

EXPLANATORY MEMORANDUM TO
THE LOCAL GOVERNMENT PENSION SCHEME (BENEFITS, MEMBERSHIP AND
CONTRIBUTIONS) REGULATIONS 2007

2007 No. 1166

1. This explanatory memorandum has been prepared by the Department for Communities and Local Government and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Description**

2.1 These Regulations contain provisions relating to membership in, contributions to, and benefits receivable from, the new Local Government Pension Scheme which will come into force on 1st April 2008, replacing the Scheme established under the Local Government Pension Scheme Regulations 1997 (S.I. 1977/1612).

3. **Matters of special interest to the Select Committee on Statutory Instruments**

3.1 Further Regulations relating to the administration of the new Scheme, to pensions for local authority councillors, and to transitional arrangements will be laid during the course of the year.

4. **Legislative Background**

4.1 The Regulations are made under the powers conferred by sections 7 and 12 of the Superannuation Act 1972.

5. **Territorial Extent and Application**

5.1 This instrument applies to England and Wales.

6. **European Convention on Human Rights**

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. **Policy background**

7.1 These regulations are the culmination of over two years of consultation and discussion with all local government pension scheme interested parties, which began with the publication of a consultation document *Facing the Future* in October 2004. From April 2005 until September 2006 much of the discussion centred on the removal of a provision from the

Scheme, a rule of 85, which ultimately the High Court confirmed was discriminatory on grounds of age. The significance of removing this provision was to confirm the Scheme's normal retirement age of 65, and allowed development of a new benefit structure which recycled half of the savings from this change. The final removal of the rule was effected in April 2006 and transitional protections confirmed by July 2006.

7.2 Following this regulatory change to the current Scheme a further consultation document *Where Next* was published in June 2006 which set out four costed proposals for a new benefit package which would be put in place from 1 April 2008. These options were the refined product of a greater range of possible benefit structures which had been discussed with employers and trades unions, based on actuarial modelling provided by the Government Actuary's Department, between March and May 2006. To allow for administrative issues to be resolved it was made clear that the required amending regulations would be put in place by the end of March 2007, giving all administrators one year in which to amend systems and advise current Scheme members. Responses were requested by October 2006, and some 435 responses were received from a wide range of LGPS interests. A full report of these responses was posted on the Department website.

7.3 In written statements to Parliament on 23 November the Ministers, Phil Woolas and Baroness Andrews, set out the proposed way forward which followed as a result of comments made during the consultation. An official letter from Communities and Local Government, which provided more technical detail, was issued on the same day, promising that a draft copy of a statutory instrument giving effect to these proposals would be published in December. The draft SI was sent to all interested parties on 22 December 2006.

7.4 The consultation on these draft proposals ended on 28 February, and some 173 responses were received. During the consultation period discussions continued with interested parties to overcome any outstanding issues from either an employers or trade union perspective. Both the responses and these discussions helped finalise the statutory instrument which has now been made.

7.5 The main features of the new benefit package are:-

- An improved accrual rate of 1/60th per year in a final salary pension scheme, replacing the old 1/80th with automatic lump sum
- Improved death in service benefits, from twice to three times pensionable pay
- Better targeted ill health provisions with two levels of benefit enhancement
- Extended access to flexible retirement, with either the whole or part of accrued rights coming into payment
- Extension of survivor benefits to nominated co-habiting partners
- Tiered contribution rates to address equity issues across the whole membership

7.6 Before proceeding in regulation, Ministers gave full consideration to the views expressed and the extensive discussions which have taken place over the last two and a half years, and in particular the detailed discussions on a suitable benefit package from April 2008 which meets the need to stabilise Scheme costs while at the same time providing a benefit structure which meets both employer requirements and member needs. An important consideration has also been the need to avoid passing the cost of offering a pension scheme to LGPS employees which did not impose a burden on national taxpayers and council tax payers

7.7 These regulations also require the Secretary of State to issue guidance by no later than March 2009 on how long term demographic pressures are to be dealt with. This guidance will be

informed by a policy review group which will meet for the first time in May 2007. This guidance will make clear the mechanisms which will operate to maintain the historic ratio of risk and cost sharing between Scheme members and LGPS employers and the need to adhere closely to the benchmark cost assessments which have been set out in the Regulatory Impact Assessment (RIA) prepared for these Regulations.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum

9. Contact

9.1 Brian Town at Department for Communities and Local Government (Tel: 020 7944 6015 or e-mail: brian.town@communities.gsi.gov.uk) can answer any queries regarding the instrument.

FINAL 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 for England and Wales, effective from April 1 2008.

Purpose and Intended Effect of Measure

Objectives

2. To replace the Local Government Pension Scheme Regulations 1997 with a reformed set of new scheme regulations to ensure the sustainability and affordability of the Local Government Pension Scheme (LGPS), particularly in relation to the challenges of greater pensioner longevity and of a changing and more diverse workforce, whilst ensuring that men and women are treated fairly and that the Scheme itself remains affordable, viable and fair to taxpayers.
3. The Government's intentions also focus on the need to stabilise the costs of the Scheme, to ensure an equitable benefit/cost balance between all stakeholders and that no additional costs are imposed on taxpayers.
4. At the same time, the benefit package must still be effective in terms of recruitment, retention and motivation, and be affordable both to employers and tax payers. The proposals build on the staged and phased reform developments of the last two years. The new Regulations will be introduced in April 2007 to come into force across England and Wales from 1 April 2008.
5. The new Regulations focus on the building up of future rights in the LGPS for Scheme members from 1 April 2008, and transitional provisions will follow to ensure that rights already accrued to 31 March 2008 are statutorily secured.

Background

6. 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.

7. The Government's written Ministerial statement to Parliament of 23 November 2006 reaffirmed the intention to retain the LGPS as a good quality final-salary pension scheme, guaranteed by statute, provided it remained affordable and viable.
8. The development of a new-look LGPS is taking place alongside reforms concerning scheme retirement ages in other public service schemes. At the same time, DWP is considering reforms of the State Pension Scheme. This is being achieved by the introduction of the Pensions Bill on 29 November 2006, followed by a further White Paper, *Personal Accounts: a new way to save* covering the introduction of savings accounts in December 2006.
9. The Teachers' Pension Scheme has already introduced reforms which came into force in January 2007. The Civil Service and NHS pension schemes are in the process of developing new regulations, and discussions continue with the intention of introducing changes shortly.
10. As confirmed in the responses to the 2006 consultation paper *Where Next?* issued by Communities and Local Government (see paragraphs 17 and 18, 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 is important in order to promote the idea of future members saving and participating in the Scheme.
11. An independent actuarial assessment, commissioned by the department in 2006 as part of the LGPS reform developmental work, also drew attention to a number of areas of concern which could potentially cause problems regarding 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 paragraphs 13-15, next Section).
12. A clear consensus of Scheme interests prior to and following the *Where Next?* consultation identified the need to reform the Scheme in line with the Government's objective to ensure its affordability and long term sustainability, based on final salary terms.

Rationale for government intervention

13. Evidence has demonstrated that life expectancy of Scheme members has increased and is continuing to increase significantly. This has placed an added burden upon all LGPS funds in England and Wales. Scheme actuaries have provided 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 examination of the employers' and employees' contribution rates, and the ratio between the two, in line with an unavoidable increase in the cost of the Scheme linked to stock market fluctuations and other factors. Inevitably, this trend in higher costs has repercussive effects on employers' budgets and, in the context of Local Authorities, feeds through directly to council tax-payers or to service delivery.
14. The commissioned actuarial study indicated that longevity of male Scheme members retiring at 65 or above has risen by 31%, with an 18% 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 for women. This is good news for members of the Scheme, but has caused a revaluation of all past service liabilities.
15. 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 (living 2 to 4 years longer than pensioners in the population as a whole).
16. Over the 1974-2004 period there has also been a significant change in the membership profile of the scheme. Membership of the LGPS in 1974 was overwhelmingly male with full time white collar workers in life time jobs in the majority. However, the Scheme has since been fully opened up to all elements of the workforce to avoid any challenges on grounds of discrimination. There are now some 1.7 million members of whom it is estimated that 70% are female, over 50% work part time, with an average period of Scheme membership down to as low as 6 years.

17. The consultation *Where Next? – Options for a New-Look Local Government Pension Scheme in England and Wales* carried out in 2006 intended to discover what employers and employees wished to see in a revised scheme, whilst remaining within the policy objectives set by the Government of sustainability, affordability and fairness to tax-payers, with a view to building a consensus about features of the new-look scheme.
18. The results of the *Where Next?* consultation formed the basis of the reform package for the new Scheme as set out in the Government's statement to Parliament on 23 November and subsequently of the draft regulations circulated for statutory consultation on 22 December 2006. Details of the new-look Scheme are featured in the next section.
19. Failure on the Government's behalf to address the range of issues and pressures described above would result in an unacceptable threat to the sustainability of the LGPS, namely; a rising cost of the Scheme leading either to substantially increased contribution rates from employers and employees or, the prospect of unacceptable increases in Council Tax.
20. The direct consequence of failure to address the need for Scheme reform at the present time would be a Scheme package which is not cost-effective and which does not deliver on the Government's intentions to provide a reasonable level of earnings in retirement. It would also fail to satisfy employers' wishes to see a valuable recruitment and retention feature of local authority employment not only retained but modernised for the increasingly diverse nature of the workforce in and around local government. This position of the employers is also solidly supported by the local government trades unions.

Consultation

Within government

21. Ongoing discussions on policies and principles for reform have taken place between officials involved with the LGPS and other public service schemes, including those in Scotland and Northern Ireland, who are managing their own particular LGPS frameworks and concurrent reforms.

Public consultation

22. A statutory consultation exercise on the proposals for the new-look Scheme regulations began on 23 November 2006, and concluded on 28 February 2007. A draft copy of the statutory instrument *The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007* was published on 22 December 2006.
23. The draft regulations reflected the substance of the responses received to the *Where Next?* consultation and discussions with key stakeholders.

The main features of those proposals in the draft regulations now form the basis of the benefit package included in the finalised regulations:

Normal Retirement Age (NRA) of 65 for release of unreduced benefit;

Pension to be indexed in line with the Retail Prices Index and must come into payment before the member's 75th birthday;

Earliest age for release of pension is 55 by 2010 for current members, except on grounds of ill-health;

Early release on objective justification basis;

Early release from age 55 on grounds of redundancy or business efficiency;

Augmentation of membership/benefits on an objectively justified basis;

Final Salary Pension based on 1/60th of salary for each year of pensionable service, with the flexible option to commute pension at the rate of £1 of annual pension for £12 of lump sum up to a maximum tax-free lump sum of 25% of capital value of accrued benefit rights at date of retirement;

The best actual in the last three years or an averaging of 3 years (financial) within the last ten;

Survivor benefits for life, payable to spouses, civil partners and “nominated” dependant partners (opposite and same sex) at a 1/160th accrual rate;

Survivor benefits payable to children at maximum accrual of 1/160th;

Revised ill-health retirement package with no review system – two levels with a higher enhancement of benefits for total incapacity; 25% (with degree of protection) enhancement with prospect of return to gainful employment;

A death in service tax-free lump sum of 3 times salary;

Post-retirement lump sum death benefit up to a maximum of 10 years before age 75;

Phased retirement arrangements that would enable LGPS members under specified circumstances to draw down some or all of their accrued pension rights from the scheme while still continuing to work;

Actuarial enhancement for those who continue in work beyond NRA of 65 without accessing their pension benefits;

Tiered employee contribution rates with 5.5% payable on first £12,000 of full time equivalent pensionable pay, and 7.5% paid on the excess over £12,000 each year;

A facility to purchase up to £5,000 of added annual pension; and

Facility to contribute to AVC arrangement in conjunction with external provider.

It was further announced that it would be a requirement of the Scheme Regulations to establish, by no later than 31 March 2009, guidance for the Secretary of State to issue in order to manage equitably potential increases in the future service costs of the LGPS.

24. A copy of the department’s letter outlining the proposals followed by the draft regulations were sent to:

The Chief Executives 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
- CIPFA

New Towns Pension Fund
ALAMA
UCEA
NALC
SLCC

Society of County Treasurers
Society of District Council Treasurers
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
UCATT
Aspect
Amicus
NAPO
Association of Educational Psychologists
Audit Commission
NILGOSC
Confederation of British Industry
Business Services Association
Other Government Departments with public service pension interests
GAD, DoE(NI) and SPPA;

25. In addition, the department maintained a high level of engagement with key stakeholders throughout the consultation period in order to explain, respond to queries about and revise several elements of the draft proposals to achieve as much consensus as possible within the cost envelope for the new Scheme. A total of 175 responses were received by the close of the consultation.
26. The consultation documents were made available to Scheme interests via the LGPS website www.communities.gov.uk/lgps. An interactive discussion forum (<http://forum.communities.gov.uk/lgps>) was also established to increase communication amongst stakeholders and to improve the flow of information throughout the consultation process. Over 1,500 individuals registered an interest via the LGPS website and were provided with an electronic document containing answers to frequently asked questions regarding the proposed regulations. The level of engagement produced by this innovation is greatly welcomed.
27. An analysis of these responses and a series of constructive discussions between employer and employee representatives during the consultation period has led to making a number of changes to the regulations in order to better meet equality and fairness requirements, the need to clarify some of the proposals and to respond to comments and responses about implementation, reducing adverse impacts and improving the focus of the reforms.
28. These alterations include, specifically, adjustments to provisions now covered by Regulation 19 (Early leavers: inefficiency and redundancy) and Regulation 20 (Early leavers: ill-health) as well as in Regulation 4 which deals with employee contributions and regulations 28, 34 and 37 dealing with orphaned children.
29. Consultees requested that consideration be given also to the revision of contribution rates to an older protected group of “manual workers” still paying an employee contribution rate of 5%. A solution has been agreed with the local authority employers and trades unions and this will be reflected in the new Scheme package by means of other, transitional provisions.
30. Following an assessment of the consultation responses and representations made by key stakeholder representatives, there appears to be a broad acceptance of the final proposals including both employees’ representatives and employers.
31. A suitable cost-sharing mechanism within the Scheme is to be developed within the Policy Review Group whose membership is to be announced shortly, with a view to implementation by 31 March 2009. This will feed into, and be influenced by, the 2010 actuarial valuation of the LGPS. This exercise will allow a range of

Scheme factors to be monitored, including the effects of new tiered contributions, ill-health decisions and commutation of pension take up.

32. It will focus on the trend of Scheme demographics and factors which influence future costs, to ensure the maintenance of the historic ratio of bearing inherent risks between employers and members. The approach will be in line with that being taken by the other public service pension schemes, though having to recognise the particular nature of the LGPS.
33. Summaries and details of the responses to the consultation in full will be available shortly from the Communities and Local Government website www.communities.gov.uk/lgps.

Options

34. Two options have been identified:

- A) Do nothing
- B) Introduce regulations to provide for a new-look Local Government Pension Scheme for implementation from 1 April 2008

Option A - Do nothing

35. To do nothing would fail to deliver the government's promise of providing a sustainable and affordable LGPS.
36. 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 supported by LGPS interested parties.
37. Failure to deliver on either of these two issues would leave open serious questions about the Scheme's immediate cost stability and viability and, more significantly, taxpayers who would otherwise face increasing costs of provision and lead to potentially higher Council Tax bills.

Option B – Introduce regulations to provide a new-look Local Government Pension Scheme for implementation from 1 April 2008

38. 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 advantageous in comparison with the current 1/80th rate, which also provides an automatic lump sum with a 3/80th accrual. As part of the reforms, provision of a tiered contribution rate produces a greater yield overall, without imposing too great a burden on lower paid, predominantly female, part timers. This meets a twin aim of helping to sustain the Scheme and providing for some improving proposals to be developed further. It aims to assist lower paid members within the Scheme and is intended to encourage a higher take-up of membership from all parts of the workforce.
39. Allied to this is the need to achieve a proper balance of risk sharing between Scheme employers and active members to maintain the Scheme's sustainability. This will be done through regulatory mechanisms, to be in place by no later than March 2009, which ensure costs are contained and that equitable principles of sharing costs are adopted.

Alternative options considered

40. In the light of the reaction to and overall support for a final salary arrangement from respondees to the national and extensive *Where Next?* consultation in 2006, Ministers decided that no other options should be considered for consultation.

Costs and Benefits

Sectors and groups affected

41. This set of proposals affects the public sector employers and employees in and around local government. There are currently 1.7 million members of 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 i.e. 41% of the total workforce are female part-time workers.
42. The Government's intentions in developing a new-look Scheme are designed to ensure there are no significant adverse effects on Council Tax, that the interests of tax payers generally are taken into account and to ensure ongoing solvency, cost stability and viability of the Scheme.
43. Private sector firms and their workforce operating in the UK providing local government services on a contracted out basis, voluntary organisations and charities, or consumers involved with the LGPS will also benefit from Government's objectives for the Scheme being fully achieved.

Gender equality assessment

44. The figures stated in paragraph 41 above indicate the importance of ensuring that the LGPS is gender-equitable and accessible to all male and female employees. This important aspect was underlined in a number of responses to the consultation exercise on the draft regulations.
45. A new Gender Equality Duty (GED) comes into force on 6 April 2007 and requires public authorities to promote gender equality and eliminate unlawful sex discrimination. Instead of depending on individuals making complaints about unlawful sex discrimination, the duty also requires public authorities (including local authorities) to be proactive in promoting equality of opportunity between women and men. In effect, this means that individual needs of women and men will have to be taken to account in a public authority's employment practices, policy functions and in their service delivery.
46. All public authorities, including local authorities, have a duty to demonstrate how they are meeting the duty's requirements and this includes the Scheme. The provisions now set out in the new regulations for the LGPS do not prevent anyone who enters into a proper contract of employment with a Scheme employer from joining. This fully meets the GED objective as it provides equal access to the Scheme and equal treatment in terms of accruing pension rights for both men and women who join.
47. The new Scheme reforms, therefore, directly and positively address these principles in terms of access to the Scheme and its final salary terms, of membership, contribution rates, choice and the provision of an overall pension package.

Race equality assessment

48. It is for individual employers operating within the framework provided to ensure they are not placing discriminatory provisions in the workplace and to promote the equality of opportunity. The framework of the Scheme meets the objective of not being discriminatory as it provides full and equal access to all employees of all LGPS employers.

Health impact assessment

49. Any individual employed by a LGPS employer who is fit to work, is automatically enrolled in the Scheme, but can choose to opt out, if it is their preference at any time.
50. The aim of the new-look Scheme is to provide sufficient retirement income based on service and final salary, in a way that is available and accessible to all.
51. Flexible retirement provisions in the benefit package can allow Scheme members to continue working at reduced hours and/or grade, and accruing pension whilst starting to draw their pension. This allows for a smoother transition from full-time working to full retirement and helps both employers and employees manage the last years of their working lives in the most effective way.
52. Similarly, the revised ill-health retirement package is designed to facilitate fair and equal access to benefits for all those that meet the qualifying standards due to incapacity to continue in their employment. This involves provisions to better target benefits in a two level structure for those who have either little or no

prospect of any future employment.

Rural considerations

53. There are no specific rural considerations applying to the LGPS reforms. 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 is likely to have a greater impact on cost pressures facing the LGPS Rural pension funds than it will on some Urban funds.

Breakdown of costs and benefits

Option A - Do nothing

54. Economic

Benefits:

Following what was stated in the previous two Final RIAs that accompanied LGPS regulations, the removal of the Rule of 85 saved an estimated £250 million per year. The 'Do nothing' option would not affect this saving in any way, but would not deliver on the undertaking to make improvements to the overall benefit package.

Costs:

Failure to address increasing longevity and other associated issues challenges the Scheme's ability to remain affordable and viable, fair to taxpayers and attractive to existing and future scheme members, and employers alike.

The 'Do nothing' option is not feasible in the medium to long-term. Expectations of salary increases following the assurance that 50% of savings from removal of the Rule of 85 would be recycled back into the LGPS would not be met if this option was introduced. Industrial action by trades unions and their members would be almost inevitable. The Scheme's stability could be jeopardised.

The previous two Final RIAs concerning the LGPS detail the costs of the "do nothing" option. The relevant references can be found in paragraphs 26, 29 and 32 of the July 2005 RIA and Annexe H of the March 2006 RIA.

55. Environmental

There are no direct environmental costs or benefits to the LGPS reform regulations.

56. Social

Benefits:

There are no obvious social benefits resulting from the introduction of Option A.

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 would unfavourably impact on the high proportion of lower paid and part-time employees, the majority of which are female. This option 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 would adversely impact on tax payers. The scheme's stability would be threatened.

Option B – Introduce final regulations to reform the LGPS

57. Economic

Benefits:

The economic benefits of the new-look Scheme are designed to ensure effective addressing of the inequalities that occur in the current Scheme between part- and full-time employees. At the same time, extensive efforts have been made to accommodate employers' side concerns about the likelihood of increased costs of offering an improved benefit package.

The table below sets out the estimated benchmark cost of the new-look Scheme for both existing and new members (from 1 April 2008). Since the initial RIA was published along with draft regulations, GAD has refined its methodology used to calculate the benchmark figures. As a result of this revised approach the table below now features a reduced existing member cost in comparison to that outlined in the *Where Next?* document (20.9% has now been reduced to 20.7%).

Cost-Generating Feature	Existing Members	New Entrants
Refined <i>Where Next?</i> cost	20.7	18.6
New ill-health benefits package	0.2	-0.1
10 year guarantee on death after age retirement	0.1	0.1
Spouses' pensions at 1/160 th	-0.4	-0.4
Total benchmark cost	20.6	18.2
Employee contributions' yield	6.3	6.3
Employer benchmark cost	14.3	11.9

In the short-term, average employer future service costs have been calculated as the mean of costs for existing members and new entrants. LGPS employers are currently contributing some 13.1% of pensionable payroll as in 2004/05 (with payroll taken to be £26-27 billion). This is expected to increase by 1-1.5% in 2005/06 and 2006/07 as set out at the last actuarial valuation in 2004. There is no direct comparison between these employer contribution levels and the benchmark figures quoted above. The benchmark costs are for future costs of accrual, the current rates include past service liabilities and managing the effects of external market influences which impacted on the last actuarial valuation.

Over the medium to long-term, as the number of existing members will gradually be replaced by new entrants it is anticipated that the total benchmark cost could trend towards the 18.2% figure shown above on the assumption that the average age of new entrants stays the same as recent historic data used in current costings. In an ageing population, with older new entrants (particularly female part-timers), there is potential for the overall new entrant cost to move upwards. This position will, therefore, need to be subject to ongoing monitoring in the Policy Review Group as it develops the cost-sharing principles intended to feed into the 2010 Scheme valuation.

The regulations for the new-look Scheme follow the requirements of gender equality-proofing (see paragraph 44-47). All members will contribute at the annual rate of 5.5% on the first £12,000 of full-time equivalent earnings and 7.5% on the excess earned above this amount. This achieves across all levels of earnings a more equitable level of contribution and addresses, in particular, the large number of low paid, mainly female part-time members' interests. At this extreme more than 50% of the membership have whole time equivalent earnings of below £16,000 per year.

At the other end of the scale, higher earners will pay a higher level of contributions given the anticipated level of their (potential) improved benefits under the new Scheme. For higher earners this also reflects the point made by some actuaries and respondees to consultations that some 10% of the Scheme's membership represents some 45% of individual pension fund liabilities.

The following indicative table was provided with the consultation material to enable members to relate more easily this tiering with their current salary levels.

Full Time Equivalent Salary	Contribution Rate
£5,000	5.5%

£10,000	5.5%
£15,000	5.9%
£20,000	6.3%
£25,000	6.5%
£30,000	6.7%
£40,000	6.9%
£50,000	7.0%
£75,000	7.2%

Responses received from the recent consultation exercise indicated that tiering would cause administrative difficulties for employers' payroll systems. To resolve this, a specific banded contribution rate structure as set out below has been suggested, to be linked to contractual pay. This is established either on the basis of earnings in a previous twelve months or starting pay on commencement. The banding set at these levels indicates a yield of 6.3% employee contributions.

Band	FTE Salary Range	Whole-Pay Contribution Rate
1	£0 - £12,000	5.5%
2	£12,001 - £14,000	5.8%
3	£14,001 - £18,000	5.9%
4	£18,001 - £30,000	6.5%
5	£30,001 - £40,000	6.8%
6	£40,001 - £75,000	7.2%
7	£75,001+	7.5%

The effects of introducing this form of banded employee contribution rates in the Scheme will be monitored to ensure ongoing equity and fairness for Scheme members and their employers by the Policy Review Group. The outcome of the work to develop new cost-sharing arrangements could influence the rate at which employees contribute to the Scheme.

Costs:

As indicated in previous RIAs relating to the LGPS reforms, the costs of pension provision for the existing Scheme's membership are expected to increase. In contrast, costs of new entrants' membership to the new Scheme can be expected to decrease, on the basis of having over time a younger workforce overall. Following careful consideration and lengthy consultation, a package has been designed that would enable the Government to honour its promise to provide a sustainable and affordable Scheme for the long term. The cost-sharing arrangements to be in place for March 2009 are critical to this.

The estimated cost of the improved benefit package needs to be compared to the position in the Scheme before the removal of the discriminatory Rule of 85 which permitted release of unreduced pension 5 years before the normal retirement age of 65. On this basis the overall benefit package of the new LGPS costs some £100-£150 million less than the old arrangement. This represents 50% of the savings from the removal of the Rule of 85, changes to rights to commute pension, and fully honours the commitment given by the Government to recycle savings from the rule's removal.

58. Environmental

There are no expected environmental costs or benefits to this proposal.

59. Social

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

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

Small Firms' Impact Test (SFIT)

60. There is no absolute requirement for such a test as the regulations relate in the main to the local government, and related, sector.
61. A separate consultation process, however, is continuing on how external contractors' positions in terms of Scheme membership can continue to be accommodated satisfactorily and cost-effectively within the LGPS framework.

Competition Assessment

62. This is not required for this proposal.

Enforcement, Sanctions and Monitoring

Enforcement

63. This is not required for this proposal.

Sanctions

64. This is not required for this proposal.

Monitoring and review

65. All eighty-nine English and Welsh LGPS pension funds undergo an actuarial valuation every three years. The last valuation took place at March 2004 and the next takes place as at 31 March 2007. LGPS administering authorities' funds and their actuarial context are both separately monitored on a regular basis by investment consultants and actuaries and internal audit and external systems. 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 as well as a linkage with each fund's Statement of Investment Principles.
66. To assist in the on-going monitoring of the Scheme's regulatory and policy development, Ministers have agreed to set up a Policy Review Group of key interested parties 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, to monitor changes in Scheme demographics and develop new cost-sharing arrangements which are to be in place for March 2009. The work of the group will be reported to Ministers and will complement the substantial statutory and non-statutory consultation arrangements which already exist within the current regulatory framework for the Scheme.

Implementation and Delivery Plan

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

Post-Implementation Review

68. Communities and Local Government are in the process of establishing a Policy Review Group with the intention of monitoring the implementation of the Regulations (see Paragraph 66 above).
69. 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.
70. As outlined in Paragraph 65, an actuarial review of all LGPS funds is carried out every three years. The next review will take place on 31 March 2007. A regular dialogue takes place with actuaries and actuarial

advisers, and with the Government Actuary's Department.

Summary and Recommendation

Option	Total cost per annum: economic, environmental, social	Total benefit per annum: economic, environmental, social
A - Do nothing	<p>Economic – The previous two RIAs on this matter indicate the economic costs of the ‘do nothing’ option. See Annex H of the March 2006 RIA and paragraphs 26, 29 and 32 of the July 2005 RIA</p> <p>Environmental – None</p> <p>Social – Equality proofing would not be achieved, undermining Scheme viability and adversely impacting on taxpayers. Industrial relations would be gravely damaged by the Government’s failure to fulfil its equality-proofing requirements.</p>	<p>Economic – Theoretic savings of £250 million per year would not be affected</p> <p>Environmental – None</p> <p>Social – None, it would result in non-compliance with the law on gender equality.</p>
B – Approve LGPS reform regulations	<p>Economic – The overall benefit package costs some £100-£150 million less than the old arrangement. By recycling up to half of savings from the removal of the age discriminatory provision, the commitment to workforce is fulfilled and the remainder of savings leads towards measures to ensure the Scheme’s sustainability and affordability.</p> <p>Environmental – None</p> <p>Social – None</p>	<p>Economic – £250 million saved from removal of the Rule of 85, in addition to maintaining an important feature of local government employment.</p> <p>Environmental – None</p> <p>Social – An equality-proofed Scheme ensures access to the LGPS for all employees employed in and around local government. Employment policies will be directly assisted and terms of employment enhanced. The regulations seek to address positively issues of gender equality in particular, in addition to better targeted provisions for ill-health retirees.</p>

71. The recommendation is for option B (approval, making and laying of the LGPS reform regulations) to be adopted and the necessary information has been prepared for Ministerial approval to achieve that.

Declaration and Publication

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

SignedAngela Smith.....

Date.....3rd April 2007.....

Angela Smith, Parliamentary Under Secretary of State, Communities and Local Government

Contact point for enquiries and comments:

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