

Nest egg

A newsletter for members of the Local Government Pension Scheme participating in the Staffordshire County Pension Fund

January 2006 Issue 2

Proposed 2006 changes to the Local Government Pension Scheme Published – 85 Year Rule Abolished

Welcome to this special edition of Nest egg. When I wrote my last introduction, I didn't expect to be writing the next one quite so soon. I believe, however, it is important for you to understand the background to some of the proposed regulation changes recently published by the Office of the Deputy Prime Minister (ODPM); in particular, the abolition of the '85 year rule' now planned for 1 October 2006.

During the summer the unions, employers and the Government have been discussing possible changes to the Local Government Pension Scheme to resolve the issues surrounding the revocation of the April 2005 changes. The Government has recently issued a set of draft regulations for consultation which cover the changes that are needed to the scheme rules to bring them into line with overriding tax and equality legislation.

Some of the finer details of how these proposals will work in practice have yet to be agreed upon.

Although you are always welcome to contact Pensions Services we will not as yet have the detailed answers to some of the questions that may arise with regard to your personal circumstances, until the regulations have been finalised, which could be as late as March 2006.

Our contact details are given on the back page.

Janet Caiazzo
Pensions Manager

Main Proposals in Brief

- Earnings cap removed.
- Membership limits removed.
- 15% contribution limit removed.
- Flexible retirement introduced.
- Bigger tax-free retirement grant.
- Able to join up to age 75.
- '85 year rule' test abolished.
- Protection for those aged 60 by 1/4/2013.
- Membership Purchase changes.
- Retention of AVC Schemes.



Staffordshire

Cost of Pensions – Some Facts

Future of the Scheme

The Government is currently discussing the proposed changes effective from April 2006 together with future changes with a view to introducing a 'new look' scheme in 2008. There are some key economic and political messages in this process such as;

- The cost of the scheme is a concern to employers.
- There is potential 'envy' from non public sectors workers (and council taxpayers) at the cost of retention of the final salary scheme.

Scheme Funding

The LGPS is funded from three main sources;

- Most **employees** pay 6% from their pay (tax free);
- The Pension Fund invests in shares, bonds and property which can grow or fall in value depending mainly on stock markets;
- The **employer** pays whatever is then needed to meet all pension payments.

The Actuary carries out an exercise every three years to determine the level of contributions paid by each employer.

The Cost of Pensions is Rising

Stock markets fell dramatically during 2000-2002 resulting in a large deficit between the commitment to future pensions and the amount of assets available to cover those commitments. The Actuary calculated the fund deficit for Staffordshire at £269m. This resulted in an increase in **employers'** contribution rate of almost 5% of pay.

The overall **employers'** contribution rate is over 16%. This is a substantial cost on budgets.

Cost of Abolition of the '85 year rule'

The '85 year rule' is due to be abolished with effect from 1 October 2006 with protection for staff nearing retirement age. The Unions are opposed to the abolition of the '85 year rule'.

The actuary has calculated that the cost of **not** abolishing the '85 year rule' would add around 2% to the employers' contribution rate. This could vary depending on the level of protection to existing staff.

Other Public Sector Schemes

It is understood that teachers, health workers and the civil service have received agreement to protect the pensions of all existing staff at age 60. The publicity around this agreement implied that the cost of retaining protection for existing staff had been offset by foregoing improvements to the scheme.

Ongoing Discussions

The Government has suggested that the statutory consultation on the present changes including the abolition of the '85 year rule' can continue, for a short time, to run alongside the discussions for a new scheme due to be introduced in 2008.

The offer of parallel discussions would allow Local Government unions an opportunity to discuss the level of protection, in the context of both the draft regulations as they stand, and the new scheme. The consultation on the draft regulations finishes on 28 February 2006. Discussions on the new scheme are due to carry on into the Summer of 2006.

However, the reality is that the Government and employers are unlikely to move from a clear position that any concession on the '85 year rule' must be met with equivalent cost savings in the scheme.

Proposed changes to LGPS

How could this affect your retirement benefits?

'85 year rule'

Because the '85 year rule' is age discriminatory it will be removed with effect from 1 October 2006.

- Currently any scheme member can retire at or after age 60 with unreduced benefits where the sum of their age plus membership equals 85;
- After the removal of the '85 year rule' benefits based on membership from 1 October 2006 onwards which are brought into payment on retirement between the ages of 60 and 65 will have a reduction applied unless;
 - the scheme member is aged 60 before 1 April 2013, in which case their current '85 year rule' date will be protected, or
 - the scheme member nominates a date on which he/she intends to retire between age 60 and 65 and elects to pay extra contributions to offset the reduction.

Flexible Retirement

It is intended to introduce flexible retirement with effect from 6 April 2006

- Currently it is not possible to draw retirement benefits from the pension scheme and continue working in the same employment but changes in overriding tax legislation mean that this may become possible;
- Flexible retirement arrangements would mean that a scheme member could draw retirement benefits whilst remaining in employment where;
 - they are aged 60 or over, and
 - there is a reduction in either their hours worked or pay grade, and
 - the employer has given consent.

It is likely that individual employers will need to draft a policy defining the circumstances where they would be prepared to give consent to such an arrangement.

Bigger Tax-free Retirement Grants

- ✓ Currently, on retirement, scheme members take a tax-free retirement grant of 3 times the amount of their annual pension.
- ✓ From 6 April 2006 scheme members will be able to increase this amount by giving up part of their annual pension.
 - ✓ For every £1 of pension given up an extra £12 retirement grant would be paid.
 - ✓ The maximum amount of retirement grant payable will be equal to 25% of the capital value of the member's pension fund. (the current retirement grant is equal to roughly 15% of the capital value).
- ✓ Spouse's/civil partner's benefits would not be affected by any reduction to the standard pension
(the amount given up to produce a larger retirement grant would be ignored).

Tax changes

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A Day – 6 April 2006

The last edition of Nest egg summarised the changes that would be necessary to comply with the new tax regime operative from 6 April 2006. It is now possible to look at those changes and the effect they will have on LGPS members in greater detail;

What does it mean for us?

- The **majority** of LGPS members will not be affected.

High Earners

- Pension contributions may be deducted on actual earnings – the cap may no longer apply;
- Membership prior to 6 April 2006 could be scaled down to reflect the fact that it was based on capped earnings.

Lifetime Allowance

This is an overall limit on the capital value of all retirement benefits that can be paid to an individual tax-free. It is calculated by multiplying your annual pension by a factor of 20 and adding this to your retirement grant;

- All an individual's pension arrangements are taken into account;
- If the lifetime allowance is exceeded the excess will be subject to tax deductions;
- Before a scheme is able to make payment of benefits they will need to know the capital value of benefits held with any other provider;
- The value of the lifetime allowance for 2006/2007 is £1.5 million;
- This value will increase annually.

Annual Allowance

This is an annual limit on the amount of capital growth benefits can increase by, before becoming subject to tax deductions;

- The annual allowance for 2006/2007 is £215,000;
- This value will increase annually;
- LGPS will have to perform an annual check on your benefits and notify you of the capital value of your benefit growth;
- Where an individual has exceeded the annual allowance (all pension arrangements have to be taken into account) they must declare this to Her Majesty's Revenue and Customs ("HMRC" - formerly known as the Inland Revenue).

Removal of the 15% limit on contributions

This means that you will be able to pay pension contributions up to the higher of 100% of pensionable pay or £3600;

- Additional Voluntary Contribution (AVC) Schemes will continue to operate.
- Added years purchases will be subject to a maximum purchase limit of 6 years 243 days)

In the meantime, if you want further information on the draft regulations, you can do so at

www.xoq83.dialpipex.com

if you want to make your views known, you can do so by emailing the following address

Nicola.rochester@odpm.gsi.gov.uk

Contact us



by writing to:

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We also have a website at: www.staffordshire.gov.uk/pensions

If a copy of the information in this Newsletter is needed in large print, Braille, another language or on cassette, please get in touch with us

The Final Regulations may differ from these proposals