DUNDEE CITY COUNCIL

REPORT TO: **Policy and Resources Committee - 21 March 2005**

REPORT ON: **Consultation Document - Principles and Propositions for an Affordable and Sustainable Local Government Pension Scheme in Scotland**

REPORT BY: **Depute Chief Executive (Finance) and Assistant Chief Executive (Management)**

REPORT NO: **206-2005**

1 PURPOSE OF REPORT

1.1 To suggest appropriate responses by the Council to possible changes to the Local Government Pension Scheme in Scotland contained in a consultation document issued by the Scottish Public Pensions Agency.

2 RECOMMENDATIONS

2.1 It is recommended that the Committee endorses the suggested Council responses to possible changes to the Local Government Pension Scheme in Scotland as outlined in this report and Appendix 1 and agrees that these be forwarded to the Scottish Public Pensions Agency representing the Council's views on these issues.

3 FINANCIAL IMPLICATIONS

3.1 There are no immediate financial implications of this report. However, implementation of some or all of the possible changes would have financial implications for authorities, but the potential costs, savings and balances cannot be estimated at present.

4 SUSTAINABILITY IMPLICATIONS

4.1 None.

5 EQUAL OPPORTUNITIES IMPLICATIONS

5.1 None.

6 BACKGROUND

6.1 A consultation paper entitled "Facing the Future - Principles and Propositions for an Affordable and Sustainable Local Government Pension Scheme in Scotland" was issued on 25 November 2004 by the Scottish Public Pensions Agency.

6.2 In recent years pension schemes have suffered from reductions in income resulting from falls in the value of investments in equities. Many private sector organisations have closed their final salary, defined benefit schemes to new employees and some schemes have even been unable to honour their commitments to members.

6.3 Ministers of Central Government have stated that they wish to see the Local Government Pension Scheme safeguarded as a statutory, funded, final salary pension scheme. However, they believe that this must be balanced against the increasing cost of pension provision. Recent changes to the current scheme, which are due to come into effect on 1 April 2006, have sought to achieve ongoing affordability by raising the retirement age to reflect the fact that people are living longer.

6.4 The UK Government has also recognised a need to address the changing ratio of the economically active population to those in retirement. The intention is to respond to these social and demographic changes by encouraging people to work longer, (increasingly there are many people who wish to work longer and object to enforced retirement) to help stabilise the affordability of pension provision and to improve the retention and transfer of knowledge and skills in the workforce.

7 RESPONSES

7.1 The Depute Chief Executive (Finance) and the Assistant Chief Executive (Management) have considered the possible changes to the Local Government Pension Scheme taking account of the interests of employees, the Council and citizens. Their suggested responses to the main change options are outlined in Appendix 1.

7.2 The main emphasis of the responses is that every effort must be made to safeguard the benefits expected by current scheme members and that the main method of funding this should be a phased increase in employee contributions. While an increase in contributions will be resisted by scheme members and their trade unions, this is likely to have less of a detrimental effect on morale than a reduction in scheme benefits.

7.3 Consideration should also be given to introducing a different scheme for those joining after a certain date. Notwithstanding the fact that this scheme would not be as beneficial as the present scheme, it would still be reasonably attractive, given its final salary and index-linked properties. It is proposed to submit these comments to the Scottish Public Pensions Agency on behalf of the Council by the return date of 31 March 2005.

8 CONSULTATION

8.1 The Chief Executive and the Depute Chief Executive (Support Services) have been consulted in the preparation of this report.

9 BACKGROUND PAPERS

9.1 "Facing the Future - Principles and Propositions for an Affordable and Sustainable Local Government Pension Scheme in Scotland" - Scottish Public Pensions Agency Consultation Paper, November 2004.

D Dorward
Depute Chief Executive (Finance)

15 March 2005

J C Petrie
Assistant Chief Executive (Management)

15 March 2005

APPENDIX 1

RESPONSE TO CONSULTATION PAPER "FACING THE FUTURE - PRINCIPLES AND PROPOSITIONS FOR AN AFFORDABLE AND SUSTAINABLE LOCAL GOVERNMENT PENSION SCHEME IN SCOTLAND" INTENDED FOR INTRODUCTION IN 2008

POSSIBLE PROPOSED CHANGE		SUGGESTED COUNCIL VIEW/COMMENTS
1	Pensionable Pay (and therefore benefits) could be limited to basic salary, excluding all other payments such as bonuses, fees, contractual overtime and allowances.	This would disadvantage employees in jobs where a significant part of their total earnings comes from payments additional to their basic wage/salary. In particular, existing employees, who have already made pension scheme contributions on these additional payments, would lose out. Contributions should continue to be made on earnings as at present and this proposal is not supported.
2	Employee contributions could be increased to 7% (currently 5%/6%)	The Government view is that there should be an equitable division of the increased costs of providing pensions between employee and employer. People are living longer and some of the proposed changes to the pension scheme are improvements with cost implications. If employees do not share the increased costs, greater demands will be made on the employer and ultimately the taxpayer. However, it may be that increased contributions could be introduced on a phased basis. Trade unions and employees are thoroughly opposed to this proposal in principle and a dispute has already been called. This proposal should not be rejected out of hand but any imposition is likely to lead to considerable industrial relations strife. It is considered that further negotiations, possibly taking more time, should be carried out by Central Government with the national trade unions with the object of achieving equitably shared increased costs.
3	The possibility of banded employee contributions with the lower paid paying a smaller percentage of their pensionable earnings and the higher paid paying a higher percentage eg those earning less than £5,000 might have a contribution rate of 2½% whereas those earning £80,000 might have a contribution rate of 10%.	There are problems with this proposal. It would be more complicated to administer and some employees receiving a promotion or pay increase, which took them into the next band, could find themselves worse off financially. It could also affect authorities differently depending on the mix of employee types. An alternative tiered arrangement whereby employees pay eg 2½% on the first £5,000 of earnings and then 5% on the next £5,000, etc would be preferable but would not significantly reduce the administration burden. The preferred option is to maintain a flat rate for everyone as at present.

4	Benefits could accrue at an increased rate of 1.6% per annum (this would produce a pension of 1/62.5 of final salary for each year of service as opposed to 1/64 in the current scheme, including lump sum). There would be no automatic lump sum but members could commute part of their pension at a rate of 12:1 ie for every £1 of pension given up £12 of lump sum would be awarded.	This would represent an improvement for employees retiring at age 65. After 40 years service a member would receive a pension based upon 64% of their salary with the option of flexible commutation to provide a lump sum. There is a concern that an employee could opt for a much bigger lump sum than at present (up to 25% of pension) and end up with a much smaller pension, which might result in an individual spending the lump sum and ending up in reduced circumstances. While this proposal represents an improvement to the Scheme, this would come at a cost and, accordingly, it is assumed that existing Scheme members would prefer to retain the present benefits.
5	An actuarial reduction could be applied to employees retiring before age 65 unless on ill health grounds.	It is Government policy to encourage employees to work longer. There are fewer younger people in the pipeline and it is in employers' interests to retain experienced staff for longer. The reality of the demographic situation means that this proposal, which will be unwelcome to employees, will probably be introduced. However, the view of the Council is that employees should continue to be allowed to retire at 60, in appropriate prescribed circumstances, without penalty.
6	Employees could remain in employment beyond age 65 and continue to accrue pension.	This proposal is acceptable.
7	A two tier system for ill health retirals could be introduced with possible reviews every two years. This would differentiate between employees who, in the opinion of an independent medical practitioner, are incapable of any further employment up to the statutory retirement age and employees who are unable to perform the duties of their existing employment but are capable of undertaking alternative employment. Those in the first category would receive enhancement up to statutory retirement age, a significant improvement on current arrangements, but would be subject to reviews in the event of advances in medical science affecting their position. Members in the second category could receive payment of their accrued pension rights with no enhancement. This would be subject to a review process with the benefit ceasing or being reduced where the employee took up subsequent employment.	Most employees who retire on ill health would be adversely affected. The review process would be more complicated and perhaps costly to administer. This proposal is not considered appropriate and the current arrangements should continue.

8	Employees approaching retirement could be permitted to receive an actuarially reduced pension whilst continuing to work reduced hours and/or in a lower graded job. (Further pension entitlement would accrue in the new role.)	This would provide more flexibility to individual employees and, if it suited them, they could choose to make use of such arrangements. It would be down to individual choice with employer's agreement. This is regarded as acceptable.
9	Pensions for partners could be introduced.	This has been requested by employees and trade unions for a number of years. It would require some definition of what constitutes a partner and it would be an additional cost to the scheme. However, this would be an acceptable proposal.
10	A deceased employee's spouse could lose the short-term pension benefit ie part of the financial protection available for the first 3 or 6 months.	This would represent a loss to an employee's surviving spouse and family at a very difficult time for them and consequently this proposal is not regarded as being acceptable.
11	The death in service payment could be increased from twice to 3 times an employee's earnings.	This would be an improved benefit to the family of an employee who dies in service and the overall costs to employers would be relatively small. While this proposal represents an improvement to the Scheme, this would come at a cost and, accordingly, it is assumed that Scheme members would prefer to retain the present benefits.
12	Additional Voluntary Contributions and the Purchase of Added Years by employees could be replaced by a new voluntary defined contribution scheme run by the pensions section.	Changes in legislation will enable employees to take out second or third pensions with external bodies. There are no obvious advantages in pensions sections providing one also. Moreover, doing so would be complex and time consuming. This proposal should not be pursued.
13	Voluntary Redundancy and Retirement in the Interests of the Efficiency of the Service could be considered at the request of employees with a reduction in their benefits but which the employer could choose to waive/reduce at the employer's cost. An alternative suggestion is that employees leaving early on the grounds of redundancy/efficiency could be given a lump sum payment based on service (similar to statutory redundancy payments) and a deferred pension.	It is considered that a discretionary system for reducing/waiving pension reductions would be more open to challenge and require more administration than the existing arrangements. This proposal is therefore not supported.
14	All existing employees could be transferred into the new scheme with actuarially calculated lengths of service, thus doing away with the need to calculate pre and post change benefits separately.	In theory this would simplify matters for all concerned, but it would be difficult to explain and some employees' benefits statements would be worse than previous ones. The calculations required to cover all the variable components such as contribution rates, part time service, added years contracts, service pre 1st April 2006, the rule of 85, etc would be complex and difficult to explain to individuals. The view is that this proposal would be acceptable subject to individual calculations being done for each member to ensure and demonstrate no detriment. Existing employees should have the option of remaining subject to the rules of the old Scheme.