Title: Local Government Pension Scheme 2014 (England and Wales) The Local Government Pension Scheme Regulations 2013 **IA No:** **Lead department or agency:** Department for Communities and Local Government **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 06/09/2013 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Robert Holloway robert.holloway@communities.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: Not Applicable

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
£m	£m	-£93m	No	NA

What is the problem under consideration? Why is government intervention necessary?

At the June 2010 Budget, the Government committed to establishing an independent commission to review the long term affordability of public sector pensions. The cost of public service pensions paid out has risen by over a third over the last 10 years, and Lord Hutton's review found that the cost had mostly fallen to the taxpayer. The review recommended that significant reform was needed to make these Schemes more sustainable and affordable in the long term, fair to public sector workers and the tax payer. In response, the Government brought forward the Public Service Pensions Act 2013 ("the 2013 Act"). These proposals are necessary to meet the requirements for reform set out in the 2013 Act for the Local Government Pension Scheme (LGPS).

What are the policy objectives and the intended effects?

The policy intends to reform the Local Government Pension Scheme in line with the 2013 Act, making the new Scheme more sustainable and affordable in the long term. In addition to meeting the Act's requirements for reform, the proposals also intend to address the Government's stated objectives for public service pensions. These include ensuring a good level of retirement income for public service workers; establishing an affordable and sustainable scheme that will last for at least 25 years; offering a fairer balance of cost and benefits between public service workers and other taxpayers; protecting those close to retirement and providing a clear legal framework easily understood by members.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Regulatory reform of the LGPS is necessary as the 2013 Act requires the existing Scheme to close on 31 March 2014. As the Government committed to protect accrued pension rights and establish fairer public service schemes, a reformed 2014 Scheme must come into effect on 1 April 2014. Secondary legislation is needed to implement the proposed reforms to the Scheme because the LGPS is a statutory occupational pension scheme. The preferred option was to develop a new Scheme that met the requirements of the 2013 Act and was within the parameters of HM Treasury's reference Scheme, but was also responsive to the needs of LGPS members and employers. The proposals were therefore developed in conjunction with the Local Government Association and three of the major local government trade unions, and have been subject to three formal consultations. The proposal includes transitional protections for those close to retirement and a new 50:50 arrangement to encourage new joiners to the Scheme.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?			Yes / No / N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:**	**Non-traded:**	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Brandon Lewis Date: 12 September 2013

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

Moving to a career average defined benefit scheme will require detailed records of employees' salaries to be kept throughout their career. This may create some implementation costs for employers who do not currently maintain full employment records. As the thousands of individual Scheme employers would need to determine whether they would need changes to their systems and the cost of implmenting any changes, this cost cannot be reliably estimated.

Other key non-monetised costs by 'main affected groups'

Scheme members further from retirement who do not benefit from transitional protections will see their retirement age increase to match State Pension Age, and so may need to work for longer than would be the case under the 2008 Scheme. Members can elect not to work longer and instead take early retirement with an actuarially reduced pension or to purchase additional service. As it is not possible to determine how individuals might elect to manage this cost, no estimation of cost can be given.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate			£622m	

Description and scale of key monetised benefits by 'main affected groups'

The Government Actuary's Department has assessed the cost of the current LGPS benefits and the equivalent proposals under the reformed Scheme. They found that, in isolation of other factors outside of the scope these Regulations, employers should see an average saving of 2.2% of total pensionable pay per annum as a result of these proposals. Applied under the terms of the current Scheme to the 2011-12 total pensionable pay bill, this would represent a saving of £622 million per year.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks | **Discount rate (%)** |

In order to determine the cost of the new Scheme, a number of assumptions had to be taken by the Government Actuary's Department. However, these assumptions form part of the actuarial assessment of the cost of the Scheme and have been determined in line with the actuarial profession's standard working practices. The annexes to this document sets out these assumptions in more detail.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	**Benefits:** £93m	**Net:** £93m	No	NA

Supporting evidence

1. The policy issue and rationale for Government intervention

1.1 At the June 2010 Budget, the Government invited Lord Hutton of Furness to chair the Independent Public Services Pensions Commission and review public service pension provision. The Commission was asked to give recommendations about how public service pensions could be made more sustainable and affordable in the long term and fair to both public sector workers and the taxpayer. Their proposals were to protect accrued rights, whilst being consistent with the fiscal challenges ahead.

1.2 Lord Hutton's final report was published in March 2011 and made clear that change was needed to "make public service pension schemes simpler and more transparent, fairer to those on low and moderate earnings."[1] The Schemes also needed to become more cost-effective if they were to be sustainable. The cost of public service pensions paid out has risen by over a third over the last 10 years to £32 billion a year[2] and the Commission found that these additional costs have mostly fallen to the taxpayer.[3]

1.3 In response to Lord Hutton's report, the Government brought forward the Public Service Pensions Act 2013. The 2013 Act provides public service pensions with a framework for reform and specifies some of the changes to be reflected in the new public service pension schemes.

1.4 These proposals are therefore concerned with the membership of, contributions to and benefits receivable from, a new 2014 Local Government Pension Scheme (LGPS) which is in keeping with the 2013 Act. The proposed Scheme, which was developed in conjunction with employers and trades unions, seeks to provide members with a high-quality pension that is also sustainable in the long term and at a lower cost to employers and the taxpayer.

1.5 The existing Local Government Pension Scheme is established under the Superannuation Act 1972 and comprises the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (S.I. 2007 No 1166) and The Local Government Pension Scheme (Administration) Regulations 2008 (S.I. 2008 No 239). Secondary legislation is therefore required to introduce a new Local Government Pension Scheme on 1 April 2014.

1.6 As part of the discussions to determine the terms of the new Scheme, Government agreed that the reformed LGPS would come into effect one year earlier than other public service schemes. As such, the commencement of the relevant parts of the 2013 Act is not expected until after the reformed Scheme has come into effect. The 2014 Scheme Regulations will therefore be made under the Superannuation Act 1972, but will be deemed to have been made under the 2013 Act once the relevant parts have been commenced.

2. Policy objectives and intended effects

2.1 The Government's November 2011 paper, *Public Service Pensions: good pensions that last*, accepted Lord Hutton's view that comprehensive reform of public service pensions was needed if public service employees were to continue to have access to good quality, sustainable and fairer defined benefit pension schemes. The Government recognised that these new schemes would

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[1] Independent Public Service Pensions Commission Final Report, page 5, https://www.gov.uk/government/publications/independent-public-service-pensions-commission-final-report-by-lord-hutton
[2] Public Service Pensions: good pensions that last, https://www.gov.uk/government/publications/public-service-pensions-good-pensions-that-last--2
[3] Independent Public Services Commission Interim Report, page 20, http://webarchive.nationalarchives.gov.uk/20120210065955/http://www.hm-treasury.gov.uk/d/hutton_pensionsinterim_071010.pdf

need to balance taxpayers' concerns about the present and future cost of these pensions, with the need to ensure decent levels of retirement income for public service employees.

2.2 The resultant Public Service Pensions Act 2013 was designed to facilitate the reform of public service pension schemes. These proposals seek to meet the Act's requirements for the reform of the LGPS as well as the Government's stated objectives for public service pensions, which are to:

- ensure a good level of retirement income for public service workers, with a reasonable degree of certainty;
- be affordable and sustainable – with cost risk managed and shared effectively;
- provide a fair balance of cost and benefits between public service workers and other taxpayers;
- protect those closest to retirement;
- have a clear legal framework which can be widely understood by workers; and
- stand the test of time – with no more reform for at least 25 years.

3. Policy options considered

Option 1: Do nothing

3.1 The 2013 Act requires that the existing Local Government Pension Scheme is closed on 31 March 2014. As the Government has committed to protect accrued pension rights and establish fairer, sustainable public service pension schemes, a reformed 2014 Scheme must come into effect on 1 April 2014. It was therefore not possible to consider the "do nothing" option. This is also the case for the transitional regulations, which are required to deliver the Government's commitment to protect accrued rights and the financial plans of those closest to retirement.

Option 2: Use HM Treasury's reference scheme

3.2 Public service pension schemes were required to develop their reformed schemes based on the design elements set out in a reference scheme prescribed by HM Treasury. One option therefore, was to use the 2014 Scheme on the terms of the reference Scheme, without taking into consideration the existing benefit structure or terms of the current LGPS. As a more flexible and responsive approach was available, this option was not selected.

Option 3: Develop an alternative scheme under the principles of the reference scheme

3.3 Whilst the proposals for the new Scheme had to meet the key parameters of the reference scheme and the 2013 Act, schemes were permitted some flexibility around most of the individual elements. As with the majority of schemes, the LGPS selected this option and developed proposals that took advantage of those flexibilities rather than apply the reference scheme in total. As a result, the final proposal for the Scheme was informed by the sector and better tailored to the needs of LGPS employers and employees, whilst also meeting the minimum reference scheme requirements.

Implementation

3.4 A collaborative Project Board was formed early in the reform process in January 2012. Asked to establish a set of high level design principles for the new Scheme, the Board comprised of representatives from the Local Government Association, DCLG and three of the major local government trades unions: Unite, Unison and the GMB.

3.5 The main features of the Board's proposals for the new LGPS include:

- defined benefit structure for members – based on Career Average Re-valued Earnings (CARE) for service from 1 April 2014
- revaluation of accrued rights during active membership at the Consumer Prices Index rate
- Normal Pension Age linked to changes to the State Pension Age
- Initial employee contribution rates unchanged from the current Scheme
- lump sum commutation at the same rate as the current Scheme
- transitional protections for those closer to retirement

- a 50/50 arrangement to encourage new participants in the Scheme and minimise the risk of members opting-out, offering membership at a half-rate in return for half the final pension benefits in respect of that period.

3.6 Three formal consultations have been undertaken on the Board's suggested principles for the new Scheme, including draft Regulations. The proposals are therefore the final option under consideration and include changes made as a result of the consultations.

3.7 The 2014 Local Government Pension Scheme is intended to come into effect on 1 April 2014. There are currently 89 Funds within the Scheme across England and Wales; each with its own administering authority. Typically a local authority, it is these administrating authorities who will be responsible for implementing the new Scheme.

3.8 The Regulations governing the new Scheme will be laid before Parliament in September, allowing administrators time to familiarise themselves with the changes and to begin to implement any necessary new systems. The Department will continue to offer support to authorities to aid the implementation of the new Scheme.

4. Expected level of impact on business

Extent of the effect on business and civil society

4.1 The majority of LGPS members are employed by best value authorities.[4] Although not an exhaustive list, best value authorities include local authorities (county councils, district councils and London boroughs), fire and rescue authorities, waste disposal authorities, National Park and Integrated Transport Authorities. It is only authorities listed in Schedule 1 to the Regulations who are required to offer the LGPS to their employees.

4.2 However, some private sector and civil society organisations also participate in the Scheme, usually on a voluntary basis. These organisations often come into the LGPS having elected to undertake a public service delivery contract on behalf of a best value authority. In these cases, where staff are compulsory transferred into a private sector or civil society organisation, the Best Value Authorities Staff Transfers (Pensions) Direction 2007 secures a 'broadly comparable' pension, for future service only, for staff transferring from a best value authority in England. The external provider is therefore able to offer transferred staff either continued access to the LGPS or membership of a scheme of broadly comparable value. As such, their participation in the LGPS is not compulsory.

4.3 It is not possible to identify how many private or voluntary sector employers are in the LGPS, or the number of Scheme members working outside of the public sector. However, it is anticipated that around 75 per cent of Scheme members are employed by local authorities. The remaining 25 per cent would therefore be employed by the private sector, civil society organisations and other public sector bodies such as higher and further education establishments. It has been assumed that around 15 per cent of Scheme costs are born by private and civil society contracting bodies, although the savings for this sector have also been estimated at 10 per cent and 20 per cent of total LGPS membership.

Monetised benefits

4.4 One of the primary objectives of LGPS reform is to reduce its cost to taxpayers and employers and to ensure that scheme members bear a greater proportion of these costs. The Government Actuary's Department have assessed the cost of the new Local Government Pension Scheme on 1 April 2014 as 19.5 per cent of pensionable pay and the cost of the current scheme at the same date as 21.7 per cent of pensionable pay. This represents an average saving to employers of 2.2 per cent of total pensionable pay per annum when compared to the "do nothing" option.

[4] http://www.legislation.gov.uk/ukpga/1999/27/contents

4.5 Individual employee contribution rates are determined using salary bands, so that those earning a higher salary contribute a higher proportion of their salary to the fund. Across all employees, the contribution should be 6.5 per cent of total pensionable pay, although this yield is sometimes not achieved, for example as the number of individuals in each salary band changes. Accepting that the total employees' contributions for 2011-12 were £1.839 billion and equivalent to 6.5 per cent of pensionable pay, it is possible to estimate that the total pensionable pay bill is £28.292 billion.[5] Applying a saving of 2.2 per cent to the total pensionable pay under the terms of the current Scheme, this would represent a saving of £622 million per year across all Scheme employers.

4.6 Any proposal for the 2014 Scheme must fit within the cost ceiling set by the reference scheme (option two). As the Board's proposals (option three) match that cost ceiling, there is no difference in the cost to employers between these two options.

4.7 The Scheme uses individual employer contribution rates, so it is not possible to isolate the specific cost impact on private and civil society bodies. The following levels of indicative savings, which would contribute to the total saving set out above, have been modelled based on Scheme membership from these sectors of 10, 15 and 20 per cent.

Proportion of Scheme members in sectors %	Proportion of total pensionable pay per annum £ million	2.2% of pensionable pay saving to employers per year £ million
10%	2,829	62
15%	4,244	93
20%	5,658	124

4.8 To illustrate what the savings might mean in practice, a county council with an annual pensionable pay bill of £690 million would realise an annual saving of £15 million. Similarly, a small business with a total pensionable pay bill of £0.5 million would achieve an annual saving of £11,000.

4.9 Whilst the changes to the Scheme are expected to realise savings of 2.2 per cent of pensionable pay when compared to the "do nothing" option, it is important to note that factors outside of the Scheme Regulations; such as workforce demographic changes and investment performance, will also impact on the overall cost to employers. These external factors would affect the cost of both the current and new Schemes.

4.10 The 2013 valuation of the existing Scheme is currently underway. This will consider how the Funds have changed since the 2010 valuation and provide an actuarial assessment of the cost of the Scheme at 31 March 2013. If the cost has increased, the valuation will set higher employer contribution rates for the triennial period running from 1 April 2014. As these new rates and the new Scheme will come into effect on the same day, employers may not see the 2.2 percentage point reduction in contribution rates that is expected to arise from the implementation of the new Scheme. In this case, the reduction in employer costs will be off-set by the likely increase in rates resulting from the valuation. As such, whilst individual employers may see an overall increase in their contribution rates on 1 April 2014, the increase should, on average, be 2.2 percentage points lower than if the "do nothing" option had been pursued.

Monetised costs

4.11 There are likely to be some costs associated with the implementation of the new Scheme for participating employers. For example, the change to the defined benefit mechanism, moving from final salary to Career Average Re-valued Earnings, will require more detailed payroll records to be kept than is currently the case for some employers. Employers will now need to maintain full records of the relevant career earnings history for each member of staff, including the date and amount of every change in pensionable pay. Similarly, changes may be needed to the pension

[5] https://www.gov.uk/government/publications/local-government-pension-scheme-funds-for-england-2011-to-2012 It should be noted that applying the same calculation to the employers' contributions will result in a different total for pensionable pay. This is because employers' contribution rates are set locally by each fund's actuary and reflect the individual level of risk associated with each employer and local demographics. As such, whilst the cost of the Scheme to employers is established as 15.2 per cent of pensionable pay, this will not match the total employers' contributions which also reflect the risk of individual employers.

administrators' systems to facilitate the transitional arrangements designed to protect those closer to retirement, where the link to final salary as defined by the current Scheme regulations will need to be maintained.

4.12 It is not possible to estimate the cost to business of implementation as data is not held on employer administration and payroll systems. To estimate this cost, each employer would need to indicate the extent of the changes required to their administration or payroll systems and the associated cost. In addition, across all three consultations, very few responses raised payroll record keeping as a concern. On this basis, it would not be proportionate to ask the thousands of LGPS employers to provide the Department with the data needed to estimate this cost.

Impact on Scheme members

4.13 Scheme members will be affected by the proposals for a reformed LGPS, although the transitional regulations will protect those closest to retirement. The savings generated for LGPS employers have been found by revising the structure of the members' benefits in order to make the overall Scheme cheaper. Whilst this has created some terms that are more favourable to members; such as a faster accrual rate; members without any transitional arrangements are ultimately likely to see a reduction in their overall pension benefits. In a significant number of cases, members could still receive the same level of pension benefit, but would need to either work for longer than the current Scheme's Normal Retirement Age, or purchase additional service.

4.14 For example, a member in the new Scheme with a normal retirement age of 66 based on his State pension Age of 66 could retire at that age with an annual pension of £5,013. But if he chooses to retire at his former normal retirement age of 65, the annual pension would be reduced by 6 per cent to £4,712.

4.15 An Equalities Statement has also been produced to accompany the introduction of the 2014 Scheme. This considers in more detail the impact of the changes on Scheme members and in particular those protected by equalities legislation. For example, the additional transitional protections afforded to older members closer to retirement, and the greater impact of moving to a career average scheme on men as they are more strongly represented in the higher earners group, is explored in full.

5. Risks and assumptions

Assumptions

5.1 The Government Actuary's Department have provided the Department with an actuarially determined estimate of the cost of the proposals for the new Local Government Pension Scheme. This cost has been estimated using the most recently available membership data from the 2010 Valuation.

5.2 In order to determine the cost of the new Scheme, a number of assumptions had to be taken by the Government Actuary's Department. Set out in more detail in the accompanying annexes, the assumptions form part of the actuarial assessment of the cost of the Scheme and have been determined in line with the actuarial profession's standard working practices.

5.3 Although the cost of the proposed Scheme has been estimated and underpinned by actuarially determined assumptions, it is likely that the actual cost of the Scheme from 1 April 2014 will differ. This is because the cost of the Scheme and therefore the actual employers' contribution rates are always calculated by fund actuaries based on locally determined demographic and financial assumptions. The final cost to each employer will also be tailored to reflect their individual level of risk.

5.4 The costs of both the new and current Schemes are dependent on the investment market remaining stable. If the value of the assets underpinning any fund were to drop significantly, the cost of that Scheme would increase substantially as higher levels of income would be needed to match the fund's liabilities. Whilst investment income is subject to market conditions, LGPS funds are encouraged to manage their investment portfolio to ensure the maximum return within reasonable risk parameters. As the changes to the Scheme do not alter the investment regulations, they are not expected to impact on investment income or increase the risk of market instability. The investments held by individual funds and the return they earn from them, are outside the control of the Department.

Risks

5.5 A number of risks have been identified and mitigated through the development of the proposals for the new Scheme.

5.6 **Reduced membership:** If the revised benefit package was not considered to offer value for money, members may elect to opt out of the Scheme. Fewer active members would increase the cost of the Scheme initially as lower employee contributions would reduce the funding available for investment and payment of pensions. Using a Board comprised of trades unions and employer representatives to develop the Scheme has helped to mitigate this risk. Indeed, each of the trade unions secured approval for the proposed Scheme design from their members.

5.7 In addition to the requirement to automatically enrol staff into a valid pension scheme, the Board created a new 50-50 option to encourage staff concerned about the cost of membership to remain in the Scheme. 50-50 allows members to pay half the normal rate of contribution in return for half of the pension benefits in respect of that period.

5.8 **Delayed implementation of the 2014 Scheme:** In recognition of the savings generated by the LGPS by commencing its reformed Scheme in 2014, one year before the other reformed public service pension schemes, the Government agreed that the three per cent increase in employees' contributions being made elsewhere in the public sector should not apply. If the deadline of April 2014 is missed, the Department might be required to find the equivalent saving, as the reform savings would no longer accrue a year early. The Department would also need to amend the 2013 Act which requires the existing Scheme to come to a close on 31 March 2014. The close involvement of employers and trade unions in the Scheme development from the outset, has helped to engender support for the proposals. The Regulations are also being laid seven months before the current Scheme closes in order to mitigate the risk that the introduction of the 2014 Scheme is delayed.

5.9 **Administrative complexity:** In addition to implementing a new Scheme in 2014, transitional arrangements for those close to retirement are also required. Existing LGPS members will receive a two-part pension; partly under the new Scheme and partly on the terms of the existing Scheme on the basis of their accrued rights. This complex administrative arrangement may lead to errors in the payment of pensions, driving up costs and losing the support of pensioners. Regular meetings have been held with pension fund software and systems providers to ensure that as much of the record keeping and administration as possible can be automated. Administrators have also been involved in the design of the Scheme, represented by the LGA at the Project Board. In addition, the 2014 Scheme Regulations include a Treasury directive detailing the content of pension statements that will also provide members with an opportunity to review their benefits statements annually and inform administrators of any inaccuracies in their records.

5.10 **Future scheme cost rises:** The Government Actuary's Department have determined the cost of the Scheme on 1 April 2014 as being 19.5 per cent of total pensionable pay. However, just as with the existing Scheme, as key factors such as investment returns, scheme membership and longevity expectations change with time, so the cost of the Scheme will change. Cost management arrangements are in the process of being finalised to prevent future costs to employers rising above the agreed current employer contribution rate of 13 per cent. This will also help to ensure that the existing 2:1 employer to employee contribution ratio is maintained.