Report No.
RES 11123

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Pensions Investment Sub-Committee**
Date:	**9th November 2011**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**GENERAL UPDATE**
Contact Officer:	Peter Turner, Finance Director, Tel: 020 8313 4668 E-mail: peter.turner@bromley.gov.uk
Chief Officer:	Director of Resources
Ward:	All

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1. Reason for report

This report provides a general update to Members on changes that will impact on the Pension Fund.

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2. RECOMMENDATION

2.1 The Sub-Committee is asked to note the report.

Corporate Policy

1. Policy Status: Existing policy. The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: No cost

2. Ongoing costs: Recurring cost. Total administration costs estimated at £2.5m (includes fund manager/actuary fees, Liberata charge and officer time)

3. Budget head/performance centre: Pension Fund

4. Total current budget for this head: £31.6m expenditure (pensions, lump sums, etc); £40.3m income (contributions, investment income, etc); £434m total fund value at 30th September 2011)

5. Source of funding: Contributions to Pension Fund

Staff

1. Number of staff (current and additional): 0.4 FTE

2. If from existing staff resources, number of staff hours: c 14 hours per week

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Legal

1. Legal Requirement: Statutory requirement. Local Government Pension Scheme (LGPS) Regulations 2007

2. Call-in: Call-in is not applicable.

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): 5,103 current employees; 4,578 pensioners; 4,028 deferred pensioners

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? No.

2. Summary of Ward Councillors comments: N/A

3. COMMENTARY

3.1 Previous Updates

3.1.1 The report to this Sub-Committee on 10th May 2011 provided summary details of the outcome of the Independent Public Services Pension Commission, initial suggestions from Department for Communities and Local Government (DCLG) of possible options for increases in employee contributions to the pension scheme and changes relating to restricting pensions tax relief.

3.1.2 The Governments final response to the Commission is expected during 2012 and revised proposals have been issued for short term savings in the Local Government Pension Schemes (see 3.2). Legislation has now been implemented for the restriction of pensions tax relief. This report focuses mainly on the latest short term proposals for savings in the LGPS.

3.1.3 For staff in the LGPS, there is currently a graduation from a minimum employee contribution of 5.5% to a maximum of 7.5% with an accrual rate of 1/60th. It is now proposed to have a greater number of salary bands (increased from 7 to 11) with contributions ranging from 5.5% for the lowest paid staff (those earning less than £12,900) up to a top rate of 12.5% for those earning in excess of £150,000.

3.2 Latest Government Proposals

3.2.1 On 7th October, DCLG issued their consultation document with proposals on short term reforms required by the Treasury to produce £900m savings for LGPS by 2014/15.

3.2.2 The consultation sets out two options and CLG also include proposals submitted by the Local Government Group. The consultation on the options for change will run until 6th January 2012 and is centred on the following main areas:

- Increasing member contributions from April 2012;
- A reduced rate of benefit accrual; from April 2013 and/or April 2014 (benefit accrual rate was 1/80th until April 2008 and is currently 1/60th);
- An increase in the normal pension age

3.2.3 The two options comprise a) a higher contribution rate increase with lower accrual reduction and b) a lower contribution rate increase with higher accrual rate reduction. A key concern was to minimise “opt out risk” associated with trying to achieve the savings via an increase in member contributions only and the changes seek to address this concern as follows:

Local Government pension Scheme	Approach 1	Approach 2
Average increase in member contributions	1.5%	1.0%
Maximum increase in member contributions	5.0%	5.0%
Accrual rate 2012/13	1/60th	1/60th
Accrual rate 2013/14	1/64th	1/60th
Accrual rate 2014/15	1/65th	1/67th
Overall saving in pensionable paybill	3.0%	3.0%

Further details are provided in Appendix 1 and are also available on the DCLG link below:

http://www.lge.gov.uk/lge/aio/13931436

3.2.4 DCLG is proposing that employee contributions increase by 1.5% (or 1.0%) of pay on average over three years. In addition, the accrual rate will be reduced from 1/60th to 1/65th (or 1/67th) of final salary between April 2013 and April 2014, providing further savings. In Option 1, the DCLG is suggesting that half of the savings (£450m) should come from employee contribution increases from April 2012 with the other half from changes to accrual rates from April 2013. Those earning under £15,100 will not face any increase. The Government has also confirmed that those earning up to £21,000 would not see a rise greater than 1.2%. However, those on higher incomes will face increases of up to 5% of pay, with those earning over £150,000 seeing their contributions increase from 7.5% to 12.5% in three steps from April 2012 to April 2014. An average earner with a salary of £25,000 will see their contribution increase in three steps from 6.5% to 8.3% of pay.

3.2.5 The treasury's original proposals for short term changes have been amended (see previous report in May). Instead of achieving the whole of the savings target by increasing employee contribution rates, DCLG is suggesting realising half (or optionally a third) of the savings through a smaller average increase in contributions. The remaining savings will come from a change in the accrual rate from April 2013, producing smaller benefits when staff retire.

3.2.6 Other changes to the LGPS are also on the horizon from 2015 following the recommendations from the Hutton report (see previous report). Details are expected once CLG have submitted their headline proposals to the treasury by the end of October 2011.

3.2.7 The Local Government Group has produced alternative proposals, included in the consultation documents, comprising an increase to the normal pension age from 65 years to 66 years and a member choice of an increased contribution rate or a change in the scheme's accrual rate. The negotiations between the local government employers and the trade unions failed to reach agreement, so the proposals outlined above are DCLG's own solution. However, the unions and employers have been encouraged to continue negotiations during the consultation period.

3.2.8 These proposals aim to achieve short term savings of £900m per annum within the LGPS by 2014/15, equivalent to an overall contribution increase of 3.2% in the unfunded public service pension schemes.

3.2.9 Some concerns have been expressed that changes could lead to higher opt out rates. Although target savings will initially be achieved, funds could face increasing deficits which may require further contributions from employers. The combination of redundancies and outsourcing will further reduce the number of active members nationally. This trend is expected to continue. A significant opt out rate would make schemes more mature , requiring different investment strategies to match assets and liabilities, which would mean a switch from investing in riskier assets such as equities to less risky assets such as bonds. This could ultimately have adverse longer-term consequences on the viability of the scheme.

3.2.10 The changes are also likely to create additional administrative work with further changes from 2015. Some members will end up with potentially four sets of benefits outlined on their statements – those calculated under pre-2008 reforms, those based on the accrual rate implemented under the previous Government, post-2012 accruals and any further changes from 2015.

3.2.11 Respondents are required to put forward alternative and suitably costed proposals but must confirm their intention to do so by 28th October 2011 and supply supporting cost information by 25th November 2011.

3.2.12 The requirement to have triennial valuations is set out in regulations and provides for a valuation to be carried out as at 31st March 2010 and every three years thereafter. Amending the current legislation will be required to enable the valuation certificate to be reviewed. The Government plans to amend legislation that will be introduced before April 2012 to allow actuaries to revisit employer contribution rates included within their contribution certificates issued at the 2010 valuations (with the expectation of a reduction. i.e. additional contributions from employees can be offset against employer contributions). Latest estimates indicate that there could be full year savings in employer costs of about £1.5m. Any final savings will depend on the detailed final proposals.

3.2.13 The Chancellor's Budget (March 2011) referred to merging the operation of National Insurance and Income Tax. In addition, there are plans to change the state pension scheme, which could be the "beginning of the end" of the contracted-out national insurance rate for defined benefit pension schemes. Under current arrangements, employees pay 1.6% less and employers 3.7% less than the standard rates. From April 2012, these discounts will be cut back. In the longer term, the elimination of the contracted-out rate would result in additional costs of £1.4m per annum for the Council as well as a reduction in take home pay for employees.

3.3 Future Cost Envelopes

3.3.1 The Treasury has written to the unions on the future "cost envelopes" which determine the maximum employer contribution to the national schemes (as a percentage of pensionable salary costs). Recent reports indicate the following:

Scheme	Total cost	Average Employee Contributions
NHS	20.2%	9.5%
Civil Service	20.8%	5.6%
Teachers	20.1%	9.6%
LGPS	17.3%	8.0%

3.3.2 These cost ceilings are likely to be applicable from 2015. The LGPS would, based on the above, have less to spend on the new scheme than the other schemes identified. It is not clear why there are such significant differences at this stage and more details on the reasons for the differences are awaited.

3.4 Independent Public Services Pension Commission

3.4.1 Further changes are on the horizon arising from the recommendations of the Hutton report (see previous report) from 2015.

3.4.2 The Chancellor, as part of the March Budget, has confirmed that the Government "accepts Hutton's recommendations as a basis for consultation with public sector workers, unions and others" and agreed that there should be "no cherry-picking on either side". There is likely to be some delay in the implementation of the changes to allow for consultation but the changes will certainly be implemented before the end of the parliamentary term.

3.4.3 Ex-Labour Cabinet minister John Hutton was appointed by the coalition Government to head a commission into public sector pensions with the aim of providing full proposals in time for the 2011 Budget.

3.4.4 A summary of the key changes arising from his proposals, reported previously to this Sub-Committee, is shown below:

(a) Final salary pension scheme to be replaced by career average scheme but existing accrued pension rights to date to be honoured (thereafter move to average salary for the remaining years only in new scheme);
(b) Normal pension age to be linked to state pension age (state pension age is set to rise to 66 by 2020);
(c) If the employer contribution exceeds a set ceiling (to be determined), then there should be a review of costs, which could include the option to increase employee contributions or alternatively a review of the whole scheme;
(d) New changes will be introduced before the end of the current Parliament.

4. POLICY IMPLICATIONS

4.1 The Council's Pension Fund is a defined benefit scheme operated under the provisions of the Local Government Pension Scheme (LGPS) Regulations 2007, for the purpose of providing pension benefits for its employees. These regulations allow local authorities to use all the established categories of investments, e.g. equities, bonds, property etc, and to appoint external investment managers who are required to use a wide variety of investments and to comply with certain specific limits.

5. FINANCIAL IMPLICATIONS

5.1 Details are provided in the main body of the report.

Legal and Personnel Implications	None directly arising from this report
Background Documents: (Access via Contact Officer)	References to websites that give background information are provided in the report.

6. PERSONNEL IMPLICATIONS

The key implications in summary form are as follows

6.1 Against the background of pay freeze since 10/11 and the unprecedented cost cutting measures and the associated organisational changes, the proposed changes to employee pension contributions and benefits will undermine the ‘psychological contract’ and the wider relationship between local government staff and their employers. The mix of pay freeze, redundancies and increased employee pension contributions are likely to impact on staff morale.

6.2 There is an increasing possibility of challenging industrial relations at national and local levels. The TUC and its main constituent trade unions have already indicated that a coordinated strike action is likely to take place on 30 November 2011, in direct response to the proposed changes to public sector pension schemes. To that effect all the main trade unions in the Council (including the teaching unions) have issued ballot papers their members on whether to strike or not. Managers have been asked to assess the impact of industrial action on their service and plan accordingly. Although the Council does not have the final say over pension changes, we will seek to influence and manage the local industrial relations climate with a view to minimising the impact on frontline services

Legal Implications	None directly arising from this report
Background Documents: (Access via Contact Officer)	References to websites that give background information are provided in the report.

Appendix 1

Approach 1 – Employee Contribution Rate and Accrual Rate

Tariff Band	Current	2012/13	2013/14	2014/15
£0 - £12,900	5.5%	5.5%	5.5%	5.5%
£12,901 - £15,100	5.8%	5.8%	5.8%	5.8%
£15,101 - £19,400	5.9%	5.9%	6.0%	6.0%
£19,401 - £21,000	6.5%	6.7%	7.2%	7.7%
£21,001 - £32,400	6.5%	7.2%	8.0%	8.3%
£32,401 - £43,300	6.8%	7.5%	8.3%	8.7%
£43,301 - £60,000	7.2%	8.2%	8.7%	9.0%
£60,001 - £81,100	7.2%	8.7%	9.2%	10.0%
£81,101 - £100,000	7.5%	9.0%	9.8%	11.0%
£100,001 - £150,000	7.5%	9.5%	11.0%	12.0%
£150,001 +	7.5%	10.0%	12.0%	12.5%
Accrual Rate	1/60th	1/60th	1/64th	1/65th

Approach 2 – Employee Contribution Rate and Accrual Rate

Tariff Band	Current	2012/13	2013/14	2014/15
£0 - £12,900	5.5%	5.5%	5.5%	5.5%
£12,901 - £15,100	5.8%	5.8%	5.8%	5.8%
£15,101 - £19,400	5.9%	5.9%	6.0%	6.0%
£19,401 - £21,000	6.5%	6.5%	6.8%	6.8%
£21,001 - £32,400	6.5%	6.8%	7.2%	7.5%
£32,401 - £43,300	6.8%	7.1%	7.8%	8.2%
£43,301 - £60,000	7.2%	7.8%	8.4%	8.8%
£60,001 - £81,100	7.2%	8.7%	8.8%	9.5%
£81,101 - £100,000	7.5%	9.0%	9.8%	10.5%
£100,001 - £150,000	7.5%	9.3%	10.8%	11.5%
£150,001 +	7.5%	9.5%	11.8%	12.5%
Accrual Rate	1/60th	1/60th	1/60th	1/67th