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Dear Colleague

Local Government Pension Scheme – Regulatory Impact Assessment

Please find attached (at **A**) a copy of the Regulatory Impact Assessment (RIA) produced by Communities and Local Government and published on 29 December 2006 that accompanies the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007.

For enquiries on the content of this letter and the RIA, please e-mail Charlotte Hine-Haycock Charlotte.Hine-Haycock@communities.gsi.gov.uk or Nicola Rochester Nicola.Rochester@communities.gsi.gov.uk. Alternatively, you can telephone 020 7944 6016.

Yours sincerely

Charlotte Hine-Haycock

ADDRESSEES

The Chief Executive of:

County Councils (England)
District Councils (England)
Metropolitan Borough Councils (England)
Unitary Councils (England)
County and County Borough Councils in Wales
London Borough Councils
South Yorkshire Pensions Authority
Tameside Metropolitan Borough Council
Wirral Metropolitan Borough Council
City of Bradford Metropolitan District Council
South Tyneside Metropolitan Borough Council
Wolverhampton City Council
London Pension Fund Authority
Environment Agency
Police Authorities in England and Wales
Fire and Rescue Authorities in England and Wales.
National Probation Service for England and Wales

Town Clerk, City of London Corporation
Clerk, South Yorkshire PTA
Clerk, West Midlands PTA

The Secretaries of:

Local Government Association
LGPC
Employers' Organisation for Local Government (LGE)
PPMA
SOLACE
ALACE
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New Towns Pension Fund
ALAMA
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Society of County Treasurers
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Society of Welsh Treasurers
Association of Metropolitan Treasurers
Society of London Treasurers
Association of Consulting Actuaries
Northern Ireland Public Service Alliance

Trades Union Congress

UNISON
TGWU
GMB
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Aspect
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Association of Educational Psychologists
Audit Commission
NILGOSC
Confederation of British Industry
Business Services Association

Other Government Departments:

GAD; DoE (NI);SPPA ; DEFRA; DfES

INITIAL REGULATORY IMPACT ASSESSMENT (RIA)

Title of Proposal

1. To replace the existing Local Government Pension Scheme Regulations 1997 (as amended) with the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007.

Purpose and Intended Effect of Measure

Objective

2. To replace the Local Government Pension Scheme Regulations 1997 with new regulations to ensure the sustainability and affordability of the Local Government Pension Scheme (LGPS), particularly in relation to the consequences of greater pensioner longevity and the challenge of a changing and more diverse workforce. At the same time the benefit package must still be useful in terms of recruitment retention and motivation, whilst being seen as affordable by employers and tax payers. The proposals build on the staged and phased developments of the last 18 months. The new Regulations will be introduced on 1 April 2007 to come into force across England and Wales from 1 April 2008.
3. The new Regulations focus on the building up of future rights in the LGPS for Scheme members from 1 April 2008, and how rights accrued to 31 March 2008 are secured.

Background

4. Communities and Local Government oversees the statutory framework of the LGPS and the Secretary of State has responsibility as regulator of the Scheme to ensure its ongoing solvency. The Secretary of State, by means of the Local Government Pension Scheme Regulations 1997, requires local authority pension funds to carry out actuarial valuations every three years to ensure the funds remain sustainable and viable for the future.
5. The minister outlined in his statement of 23 November the decision to retain the LGPS as a good quality final-salary pension scheme, guaranteed by statute.
6. The development of a new-look LGPS is taking place alongside reforms to other public service schemes and to the state pension system. At the same time, DWP is considering reforms of the State Pension Scheme, featuring the Pensions Bill of 29 November 2006. This was followed by the 12 December Pensions White Paper, *Personal Accounts: a new way to save*.
7. Separately the Teachers', Civil Service and NHS pension schemes are each completing, or are in the process of developing, new schemes. The Teachers' Pension Scheme has already introduced amending regulations which will come into affect in January 2007. Discussions continue in relation to the Civil Service and NHS schemes with the intention of introducing changes in the New Year.

8. As confirmed in the responses to this summer's consultation paper *Where Next?* (see next Section) the LGPS is recognised by the majority of stakeholders as a key component of the reward package available to workers in and around local government. Maintaining the attractiveness of the Scheme as an investment option is important in order to promote the idea of future members saving and participating in the Scheme.
9. An independent actuarial assessment, commissioned as part of the LGPS reform developmental work, also drew attention to a number of areas of concern which could potentially cause problems for the viability and affordability of the existing Scheme. In particular, increasing pensioner longevity is placing a greater than estimated strain upon Funds throughout England and Wales (see next Section).
10. A clear consensus has emerged within the Scheme during 2006 and following the *Where Next* consultation around the need to reform the Scheme to ensure its sustainability and affordability

Rationale for government intervention

11. Evidence has demonstrated that life expectancy of Scheme members is increasing significantly. This has placed added burden upon pension funds across the country. Scheme actuaries now have evidence to show that earlier assumptions had underestimated the level of liabilities relating to life expectancy, indicating that contribution rates to the Scheme were too low. This has led to a necessary revision of contribution rates, falling to employers, in line with an inevitable increase in the cost of the Scheme.
12. The actuarial study has indicated that longevity of male Scheme members retiring at 65 or above has risen by 31% along with a 19% rise for women in the Scheme between 1974 and 2004. That is to say, the average period that a pension is expected to be in payment has risen from 12.2 years to 16.0 years for men and from 16.1 years to 19.0 years.
13. Further to this, local government pensioner longevity, i.e. the life expectancy of Scheme pensioners once they have reached the age of 65, is higher in the LGPS than the national average.
14. The decision to consult on a number of proposals for a new-look LGPS was designed to find out what employers and employees wished from a revised scheme, whilst remaining within the boundaries of sustainability, affordability and fairness, with a view to building a consensus about features of the new-look scheme.
15. A failure on the Government's behalf to act against the background of the above issues would result in a number of significant threats to the sustainability of the LGPS, namely; a rising cost of the Scheme leading either to substantially increased contribution rates from employers and/or employees, or in some cases consequential increases in Council Tax. The alternative would be to offer a Scheme package that does not deliver on the Government's intention to provide a reasonable level of earnings in retirement and employers' wishes to see a valuable recruitment and retention feature of local authority employment sustained.

Consultation

Within government

16. Ongoing exchanges of policies and principles have taken place between officials from the LGPS and other public sector schemes, including those in Scotland and Northern Ireland.

Public consultation

17. A statutory consultation exercise (*Where Next? – Options for a new-look Local Government Pension Scheme in England and Wales*) on the proposals for a new-look Local Government Pension took place between 30 June and 29 September 2006.
18. The consultation paper set out four options for a future LGPS:
 - Option A
An updated current (final salary) scheme base on an accrual rate of 1/80th, with minor additional benefit improvements;
 - Option B
A new, final salary scheme with an accrual rate of 1/60th rather than 1/80th, plus automatic lump sum and minor additional benefit improvements;
 - Option C
A new, career-average scheme with benefits accruing at least 1.65% of pay each year with indexation, and minor additional benefit improvements; or
 - Option D
A new, hybrid arrangement, based on a career-average core plus a final salary *option* and minor additional benefits.
19. A copy of the department's letter outlining the proposals and the report itself were sent for comment to;

The Chief Executives of:

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- District Councils (England)
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- South Yorkshire Pension Authority
- Tameside Metropolitan Borough Council
- Wirral Metropolitan Borough Council
- City of Bradford Metropolitan Borough Council
- South Tyneside Metropolitan Borough Council
- Wolverhampton City Council
- London Pension Fund Authority
- Environment Agency
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GAD

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SPPA

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20. By the end of October 2006 a total of 431 responses to the *Where Next* consultation document had been received.
21. There was a clear and strong consensus amongst respondees to the *Where Next?* consultation indicating significant support for a final-salary scheme which meets the test of affordability, viability and fairness to members employers and taxpayers.

22. A final-salary scheme approach would successfully deliver on the employers' intention to maintain the Scheme as attractive to members for recruitment and retention purposes, and staff motivation and the Government's to provide good quality, secure pensions for workers in and around Government.
23. Summaries and details of the responses in full are available from the Communities and Local Government website www.communities.gov.uk/lgps.
24. At this stage it was evident that the majority of interested parties had dismissed the possibilities set out in *Where Next?* to introduce a new-look scheme based upon CARE (Career Average Revalued Earnings).
25. The more radical options of a CARE scheme or a hybrid system linking CARE and final salary were not supported across the board by respondees for a number of reasons including their wish to see the LGPS compare with other public services and a failure to meet the challenge of providing a benefit package which would directly assist in recruiting, motivating and retaining staff.
26. Whilst a final-salary scheme based upon Option A was favoured by a number of Scheme interests, such a response did not take account of the need to recycle 50% of the savings from the removal of the Rule of 85, as had been agreed by the Government and the main stakeholders.

Options

27. Two options have been considered:
 - A) Doing nothing;
 - B) Proceeding with a final-salary cost framework.

Option A - Introduce a revised version of the current scheme with additional benefits

28. The option to do nothing in the way of changing the existing Scheme is not sustainable. Following ministerial assurance earlier in the year that 50% of the saving to be made from the removal of the Rule of 85 would be recycled into the Scheme, a failure to reform would contradict this agreement which was also jointly supported by the Government and LGPS interested parties. This would leave open serious questions about the Scheme's viability and acceptability to taxpayers who would otherwise face increasing costs of provision through potentially higher council tax bills.

Option B – A revised, final salary scheme with an improved accrual rate

29. It is recognised that a final salary scheme is both attractive to potential employees and is a useful tool in recruiting and retaining LGPS members. An improved accrual rate of 1/60th is seen as particularly appealing in comparison with the current 1/80th rate. As part of the reforms, provision of a tiered contribution rate produces more yield within the Scheme to help sustain it and to allow some improving proposals to be developed further. It also assists lower paid members within the Scheme and encourages a higher take-up of

membership.

Alternative options considered

30. No other options were considered appropriate in the light of the clear reaction and support for a final salary arrangement from employers, trades unions and members following the *Where Next?* consultation.

Costs and Benefits

Sectors and groups affected

31. This set of proposals affects the public sector employers and employees involved in employment for local government. There are currently 1.7 million employees in the Local Government Pension Scheme. The latest figures indicate that 72% of the Scheme membership comprises women and that 57% of these members work part-time.
32. The intention of the new-look Scheme is to avoid any adverse costs for non-Scheme members and their employers. The Government's actions are designed also to ensure there are no significant adverse effects on council tax and to ensure ongoing solvency and stability in the Scheme.
33. Private sector firms and their workforce operating in the UK, voluntary organisations and charities, or consumers will also benefit from the Government's objectives for the scheme being achieved.

Race equality assessment

34. It is for individual employers operating within the framework provided to ensure they are not placing discriminatory provisions in the workplace. The framework itself meets the objective of not being discriminatory by providing full and equal access to employees of all LGPS bodies.

Health impact assessment

35. If potential members are fit to work, they are recognised to be fit to join the Scheme.
36. The aim of the new-look Scheme is to ensure that sufficient retirement income is available and accessible to maintain a satisfactory standard of living in retirement for Scheme members.
37. Flexible retirement provisions as part of the benefit package are considered to allow Scheme members to continue working at reduced hours and/or grade, and accruing pension whilst starting to draw their pension.

Rural considerations

38. There are no distinct rural considerations in this reform proposal. There is, however, an identified difference in mortality rates in geographic terms within England and Wales. The *Review of Demographic Patterns* carried out by Hymans Robertson illustrated that Scheme members living in Rural areas were living, on average, 1.5 years longer than those in Urban areas (where Rural is

understood to be County Councils and Urban is Metropolitan funds). Increasing longevity will have a greater impact on cost pressures facing the LGPS Rural funds than it will Urban funds.

Breakdown of costs and benefits

Option A – Do nothing

39. Economic

Benefits – There are no benefits to be obtained from the ‘do nothing’ option.

Costs – Failing to address the longevity and other associated issues will greatly challenge the Scheme’s ability to remain affordable and viable, fair to taxpayers and attractive to existing and future scheme members, and employers alike.

40. Environmental

There are no environmental costs or benefits to this proposal.

41. Social

Benefits – There are no obvious social benefits resulting from the introduction of Option A. This proposal fails to meet fully the equality proofing requirements of the LGPS. Scheme viability would not be reinforced for the longer term benefit of membership and for tax payers generally.

Costs – A failure to reform would not meet the equality proofing necessary to ensure fairness in terms of access and individual cost across the workforce, and unfavourably impact on the high proportion of lower paid and part-time employees, the majority of which are female.

Option B - Introduce a revised, final-salary scheme

42. Economic

Benefits - The benchmark costings produced by GAD indicate that the financial cost of this scheme will decrease over time as existing scheme members (at a cost of 20.5% of payroll) are replaced by new entrants (18.6%). This favourably impacts upon several interests but, critically, ensures the Scheme’s viability.

The table below illustrates the outline benchmark costs of a revised LGPS benefit structure to apply from 1 April 2008:

	% of Payroll for Existing Members	% of Payroll for New Entrants
Refined <i>Where Next</i> Cost	20.7	18.6
More Generous Ill-Health	0.1	0.2
10 Year Guarantee on Age Retirement	0.1	0.1
Spouses’ Pension at 160th	-0.4	-0.4
TOTAL COST	20.5	18.5
Less Employee Contributions	6.3	6.3

EMPLOYER CONTRIBUTION RATES	14.2	12.2
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43. Environmental

There are no environmental costs or benefits to this proposal.

44. Social

Benefits – Social benefits will be enhanced by the increased access to the Scheme of mainly female part-time employees. Further development of flexible retirement options provides more choice for older members and employers needing to manage an ageing workforce. In addition, these proposals meet the equality proofing requirements of the LGPS as well as ensuring long-term Scheme viability to the benefit of membership and tax payers generally.

Costs – There appear to be no social costs associated with this option.

Small Firms' Impact Test (SFIT)

45. This is not required as the proposals relate in the main to the public sector.

46. A separate consultation process is continuing on how contractors could best be accommodated within the LGPS.

Competition Assessment

47. This is not required for this proposal.

Enforcement, Sanctions and Monitoring

Enforcement

48. This is not required for this proposal.

Sanctions

49. This is not required for this proposal.

Monitoring and review

50. All LGPS funds undergo an actuarial valuation every three years. The last valuation took place at March 2004 and the next will take place at March 2007. LGPS administering authorities' pension funds and their actuarial context are both separately monitored regularly by investment consultants and actuaries. In addition, Funding Strategy Statements must be regularly reviewed and provide a statutory framework for the relevant actuarial valuation exercise and any informal, interim reviews.

51. To assist in the on-going monitoring of the Scheme's regulatory and policy development, Ministers have agreed that a policy review group of key interested parties should be established to focus on strategic issues and establish common ground among stakeholders as a basis for co-operative decision-making on Scheme developments and future changes, changes in Scheme demographics and new cost-sharing arrangements which are to be in place for March 2009. The work of the group will complement the substantial statutory and non-statutory consultation arrangements which already exist within the current regulatory framework for the Scheme. One of the first issues the Group might wish to consider is the policy development process surrounding the new Pensions Bill and, in particular, the relationship of State retirement age reforms to occupational schemes, such as the LGPS. Arrangements to establish the Group will begin shortly.

Implementation and Delivery Plan

52. The regulations are designed to be in place to assist with implementation on 1 April 2007. They will take effect on 1 April 2008.

Post-Implementation Review

53. Communities and Local Government are to establish a policy review group with the intention of monitoring the implementation of the Regulations.
54. As outlined in Paragraph 50, an actuarial review of all LGPS funds is carried out every three years. The next review is due in March 2007. A regular dialogue takes place with actuaries and actuarial advisers.
55. By 31 March 2009 guidelines on a cost sharing mechanism to inform further development and actuarial valuations will also be in place to assist in ensuring affordability and viability objectives are in place.

Summary and Recommendation

Option	Total cost per annum Economic, environmental, social	Total benefit per annum Economic, environmental, social
A - Do nothing	<p>Economic – Scheme viability comes under increasing threat .</p> <p>Environmental – None</p> <p>Social – Challenges of a changing workforce not met and certain unfairnesses in meeting costs not removed. Lack of good quality pensions provision, particularly for part-timers and/or female workers.</p>	<p>Economic – A more stable basis to meet future challenges and fairness to taxpayers not achieved</p> <p>Environment – None</p> <p>Social – Equality-proofing would not be achieved. Reduced incomes in retirement.</p>
B – Introduce a revised, final-salary scheme	<p>Economic – Scheme costs will decrease as the ratio of</p>	<p>Economic – Areas where pensioner longevity is</p>

	<p>New Entrants to Existing Members moves in favour of the former</p> <p>Environmental – None</p> <p>Social - None</p>	<p>higher than the national average may experience an increase in Scheme liabilities (typically rural funds)</p> <p>Environmental – None</p> <p>Social – Equality proofing requirements would be met. Encourages workforce diversity and increases take-up.</p>
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56. The recommendation is for option B to be adopted and the necessary regulations have been prepared for Ministerial approval to achieve that.

***** As this is an Initial RIA, this section is subject to change and review *****

Declaration and Publication

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

Signed

Date

Minister's name, title, department

Contact point for enquiries and comments: