

WANDSWORTH BOROUGH COUNCIL

FINANCE AND CORPORATE RESOURCES OVERVIEW AND SCRUTINY
COMMITTEE – 16TH NOVEMBER 2011

EXECUTIVE – 21ST NOVEMBER 2011

PENSIONS COMMITTEE – 24TH NOVEMBER 2011

Report by the Director of Finance on a consultation to increase employee contributions to the
Local Government Pension Scheme

SUMMARY

Background. The coalition Government announced in its Spending Review (in October 2010) that, in order to make short term savings, it would be looking to introduce increases in employee contribution rates with effect from April 2012 with the aim of making savings of £900 million per annum in the Local Government Pension Scheme (LGPS). Consequently, the Department for Communities and Local Government (DCLG) are consulting on two hybrid proposals involving some increase in employee contributions coupled with a reduction in the rate at which future pensions accrue. This report summarises the Government's proposals and proposes the Council's response.

Policy issues/proposals. In March and July 2011, the former and current Leader of the Council wrote to the Secretary of State setting out the Council's view that a large employee contribution increase would be likely to result in a high number of opt-outs well in excess of the Treasury estimates. This would immediately bring to the fore risks of a downward funding spiral with reducing returns requiring a radical change to asset allocation away from equities. The change in asset allocation would have the adverse effect of higher employer contributions to balance the scheme. The Leader's letter suggested reducing the current accrual rate of 1/60th of salary for each year to 1/70th to produce a 3.2 per cent yield on pensionable pay and therefore have the same impact as an increase in employee contributions of the same amount. Those employees who wanted to retain a 1/60th accrual rate could have the option of an increased contribution of 3.2 per cent which could be applied across all salary bands.

Costs/Finance considerations. Any saving from increased employee contributions or reduced accrual of pensions would reduce the call on employer contributions at the next triennial valuation of the Pension Fund.

Conclusion. CLG have requested views be submitted as part of the consultation exercise with reference to specific questions. The Questions and proposed response are set out in Appendix 1. It is also proposed that the Council response reiterates the principles of the Leader's letter of 8th July 2011 to the Secretary of State

GLOSSARY

DCLG	Department for Communities and Local Government
IPSPC	Independent Public Service Pensions Commission
LGG	Local Government Group (formerly the Local Government Employers)
LGPS	Local Government Pension Scheme
NPA	Normal Pension Age
SPA	State Pension Age

RECOMMENDATIONS

1. The Finance and Corporate Resources Overview and Scrutiny Committees are asked to support the recommendation set out in paragraph 2 below. If they approve any views, comments or additional recommendations on this report, these will be submitted to the Executive and/or the Pensions Committee for consideration.
2. The Executive and the Pensions Committee are recommended to approve the Council's response to the consultation as set out in Appendix 1.

INTRODUCTION

3. Lord Hutton's interim report on the future of public sector pensions in October 2010 recommended that, if the Government wished to make short term savings to meet current cost pressures, then raising contribution rates would be the most effective way to achieve that objective. He also recommended that "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."
4. The coalition Government announced in its Spending Review (20 October 2010) that, in order to make short term savings, it would be looking to introduce increases in employee contribution rates with effect from April 2012 with the aim of making savings of £2.8bn a year by 2014/15 across all public service pension schemes – the share for the LGPS is £900million per annum. The Government accepted that separate discussions should take place in respect of the LGPS, recognising the funded nature of the scheme, and acknowledging that there could be alternative ways to achieve the required savings other than increasing employee contribution rates.

THE CONSULTATION

5. The Secretary of State for Communities and Local Government (Rt. Hon. Eric Pickles, M.P.) has commenced a consultation exercise outlining possible approaches to amendments to the LGPS contribution rates and accrual rates that would achieve the £900m saving. A copy of the Consultation Document has been placed in the Members' Room. The consultation period closes on 6th January 2012. However, the

CLG have requested earlier notification where an alternative approach is being proposed.

THE COUNCIL'S PRINCIPLES

6. The Council considered Lord Hutton's report in Paper No 11-375 to the Pensions Committee, Finance and Corporate Resources Overview and Scrutiny Committee and the Executive on 13th, 20th and 26th April 2011 respectively. The Council's view was that a large employee contribution increase would be likely to result in a high number of opt-outs well in excess of the Treasury estimates. This would immediately bring to the fore risks of a downward funding spiral with reducing returns requiring a radical change to asset allocation away from equities. The change in asset allocation would have the adverse effect of higher employer contributions to balance the scheme. An alternative of a lower rate scheme going forward was suggested. These views were sent to the Secretary of State by the former and current Leader of the Council on 10th March 2011 and 8th July 2011 respectively.
7. The most recent letter highlighted the case for an alternative to the proposed increase in employee contributions looking instead at reducing accrual rates. The Leader's letter suggested reducing the current accrual rate of 1/60th of salary for each year to 1/70th to produce a 3.2 per cent yield on pensionable pay and therefore have the same impact as an increase in employee contributions of the same amount. Those employees who wanted to retain a 1/60th accrual rate could have the option of an increased contribution of 3.2 per cent which could be applied across all salary bands. It is proposed that these principles form the basis of the Council's response

CLG PROPOSALS

8. The Government is consulting on two hybrid proposals involving some increase in employee contributions married to a smaller reduction in the accrual rate than that suggested by the Leader. The Government's preferred parameters for increases in contributions are as follows:
 - (a) there should be no increase in employee contributions for those earning less than £15,000; there should be no more than 1.5 percentage point increase in total by 2014/15 for those earning up to £21,000; and
 - (b) high earners should pay progressively more than those in lower salary bands but no more than 6 percentage points (before tax relief) more.
9. The CLG have set out two possible approaches that comprise two elements designed to achieve the Government's required saving of £900m by 2014/15 (3 per cent of the forecast pensionable paybill).

Option 1: Increase the employees' contribution rates from April 2012 so as to raise £450m (equivalent to 1.5 per cent of the pensionable paybill) lowers the rate at which future pensions accrue from April 2013 also to raise £450m savings. A phased increase in employee contributions is proposed starting in 2012/13 and a change in the current pension accrual rate of 1/60th of final pay for each year of service. This would reduce to 1/64th for service

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between 1 April 2013 and 31 March 2014, and to 1/65th for each year of service after 31 March 2014.

Option 2: Increase employees' contribution rates at a lower level (but still phased over three years) offset by greater reductions in the rate at which future pensions accrue. The Government suggest that one approach could be an increase of employee contribution rates from April 2012 to raise £300m (1 per cent of the pensionable paybill) plus a change in the scheme accrual rate to raise the remaining £600m. Under this option the accrual rate would reduce to 1/67th per year of service built up after March 2014.

10. The salary bands (based on full time equivalent earnings) and proposed employee contribution rates are shown in the table below. The rates are within the parameters set by the Government (e.g. no increase for the low earners).

OPTION 1 - Salary Band (national % of membership)	Current rate	2012/13 (increase %)	2013/14 (increase %)	2014/15 (increase %)
£0 - £12,900 (8.67%)	5.5%	5.5% (0.0%)	5.5% (0.0%)	5.5% (0.0%)
£12,901- £15,100 (10.61%)	5.8%	5.8% (0.0%)	5.8% (0.0%)	5.8% (0.0%)
£15,101- £19,400 (25.20%)	5.9%	5.9% (0.0%)	6.0% (0.1%)	6.0% (0.1%)
£19,401- £21,000 (7.47%)	6.5%	6.7% (0.2%)	7.2% (0.7%)	7.7% (1.2%)
£21,001- £32,400 (31.34%)	6.5%	7.2% (0.7%)	8.0% (1.5%)	8.3% (1.8%)
£32,401- £43,300 (11.16%)	6.8%	7.5% (0.7%)	8.3% (1.5%)	8.7% (1.9%)
£43,301- £60,000 (4.18%)	7.2%	8.2% (1.0%)	8.7% (1.5%)	9.0% (1.8%)
£60,001- £81,100 (0.91%)	7.2%	8.7% (1.5%)	9.2% (2.0%)	10.0% (2.8%)
£81,101- £100,000 (0.25%)	7.5%	9.0% (1.5%)	9.8% (2.3%)	11.0% (3.5%)
£100,001- £150,000 (0.16%)	7.5%	9.5% (2.0%)	11.0% (3.5%)	12.0% (4.5%)
£150,001+ (0.05%)	7.5%	10.0% (2.5%)	12.0% (4.5%)	12.5% (5.0%)
Option 2 - Salary Band (national % of membership)				
£0 - £12,900 (8.67%)	5.5%	5.5% (0.0%)	5.5% (0.0%)	5.5% (0.0%)
£12,901- £15,100 (10.61%)	5.8%	5.8% (0.0%)	5.8% (0.0%)	5.8% (0.0%)
£15,101- £19,400 (25.20%)	5.9%	5.9% (0.0%)	6.0% (0.1%)	6.0% (0.1%)
£19,401- £21,000 (7.47%)	6.5%	6.5% (0.0%)	6.8% (0.3%)	6.8% (0.3%)
£21,001- £32,400 (31.34%)	6.5%	6.8% (0.3%)	7.2% (0.7%)	7.5% (1.0%)
£32,401- £43,300 (11.16%)	6.8%	7.1% (0.3%)	7.8% (1.0%)	8.2% (1.4%)
£43,301- £60,000 (4.18%)	7.2%	7.8% (0.6%)	8.4% (1.2%)	8.8% (1.6%)
£60,001- £81,100 (0.91%)	7.2%	8.7% (1.5%)	8.8% (1.6%)	9.5% (2.3%)
£81,101- £100,000 (0.25%)	7.5%	9.0% (1.5%)	9.8% (2.3%)	10.5% (3.0%)
£100,001- £150,000 (0.16%)	7.5%	9.3% (1.8%)	10.8% (3.3%)	11.5% (4.0%)
£150,001+ (0.05%)	7.5%	9.5% (2.0%)	11.8% (4.3%)	12.5% (5.0%)

11. The effects on the amount of pension accrued for one year's service is shown in the table below.

OPTION 1 - Final pensionable pay (31/03/2015)	1 year of service		
	Current - 1/60th	1 April 2013 - 1/64th	1 April 2014 - 1/65th
£10,000	£166.66	£156.25	£153.85
£25,000	£416.67	£390.63	£384.62
£40,000	£666.67	£625.00	£615.38
£80,000	£1,333.33	£1,250.00	£1,230.77

OPTION 2 - Final pensionable pay (31/03/2015)	1 year of service	
	Current - 1/60th	1 April 2014 - 1/67th
£10,000	£166.67	£149.25
£25,000	£416.67	£373.13
£40,000	£666.67	£597.01
£80,000	£1,333.33	£1,194.03

12. CLG have illustrated that the expected savings that would be achieved by these options are as follows:

OPTION 1	2012/13	2013/14	2014/15
Contribution Increase	£180m	£360m	£450m
Accrual Rate change	£0	£360m	£450m
Total	£180m	£720m	£900m
OPTION 2			
Contribution Increase	£95m	£220m	£300m
Accrual Rate change	£0	£0m	£600m
Total	£120m	£240m	£900m

13. In September the Local Government Group submitted a proposal to CLG aimed at securing savings of £900m by 2014/15. Their proposal consists of raising the Normal Pension Age to 66 and providing Scheme member choice of either an increase in employee contributions or a change in accrual rate.

CONCLUSIONS

14. There is also a presentational difficulty with any move to further increase employee contributions as it would simply accentuate the divide between the funded LGPS and the other unfunded public sector schemes. Just to take one example, the Head of the Civil Service (salary £235,000) will pay a maximum additional contribution of 6 per cent to the Civil Service scheme by 2014/15 - taking his total contribution to 7.5 per cent. By comparison a council employee in London currently pays 6.8 per cent (for a salary of £32,500) or 7.2 per cent (for a salary of £43,301). This is before any proposed increase in contributions which would push these figures well above the revised Civil Service figure. This makes it difficult to demonstrate fairness within the public sector schemes.
15. Any saving from increased employee contributions or reduced accrual of pensions would reduce the call on employer contributions at the next triennial valuation of the Pension Fund. An interim valuation performed at the current time is not supported as it would be likely to increase employer contributions as investment market values have deteriorated and Gilt yields have fallen leading to a reduction in assets and an increase in liabilities.
16. CLG have requested views be submitted as part of the consultation exercise with reference to specific questions. The Questions and proposed response are set out in [Appendix 1](#). It is also proposed that the Council response reiterates the principles of the Leader's letter of 8th July 2011 to the Secretary of State.

The Town Hall
Wandsworth
SW18 2PU
8 November 2011

C. BUSS
Director of Finance

Background Papers

No background papers were used in the preparation of this report.

All reports to the Overview and Scrutiny Committees, regulatory and other committees, the Executive and the full Council can be viewed on the Council's website (www.wandsworth.gov.uk/moderngov) unless the report was published before May 2001, in which case the Committee Secretary (Mr. G.S Collins on 020 8871 6021 or gcollins@wandsworth.gov.uk) can supply it if required.

WANDSWORTH BOROUGH COUNCIL

**PROPOSED RESPONSE TO CLG CONSULTATION
ON
THE LOCAL GOVERNMENT PENSION SCHEME**

- (a) **Question 1** – Do the proposals meet the policy and objectives to deliver the necessary level of savings in the LGPS?

Response: There are significant risks that the answer to this question is no. The LGPS is a funded scheme. Our concern is that further increases in contributions could lead to more staff choosing to leave the scheme. In the short term the council would gain from opt-outs as it would save the employer's contribution but in the longer term the cost to the council could rise significantly.

A funded scheme needs a positive cash flow from contributions to make the best return in investment markets. Any reduction in contributions will lead to increased amounts of investment income from fund managers being used to pay existing pensions. As cash flow deteriorates the Fund will need to switch investment allocations away from equities to the more predictable returns from bonds and gilts if it is to protect against the possibility of being forced to sell assets in a downturn.

The danger is that with funding levels in its Pension Fund reducing, the council would face ever higher increases in employer contributions with a consequent effect on council finances. This is now becoming more likely given growing concern about Sovereign debt, reducing equity markets, falling UK Government Gilt yields and forecasts of lower global growth.

- (b) **Question 2** – Are there any consequences or aspects of the proposals that have not been fully addressed?

Response: Yes. The potential effects of large numbers of opt outs have not been addressed and nor has the presentational difficulty with any move to further increase employee contributions as it would simply accentuate the divide between the funded LGPS and the other unfunded public sector schemes. Just to take one example, the Head of the Civil Service (salary £235,000) will pay a maximum additional contribution of 6 per cent to the Civil Service scheme by 2014/15 - taking his total contribution to 7.5 per cent. By comparison a council employee in London (salary £32,500) currently pays 6.8 per cent or 7.2 per cent for a salary of £43,301. This is before any proposed increase in contributions which would push these figures well above the revised Civil Service figure. This makes it difficult to demonstrate fairness within the public sector schemes.

- (c) **Question 3** – Is there a tariff or alternative measures which consultees think would help to further minimise any opt outs from the Scheme?

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Response: Yes. Reduce the current accrual rate of 1/60th of salary for each year to 1/70th to produce a 3.2 per cent yield on pensionable pay and therefore have the same impact as an increase in employee contributions of the same amount. Those employees who wanted to retain a 1/60th accrual rate could have the option of an increased contribution of 3.2 per cent which could be applied across all salary bands.

- (d) **Question 4** - Are there equality issues that could result in any individual groups being disproportionately affected by the proposals? If so, what are considered to be the nature and scale of that disproportionate effect? What remedies would you suggest? –

Response: No response

- (e) **Question 5** - Within the consultation period, consultee's views are invited on the prospects of introducing into the LGPS a link with State pension Age as recommended to the Government in Lord Hutton's report.

Response: This change is a complex issue involving a multitude of ways of introduction, for instance on service after State pension age change dates, or linked to individual SPA dates, and/or with any transitional protection mechanisms. Accordingly this issue should be subject to a detailed consultation on its own or as part of a new scheme.
