing the council taxpayers and others who stand behind the LGPS. This means that the decisions are taken by democratically elected local councillors working within the restraints of local authority budgets. The administration of the LGPS is a good example of democratic accountability working well.[6]

Local government employees in Scotland are covered by a separate, but very similar, scheme. It is regulated by the Scottish Public Pensions Agency (SPPA), an Executive Agency of the Scottish Executive, but administered by fund administering authorities, of which there are 11 in Scotland. Like the scheme in England and Wales, the rules of the Scottish scheme are defined in a series of regulations made under section 7 of the *Superannuation Act 1972*. Reforms were introduced in April 2009.[7]

The average (mean) annual LGPS pension in payment is £4,200. For women the average is £2,800. This compares to an average UK occupational pension in payment is £8,740.[8] The Audit Commission has said that most LGPS pensions are small, reflecting low pay or short service. Over half the local government workforce is part time and nearly three-quarters are

1 ODPM, *Facing the future - Principles and propositions for an affordable and sustainable Local Government Pension Scheme in England and Wales*, October 2004

2 Superannuation Act 1972, s7 (5)

3 ODPM, *Facing the future - Principles and propositions for an affordable and sustainable Local Government Pension Scheme in England and Wales*, October 2004

4 CLG, Local Government Pension Scheme Funds England 2010-11, 12 October 2011; See also, Local Government Pension Scheme Funds Wales 2010-11; http://www.communities.gov.uk/documents/statistics/pdf/2006206.pdf

5 LGA, UNISON, GMB and Unite, LGPS 2014- Joint Statement, 31 March 2012

6 LGA, *Submission to Independent Public Service Pensions Commission*, 13 December 2010

7 The Scottish Government Press Release, Fairer and Affordable Local Government Pension Scheme, 14 February 2008 ; More information on the scheme in Scotland, see the Scottish Public Pensions Agency website

8 LGA, UNISON, GMB and Unite, LGPS 2014- Joint Statement, 31 March 2012

women; 47 per cent are women working part time. However, at the other end of the distribution, there is also "a 'long tail' of a few people with significantly higher pensions."[9]

1.2 Scheme rules

The main provisions relating to benefits, membership and employee contributions are in the *Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007* (SI 2007 No. 1166), as amended. The administrative arrangements and processes are in the *Local Government Pension Scheme (Administration) Regulations 2008* (SI 2008/239), as amended.[10] A short description of the conditions of membership and the main benefits that apply was issued by LGPS in April 2008.[11] More detailed information can be found in a series of scheme guides.[12]

Briefly, the LGPS is available to all employees in local government, or in other organisations that have chosen to participate in it. Teachers, police officers, firefighters and employees eligible to join another statutory pension scheme are not allowed to join the LGPS. Employees of local government (other than town and parish councils, to which special arrangements apply), automatically become members of the LGPS unless they opt not to join or have previously opted out, or are a casual employee.[13]

Pension benefits are based on total membership in the scheme and pensionable pay, usually in the final year of service. If a person is part-time, their scheme membership will count as its part-time length when working out their pension and their final pay is increased to what it would have been, had they been full-time. The accrual rate from 31 March 2008 is 1/60th. Subject to certain limits, up to 25% of the capital value of pension benefits can be taken as a tax-free lump sum. £12 lump sum is received for each £1 of pension given up. For membership before 31 March 2008, a member can receive an annual pension based on 1/80th of the final year's pensionable pay and an automatic tax-free lump sum of three times their pension.[14]

LGPS will pay **survivors' benefits** to widows, widowers, civil partners and, subject to certain qualifying conditions, to a nominated cohabiting partner. Pensions are also payable for eligible children. Members can nominate who they would like any death grant paid to.[15]

CLG produced *Local Government Pension Scheme: Commentary Guidance* on the new scheme in April 2008. The Local Government Employers website (which represents employers' interests on local government pensions policy) has a section on LGPS. It includes copies of LGPS guides and leaflets.

2 Funding

2.1 Funding arrangements

Most of the large public service schemes operate on a PAYG basis, meaning that there is no fund of assets which is invested and from which pension benefits are paid. Employer and employee contributions are paid to the sponsoring government department but these

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9 Audit Commission, *Local government pensions in England. Information paper*, July 2010, para 10

10 The SIs as originally drafted can be seen here and here

11 House of Commons Deposited Paper, DEP 2008-1080

12 Local Government Employers website, Local Government Pension Scheme guides

13 DCLG, *Where next? – Options for a new-look Local Government Pension Scheme in England and Wales,* June 2006

14 Ibid

15 Ibid

contributions are not invested. Instead, the sponsoring government department pays benefits to pensioner members, netting off the contributions received.[16]

The LGPS is different in that, like Defined Benefit schemes in the private sector, it is funded. This means that contributions are paid into a fund, which is invested, and from which pension benefits are paid. The Department for Communities and Local Government (CLG) explains how this works in the case of the LGPS:

> The assets of the pension funds are for meeting the future pension liabilities of the funds, and are part of the financial corporations sector in the National Accounts, not part of the local government sector. Pensions paid out under the scheme are therefore part of the expenditure of the pension funds, not of the local authorities that administer them. Employers' and employees' contributions, part of the income of the funds, are recorded as expenditure by local authorities in their revenue accounts, either directly or indirectly under employees' expenses.[17]

The Audit Commission explains that while the funding basis for the LGPS was more like that of a private sector scheme than other public service schemes, in other respects it was different. In particular, councils have limited influence over pension costs because it is a legal requirement for them to provide pensions and they cannot adjust the benefit package. The rules are set nationally by CLG:

> 9 The legal basis of pension schemes influences the way they have responded to rising cost pressures. Private sector employers have more scope to adjust the benefits of pension schemes than employers in the public sector.
>
> - The types of action private employers would consider are: raising employer contributions; reducing accrual rates; reducing annual pensions increase; closing defined benefit schemes to new members; or closing defined benefit schemes to existing members, while preserving pensions accrued to date.
> - In the public sector, the benefit structures are determined nationally. In the LGPS, changes to the regulations in 2007 introduced a new scheme of employer contributions (Ref. 2) and in 2008 reduced early retirement benefits by abolishing the 'Rule of 85' (Ref. 3). The government intends to introduce cap and share, which will limit the employer costs of future improvements in longevity.[18]

2.2 Employer and employee contributions

Prior to the introduction of reforms in April 2008, there was a standard employee contribution rate of 6%, except for certain members with "lower rate rights", who contributed at 5%.[19] Contribution rates are now tiered according to the level of pensionable pay.[20] The pay bands and rates applying from April 2011 are:[21]

[16] PPI, *an assessment of the Government's reforms to public sector pensions*, October 2008, p7
[17] See, for example, CLG, Local Government Pension Scheme Funds England 2010-11, 12 October 2011
[18] Audit Commission, *Local government pensions in England. Information paper*, July 2010
[19] *Local Government Pension Scheme Regulations 1997*, regulation 12.
[20] *Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007 No, 1166)*, reg 3
[21] Local Government Employers, A brief guide to the Local Government Pension Scheme in England and Wales, (April 2011)

Full-time pay rate (£ pa)	Employee contribution rate
Up to £12,900	5.5%
£12,901 to £15,100	5.8%
£15,101 to £19,400	5.9%
£19,401 to £32,400	6.5%
£32,401 to £43,300	6.8%
£43,301 to £81,000	7.2%
More than £81,100	7.5%

Employer contributions are varied, on the basis of triennial actuarial valuations of each fund's assets and liabilities, in order to ensure that LGPS benefits are properly funded.[22]

The valuation of LGPS funds as at 31 March 2007 established the employer contribution rates to ensure the scheme remains solvent for the financial period 2008-09 to 2010-11.[23] The average employer contribution would rise by over one per cent of payroll over the period to March 2010.[24] To minimise the impact on council tax, increases in employer contributions are phased in over three years, on average.[25] The average employer contribution rate is now 18% of pay. The rate varies in different funds – typically between 14 and 25% of pay.[26]

2.3 Funding position

There is no single set of accounts for the LGPS - details need to be requested from the local authority responsible for an individual fund. The CLG produces an annual statistical release based on forms submitted by the funds in England. The release for 2010-11 showed that:

- Local Government Pension Scheme expenditure on benefits in 2010-11 was £6.7 billion, compared with £6.3 billion in 2009-10, an increase of 7%
- Income from employees' contributions to the Local Government Pension Scheme in 2010-11 was £2.0 billion, a small decrease on 2009-10. Income from employers' contributions to the scheme rose by 3% to £5.9 billion in the same period.
- Income from investments rose by 5% on 2009-10 to £2.7 billion.
- The market value of the funds at end of March 2011 was £143 billion. This represents an increase of 8% on March 2010 and an increase of 47% on March 2009.[27]

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22 *Local Government Pension Scheme (Administration) Regulations 2008* (SI 2008, No. 239), Part IV; Local Government Pension Scheme website – About the LGPS

23 HC Deb, 28 April 2008, c 67W

24 Society of Council Treasurers, *The Local Government Pension Scheme (LGPS) in England and Wales: Results of the 2007 Valuation*, February 2009

25 Society of Council Treasurers, *The Local Government Pension Scheme (LGPS) in England and Wales: Results of the 2007 Valuation*, February 2009

26 Audit Commission, *Local government pensions in England. Information paper*, July 2010

27 CLG, Local Government Pension Scheme Funds England 2010-11, 12 October 2011

Local authority pension funds are required to undergo a triennial actuarial valuation. This exercise "ensures that their pension liabilities can be met, sets affordable employer contribution rates and maintains on-going stability and discipline in overall funding."[28] Any funding deficit identified will be recovered through locally agreed recovery plans, typically over a 20 year period, and be reflected in employer contribution rates.[29] CLG says:

> 24. Although a shortfall or deficit may be identified by individual fund valuations, it appears to be the case across the Scheme that contribution rates are set by pension actuaries, for each valuation period, to ensure that the fund will be able to meet its pensions promise by achieving 100% funding in the long term, to meet the funding strategy set by the administering authority.[30]

CLG consultation 2009

In June 2009, the CLG wrote to LGPS stakeholders acknowledging concern about the possible impact of the valuation of the scheme due to take place as at March 2010:

> 18. Many stakeholders believe that unless some adjustments are made to stabilise the treatment of scheme liabilities at the 2010 valuation, and so mitigate any short term adverse impacts of the current economic recession on the Scheme, the effect on members, employers and taxpayers could be disproportionately significant in terms of increased costs and so potentially council tax bills from 1 April 2011, notwithstanding the application of the new LGPS cost sharing/capping provisions.[31]

DB schemes in the private sector are also required to undertake regular actuarial valuations. Schemes in deficit must put in place a recovery plan and send it to the Pensions Regulator (TPR) to review. Trustees should aim for any funding shortfall to be eliminated as quickly as the employer can reasonably afford. TPR has set "triggers" which will prompt it to look further at particular schemes, one of these is where a recovery plan is longer than then years.[32]

The LGPS is in a different position from private sector schemes because of the constitutional permanence of local government and a strong employers' covenant.[33] It has been suggested that, in view of this, LGPS funds might take a more flexible approach to funding in order to reduce costs on employers (and, potentially, council tax payers) which may be unnecessary.[34] For example, it was suggested that local authorities could prepare financing plans to demonstrate how they would fund pension liabilities over the short, medium and long-term. A further possibility would be to increase contribution rates, particularly for higher earners.[35]

The *Financial Times* reported that opinion on the proposals was divided:

> Martin Weale, director of the national Institute for Economic and Social Research agrees. He says actuarial methods that hide the true size of obligations are foolish. "Pretending the loss isn't there is silly. Letting losses accrue is part of the widespread

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28 HC Deb, 9 September 2009, c2012W

29 HC Deb, 13 May 2009, c819-20W;

30 *Local Government Pension Scheme (Administration) Regulations 2008* (SI 2008/239), Part IV

31 Ibid

32 This is discussed in more detail in Library Standard Note, SN/BT 4877, Pension scheme funding

33 The employer covenant refers to the strength of the employer's financial position and prospects and its willingness to continue to fund scheme benefits. The Pensions Regulator, Code of Practice No 3 – Funding defined benefits, para 57

34 HMT, *Budget June 2010*

35 Ibid

policy of hoping for the best, which is what we have done in pensions for the past 30 year."

But Mike Taylor, chief executive of the London Pension Fund Authority, one of the largest members of the local government pension scheme, says there are good reasons for a temporary change of actuarial approach.

"The LGPS pays out about £5bn each year in benefits and takes in £10bn in income. There is no cash crisis for some time and most schemes are cash positive for the next 14 to 20 years."

Big increases in contributions also fly in the face of legislation underpinning local government pensions, Mr Taylor says, which requires that contribution rates remain stable from year to year.[36]

Local Government Employers said in its response to the consultation that it agreed "employer contribution rates arising from the 2010 Fund valuations are likely to be a significant issue of employers." It argued that the proposal for a financing plan to demonstrate how employers would fund their liabilities over the over the short, medium and then long-term was "sensible." It added that "full solvency, however that may be defined, should remain the clearly stated long-term objective."[37]

UNISON argued that any discussion on affordability should take account of issues such as "periods of underfunding in the 1980's and early 1990's when employer contributions were very low and some funds even took employer contribution holidays."[38] It supported the proposal that funding principles for the LGPS should be different to those in the private sector on the grounds that it was "ultimately guaranteed by central Government and does not need the same level of protection as private sector schemes."[39] The GMB also supported "detailed financing plans outlining the proportionate measures to be taken to meet the short, medium and long term funding of liabilities." It saw little merit in the proposal for local funding targets on the basis this "would diminish scrutiny of the funds and allow administering authorities, if they were so minded, to undermine the sustainability of the scheme through a pattern of routine underfunding."[40]

3 Recent reforms

3.1 2008 reforms

Following consultation, reforms to the LGPS were introduced in April 2008. Post-reform, the LGPS remains a Defined Benefit scheme, with benefits based on final salary. Pension benefits accrue at a rate of 1/60th of final salary for each year of service (compared to 1/80th and a lump sum of 3 times final salary pre-reform). The LGPS has a normal pension age of 65. The old "rule of 85" under which some employees could retire earlier than this on a full pension is being phased out, with some transitional protection. Employees pay tiered contributions, according to pay.[41]

[36] Norma Cohen, 'Pension plan for councils splits experts, *Financial Times,* 10 July 2009

[37] Local Government Employers, Local Government Pension Scheme – Delivering Affordability, Viability and Fairness, 23 August 2009

[38] UNISON, Response to LGPS England and Wales - A CLG consultation on Affordability and Viability and Fairness, September 2009

[39] Ibid

[40] GMB response to 'Local Government Pension Scheme – Affordability, Viability and Fairness'

[41] These reforms are discussed in more detail in Library Standard Note SN/BT 4115, Local Government Pension Scheme, 2008 reforms

The Audit Commission noted that post-reform employee benefits for new members of the LGPS, the civil service and the NHS are broadly similar. They are also "broadly similar to the benefits offered by private sector defined benefit pension schemes, where those are still available."[42]

The Independent Public Service Pensions Commission estimated the savings as follows:

> Across the four largest categories of scheme (local government, civil service, NHS and teachers) cost savings from the reforms, compared with what costs might have been, may be equivalent to five per cent or more of overall scheme cost by the 2040s. This estimate excludes any allowance for the possible effects at future pension scheme valuations of new arrangements for risk transfer (cap and share).[43]

3.2 Cap and share

One of the objectives of the Labour Government's reform of public service pension schemes was to ensure their "long-term sustainability." For this reason, negotiations on reforms of the teachers, NHS and civil service schemes included agreements on "cost sharing" and "cost capping". The aim was to:

> …ensure that any future increases in costs will be fairly shared between employers and employees. In addition, the cost capping mechanism will ensure that there will be an upper limit on the costs to the tax payer should costs increase [44]

The then Government's intention was to introduce a similar mechanism in the LGPS.[45] A consultation paper, *Sustaining the Local Government Pension Scheme in England and Wales* was published in February 2008. It explained the need to develop a cost-sharing approach that would be appropriate to the LGPS, given its nature as a funded and multi-employer scheme. The proposal was to establish a model national fund which would be used to calculate the proportion of costs (or savings) falling to members. This amount could be recognised through a change of contribution rates or in benefits. This change would then be fed back into the local valuation process to determine the local employer contribution rate.[46] It was proposed that stability in contribution rates could be improved by having regard to fluctuations over the longer term and by adopting a long period over which any surplus or deficit was spread. An average of 20 years is "not untypical in LGPS funds". It was proposed that costs emerging from the model scheme should be shared between employers and members on a "50:50 basis" and that employer contributions should be subject to a cap.[47]

Draft regulations were published for consultation on 27 November 2008.[48] *The Local Government Pension Scheme (Amendment) Regulations 2009* (SI 2009 No. 1025) came into force on 15 May 2009.[49]

The Independent Public Service Pensions Commission (see section 4.2 below) considered "cap and share" to have limitations:

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[42] Audit Commission, *Local government pensions in England. Information paper*, July 2010, p16, para 23-4

[43] Independent Public Service Pensions Commission: Interim Report, 7 October 2010, para 2.9, p42

[44] HL Deb, 27 October 2008, c1397W

[45] HC Deb, 23 November 2006, c 70-72WS

[46] DCLG, *Sustaining the Local Government Pension Scheme in England and Wales*, February 2008

[47] Ibid, para 42-44

[48] DCLG letter 27 November 2008

[49] These proposals are discussed in more detail in Library Standard Note SN/BT 4115, *Local Government Pension Scheme, 2008 reforms*

> Cap and share cannot take account of the increases in cost of pensions over recent decades because people have been living longer. Also, untested, complex cap and share arrangements cannot of themselves, address the underlying issue of structural reforms, nor significantly reduce current costs to taxpayers.[50]

3.3 Switch to the CPI

The Conservative Liberal Democrat Coalition Government announced in the June 2010 Budget that it would instead adopt the Consumer Prices Index (CPI) for the price indexation of the additional State Pension and public service pensions (as well as benefits and tax credits). The rationale was that it more accurately reflected pensioners' inflation experiences:

> 1.106 The Government will use the CPI for the price indexation of benefits and tax credits from April 2011. The CPI provides a more appropriate measure of benefit and pension recipients' inflation experiences than RPI, because it excludes the majority of housing costs faced by homeowners (low income households are subsidised separately through Housing Benefit, and the majority of pensioners own their home outright), and differences in calculation mean it may be considered a better representation of the way consumers change their consumption patterns in response to price changes. **This will also ensure consistency with the measure of inflation used by the Bank of England. This change will also apply to public service pensions through the statutory link to the indexation of the Second State Pension. The Government is also reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues**.[51]

The Audit Commission said that the switch to the CPI would to some extent offset the decline in funding levels caused by the financial climate:

> 39 An update of the 2007 actuarial valuations to take account of the financial climate in 2010 suggests that funding levels would have declined from an average of 84 per cent in 2007, to around 66 per cent in 2010 (Appendix D). But actuaries estimate that recent changes to the indexation could improve this by about 6 per cent. The combined effect would take funds back to around their 2004 funding position, when the aggregate funding level was about 75 per cent. [52]

The change has proved controversial because CPI increases are generally lower than RPI. Trade unions applied for judicial review of the decision to switch to the CPI for increasing public service pensions. [53] On 2 December 2011, the High Court dismissed three of the four grounds of challenge and rejected one by a majority of two to one. The unions were given permission to appeal to the Court of Appeal on some of the issues raised.[54] On 12 January, a group of unions (the FDA, Prospect, the GMB and the NUT, together with the Civil Service Pensioners' Alliance) announced that it was appealing to the Court of Appeal. [55] The issues are discussed further in Library Standard Note SN 05434 *Public service pension increases* and SN 5830 *The CPI – uprating benefits and pensions.*

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[50] Independent Public Service Pensions Commission: Interim Report, 7 October 2010, p39

[51] HM Treasury, *June 2010 Budget*, para 1.106. This is discussed in more detail in Library Standard Note SN/BT 5434 Public service pension increases

[52] Audit Commission, *Local government pensions in England. Information paper*, July 2010, para 39

[53] Prospect Press Release, 15 April 2011, Unions launch legal challenge to CPI switch; See also FDA Press Release, 19 April 2011, 'Union challenges legality of Government's pension decision'

[54] R v Staff Side of Police Negotiating Board and Others ; [2011] EWHC 3175 (Admin); NHS Employers website, High Court rules switch to CPI lawful, 2 December 2011

[55] See FDA press release 12 January 2012, FDA appeals High Court decision

4 Proposed further reforms

4.1 Debate

The sustainability and affordability of the LGPS, is an issue of ongoing debate.[56]

The Audit Commission concluded that although the LGPS had funds to cover around three-quarters of its future liabilities, and had a positive cash-flow, the current approach could not be continued indefinitely:

> The LGPS has funds to cover about three-quarters of its future liabilities, and there is a positive cashflow.
>
> - LGPS funds defray the cost of paying pensions. These funds cover about three-quarters of the total pension liabilities. The LGPS us the only major public service scheme with its own funds.
> - LGPS funds currently have a positive cashflow: more money is going into the funds than is coming out of them.
> - The LGPS assets will cover the costs of pensions in payment for the foreseeable future, given the positive cashflow and constitutional permanence of local government as an employer.
> - It is likely that there will be fewer employees contributing to funds over the next few years, but this will not affect pensions in payment.
> - A high proportion of the pensions costs of current employees in the LGPS are paid for up-front, reducing the reliance on future generations to fund pensions in payment.
>
> But the current approach cannot continue indefinitely because unfunded liabilities are being deferred into the future, to make the scheme more affordable to employers in the short term.
>
> - The cost of providing pensions for local authority employees is rising in absolute terms and as a proportion of pay because of increasing life expectancy and action needed to recover funding deficits.
> - Pension funds have been affected by lower than anticipated investment returns; the value of assets today is about 15 per cent lower than anticipated in 2007.
> - The cost of pensions affects the amount of money available to fund services, and influences council tax decisions: there are questions about whether LGPS benefits are affordable in the long run.
> - Some of the underlying affordability issues, such as the costs resulting from future improvements in life expectancy, have already been covered by forthcoming reforms to LGPS. But the proposals will not guarantee long-term sustainability.

[56] See, for example, Pauline Skypala, 'Local schemes urged to take Yale route', *Financial Times,* 20 December 2010

- The LGPS needs further reform to address the growing mismatch between liabilities and the resources available to fund them.[57]

However, any proposed changes needed to take account of the nature of the LGPS membership:

> Action is required now. The government should consider:
>
> - Reviewing employee benefits. For example, a change that would make quick savings would be to raise the normal retirement age and reduce accrual rates;
> - Giving more discretion to local pension funds to adjust the level of benefits they offer pension fund members; and
> - Raising employee contributions. Increases could be tapered to avoid increasing opt-out rates.
>
> Any reforms to the benefit structure should take into account:
>
> - The nature of LGPS membership; there are high proportions of part-time and low-paid workers; and
> - The interaction between occupational pensions and state benefits: this should be considered carefully because around half of pensions in payment are below £3,000.
>
> To avoid significant increases in employer contributions, action at the local level is also required.
>
> - Most LGPS funds could improve their funding position by adjusting actuarial assumptions; but this does not address the underlying issues.
> - Instead, pension funds need to focus on improving their investment performance, within acceptable levels of risk locally.
> - Employers should actively limit pension liabilities through measures such as controlling wage costs.[58]

In October 2009, Mike Taylor, chief executive of the London Pensions Fund Authority, argued that the LGPS needed to respond to increasing longevity:

> The LGPS is not designed to pay benefits for ever increasing periods of retirement and, without change, will face extinction. [...] Employer or taxpayer contribution rates currently take all the strain of increasing liabilities in the LGPS. This situation cannot continue and either those costs must be reduced, or employees bear a fairer share of the increasing costs.[59]

4.2 Independent Public Service Pensions Commission

Budget 2010 announced the establishment of the Independent Public Service Pensions Commission, to be chaired by former Labour Work and Pensions Secretary of State, Lord Hutton of Furness. This was to "undertake a fundamental, structural review of public service

[57] Audit Commission, *Local government pensions in England. Information paper*, July 2010

[58] Ibid

[59] Speech to National Association of Pension Funds, 16 October 2009, 'Public sector pensions: Raise the age, cut benefits'

pension provision by Budget 2011 and consider the case for short-term savings in the Spending Review period, by September 2010."[60]

Interim report

In its interim report, published in October 2010, the Commission said it had concluded that, compared to the other options, an increase in member contribution rates was the most effective way of making short-term savings. The details would be for the Government to decide. "Effective benefit levels" vary between the different schemes, and any proposed increase might need to take account of this. The Commission recommended that the Government might also wish to consider staging any increase in contributions:

> 8.16 It is up to the Government to decide on changes to the structure and level of employee contributions. Since effective benefit levels vary considerably between different schemes, particularly between pre and post reform schemes, then changes to employee contributions could be made to reflect this. However, these differences will, to some extent, be due to historic negotiations around pensions and pay.
>
> 8.17 The Commission's terms of reference set out that any case for delivering savings should be consistent with the Government's commitment to protect those on low incomes. This is important as an issue of fairness but also because of two important factors:
>
> - it is reasonable to assume that lower paid workers are more likely to opt out of a pension scheme than higher paid workers if they face the same increase in pension contributions as a proportion of their salary. This is in no one's interests, since these people could end up with an inadequate retirement income and could fall onto means tested benefits later in life. The Government would lose revenue in the short-term since these people would no longer be paying any contributions to the scheme; and
> - the Commission has shown that in final salary schemes, which still dominate the public service pension landscape, high flyers tend to do better from schemes. People with higher pensions also live for longer and so benefit from pensions for longer. This suggests that there may be a case for targeting contribution increases at high-earners, or to introduce tiered contribution levels; in a similar way that member contributions are currently tiered in the local government and NHS schemes.
>
> 8.18 To reduce the level of opt-out across the board, the Government should consider staging any increase in contributions, especially in the context of the current pay freeze. Although this might appear to reduce savings in the first few years, if it reduces opt-out levels such staging could in fact maximise extra revenue from member contributions at all income levels. In addition, the Commission does not believe that member contributions should be introduced for the armed forces at this time.

Final report

The Commission thought long-term structural reform was needed:

> The issues around fairness, sustainability, promoting productivity and the need for transparency and simplicity mean there is a need to consider long-term structural reform of public service pensions.[61]

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[60] HM Treasury, Budget 2010, HC 61, June 2010

[61] *Independent Public Service Pensions Commission: Interim Report*, 7 October 2010, Ex. 26

It summarised the issues facing public service schemes as including:

- rising benefits due to increasing longevity;
- unequal treatment of members within the same profession;
- unfair sharing of costs between the employee, the employer and taxpayers; and
- not realising the potential for plurality in the ways public services are provided.

It did not think these issues could be dealt with through traditional final salary defined benefit schemes, or by a move to a Defined Contribution [DC] model for all employees:

> 9.2 This range of issues cannot be tackled through provision of final salary defined benefit schemes. But neither would it be feasible or desirable to move towards a funded, individual account DC model for all public service employees. Apart from the major financing burden on the current generation of taxpayers, who would have to pay for both employer contributions and current benefit payments, this ignores the ability of Government as a large employer to pool and manage certain types of risk better than individuals. In addition, if lower paid employees were fully exposed to investment risk, this would increase uncertainty of income in retirement, which is difficult in particular for the low paid to manage. This is not desirable or necessary. Instead, the public service should aim to identify an appropriate way of sharing the uncertainties and risks inherent in pension provision between both the employee and employer.[62]

The Commission considered whether the LGPS should move to an unfunded model as a way of removing investment return volatility and releasing cash in the short term but decided against on the grounds that:

> [...] this might reduce employers' and funds' ability to adjust recovery periods and other assumptions, in order to limit immediate LGPS valuation pressures on employer contribution rates and Council Tax. Also, if such relaxation of funding requirements were applied to private sector admitted bodies such as contractors and charities and other non-profit making organisations, of which there may be several thousand in the LGPS, it would be equivalent to providing a new Government subsidy for the DB pensions of these private sector employers with the Government having limited control over the risk. It would also contrast with the regulatory requirements placed on other private sector employers who were offering DB schemes to employees.[63]

However, the "holding investment funds does not remove the need to consider structural reforms to deal with issues around the sustainability and fairness of benefits – issues common to all public service pension schemes."[64]

In its final report, the Commission recommended that members of the current public service schemes should be moved to the new schemes for future service, with benefits based on career average earnings:

> The main recommendation of the report is that existing final salary public service pension schemes should be replaced by new schemes, where an employee's pension entitlement is still linked to their salary (a "defined benefit scheme") but is related to

[62] Ibid, para 9.2
[63] Ibid, p84
[64] Ibid, Box 4A

their career average earnings, with appropriate adjustments in earlier years so that benefits maintain their value.[65]

Furthermore, the members' normal pension age in the new schemes should increase in line with their State Pension age:

> The Government should increase the member's Normal Pension Age in the new schemes so that it is in line with their State Pension Age. The link between the State Pension Age and Normal Pension Age should be regularly reviewed, to make sure it is still appropriate, with a preference for keeping the two pension ages linked.[66]

LGPS already has a normal pension age of 65 (in line with the current State Pension age for men). However, the State Pension age is set to increase. Under existing legislation, the State Pension age (SPA) for women is scheduled to increase from 60 to 65 over the period April 2010 to April 2020. The equalised SPA is then scheduled to increase: to 66 over two years starting from April 2024; to 67 over two years starting in April 2034; and to 68 over two years starting in April 2044.[67] However, measures in the *Pensions Bill 2011* would speed up the pace of SPA equalisation for women from April 2016 so that women's SPA reaches 65 in November 2018. The equalised SPA would then increase to 66 for both men and women from December 2018 to April 2020.[68]

Lord Hutton recommended that accrued rights should be protected:

> The Government should honour in full the pension promises that have been accrued by scheme members: their accrued rights. In doing so, the Commission recommends maintaining the final salary link for past service for current members.[69]

As regards the increase in the normal pension age, this meant that "pension rights earned up to the date of any change would be based on the current pension ages that apply to that service."[70]

4.3 Initial responses

The Government

In response to Lord Hutton's interim report, the Government said it intended to introduce "progressive" changes to employee contributions from April 2012:

> The Government will implement progressive changes to the level of employee contributions equivalent to an average of three percentage points, to be phased in from April 2012. The armed forces will be exempt from this increase.[71]

Once the armed forces are excluded, the proposed increase is equivalent to 3.2 percentage points on average:

> The interim report of the Independent Public Service Pensions Commission, chaired by Lord Hutton of Furness, found that the value of public service pensions been

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[65] Independent Public Service Pensions Commission press release, 10 March 2011, *Lord Hutton publishes his final report on public service pensions*

[66] Independent Public Service Pensions Commission: Final Report, 10 March 2010, Executive Summary

[67] *Pensions Act 2007,* s13

[68] This is discussed in more detail in Library Standard Note SN 02234 State Pension age

[69] Ibid, recommendation 4, page 154

[70] Ibid, para 7.24

[71] HM Treasury, Spending Review – policy costings, October 2010

> increasing following dramatic increase in life expectancy at retirement. Current pensioners are expected to spend over 40% of their adult lives in retirement, compared to 30% for pensioners in the 1950s. Most of these extra costs have fallen to employers and taxpayers.
>
> Spending review 2010 announced progressive changes to the level of employee contributions to public service pensions that lead to savings of £2.8 billion a year from the unfunded pension schemes by 2014-15, to be phased in from 2012-13, excluding the armed forces. This is equivalent to 3.2 percentage point increase on average. No decisions have been taken on individual schemes—this is subject of discussions with trade unions and other work force representatives.[72]

It said it expected savings from the LGPS of £900 million a year by 2014/15 as a result.[73]

Responding to the final report in Budget 2011, it said it accepted Lord Hutton's recommendations as a basis for consultation:

> The Government accepts Lord Hutton's recommendations as a basis for consultation with public sector workers, trades unions and others, recognising that the position of the uniformed services will require particularly careful consideration. The Government will set out proposals in the autumn that are affordable, sustainable and fair to both the public sector workforce and the taxpayer.[74]

Outside organisations

Most of the initial responses from outside organisations centred on the proposed increase in member contributions. The GMB union described the proposed increase as "unaffordable and unworkable":

> This unwarranted hike in member contributions will contribute nothing to the deficit yet will price many council workers out of the scheme. GMBs analysis of the effect of the contribution hike the government wants shows that it is simply not affordable to employees who are already suffering pay freezes and job losses. It is in direct conflict with the recommendations of the Hutton report in not taking any account of employee affordability.[75]

On 16 February 2010, the Local Government Group[76] wrote to the Chancellor setting out its concerns about the increase in contributions:

> The Local Government Group are very concerned that the implications for local authorities, their workforce and the wider economy may not have been fully considered by HM Treasury. These include:
>
> - with only 6.5% of the LGPS membership earning in excess of £42,000 and with protection for lower paid employees (40% of the LGPS workforce earn less than £18,000), the main burden of the 3.2% increase will fall on middle earners;

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[72] HC Deb, 24 May 2011,c590-1W

[73] HC Deb, 28 April 2011, c555-6

[74] HM Treasury, Budget 2011, para 1.132; See also HC Deb, 23 March 2011, c961 [George Osborne]

[75] GMB Press Release, 26 October 2010, '£1 billion pension raid on council workers is wrong and unsustainable'

[76] The Local Government Group says it is "an organisation that is run by its members. We are a political organisation because it is our elected representatives from all the different parties that direct the organisation through our boards and panels. However we always strive to agree a common cross-party position on issues and to speak with one voice on behalf of local government." It is made up of six organisations, including the Local Government Association

- there may be pressure during pay negotiations to recoup, via the pay settlement, the effects of any increase in contributions (or loss of future pension rights upon opting out);

- the demographics of the Scheme's membership makes it difficult to produce a set of tariff tables that are fair and progressive across all salary bands;

- there is strong evidence to suggest that the opt-out rate will be far greater than the 1% envisaged in the Spending Review announcement. Neither is there any evidence to suggest that full account has been taken of the likely reductions in the local government workforce over the Spending Review period, a large proportion of which will be scheme members;

- there is a considerable risk therefore that the £900 million target additional income by 2014/15 will not be achieved unless even greater increases are imposed on those scheme members who remain (leading to the possibility of a vicious circle of even higher opt-out rates);

- a significant increase in employee contributions at a time of pay restraint/pay cuts and increasing inflation is likely to lead to a significant worsening in industrial relations;

- such an increase in contributions will lead to a further dampening of employee spending power at a time when the Government is seeking to promote economic recovery;

- there are real concerns over the disparity between public sector schemes meaning that, for example, highly paid members of some other public service schemes will be paying a lower contribution rate than the lowest paid workers in local government;

- there are consequential recruitment, retention and promotion implications. The pension scheme as an element of the reward package will be less attractive and the cliff edges contained in the above table may act as a disincentive to seek promotion (e.g. an employee earning £24,000 who receives a £1 increase would pay an extra 3.2% on all of their earnings, reducing their take-home pay to significantly less than it was prior to the promotion);

- part-time employees, who constitute the overwhelming majority of low paid workers in local government, have their contribution rate assessed by reference to their wholetime equivalent salary. Thus, many of those part-time employees with part-time salaries below the low pay protection threshold will, in fact, not benefit from the protection (because their whole time equivalent salary is greater than £24,000);

- a significant level of opt outs would result in:

i. a serious and detrimental impact on the Scheme's future sustainability and viability;

ii. LGPS Funds would become more mature leading to a move away from equities into bonds. This could distort the bond market and a move out of UK equities (in which the LGPS Funds have significant holdings) could have an impact on the UK investment sector (FTSE).

iii. fewer employees would be making adequate pension provision for themselves, ultimately leading to further reliance on the State via means tested benefits in retirement.

> **The LGPS is different to the other public sector schemes in that it is a funded scheme and currently has a positive cash flow**.
>
> For some years the LG Group has pursued a policy position of the LGPS being sustainable and affordable. In our opinion these proposals seriously undermine these principles. All political Groups within the LGA strongly urge that this is recognised and that the Government enters into dialogue with employers and unions in order to consider further how best to achieve the Government's aims ahead of the outcomes from the report of the Independent Public Service Pensions Commission.
>
> We are prepared to consider amendments to Scheme benefits with CLG as regulator and the trade unions to try and find alternatives to mitigate the rising cost of pensions to the public purse.[77]

The trade union, Unite, also argued that alternative ways of making savings should be considered:

> The Chancellor is mistaken in demanding a 3% increase in employee contributions from the LPGS, it simply can be done. However, if savings are to be made this can be achieved through other means that will enable members to stay in the scheme rather than pricing them out through higher contributions. The LGPS is a very different scheme to others in the public sector and we urge all those who value it to make clear to the Chancellor and the Hutton Commission that LGPS reform must reflect the fact that it is a well run scheme with a large, diverse membership for whom LGPS provision is the only barrier to a retirement reliant on state benefits.[78]

EMD 1538 called on the Government to work with the LGPS Policy Review Group to examine alternative reforms:

> That this House notes the application of a 1 billion hike in employee contributions to the Local Government Pension Scheme (LGPS); that none of the additional revenue will go towards improving the financial security of the scheme; that in addition, research indicates that 40-50 per cent. of affected members may opt out of the scheme as a result of this policy thereby undermining the viability of the largest pension scheme in the UK; and calls on the Government to withdraw this policy from the LGPS and instead work with the scheme's Policy Review Group to examine alternative reforms aimed at achieving long-term sustainability of the LGPS for taxpayers, members, pensioners and participating employers.

4.4 Taking the reforms forward

As explained in section 4.3 above, most of the concern expressed by LGPS stakeholders so far has centred on the proposed increase in member contributions. Both the Local Government Group and trade unions argued that, given the particular nature of the LGPS as a funded scheme, alternative ways of making savings should be investigated.[79]

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77 Letter to Chancellor from Local Government Group, 16 February 2011

78 Unite, LGPS -2011 Budget

79 See, for example, Letter to Chancellor from Local Government Group, 16 February 2011

On 5 April, Local Government Minister, Bob Neill, said the Local Government Pension Scheme Policy Review Group[80] was engaged in developing a collective response to Hutton, with the objective of maintaining the long-term sustainability of the scheme:

> Robert Flello: To ask the Secretary of State for Communities and Local Government if he will work with the Local Government Pension Scheme (LGPS) Review Group to examine alternative reforms to achieve long term sustainability of the LGPS. [51478]
>
> Robert Neill: The Local Government Pension Scheme Policy Review Group is engaged in developing its collective response to the recommendations made by Lord Hutton in his recently published report on public service pension scheme reform. This includes the central objective of maintaining the long term sustainability of the scheme, its affordability and fairness to employers and taxpayers.
>
> Robert Flello: To ask the Secretary of State for Communities and Local Government for what reasons the funding raised by additional employee contributions to the local government pension scheme will not be used to improve the financial security of the scheme. [51479]
>
> Robert Neill: Regulatory adjustments being considered to the existing local government pension scheme employee contribution tariff will improve the viability and affordability of the scheme, and its fairness to employers and taxpayers.[81]

In a speech to the Local Government Association on 28 June 2011, the Prime Minister, David Cameron, acknowledged that the different position of the LGPS:

> Of course, because it is a funded scheme, the Local Government Pension Scheme is different from other public sector pension schemes. That's why we will have a more in-depth discussion with local government unions and the TUC about how we take this into account. But the broad thrust of the wider reforms we are proposing will affect people in this room and your workforces.[82]

On 19 July 2011, the Chief Secretary to the Treasury, Danny Alexander, made a statement setting out how discussions would be taken forward. Talks so far had established a "basis for agreement in several areas", although differences remained on "some of the key recommendations."[83] He announced the establishment of scheme-specific discussions, tasked with delivering:

> [...] initial proposals for reformed schemes by the end of October this year, allowing further work to finalise detailed scheme design before the Government introduces legislation in due course. Lord Hutton's recommendations will inform these scheme level discussions and the Government will provide scheme-specific cost ceilings. These ceilings will be based on Lord Hutton's proposals, but will go further and ensure that the pension individuals receive at normal pension age would be broadly as generous for low and middle income earners as it is now. These cost ceilings will

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[80] The LGPS Policy Review Group is a group of "key interested parties" set up in November 2006 by CLG to "assist in the on-going monitoring of the Scheme's regulatory and policy development". In order to do this, it would "focus on strategic issues, establish common ground between stakeholders and [..] monitor demographic experience in the Scheme as a basis for co-operative decision-making on Scheme developments, regulatory changes and Scheme cost-sharing." (HC Deb, 23 November 2006, c69-70WS).

[81] HC Deb, 5 Apr 2011,c 852W

[82] Prime Minister's speech to the Local Government Association Conference – 28 June 2011

[83] HC Deb, 19 July 2011, c91-4

> ensure that public service pensions remain affordable and sustainable, by setting a limit on the contribution made by the Government and ultimately the taxpayer.[84]

The Government was also committed to achieving the savings from the proposed increase in member contributions announced at Spending Review 2010. However, for the LGPS, it would discuss whether there were alternative ways to deliver some or all of the savings:

> Further to the rationale for short term savings set out in Lord Hutton's interim report, the Government announced plans to target £2.8bn savings per year by 2014-15 through public service employee pension contributions at Spending Review 2010. The scheme-by-scheme consultations for the unfunded public service pension schemes to deliver the first years' savings of £1.2bn will commence by the end of this month. Reflecting the Government's commitment to protect the low paid, the Government's has set out its preferred parameters for any design. There should be no increase in employee contributions for those earning less that £15,000 and no more than a 1.5 percentage point increase in total by 2014-15 for those earning up to £21,000. This amounts to a 0.6 percentage point increase in 2012-13 on a pro-rata basis. It is proposed that higher earners will pay more but the Government has proposed a cap on the maximum increase of 6 percentage points (before tax relief) by 2014-15. This amounts to a 2.4 percentage point cap in 2012-13 on a pro-rata basis. These consultations will be completed by the end of October, in order to ensure implementation by April 2012.
>
> The Government remains committed to securing the full Spending Review savings of £2.3bn in 2013-14 and £2.8bn in 2014-15, requiring each scheme to find savings equivalent to a 3.2 percentage point increase. Scheme specific discussions will make proposals on how these savings are achieved and will be required to make proposals by the end of October this year. For local government, the Government recognise that the funded nature of the scheme puts it in a different position and will discuss whether there are alternative ways to deliver some or all of the savings. I have today exchanged letters on these issues with the General Secretary of the Trades Union Congress and copies of these letters have been deposited in the Libraries of both Houses.[85]

The Chief Secretary to the Treasury's letter to TUC General Secretary, Brendan Barber, said:

> DCLG will invite the Local Government Group to conduct discussions with the Local Government Trade Unions with the aim of establishing a package of measures to secure the required short-term savings, equivalent to a 3.2 percentage point contributions increase in other schemes. The package will include protection from contributions increases for the lowest paid. Other issues important to the long term sustainability of the scheme shall also be discussed. DCLG will then begin the statutory consultation exercise to implement the necessary Scheme amendments to that they come into force on 1 April 2012.[86]

The TUC made the following statement:

> A meeting of the TUC's public service unions yesterday (Monday) agreed to extend the TUC's negotiations with the government on public service pensions.
>
> Further talks will take place centrally, and individual unions will be actively considering also participating in scheme level talks in order to fully explore all the issues and to

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[84] HC Deb, 19 July 2011, c91-4
[85] HC Deb, 19 July 2011, c91-4
[86] Letter from the Chief Secretary to the Treasury to TUC General Secretary, Brendan Barber, 18 July 2011

enable unions and their members to reach a judgement on whether agreement is possible or whether more unions will enter into dispute and plan industrial action.

The TUC has made clear to the government, in agreeing to continue negotiations, that unions have not agreed to or accepted any of the government's objectives or the change in indexation from RPI to CPI.[87]

October 2011 - Consultation on achieving short-term savings

On 23 September, the Local Government Group submitted its proposals on how to achieve the required short-term savings, although it had not been able to reach agreement with the unions. The key elements of its proposals were:

- No increase in employee contributions for staff earning less than £15,000, a moderate increase for those earning between £15,000 and £21,000 of 1.5 per cent and an increase of between 2 and 2.5 per cent for those earning over £21,000.
- Choice for employees by giving, for those who feel they cannot afford an increase in contributions, the option of taking a reduced pension accrual rate instead for future service from April 2014.
- Raising the normal pension age from 65 to 66 from April 2014, but only for benefits built up from April 2014. Benefits built up prior to then would retain a normal pension age of 65.[88]

On 7 October 2011, the Department for Communities and Local Government (CLG) issued a consultation paper setting out its draft proposals:

> to achieve short-term savings of £900m within the LGPS by 2014-15, equivalent to the 3.2 percentage point contribution increases in the unfunded public service pension schemes.[89]

The paper set out two options for reform involving changes to contribution and accrual rates:

> 4.1 For the LGPS in England and Wales, ministers believe there is an opportunity to consider a broad range of measures to secure appropriate levels of savings for scheme employers. This should enable the Government's priorities in implementing the £900m savings package to be met; protecting the high proportion of low paid, part-time members of the Scheme; and ensuring contribution increases are progressive.
>
> 4.3 **Option 1 -** The following approach fully meets the Government's priorities. This is the option on the basis of which we have set the cost ceiling1 for wider reform of the Local Government Pension Scheme.
>
> Option 1 - This proposal to achieve the required £900m savings by 2014-15 (3 per cent of forecast pensionable paybill) comprises of two separate elements:
>
> i) An increase in the employees' contribution tariff from April 2012, to raise an additional £450m (1.5 per cent of pensionable paybill), and
>
> ii) A change in the scheme's accrual rate from April 2013, to raise an additional £450m (1.5 per cent of pensionable paybill)

[87] TUC statement on public sector talks, 19 July 2011

[88] LG Group press release, 'Councils submit pension reform proposal to Secretary of State', 23 September 2011

[89] CLG, Consultation on proposed increases to employee contribution rates and changes to scheme accrual rates, effective from 1 April 2012 in England and Wales, 7 October 2011

A more detailed analysis is shown at Annex A

4.4 The Government Actuary's Department confirms that the measures described at Annex A above can achieve the required savings of £900m by 2014-15.

4.5 **Option 2 -** A variation on that approach involving lower tariff increases, but offset by greater changes in accrual rate, or vice versa, could be chosen. One approach is set out below.

Option 2 - This proposal to achieve the required £900m savings by 2014-15 (3 per cent of forecast pensionable paybill) comprises of two separate elements. It differs from Option 1 due to a lower contribution rate increase which is offset by a greater reduction in the accrual rate:

i) An increase in employees' contribution tariff from April 2012, to raise an additional £300m (1 per cent of pensionable paybill), and

ii) A change in scheme's accrual rate from April 2014, to raise an additional £600m (2 per cent of pensionable paybill)

A more detailed analysis is shown at Annex A

The contribution band for part-time members would (as now) be determined by their full-time equivalent salary.

CLG said that an increase in the Normal Pension Age, in combination with an increase in contribution rates and a reduction in accrual rates, could also deliver the required savings:

4.6. **Normal Pension Age:** In his final report, Lord Hutton recommended that the pension age in public sector schemes could be linked to the State Pension Age.

According to the Government Actuary's Department, setting the national pension age of the LGPS at the national State Pension Age would deliver annual savings in the region 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.

4.7 **Local Government Group:** In response to the Secretary of State's invitation of 20 July, the Local Government Group submitted a proposal to secure £900m savings by 2014-15. This consists of an increase to the normal pension age to 66, and a member choice of an increased contribution rate of change in the scheme's accrual rate.

4.8 The Local Government Group's submission (including detailed costings) to the Secretary of State for Communities and Local Government can be found in full in **Annex B** and **C** respectively.[90]

It would consider the details of the package proposed by the Local Government Group within the statutory consultation period.[91]

It proposed changing the regulations to allow employers to reduce their contributions between valuations:

4.10 The additional income achieved from the scheme amendments following the Spending Review announcement will help to re-balance the costs of public service

[90] Ibid
[91] Ibid, para 6.2

> pension provision between scheme members on the one hand, and employers and taxpayers on the other. In the context of the funded, locally administered LGPS, this is achieved when employers' contributions are reduced as part of the scheme's statutory triennial actuarial valuation process. However, the current regulations do not allow a downward revision of employer contribution rates between three-yearly actuarial valuations.
>
> 4.11 To ensure LGPS employers and taxpayers benefit from the savings achieved by the statutory amendments finally introduced, we suggest that it would be necessary to provide a technical amendment, effective from April 2012, that enables scheme-appointed actuaries to vary rates and adjustment certificates both between valuation exercises (i.e. between the 2010 and 2013 valuations), and provide that the accrual rate changes proposed are reflected specifically in the 31 March 2013 valuation exercise to reflect the level of savings produced in scheme employers` contribution rates from April 2014. Views are invited on this particular proposal and how best it might be achieved in regulatory terms.[92]

Heads of LGPS funds expressed concerns about the complexity of the proposals:

> West Yorkshire Pension Fund chair Ian Greenwood said: "It's extremely complex and I haven't got my head fully round it. I don't know how any ordinary member will understand what's in there. The single biggest danger to the scheme is crystallisation. We want them to ensure the vast majority of people stay in the scheme. If the liabilities and assets aren't aligned you would get a catastrophic situation for councils." [...]
>
> London Pension Fund Authority chief executive Mike Taylor labelled the plans "fiendishly complicated".
>
> "The two options CLG put forward are so complicated I find it difficult to get my head around. It does appear to be at the level of complication that it would be difficult to explain to our members what the proposals mean," he said.
>
> Greater Manchester Pensions Fund director of pensions Peter Morris said it was a "potentially tricky" message to get across to members."This is about as contentious an item as we've had for a while," he added.[93]

The trade union, UNISON, considered the changes to be "unnecessary" (given the funding position of the scheme and reforms already introduced) and "unfair":

> The Government wants to cut £900 million from the Local Government scheme. Even though the Department for Communities and Local Government (DCLG) argue that it wants to protect the lowest paid, their proposals to worsen the accrual rate will cut pension benefits by between £300 and £450 million by 2015. This is especially worrying for the predominantly low paid women workforce who have an average pension of just £2,800 a year – just enough to keep them off means tested benefits.
>
> The pensions' raid may not be over. Further changes to the schemes are on the table, based on the Hutton Report, this could see final salary schemes switched to career average schemes. These can sometimes be a fair alternative to final salary schemes, but only if they are carefully crafted to ensure it isn't simply a cost-cutting exercise, but designed to redistribute benefits.[94]

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[92] Ibid

[93] Michael Bow, 'Managers: LGPS plans 'fiendishly complicated', *Professional pensions,* 13 October 2011

[94] UNISON press release, Stop the great pensions robbery, 20 October 2011

Brian Strutton of the GMB was concerned that the changes could lead to "thousands of staff opting out."[95]

December 2011 – negotiations on a one-stage solution

On 20 December 2011, the Government announced that "heads of agreement" had been established with most unions in the local government, health, civil service and teachers' schemes. As previously announced, the local government scheme would be treated differently given its funded nature:

> The Local Government Association and the trade unions have agreed that the pension age in the new scheme will be linked to the state pension age, and their preference is to deliver a career average scheme. Further discussions will take place over the next three months to agree the details.[96]

A Written Statement explained that the aim would be to introduce a new scheme in 2014:

> **Local Government Pension Scheme**
>
> The Secretary of State for Communities and Local Government (Mr Eric Pickles): On 2 November the Chief Secretary to the Treasury made a statement to the House setting out an improved offer on public service pensions to public sector workers (Cm 8214). This offer provided a more generous cost ceiling for scheme-specific discussions to work within, and protected all those within 10 years of their pension age from any further change. This generous offer was conditional on the Government and trade unions reaching agreement by the end of the year, including the local government pension scheme in England and Wales, bringing to a conclusion talks that have lasted since February 2011.
>
> Since 2 November, I have been engaged in talks with the local government trade unions and the Local Government Association (LGA) to enable purposeful discussions on local government pensions reform. I can now report to the House on the heads of agreement signed jointly by the local government trade unions and the LGA on the principles governing the scheme design, ongoing cost management and governance of the new scheme to be introduced in 2014. Further work on these agreed principles will commence in the new year under the supervision of a newly appointed project board representing key scheme partners. The Government have made it clear this sets out their final position on the main elements of scheme design, which unions have agreed to. This includes a commitment to suspend any further industrial action while the final details are resolved and unions are consulting their members.
>
> The core parameters of the agreed new scheme design are set out below:
>
> a. a single solution to both the short and long term issues by the early introduction of the new scheme in April 2014, with regulations in place by April 2013;
>
> b. the single solution to be built on the basis of career average earnings;
>
> c. can include zero increases in employee contributions for all, or the vast majority of members, provided that overall financial constraints set by the Government are met;
>
> d. some elements of choice to encourage retention of existing membership and encourage new membership; and

[95] BBC News, 7 October 2011, Local government pension contribution rates to rise
[96] HC Deb, 20 December 2011, c1202

e. flexible retirement age built around the scheme's normal retirement age equal to the state pension age or age 65, whichever is later, and applies both to active members and deferred members (new scheme service only). If a member's state pension age rises, then normal pension age will do so too for all post 2015 service.

A copy of the heads of agreement has been placed in the Library of the House.[97]

The aim was to find a single solution to short and long-term issues in the LGPS:

> *Principle 1.* A single solution to both short and long term issues by the early introduction of the new scheme (regulations by April 2013 and implementation from April 2014) negating the need for scheme changes prior to April 2014.
>
> *Principle 2.* That the single solution be designed around options that will be worked on the basis of career average and can include zero increases in employee contributions for all or the vast majority of members provided overall financial constraints are met (recognising that such constraints may change subject to further negotiations with Treasury on meeting the costs of protections – principle 7 - and that there will be no triple counting of recycled savings).[98]

Scoping the principles of reform was part one of a two-part process:

> The second (and potentially most important part) being the setting of the employer contribution cap and the associated cost management and governance mechanisms required to ensure that the scheme can in future manage its own affairs without the need for secondary legislation.[99]

The 'big ticket' items to be agreed by April 2012 were:

- Confirmation of the basis of the scheme design (e.g. CARE, being a scheme where benefits are based on career average revalued earnings, rather than final pensionable pay)
- The accrual rate for the scheme (being the rate at which the pension is built up for each year of service in the scheme e.g. 1/60th of pay for each year)
- The revaluation rate (being the rate by which, during employment, each year's worth of pension is subsequently increased after it has been built up)
- The actuarial methodology for reducing or increasing benefits if they are drawn before or after Normal Pension Age
- The amount and timing of any employee contribution increases
- Any transitional protections for older scheme members
- The parameters for the maximum and minimum employer contribution to the new scheme (sometimes referred to as the employer "cap and collar")
- The mechanism for varying elements of the scheme design in the future to ensure costs are maintained within the cap and collar values

[97] HC Deb, 20 December 2011, c152-3WS
[98] Employer and union agreement on the future of the LGPS, 15 December 2011
[99] Ibid

- Recommendations on best practice in scheme governance and procurement of services by pension funds.[100]

On 9 January 2012, the "principles document" was rejected by UNITE as a "basis for a satisfactory outcome." General Secretary, Len McClusky said:

> Our senior representatives believe they have no choice but to reject the 'principles document' after Eric Pickles claimed the unions had made commitments which have not been fully discussed. There now needs to be genuine discussions without arbitary deadlines. Our members need clarity before we can move forward. In a letter on 20 December, communities secretary, Eric Pickles claimed commitments including linking the local government retirement age to the state pension age, a career average pension scheme and introducing an employer cost ceiling of 10.9 per cent, had been agreed when, in fact, discussions on these important issues were still due to take place. The letter has caused a crisis of confidence and trust. Unite's local authority workers will now consider their next steps.[101]

UNISON and the GMB have agreed to continue negotiations. The GMB said it did not understand why Unite had pulled out. The new set of negotiations would be "intensive and difficult":

> There is no doubt that the LGPS is a sound, sustainable scheme – there is equally no doubt that government wants to make it cheaper for taxpayers. That's why we will be negotiating hard to protect the interests of all members of the scheme.[102]

UNISON said the ballot of its members remained live:

> We will not have to reballot at the end of negotiations of they fail. Any decisions on final proposals in either the NHS or LGPS will be a decision for members, through an all-member ballot.[103]

4.5 March 2012 - agreement announced

In June 2012, the Local Government Association and Trade Unions announced that they had agreed proposals for reform of the LGPS in England and Wales. The LGA said:

> The main provisions of the proposed LGPS 2014 are as follows:
>
> - A Career Average Revalued Earnings (CARE) scheme using CPI as the revaluation factor (the current scheme is a final salary scheme).
> - The accrual rate would be 1/49th (the current scheme is 1/60th).
> - There would be no normal scheme pension age, instead each member's Normal Pension Age (NPA) would be their State Pension Age (the current scheme has an NPA of 65).
> - Average member contributions to the scheme would be 6.5% (same as the current scheme) with the rate determined on actual pay (the current scheme determines part-time contribution rates on full time equivalent (FTE) pay). While there would be no change to average member contributions, the lowest

[100] LGPS Heads of Agreement Q &A
[101] UNITE rejects local government pensions offer 9 January 2012
[102] GMB update bulletin on local government pensions negotiations, 11 January 2012
[103] UNISON, LGPS Newsletter 11;

paid would pay the same or less and the highest paid would pay higher contributions on a more progressive scale after tax relief (see table below).

- Members who have already or are considering opting out of the scheme could instead elect to pay half contributions for half the pension, while still retaining the full value of other benefits. This is known as the 50/50 option (the current scheme has no such flexible option).

- For current scheme members, benefits for service prior to 1 April 2014 are protected, including remaining 'Rule of 85' protection. Protected past service continues to be based on final salary and current NPA.

- Where scheme members are outsourced they will be able to stay in the scheme on first and subsequent transfers (currently this is a choice for the new employer).

- All other terms remain as in the current scheme.

- Full details of the above proposals will soon be published on the LGPS website and arrangements are being made for hard copies to be available. The LGA and unions will publish details of their own consultation arrangements.

  Future scheme costs will be monitored and controlled to ensure stability and affordability of the LGPS. Further details on cost management and scheme governance will be released once the ongoing discussions in the next part of the LGPS 2014 project are complete.[104]

More details are on the LGPS website.

The LGA and unions involved welcome the fact that they had been able to work together in the interests of members:

> **Sir Merrick Cockell, LGA Chairman, said…**
>
> "The LGA's objective in this process has been to ensure that the LGPS continues to be sustainable into the future by developing a set of proposals that are affordable for employers and council taxpayers while being fair to members.
>
> Our aim in reaching agreement on these proposals was to give employers the future cost stability they need. In my view, employers can be confident that these proposals, coupled with forthcoming cost control mechanisms, meet that aim.
>
> Along with the LGPS unions, we shared the goal of encouraging existing members to stay within the scheme and new employees to join, these proposals are an example of us working together to achieve such shared goals."
>
> **Heather Wakefield, UNISON National Secretary Local Government, Police and Justice Section, said…**
>
> "The negotiations over LGPS 2014 have been long and tough and have taken place in a demanding political and economic climate. The process has shown that UNISON, the LGA and the other local government unions can work productively together in the best interests of LGPS members and potential members.

[104] LGPS, Pension reform proposals agreed with unions - LGA media release 31 May 2012

LGPS 2014 is a sustainable, defined benefit scheme, which is designed to protect existing members and be affordable for the low paid and part-time workers, who are its majority. Under exacting circumstances, we have achieved the best possible outcome."

Brian Strutton, GMB National Secretary for Public Services, said…

"GMB members in the local government pension scheme will be relieved that, at long last, the uncertainty is over and they are able to see the future proposals for their pension scheme. Jointly negotiated by employers and unions and ratified by Government, I believe the proposals strike a fair balance between all the conflicting interests we have had to take into account.

Most importantly, I believe the proposals lay the foundation for continued sustainability of the LGPS, which Government's original proposals would not have done. In reaching this deal there have had to be compromises that will affect individuals differently, that's why, after a period of briefing and consultation, GMB will formally ballot members on this joint offer so that they can decide whether or not it is acceptable."

Peter Allenson, Unite National Officer for Local Government, said…

"Unite re-entered negotiations to ensure that we achieve the best outcome for LGPS members current and future within the terms of reference of the discussions

This has been a real negotiation between the trade unions and employers, and it is right that our members should now vote on whether to accept or reject the proposals."[105]

In terms of next steps, the LGA said:

These proposals will now be communicated to scheme members, employers, funds and other scheme interests. Unions will consult their members over these proposals and the LGA will consult employers. Government has confirmed that a favourable outcome of our consultations will enable them to move directly to a statutory consultation later in the Autumn to implement these proposals.[106]

A Ministerial Statement of 17 July 2012 explained that a statutory, national consultation by the Government would follow in the autumn:

Local Government Pension Scheme

The Parliamentary Under-Secretary of State for Communities and Local Government (Robert Neill): My right hon. Friend, the Secretary of State for Communities and Local Government, made a statement to the House on 20 December 2011 setting out principles to govern the reform of the local government pension scheme agreed between the Local Government Association and local government trade unions. These reforms are designed to ensure the scheme is sustainable and affordable in the long term, while at the same time being fair to both scheme members and local taxpayers.

I can now report to the House that the Local Government Association and local government trade unions have begun informal consultations with their respective memberships on new design proposals for the scheme to be in place by 2014, within the 19.5% cost ceiling agreed by the Government. A favourable outcome will be followed by a statutory, national consultation by the Government in the autumn.

[105] Ibid
[106] Ibid

> Details of the proposals are contained in a joint statement issued by the local government trade unions and the Local Government Association which can be found at www.lgps.org.uk. A copy of the statement has been placed in the Library of the House.[107]

Debate on the Public Service Pensions Bill

Debate in the HoL

Baroness Donaghy proposed an amendment regarding the compliance of the LGPS with the IORP Directive.[108]

Whether LGPS meets the requirements of article 18 of the IORP directive (c221 AND 226); regs will provide for scheme members to be represented on the board (c224).

[107] HC Deb, 17 July 2012, c123WS
[108] Ibid, c221-2