

ASSOCIATION OF LOCAL AUTHORITY CHIEF EXECUTIVES

EVIDENCE TO THE INDEPENDENT PUBLIC SERVICE PENSIONS COMMISSION

1. The Association of Local Authority Chief Executives (ALACE), founded in 1973, is a duly registered trade union whose members are heads of paid service and senior managers in local authorities in England and Wales, Northern Ireland and Scotland. ALACE members are members of the different Local Government Pension Schemes (LGPS) applicable in the jurisdictions where they are employed. The LGPS, unlike many public sector schemes, has long been a funded scheme – there are a hundred separately managed funds across the U.K. – with the top employee contribution 7.5% in England and Wales and Northern Ireland, and 12% on the sliding scale applicable in Scotland.
2. The Association is willing, indeed wishes, to supplement this written evidence orally, and will also wish in due course to be consulted on whatever conclusions and recommendations the Commission in due course makes to the Chancellor of the Exchequer.
3. Discussion of the future of pension schemes is often divided between consideration of existing accrued potential or actual benefit entitlements and consideration of those to be derived from future periods of scheme membership. This evidence reflects that division. It makes two primary points:
 - (i) **that accrued benefits should (as promised by the Prime Minister) be properly protected for everyone, but with particular reference to those nearing retirement, for whom major changes in the pensions ground rules at this stage in their careers have significant implications; and**
 - (ii) **that there should be introduced the principle of *pension equalisation*, so that – even if many different public sector schemes continue – comparable contributions for comparable periods should in due course yield (in real terms) comparable benefits, and also that portability between different parts of the public sector will be improved.**
4. First, **accrued benefits**. ALACE welcomes the Prime Minister’s confirmation that accrued benefits in public sector pension schemes will not be reduced by any proposed reforms. This is of course welcomed if it removes any doubt that benefits accumulated from past service will continue to be honoured. This is not only for the obvious reason that employees rightly consider the applicable pension scheme to be an important and integral part of their contractual conditions of service; the great majority of current LGPS members joined when membership was compulsory, and questions about different arrangements or rates could not therefore then arise.
5. Furthermore, were this protection principle to be threatened, it would create complex collateral difficulties. For all those LGPS deferred members, and members paying additional voluntary contributions or making other similar additional investments (AVCs, SCAVCs, ARCs etc.), the actuarial basis would be undermined on which the payable amounts and the related benefits to be expected from them have been based. It is important, however, that protecting existing accrued benefits involves not only calculating their values and the sums

notionally expected to be received were they to become payable at the reform date, but also that **those same calculations continue to be applicable with respect to service before the reform date even when actual entitlement occurs many years later.** This is how the LGPS currently works in relation to the accrual of annual eightieths and/or sixtieths before and after the change dates of 1st April 2008 in England and Wales and 1st April 2009 in Northern Ireland and Scotland. Despite this, however, those 2008-09 reforms have already withdrawn the so-called “rule of 85” – this has already been a significant diminution in the potential opportunity for early retirement for existing members, and the limited protections given relating to that withdrawal were essentially based on being in membership and of a given age on qualifying dates; they thereby discriminated unfairly on age grounds against those who were somewhat younger but had many more years (in some cases up to about thirty in total) of active membership in the LGPS.

6. Secondly, **future benefits.** While no-one welcomes either increased contribution costs or reduced benefits, ALACE recognises that in the current climate it is not only inevitable, but also prudent, for Government to examine the outlook now for the assumptions on which past practices and promises have been based. ALACE has recently reviewed current pension practice across all the larger parts of the public sector, and is aware of the extent to which recent years have seen reforms in other public sector schemes. (The LGPS, however, remains virtually the only fully funded such scheme, and contribution rates vary widely.) In essence there have been three principal sorts of change – in each case while leaving the basis of calculating benefits accrued before the reform date untouched. One approach has involved moving new, and sometimes existing, scheme members onto a new membership basis. A second has involved the introduction of funds to schemes unfunded before. A third has involved altering the annual accrual basis (as with the LGPS moving from eightieths to sixtieths and discontinuing lump sum accrual). A fourth kind of change, though less about the structure of given scheme, has been an increase in the contribution rates required to pay for it. Some schemes, including those for Ministers and MPs, have seen more than one substantive change while others, like those for judges and universities, have seen no such change at all. The LGPS reforms of 2008 (England and Wales) and 2009 (Northern Ireland and Scotland), while protecting past accruals, have already seen the future accrual rate change from eightieths to sixtieths, lump sums removed, and the top employee contribution rates variously increase – as noted above – from 6% to 7.5% to as high as 12%.

7. Understandably, it is the viability and long-term sustainability of pensions costs which are the prime concern leading to this present review. Whether or not those costs are wholly or partly funded, employers and employees – except in a few cases where no employee contributions are required – share them. The management of invested funds, and the performance of the investments themselves, introduce a variable element into the achievement of whatever resources are actuarially calculated to be sufficient to meet all liabilities.

8. A different kind of variable element arises from the point of view of public sector employees. Some pay, or “contribute”, more than others. In some cases this is derived from a principle that those on higher salaries can afford to pay more; in some cases – such as in the Scottish LGPS, where the highest contribution rate of 12% is markedly above the equivalent 7.5% in England and Wales and Northern Ireland. Accordingly ALACE wishes to submit the following case in the context of the Commission’s requirement to have regard to *the need to ensure that future provision is fair across the workforce.* The intention to withdraw tax relief from employer pensions contributions, if and when brought into force in April 2011, will already have a major effect on high earners earning above £130,000 p.a. who decide to remain

active LGPS members, although this is tax revenue for the Treasury rather than more contribution to the relevant pension fund – and may have an impact on the numbers of higher earners remaining in active membership and continuing to pay their proportionately higher contributions.

9. ALACE considers that this need for overall fairness can only come about if across the public sector the principle of *pension equalisation* applies. That is the principle that a given contribution for a given period based on a given pay level should be the same, and should in due course in real terms yield the same benefits. It is not necessary that everyone’s pension provision should be identical, but simply that – even where different accrual rates or other terms applied – a similar proportionate contribution should yield a similar proportionate benefit entitlement when like is compared with like. Of course, careers are not completely interchangeable; it is expected that 40 or more years of pensionable service will be ordinarily be required to entitle someone to a full pension. This number of years, however, is unlikely in the military, for example, and impractical in the cases of judges or MPs. Nevertheless, it seems reasonable to suggest that *similar contributions in similar circumstances in different parts of the public service should earn similar pension results*. This is far from the case at present. Differential pension costs and benefits also currently mitigate against **portability** within the public sector as a whole; schemes which are regarded as better than most others from the employee point of view tend to inhibit movement; so do fields where – now often largely for historic reasons – different schemes are currently applicable (such as within the NHS). At a time when there is closer working, for example between the NHS and local government generally, it is inappropriate and inequitable for any transfer between schemes to involve any kind of penalty through possible loss of value in accrued benefits.

10. Consider first local government, and the three versions of the LGPS. Taking contributions paid at the top rate per £1,000 of annual income, and comparing the one-sixtieth benefit thereby accrued, the position for 2009-10 in England and Wales, Northern Ireland and Scotland produces the following –

	Contribution Rate	Cost	Benefit	Benefit ÷ Cost
England and Wales	7.5%	£75	£16.67	0.222
Northern Ireland	7.5%	£75	£16.67	0.222
Scotland	12%	£120	£16.67	0.139

Pension benefit costs for the highest-paid employees are therefore now some 60% more expensive at the top rate in Scotland than in the rest of the UK. (In England and Wales, for the year ending 31 March 2008, 6% contributions paid on each £1,000 cost £60 and earned £12.50 annual benefit plus one lump sum of £37.50. In the year ending 31 March 2011, it now costs £75 per £1,000 – 25% more – and that earns £16.67 annual benefit with no lump sum. The increased benefit is £4.17; that represents exactly nine years’ purchase if notionally divided into the missing £37.50 lump sum.)

11. No scheme can be considered away from the context of its history, its accrued commitments and the industrial relations settlement under which reforms or re-structuring have been agreed. At one time the Civil Service supposedly received lower salaries to offset the non-contributory nature of their scheme. It is difficult to see what principle of equivalence now allows a 3.5% contribution rate there when a local government employee would pay 7.5% and the police 9.5% under the NPPS. It is clear that even when other factors like potential ill-health

benefits are factored in, and the widely varying nature of careers is considered, no single constant can currently be derived whereby a given percentage contribution for a given number of years will yield a similar benefits entitlement.

12. Nevertheless, with all the limitations of any such exercise, it is worth trying to represent the key comparisons of the main public sector pensions schemes in tabular form so that some at least of the salient points stand out. For many employees, their current benefits projections are now divided across years of service before and since the reconstruction of their schemes in the last few years. To indicate more of how things have moved, the following two tables show the position as it was before the changes – i.e., what benefits would have been had the old schemes continued unchanged – and the positions as they are now based on the assumption of a full career serving under the new rules. Of course, this paper cannot calculate career average salaries, so a ‘final pensionable pay’ sum of £100k is not necessarily identical to a ‘career average salary’ or whatever as calculated under a given scheme. Nevertheless, with all their limitations the results are interesting.

13. The assumption is a reckonable (i.e. final or career average, etc. as applicable) salary of £100k received by someone retiring at the relevant scheme’s normal retirement age (NRA) – usually now 65 – after 40 years’ pensionable service or the appropriate alternative. The employer contributions vary according to whether the relevant scheme is funded or not, and what are the sums necessary to meet current- year commitments or the actuarial requirements on valuation.

Former Schemes

	<i>Lump Sum?</i>	<i>Annual Pension</i>	<i>Employee Contributions</i>
Armed Forces	£145,500	£48,500 (34 years)	Nil
Bank of England	No	£66,667	Nil
Civil Service	£150,000	£50,000	1.5%
Firefighters	No	£66,667 (30 years)	11%
Judges	£125,000	£50,000 (20 years)	Nil
MPs (fiftieths)	No	£66,667 (33½ years)	6.0%
National Health Service	£150,000	£50,000	6.0%
Police	No	£66,667 (30 years)	11%
Teachers	£150,000	£50,000	6.0%
Universities	£150,000	£50,000	6.35%
Local Government			
England and Wales	£150,000	£50,000	6.0%
Northern Ireland	£150,000	£50,000	6.0%
Scotland	£150,000	£50,000	6.0%

Current Schemes

	<i>Lump Sum?</i>	<i>Annual Pension</i>	<i>Employee Contributions</i>
Armed Forces	£171, 429	£57,143	Nil
Bank of England	No	£61,538	Nil
Civil Service	No	£75,000	3.5%
Firefighters	No	£66,667	8.5%
Judges	£125,000	£50,000 (20 years)	Nil
MPs (fiftieths)	No	£66,667 (33 $\frac{1}{3}$ years)	7.9%
National Health Service	No	£66,667	8.5%
Police	£200,000	£50,000 (35 years)	9.5%
Teachers	No	£66,667	6.4%
Universities	£150,000	£50,000	6.35%
Local Government			
England and Wales	No	£66,667	7.5%
Northern Ireland	No	£66,667	7.5%
Scotland	No	£66,667	12.0%

14. From the above tables, only the schemes for judges and universities remain essentially unchanged over the last five years. (For universities, the employer contribution rate is 14%.) The scheme for MPs had remains the same since 2004, when the 9% contribution for the higher accrual rate was increased to 10%, but that figure has now increased as from 1 April 2009 to 11.9%.

15. ALACE considers that these often largely historical disparities ought not to be continued in any wider reform of public sector pensions. Clearly, rationalising contribution rates and returns is a complex undertaking, with implications for the management of funds and a gradual harmonisation of approach across millions of public sector workers. There has, however, never been an opportunity before to approach the fundamental problem involved before in what Lord Hutton of Furness' *Call for Evidence* calls "the long term nature of structural reform". ALACE believes that, notwithstanding shorter-term expedients, since existing pension liabilities are likely to run till about 2090, there is now a unique opportunity for that longer term to start soon.

16. Nevertheless, while recognising that the assumptions on which sound pension provision is based will need to change, ALACE believes strongly that a robust scheme continues to be vital in attracting, retaining and supporting high-calibre employees, and that before considering alternatives, the Commission should examine how the final-salary basis can be maintained – and in any event how effective transitional arrangements can be made for those with longer service who are closer to a retirement which has been predicated throughout their careers on a final-salary, RPI-indexed and not CPI-indexed basis. Otherwise there will be manifest unfairness for such LGPS members compared with those who have recently been able to access their pensions on the current basis.

By email to pensions.commission@hmtreasury.gsi.gov.uk

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