

The Local Government Pension Scheme

**Reduction or restriction in pay:
What effect does this have on my
retirement benefits?**



Reduction or restriction in pay

Sometimes a member of the Local Government Pension Scheme (LGPS), for one reason or another will have pay reduced, frozen or restricted in some way. These notes explain the effect this could have on benefits payable under the LGPS and show various options allowed under the LGPS Regulations to limit any harmful effect. To keep the notes as short and simple as possible they include generalisations and nothing mentioned here can override the provisions of the LGPS Regulations.

Why would a reduction or restriction in pay be a problem?

There would be a problem because the pension contributions you make and the benefits you receive are based on your pay. The LGPS is a “final pay” pension scheme which means that benefits are (normally) calculated on pay received in the year up to and including your last day of membership. If your last year’s pay is less than pay received earlier in your period of membership, you would receive a lower level of benefits than otherwise expected. The benefits would not reflect pay received and contributions deducted before the pay reduction.

Can I carry on paying contributions on my old rate of pay and have that used in the pension calculation?

No. Inland Revenue rules do not permit this.

What can I do to protect my pension rights?

There are a number of options. You will be asked to indicate which you prefer within certain time limits. You will have a decision to make at the time your pay reduces or becomes restricted, and in some cases you may have a further decision at the time that benefits become payable. Like most things to do with pensions there is an element of gamble about these choices because no-one can foresee the future. The advantage of one option over another will depend upon your future retirement date, the possibility of promotion or transfer to other employment covered by the LGPS, and the level of future pay awards and cost-of-living increases.

What are the options at the time that my pay is reduced/restricted?

You could choose to –

- keep previous benefits separate from future benefits where the reduction/restriction is covered by a new contract of employment
- and/or
- ask your employer to issue a Certificate of Protection of Pension Benefits

What is meant by keeping benefits separate?

If a person leaves an employment in circumstances where benefits are not immediately payable, the pension rights that have been built up to the date of leaving are worked out and then "preserved" until the earliest date at which they can be paid. If that person subsequently takes up a new employment covered by the LGPS, the earlier preserved benefits will normally be kept separate and a fresh pension record in respect of the new employment created. However, a person in this situation has the option to elect, instead, to combine the two periods of membership provided the election is made within 12 months of commencing the new pensionable employment and while still an "active" (i.e. contributing) member.

How would it help if I keep benefits separate?

Suppose you have been a member of the LGPS for 20 years and your pay is £20,000 a year. It is then reduced. Suppose benefits are not kept separate. You work another 10 years and then retire (a total of 30 years' membership). Assume the pay received in your final year of membership is £10,000. If no action is taken to protect your pension rights in some way, your benefits on retirement would be:

- Retirement pension: $1/80 \times 30 \times £10,000.00 = £ 3,750.00$ p.a.
- Retirement grant: $3/80 \times 30 \times £10,000.00 = £11,250.00$ lump sum

If, however, you had chosen to keep your benefits separate, you would be entitled to two pensions on retirement, one based on 20 years at the higher rate of pay, one based on 10 years at the lower rate:

- Retirement pension: $1/80 \times 20 \times £20,000.00 = £ 5,000.00$.
- Retirement pension: $1/80 \times 10 \times £10,000.00 = £ 1,250.00$
- TOTAL £ 6,250.00 p.a.
- Retirement grant: $3/80 \times 20 \times £20,000.00 = £15,000.00$
- Retirement grant: $3/80 \times 10 \times £10,000.00 = £ 3,750.00$
- TOTAL £18,750.00 lump sum

By keeping benefits separate you would have the higher rate of pay used against membership built up to the date of the reduction. The reduced rate of pay is set against only that membership which accrues after the reduction. This is the most equitable method of calculation. You get exactly what you've paid for. Earlier membership is not "down-graded" by the reduction in pay.

Would the earlier separated benefits decline in value as time passes?

No. A pension and retirement grant are inflation-proofed with effect from the end of the period of membership on which pay for benefits is assessed. For example, if you joined the LGPS on 1 September 1993, had a reduction in pay on 1 September 2005 and you chose to keep benefits based on the period 1 September 1993 to 31 August 2005 separate from your new period of employment, your preserved benefits in respect of that earlier period would be increased by all the public service pension increases under Pensions Increase Acts and Orders which have effect from 1 September 2005 to the date that the benefits come into payment (and each year thereafter).

But what if my pay is simply frozen? Surely my benefits will not be affected?

Suppose your pay is frozen at £20,000 after 20 years of membership. It is true that there would not appear to be any immediate problem. But what if your pay continued to be £20,000 for the next ten years and then you retire? Had the pay freeze not taken place your retirement benefits at the end of the ten years would be considerably higher, reflecting ten years' worth of pay awards. Instead, your benefits remain linked to the £20,000. Unlike the person who has a pay reduction, your benefits will be "static" rather than reduced and so you would not suffer detriment to the same extent. Nevertheless, you would have loss of expectation.

In these circumstances, it may be worthwhile to keep separate those benefits based on membership before the pay freeze because they would at least attract inflation-proofing. If you retired ten years after the pay freeze, therefore, the pre-freeze benefits would have ten years' worth of Pensions Increase added.

What if I keep my benefits separate and then my new rate of pay starts to outstrip my former rate of pay, even allowing for inflation-proofing?

This does sometimes happen. Even if your pay is reduced or restricted, in some circumstances you may receive pay awards or even promotion. Your "reduced/restricted" pay may eventually start to exceed the former level. Provided that this is within 12 months of you becoming an active member of the LGPS in your new employment you could, if you wished, elect to combine the earlier period on which preserved benefits are based with the new period of membership. Regrettably this is a very limited period (earlier Regulations allowed a person to defer their decision up to the date of retirement).

This is something which you should be prepared to monitor for yourself because the Pension Services Section may not be kept advised of increases in your pay. They will, however, be able to discuss the situation with you if you contact them with your pay details before making a decision to combine periods of membership.

Keeping benefits separate seems to be a fair solution. But are there any drawbacks?

Yes. If you have previously taken up one of the options to pay additional contributions to improve benefits you should be careful if you consider keeping benefits separate. You would still be eligible to continue with any arrangement to pay Additional Voluntary Contributions through the Pension Fund's link with a life assurance company. However, if you wish to continue to pay additional contributions to "purchase" an additional period of membership, this will be subject to a new election, but at a higher rate reflecting your age at the date of the new election. Medical clearance will also be a requirement before you can start a new "purchase" arrangement.

However, if as a married male with service before 1 April 1972 you are paying additional contributions to avoid a reduction to the lump sum retirement grant, your arrangement to pay those contributions would have to cease. There would be no similar option in respect of the new period of membership. You must elect to combine periods of membership if you wish this option to continue.

It must be emphasised that you would still be given an equitable return on the additional contributions paid to the date of salary reduction/restriction; it is the opportunity to make future contributions on the same terms which may cease or change.

Keeping benefits separate may also affect the amount of enhancement offered on ill-health retirement.

Another reason why some Scheme members might reject the option of keeping benefits separate, relying instead on the Certificate of Protection of Pension Benefits (see below) would be because, although separate benefits give a fair return for contributions paid, in some circumstances the Certificate would give a better return. In other words it is possible to make a “profit” through having paid contributions on the lower rate of pay but receiving benefits based on the higher rate.

What exactly is this Certificate of Protection of Pension Benefits?

It is a certificate to which a Scheme member has entitlement if, for reasons beyond the member’s control –

- the rate of pay is reduced, or
- the rate at which it may be increased is restricted in such a way that it is likely that the rate of retirement pension will be adversely affected.

There is no entitlement to a Certificate if

- the reduction or restriction is temporary, or
- it results from the termination of, or a reduction in, a temporary increase in the rate of pay.

So, to be eligible for a Certificate, there must be a reduction or restriction in your pay, not of a temporary nature, not following a temporary increase, and caused by circumstances beyond your control.

The Certificate must show the date of the reduction or restriction in pay and the rate of pay before and after this date. Further changes in remuneration would be noted during the time that the Certificate remains valid, i.e. a period of ten years. If you retire in the ten years following the issue of a Certificate, you can elect to have an earlier rate of pay substituted for actual final pay in the assessment of benefits. How this is done is explained later in these notes.

How is the Certificate issued?

An employing body can issue a Certificate without an application from an eligible Scheme member but need not issue one if the Scheme member has not applied for one within twelve months after the reduction or restriction. If the reduction or restriction in pay is caused by the implementation of a new pay structure by your employer Pension Services will be notified of those people affected automatically. You should however, contact Pension services before the expiry of the twelve month time limit if you have not received your certificate and believe you are entitled to one.

How is the Certificate used?

A Scheme member who has been issued with a Certificate can elect that, instead of the final year's pay being used in the calculation of benefits, the pay of an earlier period should be substituted. This option is available for the first ten years after the reduction/restriction in pay.

If, for example, you retired on 31 March 2005, the period normally looked at to calculate the average final pay for benefits would be 1 April 2004 to 31 March 2005. Suppose your pay was reduced, in circumstances beyond your control, on 1 April 2001 and you had applied for and been given a Certificate of Protection of Pension Benefits. At the time of retirement you would be eligible to elect for the pay of an earlier period to be substituted for the pay of your final year.

The period chosen must always have the same "anniversary dates" as the final year. With a retirement date of 31 March 2005, therefore, it must be a period which commences on a 1st of April and ends on a 31st of March. In this case, substituting pay received between 1 April 2000 and 31 March 2001 would probably be your best option. It is likely to be greater than pay received in any earlier or later years. The pay used in your benefits calculation on retirement would reflect the higher level of pay received four years previously, even though for the last four years you would have paid contributions on a lower level of pay. Pensions Increase would be treated as having commenced on 1 April 2001 and so you would also have the advantage of a higher rate of inflation-proofing of benefits than if your final year's pay had been used.

How does this compare with the calculation of separate benefits?

Cases will differ and the outcome of the following example should not be taken as an indication of what will happen in all of them. It should, however, give you an idea of the principles. Let's say that in the case given above the following details apply –

<u>MEMBERSHIP DATES</u>	<u>PERIOD OF MEMBERSHIP</u>	<u>FINAL YEAR'S PAY</u>
1.4.1991 – 31.3.2001	10 years	£20,000.00
1.4.2001 – 31.3.2005	4 years	£10,000.00

If you chose to keep benefits separate at the time your pay was reduced you would receive –

• Retirement pension:	1/80	x	10	x	£20,000.00	=	£ 2,500.00 ①	
• Retirement pension:	1/80	x	4	x	£10,000.00	=	<u>£ 500.00</u> ②	
TOTAL							<u>£ 3,000.00</u>	p.a.
• Retirement grant:	3/80	x	10	x	£20,000.00	=	£ 7,500.00 ①	
• Retirement grant:	3/80	x	4	x	£10,000.00	=	<u>£ 1,500.00</u> ②	
TOTAL							<u>£ 9,000.00</u>	lump sum

If a Certificate of Protection of Pension Benefits was issued and you selected pay for the period 1 April 2000 to 31 March 2001 to be used in the calculation of benefits you would receive –

• Retirement pension:	1/80	x	14	x	£20,000.00	=	£ 3,500.00 ①	p.a.
• Retirement grant:	3/80	x	14	x	£20,000.00	=	£10,500.00 ①	lump sum

① Pensions Increase calculated from 1.4.2001

② Pensions Increase calculated from 1.4. 2005

Being issued with a Certificate sounds more advantageous than keeping benefits separate. Are there any drawbacks?

Yes. A Certificate has a limited life – ten years from the date of issue. If you are still some years from retirement it may offer only limited protection.

Also, even if you retire within these ten years, experience shows that unless there has been a considerable reduction in remuneration, it is not long before the effect of pay awards, increments and promotion, mean that the figure protected – even taking the effect of Pensions Increase into account – is exceeded by the new rate of pay.

Another problem is that although a Certificate will allow the pay from an earlier period to be substituted, if the pay you are looking to include in your benefit calculation was paid more than five years before retirement, it would have to be averaged over three years rather than the usual one. The LGPS Regulations allow a member's choice of substituted pay to be in respect of –

“a year ending with a day falling within the five years ending with the last day he was an active member and of which that last day is the anniversary”

or

“any three consecutive years – falling within the period of 13 years ending with the last day he was an active member and ending with a day of which that last day is the anniversary.”

For example, suppose your pay in the year immediately before the reduction was £10,000. Before that it was £9,750, before that £9,500, and before that £9,250. In the year after reduction it was £8,000 and in the following year £8,250. The effect of averaging over a three year period is illustrated below –

		<u>Average</u>		<u>Average</u>		<u>Average</u>		<u>Average</u>
£ 9,250	£ 9,250]	↓	£ 9,500]	↓	£ 9,750]	↓	£10,000]	↓
£ 9,500	£ 9,500]		£ 9,750]		£10,000]		£ 8,000]	
£ 9,750	£ 9,750]	£ 9,500	£10,000]	£ 9,750	£ 8,000]	£ 9,250	£ 8,250]	£ 8,750
£10,000								
£ 8,000								
£ 8,250								

There is a degree of pay protection but the £10,000 cannot be achieved as the figure on which benefits are based, if pay is averaged over three years.

Can I be given a Certificate and separate benefits?

Yes, you can have both initially, but the Certificate will not be relevant if you decide to keep separate benefits; it would only have relevance if you decide, within 12 months of the pay reduction/restriction, that the period of membership before the reduction/restriction in pay should be combined with the period of membership after. Consequently, there is no reason why you should not apply for a Certificate even if you intend to keep benefits separate for the time being. In fact it may be sensible to do so, as a precautionary measure. Remember, though, that you would have to elect to combine benefits before the 12 months is up for the Certificate to have any effect.

It all seems too complicated. What if I do nothing at all?

If you fail to request a Certificate and your employer does not provide one, you would still have a short period of pay protection. A separate provision of the LGPS Regulations will allow a person, even without a Certificate, to substitute for the final year's pay, the pay from either of the two preceding years if this would produce a higher figure.

Consequently, if your pay was reduced with effect from 1 April 2005 and you retire on 31 March 2007, instead of having benefits based on pay from 1 April 2006 to 31 March 2007 you could request the substitution of pay for the period 1 April 2005 to 31 March 2006 or for 1 April 2004 to 31 March 2005. In this case, the period 1 April 2004 to 31 March 2005 would give the best figure.

This means that those who retire within two years of the reduction in pay have similar protection to those issued with a Certificate, for this limited period.

Will Staffordshire County Council advise me which is the best option?

The County Council cannot advise you what to do; it must inform you of your options and leave the choice to you.

Please summarise my options

If you have had a change of contract (this is usual where there is a detrimental change in pay) you can keep the benefits you have accrued in respect of the period of employment under your first contract separate from benefits you will accrue in respect of the period of employment under the second. This means that you would receive equitable benefits for the contributions paid. You can change your mind and ask for the benefits to be combined within 12 months of the reduction/restriction and while an active contributor.

You can also request your employer to issue a Certificate of Protection of Pension Benefits. You have twelve months from the reduction/restriction to make the request. After that your employer may still issue a Certificate but only at their discretion. The Certificate would allow an earlier, higher rate of pay to be substituted for the final year's pay normally used in the calculation of benefits. It would not, however, be relevant if you choose to keep your benefits separate. Nevertheless, it could be worthwhile to request a Certificate while you have the opportunity to do so and having it placed on your pension file so that you keep all your options open for the time being. Later on, you may be better placed to judge whether combining periods of membership and using the Certificate would be better for you than keeping your two periods of membership separate for benefits purposes. But remember you only have 12 months in which to make this decision.

What shall I do now?

If you are an employee of Staffordshire County Council and you are reading this leaflet because your pay will be reduced or restricted following notification of your new grade under a revised pay structure (Job Evaluation), you should not take any action in relation to your pension benefits at the moment. Staffordshire County Council (Job Evaluation Team) will automatically notify Pension Services of those staff affected. In the majority of cases pay will not be reduced or restricted until 1 April 2008.

If however, you would have been expecting a pay award or increment between the date of the implementation of your new pay scale and 31 March 2008 you should contact Pension Services. Please provide your full name, pay reference number and national insurance number.

If you are an employee of any other employing body in the Staffordshire County Pension Fund, you should apply directly to your employing body for a Certificate of Protection of Pension Benefits. Your employing body must issue you with a Certificate (if you apply within the twelve month time limit), must keep a record of the Certificate themselves, and must send a copy of the Certificate to the Pension Services Section

Contact Us

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**If a copy of this information is needed in large print, Braille, another language
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