EXPLANATORY MEMORANDUM TO

THE LOCAL GOVERNMENT PENSION SCHEME REGULATIONS 2013

2013 No. 2356

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 Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Regulations set up a new legal regime for the Local Government Pension Scheme which will come into force on 1 April 2014. The new legal regime will provide for benefits to accrue on a "career average revalued earnings" basis rather than on a "final salary basis" and for the normal retirement age at which a member can draw benefits without actuarial reduction to be the same as the age at which the person is entitled to draw the state retirement pension.

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

3.1 See paragraphs 4.5 to 4.10 of the legislative context section.

4. Legislative Context

4.1 These Regulations are made under section 7 of the Superannuation Act 1972 ("the 1972 Act"), but in anticipation of the superseding of the powers under that Act by the powers contained in the Public Service Pensions Act 2013 ("the 2013 Act") which received Royal Assent on 25th April 2013 but is not yet completely in force.

4.2 Section 28 of the 2013 Act provides for regulations made under section 7 of the 1972 Act in respect of a person's service on or after 1 April 2014 and which could have been made under the powers contained in the 2013 Act to have effect as if they were scheme regulations under the 2013 Act.

4.3 Certain provisions in the 2013 Act impose requirements in respect of scheme regulations under the 2013 Act, which are to some extent anticipated in these Regulations and it is the Government's intention to include transitional provision in the orders commencing those provisions to secure that so far as is necessary, the provisions in these Regulations are deemed to satisfy the requirements of the 2013 Act. To the extent that those requirements are not anticipated in these Regulations (for example, in respect of the requirements in section 13 of the 2013 Act relating to Scheme governance and section 12 of the 2013 Act in relation to cost management), it is the Government's intention to ensure that commencement of those provisions will be co-ordinated with the making of amending regulations to secure compliance by the Scheme regulations with those requirements

4.4 The Regulations will replace the Scheme ("the 2008 Scheme") established by the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (S.I. 2007 No 1166) ("the benefits regulations") and The Local Government Pension Scheme (Administration) Regulations 2008 (S.I. 2008 No 239) ("the administration regulations"). There will be separate Transitional and Savings regulations made and laid shortly which will revoke the benefits regulations and the administration regulations from 1 April 2014 and make provision to protect benefits already accrued by members of the Scheme established by them.

4.5 In its 18th report of the 2006-07 session, the JCSI reported the benefits regulations for failure to comply with proper legislative practice and defective drafting. The Committee's finding was that it was improper to make regulations which were complete neither internally nor referentially. The benefits regulations were subsequently supplemented by the administration regulations, and by transitional provisions contained in the Local Government Scheme (Transitional Provisions) Regulations 2008 (S.I. 2008/ 238) which filled in the legislative gaps.

4.6 In the preparation of these Regulations, the Department once again focussed on the need to provide certainty as early as possible to administrators and software providers of the essential elements of the new local government pension scheme. In its first consultation document, published on 21 December 2012, the Department published draft regulations broadly covering the ground contained in the benefits regulations, setting out the core elements of the new Scheme. However, rather than make those regulations 12 months before the Scheme is to come into operation, following the advice from the Committee in 2007, the Department published the revised regulations in draft in April 2013, alongside its proposals in draft regulations broadly covering the ground contained in the administration regulations.

4.7 These Regulations made now contain a complete scheme in the sense that they are not dependent on any other regulations being made to function effectively. As is noted in paragraph 4.3 above, there are some respects in which they would not comply with some legal requirements contained in the 2013 Act, were those requirements to be commenced, but the Department does not anticipate any uncoordinated commencement of those requirements.

4.8 These Regulations made now do not revoke the benefits or administration regulations, or any provisions in any earlier regulations preserved by those regulations. On 28 March 2013 the Department published some draft transitional and savings regulations which would have that effect, and which will make transitional provisions protecting both the benefits accrued by members of the scheme before 1 April 2014 and those which some members accrue after that date where those members are close to the normal retirement date applicable to them under the benefits regulations.

4.9 The Department is not in a position to make those transitional regulations simultaneously with these Regulations, but anticipates it will be able to do so within the next month. It has however concluded that administrators and software providers must now be given proper assurance that the new Scheme will indeed come into effect from 1 April 2014.

4.10 The Department has paid close regard to the report of the Committee from 2007. Nothing in these Regulations is dependent on any new regulation being made or on any definitions to be contained elsewhere - the transitional provisions will operate quite independently from these Regulations. The only element missing is the actual revocation of the benefits and administration regulations within these regulations. In the Department's view, it was inappropriate to include the revocation of those provisions in an instrument separate from the one containing the transitional and savings provisions. The Department has endeavoured to ensure that persons unfamiliar with the background to the local government pension scheme can nevertheless understand how the scheme will operate, and that the Committee is in a position to provide proper scrutiny.

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 discussion and consultation with all local government pension scheme interested parties, which began with the publication of Independent Public Service Pensions Commission's final report in March 2011.

7.2 At the June 2010 Budget, the Government invited Lord Hutton of Furness to chair the Independent Public Service Pensions Commission. The purpose of the Commission was to carry out a "fundamental structural review" of public service pension provision, and to make recommendations on pension arrangements that are "sustainable and affordable in the long term, fair to both the public service workforce and the taxpayer, and consistent with the fiscal challenges ahead, while protecting accrued rights".

7.3. The main recommendation from the Commission's final report was that the current final salary public service pension schemes should be replaced by new schemes which would continue to be defined benefit schemes with pension entitlement linked to salary, but rather than being linked to an employee's final salary, pension benefits would be linked to career average earnings.

7.4 In November 2011, the Government set out their preferred design for the new NHS, civil service, teachers and local government pension schemes in "Public Service Pensions: Good Pensions That Last" (Cm 8214). The proposed scheme designs included the following main elements:-

- A career average revalued earnings (“CARE”) pension scheme
- Public service workers benefits to be earned at a rate of 1/60th of pensionable earnings each year
- Public service workers will have their benefits increased each year they are working in the public services in line with earnings revaluation
- a normal pension age linked to state pension age or 65 (whichever is higher)
- Pensions in payment to increase in line with the consumer prices index (CPI)
- Benefits earned by leavers to increase by CPI from the date of leaving until retirement
- In the funded local government pension scheme, both member contributions and other adjustments to benefits will be reflected in cost ceilings following the outcome of the Department for Communities and Local Government’s consultation on alternatives to contribution increases
- Members given the option at retirement to convert £1 of annual pension into a £12 one-off lump sum payment in accordance with HMRC limits and regulations
- Ill-health, death and survivors benefits (ancillary benefits) to match those currently provided by schemes that are open to new members
- Members who leave the scheme and rejoin within 5 years to be able to link their new service with previous service, as if they had always been an active member
- Members transferring between public service schemes to be treated as having continuous active service (which would include those transferring between schemes who had rejoined public service after a gap of less than 5 years)
- An employer contribution cap to provide backstop protection to the taxpayer against unforeseen costs and risks.

7.5. For the new local government pension scheme, the Government invited the Local Government Association and main local government trades unions (UNISON, UNITE and GMB) to come forward with a specific set of proposals based on the Government’s preferred design within an agreed cost ceiling of 19.5% of payroll for future service costs. A key element of the agreement for the Local Government Pension Scheme was a start date of 1 April 2014, a year ahead of the unfunded public service pension schemes. Between January and May 2012, the Department worked closely with the LGA/trades unions Project Board to work up the new scheme design.

7.6. In a letter dated 30 May 2012, Bob Neill, the then Local Government Minister, informed the Project Board that he was content for the LGA and local government trades unions to proceed to an informal consultation with their respective memberships on the agreed scheme design. The Minister gave an assurance that a favourable outcome would enable the Department to move directly to a statutory consultation to implement the proposals. The result of the informal consultation was strongly in support of accepting the proposed scheme design with 93 per cent of scheme employers; 95 per cent of GMB members; 90 per cent of UNISON members and 84 per cent of UNITE members accepting the proposal.

7.7. On 5 November 2012, the Local Government Minister, Brandon Lewis, confirmed in a written statement to Parliament that the main parameters of the new Scheme would be:-

- A start date of April 2014 with core elements of the new scheme regulations in place by March 2013
- A pension scheme design based on career average and actual pay
- An accrual rate of 1/49th of pensionable earnings each year
- Revaluation of active members' benefits in line with a price index (currently CPI)
- A Normal Pension Age equal to the State Pension Age, which applies both to active members and deferred members (new scheme service only). If a member's State Pension Age rises, then Normal Pension Age will do so too for all post-2014 service
- A low cost optional arrangement allowing 50 per cent of main benefits to be accrued on a 50 per cent contribution rate
- Pensions in payment to increase in line with a price index (currently CPI)
- Benefits to increase in any period of deferment in line with a price index (currently CPI)
- Average member contribution yield of 6.5 per cent, with tiered contributions
- Optional lump sum commutation at a rate of £12 of lump sum for every £1 per annum of pension foregone in accordance with HMRC limits and regulations
- Early/late retirement factors from age 55 on an actuarially neutral basis
- A vesting period of two years
- Spouse and partner pensions to continue to be based on an accrual rate of 1/160th and three times death in service benefit
- Ill-health retirement pensions to be based on the current ill-health retirement arrangements.

7.8. Paragraphs 7.9 to 7.18 explain how the provisions in the Regulations deliver the agreement set out in paragraph 7.7 above.

7.9. **Regulation 9** provides for contributions to be paid by members at a rate applicable to their annual pay and **Regulation 20** goes on to define "pensionable pay" as the total of all salary, wages, fees and other payments paid to the employee. Under **Regulation 23(4)**, the amount of pension earned in respect of those contributions is 1/49th of the member's pensionable pay received in each year.

7.10. R**egulation 10** provides for members to elect to pay reduced contributions equivalent to 50 per cent of the normal rate set out in **Regulation 9**. **Regulation 23(5)** provides that for any period where **Regulation 10** applies, the amount of earned pension is 1/98th of the member's pensionable pay, that is, 50 per cent of the normal rate at which pension is accrued.

7.11. **Regulation 23(2),** when read in conjunction with the definition of "revaluation adjustment" in **Schedule 1** to the Regulations, provides that the member's end of year CARE balance must be adjusted by the revaluation adjustment as defined in an Order made by HM Treasury under Section 9(2) of the Public Service Pensions Act 2013.

7.12. **Regulation 30** sets out the various circumstances where pension benefits may be taken or have to be taken, in particular, when a member attains normal pension age. **Schedule 1** defines "normal pension age" as "the pensionable age of a person as specified from time to time in Schedule 4 to the Pensions Act 1995 or, if higher, 65." It also provides for members to retire and take their pension benefits at any age between 55 and 75. If retirement occurs before the member's normal retirement age the pension is reduced according to actuarial guidance issued by the Secretary of State, or increased if retirement occurs after normal retirement age.

7.13. Revaluation of the benefits of deferred and pensioner members is by virtue of the Pensions (Increase) Act 1971. **Regulations 24(7), 25(6) and 26(6)** provide for the balances in appropriate accounts to be increased to reflect that revaluation.

7.14. **Regulation 33** allows members to commute their pension for lump sum at a rate of £12 for every £1 of annual pension commuted.

7.15. **Regulation 18** provides for members to receive a return of their contributions provided that their qualifying service is less than two years.

7.16. **Regulations 40** to **48** provide for spouses' and partners' pensions to be based on an accrual rate of 1/160th and three times death in service benefit. Provision is also made for survivor benefits to be paid to the eligible children on the death of a member.

7.17. **Regulations 35 to 39** provide for ill-health retirement benefits based on the ill-health retirement framework in the 2008 Scheme.

7.18. On 13 September 2012, the Government introduced the Public Service Pensions Bill to reform the public service pension schemes in line with the recommendations made by the Independent Commission on Public Service Pensions. The Bill received Royal Assent on 25 April 2013. The main purpose of the Act is to provide the necessary regulation making powers for Departments to introduce their new schemes on 1 April 2015. As these Regulations are being made before the relevant sections of the Public Service Pensions Act 2013 have been commenced, in order that they can come into force from 1 April 2014 (a year ahead of the other major public service pension schemes), they are being made under the relevant sections of the Superannuation Act 1972.

7.19. The final consultation on the draft proposals ended on 2 August 2013, and 44 responses were received. This consultation also took into account representations received in response to two earlier consultations in December 2012 and March 2013 on earlier versions of the draft scheme regulations. This approach was adopted to ensure that IT, payroll and scheme practitioners were given as much notice as possible about the new Scheme design. Throughout all three consultations, the Department's approach has been to ensure compatibility with the Public Service Pensions Act 2013. It also met regularly with the Local Government Association, trades unions and other scheme interested parties to help finalise the statutory instrument which has now been made.

7.20. Paragraphs 7.21 to 7.24 outline those elements of the new Scheme which are not included in these Regulations, but which will be introduced later via amending regulations.

7.21. **Governance.** Under Sections 5 and 7 of the 2013 Act, the Department is required to come forward with scheme regulations to establish a national scheme advisory board and local pension boards for each of the 89 individual local government pension scheme fund authorities in England and Wales. The Act does not stipulate when these various boards have to be in place. On 20 June 2013, the Department published a discussion paper inviting interested parties to comment on the sections of the Act which impact on the governance arrangements in the new Scheme. Responses to this informal consultation, which closed for comment on 30 August 2013, will be taken into account in coming forward with draft regulations for statutory consultation later in 2013.

7.22 **Councillors' pensions**. The Government has consulted on whether councillors, directly elected mayors, the Mayor of London and members of the London Assembly should continue to have access to the local government pension scheme. The consultation closed in July 2013 and Ministers are currently considering the responses received. In the meantime, these regulations and the associated transitional provisions continue to permit access to the Scheme for these elected office holders. However, amended provisions may be introduced prior to April 2014 to reflect Ministers' decisions in the light of the consultation.

7.23. **Cost management**. Under Section 12 of the 2013 Act, the new Scheme must set an employer cost cap, expressed as a percentage of pensionable earnings of members of the Scheme, for the purpose of measuring changes in the cost of the Scheme. The employer cost cap is to be set in accordance with a Treasury direction which the Department expects to be published in September 2013. The intention will then be to include the Scheme's employer cost cap and associated provisions in draft amending regulations for consultation. It is important to note that Section 12 of the 2013 Act has no bearing on the setting of individual employers' contribution rates as part of the local valuations by each of the 89 pension fund authorities in England and Wales.

7.24. **Club transfers.** The Public Sector Club is a network of public and private sector occupational pension schemes which makes it easier for employees who move between employers covered by separate participating schemes to transfer their accrued pension rights. In general such employees will be given an opportunity to transfer their pension rights between Club schemes and to receive a broadly equivalent service credit in the new scheme in exchange for their service in their old scheme. Government policy on the reform of the public service pension schemes includes retention of the Public Sector Club for the new schemes. At the time of making these Regulations, no agreement has been reached on how the Club will operate within a CARE environment. The relevant provisions will be introduced via amending regulations once agreement has been reached.

7.25. In addition to the amending regulations described at paragraphs 7.21 to 7.24 above, it is also the intention to come forward with a separate statutory instrument on transitional protection and savings. There have been two consultations on draft regulations in March and June 2013. The intention is for them to be made in October 2013. A separate Explanatory Memorandum will accompany those regulations when they are made.

7.26. Before proceeding with these Regulations, Ministers gave full consideration to the views expressed and the extensive discussions which have taken place over the last two years – in particular, the detailed discussions on a suitable benefit package which is affordable within the various cost ceilings agreed by Government and is compliant with the reform agenda for public service pension schemes.

8. Consultation process and outcome

8.1 These Regulations were subject to three separate, but related statutory consultations. The first commenced on 21 December 2012 and ended on 8 February 2013 with 119 responses. The second commenced on 27 March 2013 and ended on 3 May 2013 with 38 responses. The final consultation commenced on 3 June 2013 and ended on 2 August 2013 with 44 responses. In each case, the consultation papers were sent to the Welsh Assembly; the chief executives of all principal local authorities in England and Wales; all local government trades unions; the five main local government treasurer bodies in England and Wales; the Trades Unions Congress; the Government Actuary's Department, and eleven separate representative bodies including the Association of Consulting Actuaries, the Chartered Institute of Public Finance and Accountancy and the Association of Local Authority Medical Advisers. Copies of each consultation paper and a full list of consultees can be found at https://www.gov.uk/government/organisations/department-for-communities-and-local-government/series/local-government-pensions

8.2 Since January 2012, the Department has chaired regular meetings with members of the Project Board (see paragraph 7.5) representing local authority employers and local government trades unions. Following the Government's agreement to the Project Board's proposed scheme design in May 2012, a smaller, technical group chaired by the Department was established to work up draft regulations and, in particular, to ensure that they complied fully with the agreed scheme design. The same group assisted the Department in analysing and reaching conclusions on each set of consultation responses.

8.3 In the context of the agreement reached between Government and the Project Board, all major policy issues were discussed at length with employers and trade unions and only taken forward as draft regulations for consultation once agreement had been reached. It was then open for consultees to comment on any issue arising from each set of draft regulations, although the main purpose of each consultation was to ensure that the draft regulations were technically correct and achieved their intended purpose.

8.4 Section 3(5) of the Public Service Pensions Act 2013, which requires scheme regulations to be subject to Treasury consent, had not been commenced at the time these Regulations were made. The Department nevertheless engaged with Treasury officials to ensure that the draft regulations issued for consultation were consistent with the wider public service pension reform agenda.

8.5 The same format was used in all three consultations, that is, a narrative section explaining the consultation process and policy context, a set of draft regulations and a series of questions on outstanding policy issues.

8.6 A summary of responses and the outcome of each consultation are set out in a separate document which is available at: https://www.gov.uk/government/organisations/department-for-communities-and-local-government/series/local-government-pensions.

8.7 As a result of the consultation responses and the feedback from regular meetings with the technical group (see paragraph 8.2), a number of significant changes to the Scheme design have been introduced. In addition, the Department maintained a high level of engagement with key interested parties throughout the consultation period in order to explain, respond to queries and revise various elements of the draft proposals to achieve as much consensus as possible within the cost envelope of the new Scheme. The changes made to draft regulations in response to the first two consultation exercises are summarised in Chapter 2 (Proposals for Consultation) in the documents referred to at paragraph 8.6 above.

8.8 The main alterations as reflected in these Regulations are summarised below:-

- There have been some clarificatory amendments to the ill health framework at the request of qualified medical practitioners and lay practitioners. The second qualifying test for the release of benefits at 35 (4) has been amended and the term ‘reduced likelihood of being capable of undertaking gainful employment’ has been replaced with ‘unlikely (or likely) to be capable of undertaking gainful employment’ where appropriate in the provisions.
- It was initially proposed that the early payment of a deferred retirement benefit on ill-health grounds should be paid from the date the permanent incapacity first arose. However, in response to representations that this would represent a significant additional cost to the Scheme and would be difficult to administer, these Regulations now include provision for payment to commence from the date the incapacitating condition was certified by an independent registered medical practitioner.
- Current Scheme regulations allow a scheme employer to award additional pension up to a maximum of £5,000 per annum. This provision was carried forward for consultation on the new Scheme regulations but in recognition of general public service pension policy, this was later amended to increase the cap to £6,500 and for the cap to be uprated annually by cost of living increases.

- As part of the overall scheme design agreed by government, it was initially proposed that the tariff table for employees' contribution should not include any automatic cost of living uprating as is the case with the current Scheme regulations. However, the Department was persuaded by consultation responses to retain it.
- These regulations introduce the concept of assumed pensionable pay ("APP") to enable employee contributions to be deducted during periods of zero pay. Initially, it was proposed that APP should apply in all circumstances where pay is reduced, but in the light of comments from consultees, these Regulations now apply APP to more limited circumstances where the pre-reduction level of pay is afforded statutory protection. In all other cases where pay is reduced, these Regulations enable scheme members to purchase additional pension to offset any reduction.
- The current Scheme allows members to purchase additional pension in respect of their own pension and also in respect of survivor benefits. There was anecdotal evidence to suggest that the take up rate for the latter was very low and this was confirmed by the consultation response. These Regulations therefore make provision for member only additional pension.
- The regulations include a range of survivor benefits payable on the death of a Scheme member. In the light of consultation responses, a number of technical changes have been introduced to clarify the various methods of calculation in each type of case.
- The provisions relating to admission to the Scheme by means of an admission agreement remain broadly as in the current Scheme but have been reordered to aid clarity. This includes the special characteristics of bodies admitted because they have entered into a contracting arrangement with a letting authority. Consultation respondents noted that a provision requiring an administering authority to admit a body if the letting authority wished it, subject to the proposed admitted body satisfying the conditions of admission. This omission has been corrected at paragraph 13 of Part 3 to Schedule 2.
- Schedule 3 introduces a list of Scheme employing authorities and their relevant administering authority. These Regulations reflect comments submitted by consultees on the accuracy of the draft list and corrects and updates the table at the end of the Schedule.
- Regulation 64, which relates to employers that cease to participate in the Scheme, has been changed so that it is clear that an exiting employer has a duty to make an exit payment where this is owed.

8.9 Following an assessment of the consultation responses and representations made by key representatives of interested parties, there appears to be a broad acceptance of the final proposals, including both employees' representatives and employers.

9. Guidance

9.1 Where mentioned in these Regulations, guidance for the new Scheme will be issued by the Department. In addition, the Local Government Association will also publish scheme guidance for both participating employers and scheme members.

10. Impact

10.1 An Impact Assessment has been prepared and can be accessed at: https://www.gov.uk/government/organisations/department-for-communities-and-local-government/series/local-government-pensions

11. Regulating small business

11.1 The legislation applies to small business. (See Impact Assessment)

12. Monitoring & review

12.1 These Regulations will be monitored by the Department and reviewed on a regular basis. To assist in this process, the Department will confer a function of advising the Secretary of State on scheme changes on the Scheme Advisory Board it will establish in 2014 as required by Section 7 of the Public Service Pensions Act 2013. The Scheme Advisory Board will also be responsible for monitoring the costs of the new Scheme and for making recommendations to the Secretary of State on any scheme changes necessary to maintain the cost within the Employer Cap (see Section 12 of the 2013 Act) and the agreed future service cost of 19.5 per cent at a contributions ratio of 2:1 for employers and employees respectively.

As part of the consultation process for the new Scheme, the Department has agreed, at some future date after the new Scheme has come into force, to review the ill-health retirement and Internal Dispute Resolution Procedure provisions of the new Scheme. The time was not available to enable this review to be undertaken during the consultation process for the new Scheme.

13. Contact

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