

## Proposed Pension Reform

Bulletin No.2

October 2011

**PLEASE NOTE: on 2 November 2011, HM Treasury issued information on the Government's revised offer on public service pensions. Some of the new proposals identified by the Treasury may alter the information contained in this bulletin. Pension Services will shortly be issuing Bulletin No.3 to advise on how these new proposals may affect LGPS members.**

### DCLG Publish Proposals

On 7 October 2011, the Department of Communities and Local Government published their response to the initial proposals for increases to employee contribution rates and changes to the scheme accrual rates, put forward by the Local Government Group (the employers) in their letter to the Secretary of State on 21 September 2011. Details of these proposals can be found in Bulletin No.1 of this series of publications.

The publication of these proposals signalled the start of a 12 week consultation process that enables employers, trade unions, administering authorities and others to comment. The closing date for responses is 6 January 2012.

### What is being proposed?

Ministers believe that the broader range of measures for increasing member contributions, suggested by the Local Government Group in their letter of 21 September 2011, will meet targeted savings of 3.2% of pay, whilst protecting low earners and be progressive, so that higher earners pay a proportionally higher increase.

There are **two** options being tabled:

**Option 1** suggests a proposal to increase members' contributions to meet 1.5% of the targeted saving. A slight reduction in pension build up would also be used to achieve the remainder of the saving.

**Option 2** considers an alternative proposal of reducing the increase in members' contributions to meet 1% (instead of the 1.5% proposed in Option 1) of the targeted saving, with a slightly higher reduction in pension build up used to achieve the remainder of the saving.

**Illustrations of how the proposals in Options 1 and 2 would work are as follows:**



**Option 1** puts forward a proposal for a higher proportion of the cost savings to be met by a phased increase in members' contributions over a three year period for full implementation by 2014-15. The proposed new rates under Option 1 are identified in the table below (*the phased increase in percentage is shown in brackets*).

Pay Band	Current Contribution Rate	Proposed new rate for 2012/13	Proposed new rate for 2013/14	Proposed new rate for 2014/15
£0 - £12,900	5.5%	5.5% (0.0%)	5.5% (0.0%)	5.5% (0.0%)
£12,901- £15,100	5.8%	5.8% (0.0%)	5.8% (0.0%)	5.8% (0.0%)
£15,101- £19,400	5.9%	5.9% (0.0%)	6.0% (0.1%)	6.0% (0.1%)
£19,401- £21,000	6.5%	6.7% (0.2%)	7.2% (0.7%)	7.7% (1.2%)
£21,001- £32,400	6.5%	7.2% (0.7%)	8.0% (1.5%)	8.3% (1.8%)
£32,401- £43,300	6.8%	7.5% (0.7%)	8.3% (1.5%)	8.7% (1.9%)
£43,301- £60,000	7.2%	8.2% (1.0%)	8.7% (1.5%)	9.0% (1.8%)
£60,001- £81,100	7.2%	8.7% (1.5%)	9.2% (2.0%)	10.0% (2.8%)
£81,101- £100,000	7.5%	9.0% (1.5%)	9.8% (2.3%)	11.0% (3.5%)
£100,001- £150,000	7.5%	9.5% (2.0%)	11.0% (3.5%)	12.0% (4.5%)
£150,001 +	7.5%	10.0% (2.5%)	12.0% (4.5%)	12.5% (5.0%)

Member's contributions are deducted from gross pay and therefore attract tax relief. The net effect of this is that the percentages shown above have less of an impact on actual take-home pay. This can be illustrated in the table below.

Full-time pay	2012/13		2013/14		2014/15	
	Contribution rate net of tax	Additional cost (£ per month)	Contribution rate net of tax	Additional cost (£ per month)	Contribution rate net of tax	Additional cost (£ per month)
£10,000	4.40%	0	4.40%	0	4.40%	0
£25,000	5.76%	12	6.40%	25	6.64%	30
£40,000	6.00%	19	6.64%	40	6.96%	51
£80,000	5.22%	60	5.52%	80	6.00%	112

Included as part of **Option 1**, is a proposed change in the level of pension build up, to take effect from April 2013. This would see the rate change from 1/60<sup>th</sup> to 1/64<sup>th</sup> in April 2013 and to 1/65<sup>th</sup> in April 2014. The impact of this proposed change can be illustrated as follows:

Final Pensionable pay	Comparison of proposed changes to pension build up for each year of service		
	1/60 <sup>th</sup> up to March 2013	1/64 <sup>th</sup> April 2013 to March 2014	1/65 <sup>th</sup> from April 2014 onwards
£10,000	£166.67	£156.25	£153.85
£25,000	£416.67	£390.63	£384.62
£40,000	£666.67	£625.00	£615.38
£80,000	£1,333.33	£1,250.00	£1,230.77

**Option 1 Example** - A higher level of increase in members' contributions to be introduced over a three year period, with full implementation by 2014-15, and a staged reduction in pension build up from April 2013 onwards, which can be illustrated as follows:

**Member A** works full-time receiving annual pay of £15,000 and has been a member since 1 April 2008. They **would not** have to pay any increase in their contributions to the scheme under the new proposals.

Their pension at 31 March 2015 may look like this:

Pension build up between April 2008 and March 2013 $5/60 \times £15,000$	Proposed pension build up during 2013/14 $1/64 \times £15,000$	Proposed pension build up during 2014/15 $1/65 \times £15,000$	Total annual pension	Under the current scheme rules the pension would be $7/60 \times £15,000$
£1,250.00*	£234.38	£230.77	£,1715.15	£1750.00#

**\* This part of the pension would be protected under the current scheme rules**

# In this example, the difference in pension build up between the existing scheme rules and the proposed new scheme rules would be £34.85 pa.

**Member B** also works full-time but receives annual pay of £35,000. They too have been a member since 1 April 2008. Under the proposals in **Option 1**, they would have to pay an increase in member contributions as follows:

Current Contribution rate on pay of £35,000	2012/13		2013/14		2014/15	
	Proposed new contribution rate	Additional cost (£ per month)	Proposed new contribution rate	Additional cost (£ per month)	Proposed new contribution rate	Additional cost (£ per month)
6.8%	7.5%	16.33	8.3%	35	8.7%	44.33

Member's contributions are deducted from gross pay and therefore attract tax relief. The table above shows the estimated increase in deduction from take-home pay.

**Member B's** pension at 31 March 2015 may look like this:

Pension build up between April 2008 and March 2013 $5/60 \times £35,000$	Proposed pension build up during 2013/14 $1/64 \times £35,000$	Proposed pension build up during 2014/15 $1/65 \times £35,000$	Total annual pension	Under the current scheme rules the pension would be $7/60 \times £35,000$
£2,916.67*	£546.88	£538.46	£4,002.01	£4083.33#

**\* This part of the pension would be protected under the current scheme rules**

# In this example, the difference in pension build up between the existing scheme rules and the proposed new scheme rules would be £81.32 pa.

**Option 2** proposes that more cost saving is made through a slightly lower rate of pension build up, therefore reducing the proposed level of increase in the contributions that members would be required to pay. The proposed new contribution rates under Option 2 are shown in the table below (*the phased increase in percentage is shown in brackets*).

Pay Band	Current Contribution Rate	Proposed new rate for 2012/13	Proposed new rate for 2013/14	Proposed new rate for 2014/15
£0 - £12,900	5.5%	5.5% (0.0%)	5.5% (0.0%)	5.5% (0.0%)
£12,901- £15,100	5.8%	5.8% (0.0%)	5.8% (0.0%)	5.8% (0.0%)
£15,101- £19,400	5.9%	5.9% (0.0%)	6.0% (0.1%)	6.0% (0.1%)
£19,401- £21,000	6.5%	6.5% (0.0%)	6.8% (0.3%)	6.8% (0.3%)
£21,001- £32,400	6.5%	6.8% (0.3%)	7.2% (0.7%)	7.5% (1.0%)
£32,401- £43,300	6.8%	7.1% (0.3%)	7.8% (1.0%)	8.2% (1.4%)
£43,301- £60,000	7.2%	7.8% (0.6%)	8.4% (1.2%)	8.8% (1.6%)
£60,001- £81,100	7.2%	8.7% (1.5%)	8.8% (1.6%)	9.5% (2.3%)
£81,101- £100,000	7.5%	9.0% (1.5%)	9.8% (2.3%)	10.5% (3.0%)
£100,001- £150,000	7.5%	9.3% (1.8%)	10.8% (3.3%)	11.5% (4.0%)
£150,001 +	7.5%	9.5% (2.0%)	11.8% (4.3%)	12.5% (5.0%)

The likely impact this would have on member's take-home pay can be illustrated in the table below.

Full-time pay	2012/13		2013/14		2014/15	
	Contribution rate net of tax	Additional cost (£ per month)	Contribution rate net of tax	Additional cost (£ per month)	Contribution rate net of tax	Additional cost (£ per month)
£10,000	4.40%	0	4.40%	0	4.40%	0
£25,000	5.44%	5	5.76%	12	6.00%	17
£40,000	5.68%	8	6.24%	27	6.56%	37
£80,000	5.22%	60	5.28%	64	5.70%	92

The proposals under Option 2 suggest that the level of pension build up is changed from 1/60<sup>th</sup> to 1/67<sup>th</sup> with effect from 1 April 2014. The impact of this proposed change can be illustrated as follows:

Final Pensionable pay	Comparison of proposed changes to pension build up for each year of service	
	1/60 <sup>th</sup> up to March 2014	1/67 <sup>th</sup> from April 2014 onwards
£10,000	£166.67	£149.25
£25,000	£416.67	£373.13
£40,000	£666.67	£597.01
£80,000	£1,333.33	£1,194.03

**Option 2 Example:** A lower level of increase in members' contributions to that in Option 1 is proposed, with a slightly higher reduction in pension build up. When applied to the same details used for **Member A** and **Member B** in the option 1 examples, the figures could look like this:

**Member A** would still **not have to have to pay any increase in contributions** on a pay figure of £15,000.

Their pension at 31 March 2015 (*based on service from 1 April 2008*), may look like this:

Pension build up between April 2008 and March 2014 $6/60 \times £15,000$	Proposed pension build up during 2014/2015 $1/67 \times £15,000$	Total annual pension	Under the current scheme rules the pension would be $7/60 \times £15,000$
£1,500.00*	£223.88	£1,723.88	£1750.00#

**\* This part of the pension would be protected under the current scheme rules**

# In this example, the difference in pension build up between the existing scheme rules and the proposed new scheme rules would be £26.12 pa.

**Member B** would pay a lower increase in contributions on their pay figure of £35,000 compared with option 1, this can be illustrated as follows:

Current Contribution rate on pay of £35,000	2012/13		2013/14		2014/15	
	Proposed new contribution rate	Additional cost (£ per month)	Proposed new contribution rate	Additional cost (£ per month)	Proposed new contribution rate	Additional cost (£ per month)
6.8%	7.1%	7.00	7.8%	23.33	8.2%	32.67

Member's contributions are deducted from gross pay and therefore attract tax relief. The table above shows the estimated increase in deduction from take-home pay.

**Member B's** pension at 31 March 2015 (*based on service from 1 April 2008*) may look like this:

Pension build up between April 2008 and March 2014 $6/60 \times £35,000$	Proposed pension build up during 2014/2015 $1/67 \times £35,000$	Total annual pension	Under the current scheme rules the pension would be $7/60 \times £35,000$
£3,500.00*	£522.39	£4,022.39	£4083.33#

**\*This part of the pension would be protected under the current scheme rules**

# In this example, the difference in pension build up between the existing scheme rules and the proposed new scheme rules would be £60.94 pa.

**In addition** to Options 1 and 2 there is a proposal to increase the normal retirement age from 65 to 66 to align with the national State Pension Age. The consultation will seek views on the prospects of introducing this recommendation.

### **Part Time Members**

The current scheme regulations require that the appropriate contribution band for part-time members is determined by their full-time equivalent pay. The appropriate rate is then applied to the member's actual pay. The proposals do not envisage this situation changing.

### **What next?**

**It is important to stress that these are only proposals at present and that there will be much debate and consultation before the full picture is clear. Further bulletins will be issued when more information regarding the reform of the LGPS is known.**