



Staffordshire Pension Fund

Local Government Pension Scheme

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



Reduction or restriction in pay

Sometimes members of the Local Government Pension Scheme ("LGPS") have a change in their contract which results in their pay being reduced or restricted. This leaflet explains the effect on LGPS benefits of such a reduction or restriction and shows various options allowed by the LGPS Regulations to limit any harmful effect. Note that the reduction or restriction must be contractual for the options to apply; the Regulations do not extend the provisions to the effect of a national public sector pay freeze.

These notes explain the position if the reduction or restriction took place on or after 1 April 2014. 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 and other pensions legislation. If you would like more information based on your personal circumstances, or if the reduction/restriction took place before 1 April 2014, you should contact your employing body or the Pension Services Section of Staffordshire County Council – contact details are given on the back page.

LGPS Benefits after 1 April 2014

If you have membership after 1 April 2014, your pension is calculated using Career Average Revalued Earnings (CARE). This means that for each year you build up a pension based on your actual pay in that year. A reduction or restriction in pay will not have such a dramatic effect on your pension for membership after 1 April 2014 and, as such, there are no protections to your CARE benefits.

What does it mean to my pension if I have a restriction/reduction in Pay?

Your pension may be affected because any benefits you receive for membership of the scheme before 31 March 2014, are calculated on a "final salary" basis. This means that these benefits are (normally) calculated on whole-time equivalent pay received in the year up to and including your last day of membership. If your final 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 the higher pay received and the amount of pension contributions you have had deducted from your pay before the reduction.

Please remember that if you are a part-time employee, whole-time equivalent pay is used in the assessment of benefits. Consequently, if your pay is reduced simply because you have changed your hours (i.e. you remain on the same pay point) there is no need to worry about protecting your benefits as outlined in these notes.

What if my pay is simply "frozen" under a new contract? Surely my benefits will not be affected?

Suppose your pay is frozen at £25,000 a year, after you have been a member of the LGPS for a number of years. It is true that there would not appear to be an immediate problem. However, what if your pay continued to be £25,000 for the next ten years and then you retire? Had the pay restriction not taken place, your retirement benefits at the end of the ten years could be considerably higher, reflecting increments and pay awards. But, instead, your benefits remain linked to £25,000. Unlike the person who has a pay reduction, your benefit will be "static" rather than reduced and so you would not suffer detriment to the same extent. Nevertheless, you would have a loss of expectation.

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

No. This is not an option available under the LGPS.

What options do I have under the LGPS to protect my benefits against a reduction or restriction in pay?

For a limited period after the reduction/restriction, the LGPS rules would protect the level of pay to be used in the calculation of benefits.

Or you could keep the benefit entitlement which has accrued up to the date at which you are given a new contract with reduced or restricted pay, separate from the benefits which accrue on and from that date; this would be by using a "deferred benefit" option.

Both of these options are explained below.

At the time that your pay reduces or becomes restricted, you would need to decide whether or not to separate your period of membership. This decision must be made within 12 months after the reduction/restriction takes effect. Like many 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 a number of things, including your future retirement date, the possibility of promotion or transfer to other employment covered by the LGPS, the level of future pay awards and the "cost-of-living" increases applied to pensions.

How do the LGPS rules protect the level of my pay?

LGPS pension benefits for membership of the scheme before 31 March 2014 are normally calculated using final pay – this is your pensionable pay averaged over your final pay period. Your final pay period is the year (365 days) ending with your last day of LGPS membership in a particular employment. For example, if your employment ended on 31 August 2023 and you had been paid –

£25,000 a year from 1 September 2022 to 31 March 2023, and
£26,000 a year from 1 April 2023 to 31 August 2023

your final pay would be assessed as follows:

1.9.2022 to 31.3.2023:	£25,000	x	212/365	=	£14,520.55
1.4.2023 to 31.8.2023:	£26,000	x	153/365	=	<u>£10,898.63</u>
	Final pay			=	<u>£25,419.18</u>

Normally, £25,419.18 would be the figure used in the calculation of your retirement benefits.

However, the LGPS rules contain a "best-of-the-last-three years" principle. If a final pay calculation based on one of the two previous years would have produced a higher figure, that higher figure can be used instead. In the above example, the "best-of-the-last-three-years" principle would allow a comparison between the averaged pay for the periods:

1.9.2020 to 31.8.2021; 1.9.2021 to 31.8.2022; 1.9.2022 to 31.8.2023

Suppose you had a substantial pay reduction following a change of contract at the end of July 2021. It is possible that your final pay for the period 1 September 2020 to 31 August 2021 would be higher than that shown above. If it is, it will replace the £25,419.18 otherwise used in the benefit calculations.

If relevant, you do not have to elect for this option. The action is taken automatically at retirement provided that Pension Services receive the necessary information from your employer about your pay over the previous three years. Check with Pension Services if you are worried that a reduction or restriction in pay may have been overlooked.

But what if my pay was reduced or restricted more than three years ago?

If your pay was reduced or restricted more than three years ago, it may still be possible to take the higher rate into account. In certain circumstances where – in the ten years ending with your last day as an active member of the LGPS – there has been a reduction or restriction in pay which is likely to have an adverse effect on your pension, final pay can be based on pensionable pay averaged over three consecutive years of your choice ending on a 31 March that fall within the period of 13 years ending with your last day of active membership.

You will only qualify for this protection if the pay drop occurred within 10 years of leaving due to one of the following reasons:

- you moved to a job with a lower grade under the same employer;
- your pay reduced as a result of a job evaluation exercise or equal pay exercise;
- your pay reduced because the pensionable pay set out in your contract changed; or
- you may also qualify for this protection if your pay is not reduced, but the increases to your pay were restricted.

You will not qualify if your pay reduced because:

- you took up a temporary position (e.g. secondment/acting up);
- you took flexible retirement and moved to a lower grade or took a lower salary;
- your actual pay went down (e.g. you reduced your hours, but your contractual full-time equivalent salary did not go down); or
- you had previously received additional payments, for example due to arrears or a performance related pay award that you do not receive the following year

A three-year averaging period is unlikely to produce as high a level of final pay as a one-year averaging period. Consequently, if your pay reduction/restriction was in your last three years, the “best-of-the-last-three-years” principle explained on the previous page would normally serve you better than this option. But this option does provide a degree of cover for those whose pay is reduced or restricted earlier in their career.

You would be required to give written notice to Staffordshire County Council, as the Fund Administering Authority, at least one month before your last day of active membership, if you wish this option to apply to you. As with the “best-of-the-last-three-years” principle, Pension Services rely on your employer to provide the relevant information about pensionable pay. Consequently, if you think you are covered by this provision and that it could work to your advantage, please let Pension Services know well in advance of the pension calculation so that they can be certain that they have been given the necessary information to provide you with figures and options.

What is the “deferred benefit” option?

If your reduction or restriction in pay is set out in a new contract, you can preserve the benefits you have built up to the date of the previous contract and start a fresh accrual of benefits based on the new. The preserved benefits would be kept separate as “deferred benefits”, i.e. held in the Pension Fund until you become eligible to draw them. You can generally take your deferred pension at any time between age 55¹ and 75. Furthermore, you can elect to receive the deferred benefits at a different time than the separate pension being built up after your pay is reduced/restricted.

How would it help if I take the deferred benefit option?

Suppose you joined the LGPS on 1 April 2008 and your pay is £31,000 a year. It is then reduced. You work for another 12 years and then retire. Assume the pay averaged over your final year is £25,000. As the reduction in pay occurred more than 10 years prior to your retirement, you cannot use the option to have final pay based on the earlier period when your pensionable earnings were greater.

If you had not taken deferred benefits based at the time when your pay was reduced, you would have a single pension based on your total service. Your pre-1 April 2014 final salary benefits on retirement² would be assessed as follows:

Retirement pension: 6 Years x 1/60th of £25,000 = £2,500 a year

If, however, you took deferred benefits when your pay reduced, you would be entitled to two separate pensions. Your pre-1 April 2014 final salary benefits on retirement would be calculated using the higher rate of final pay before the pay reduction. These benefits would be assessed as follows:

Retirement pension: 6 Years x 1/60th of £31,000 = £3,100 a year

Note: If you elected for the deferred benefit option and both pensions become payable on retirement, the total Career Average Revalued Earnings (CARE) pension for membership after 1 April 2014 will, in most cases, be the same as the CARE pension payable for a single pension record with all of your period of membership combined.

By keeping the benefits accrued before the pay reduction separate from those accrued afterwards, advantage can be taken of the higher rate of pay for earlier years. This is an equitable method of calculation. You get what you’ve paid for. The final salary benefits based on earlier membership are not “down-graded” by the reduction in pay.

¹ It should be noted that the minimum pension age is changing from 6 April 2028, when it will rise from age 55 to 57.

² In this example, to keep it simple, it is assumed that your ‘final salary’ membership is after 31 March 2008 in which case, upon retirement, you would be entitled to a pension based on 1/60th of final pay for each year of membership with an option to commute part of that pension to provide a lump sum. If you had membership before 1 April 2008, each year of that earlier membership would instead provide a pension based on 1/80th of final pay, plus a lump sum retirement grant based on 3/80^{ths} of final pay.

Would deferred benefits based on earlier membership decline in value as time passes?

No. The benefits would be inflation-proofed with effect from the end of the averaging period on which the pay used in the benefits calculation was assessed. Suppose you joined the LGPS on 1 April 2008, had a reduction in pay on 1 September 2023 and you chose to keep benefits which were based on membership from 1 April 2008 to 31 August 2023 separate from your later period of employment. Your deferred benefits in respect of that earlier period would be increased by all the public service pension increases allowed under Pensions Increase Acts and Orders which had effect from 1 September 2023 (and each year thereafter).

Even if your pay is not reduced but frozen under a new contract of employment, if you opt for deferred benefits based on membership immediately before the pay freeze, those benefits will increase in line with inflation as outlined above. If, for example, you drew the deferred benefits ten years after the pay freeze, they would have increased in value in line with Pensions Increase Orders over those ten years. This could give you a better deal than benefits based on total membership and frozen pay.

What if I take the deferred benefits option in order to 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. You may receive pay awards or increments. You may have elected for deferred benefits and then find that your new pay has reached a level which would provide greater benefits as a single pension based on total service, rather than two pensions split between previous and current employments. Provided that this effect becomes apparent within 12 months you could cancel the deferred benefits and elect to combine the two periods of membership. Regrettably this is a very limited period. (However, if your current employment ends and you take up further employment, the option to transfer benefits based on the first and second employments becomes "live" again.)

This is something which you should be prepared to monitor for yourself because Pension Services 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.

Could my choice affect the level of pension I would receive if I elect to take age retirement benefits before normal retirement age (65)?

Some longer-serving members may have protection against the reduction which is applied to age retirement benefits if they choose to retire at or after age 60 but before age 65. This protection is sometimes referred to as the "Rule of 85". Check with Pension Services if you are uncertain whether you are covered by this Rule. The position is as follows –

- if you first joined the LGPS after 30 September 2006, or you joined before 1 October 2006 and would not be able to count 21 or more years' membership if you remain in the Scheme to Normal Pension Age, the earliest age at which you can voluntarily draw your LGPS benefits without a reduction is Normal Pension Age and your decision regarding the separation of benefits on pay reduction/restriction would not affect this.

- if you first joined the LGPS before 1 October 2006 and would have had 21 or more years' membership if you had remained in the Scheme to Normal Pension Age, then some or all of your deferred benefits have protection. You should consider the following points -
 - if you separate your benefits, any protection you may have on the benefits accrued before the pay reduction/restriction will not carry across to the benefits you build up after the pay reduction/restriction. The protections will continue to apply to your deferred benefits but the earliest age at which you will be able voluntarily to draw LGPS benefits accrued after the pay reduction/restriction will be Normal Pension Age.
 - if you choose not to separate your benefits, then any protection to which you were entitled before the pay reduction/restriction will continue in force.

What if I have to leave on grounds of permanent ill-health?

If you do not keep benefits separate, all of your period of membership – both before and after the pay reduction/restriction – would be taken into account in the calculation of ill-health pension. But if you choose to take deferred benefits on the period of membership before the pay reduction/restriction then the ill-health pension would be based only on the membership after the reduction/restriction. There is no automatic entitlement to early payment of a deferred pension on ill-health grounds simply because an ill-health pension is paid in respect of a later period of employment. You would have to make a request of your employer for early payment of the deferred pension and the case would have to be considered separately.

What if I have to take redundancy/efficiency retirement?

When a LGPS member is required to retire on grounds of redundancy or efficiency at age 55 or over, benefits are paid immediately without any reduction for early payment. If you do not keep benefits separate, all of your period of membership – both before and after the pay reduction/restriction – would be taken into account in the calculation of a redundancy or efficiency pension. But if you had chosen to take deferred benefits, only the membership accrued after the pay reduction/restriction would be taken into account.

If you were aged 60 or over at the time of retirement you could receive the deferred benefits at the same time as you received your redundancy/efficiency pension, but the deferred benefits may be subject to a reduction. If you were aged between 55 and 60, the deferred benefits could be put into early payment but, again, those benefits will be reduced for early payment.

Could electing for separate pension benefits affect death benefits?

Yes. Death benefits provided by the LGPS and the effect of separating or not separating membership at the point of pay reduction/restriction are as follows:

- A death grant is payable to the estate of the deceased or to a beneficiary or beneficiaries nominated by the Scheme member if the nomination has been accepted by Staffordshire County Council as the administering authority for the Pension Fund.

- Under the current LGPS, the death grant payable in respect of deferred benefits is a lump sum equivalent to five times the deferred pension. If a person dies in service, the death grant is three times pensionable pay, regardless of the length of membership. However, Staffordshire Pension Fund can only pay the larger of a Death in Service grant, or the Deferred Benefit grant.
- Under the current LGPS, a pension is provided for a surviving spouse, civil partner or nominated cohabiting partner, and for eligible children. If a person dies while entitled to deferred benefits, dependants' pensions would be a proportion of the deferred benefits. If a person dies in service, dependants' pensions are a proportion of the ill-health pension the member would have received if retiring on health grounds at the date of death. Ill-health pensions are based on the current period of membership and, where used as a basis for dependants' pensions, include an "enhancement" of membership between the date of death and the deceased members' normal retirement age. In this respect, if you had chosen to take separate deferred benefits at the time of pay reduction/restriction, there would be no disadvantage.
- If you choose to defer benefits accrued before the pay reduction/restriction, your marital status at that time could affect the level of a surviving spouse's pension. If you were not married at that time and marry at a later date, any widow's pension in respect of the separate deferred benefits would be calculated on membership on and from 6 April 1978 only and any widower's pension would be calculated on membership on and from 6 April 1988 only. However, if you do not take deferred benefits and are married by the time that you leave the LGPS, the surviving spouse's pension would be based on your total period of membership.

I have been paying additional contributions. Will these be affected?

Yes, if you have previously taken up one of the options to pay additional contributions to improve benefits this could be affected by a reduction/restriction in pay.

You would still be eligible to continue with an arrangement to pay Additional Voluntary Contributions ("AVCs") through the Pension Fund's link with a life assurance company. You may also be allowed to continue to pay additional contributions to purchase an additional period of membership or greater benefits. If, however, your pay has been reduced and you pay a fixed sum by way of additional contributions, you will have to consider whether or not you can afford to continue to have the same amount deducted from your pay each month. If, instead, you pay a percentage of pay as additional contributions, the terms of your AVC arrangement would have to be reviewed.

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

None of us knows what the future holds and it may not be until you finally leave your employment that you can judge whether or not it was in your best interests to use the option to separate your benefits at the time of your pay reduction/restriction. These notes explain some of the points you should consider when arriving at your decision. They cannot cover all circumstances but you may find them helpful.

Further information

If you require further information about the areas covered by these notes, you can get in touch as follows:



www.staffspf.org.uk



pensions.enquiries@staffordshire.gov.uk



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