

# PENSION PLANNING



SOUTH YORKSHIRE  
PENSIONS AUTHORITY



information  
SNAPSHOT

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## Welcome to your **Pension**PLANNING **information** SNAPSHOT

Welcome to your free supplement, *Information Snapshot*, together with your freshly designed Pension Planning newsletter. In this issue we have concentrated on the Public Service Pensions Commission to bring you as up to date as possible about the future of the Local Government Pension Scheme.

We felt this subject warranted a separate publication and hope you find it useful.

# Public Sector Pensions Commission

You will have no doubt seen the recent media coverage on public sector pensions where Lord Hutton, former labour Secretary of State for Work and Pensions, was commissioned to conduct a fundamental structural review of all public service pensions.

The final report highlighting Lord Hutton's recommendations was published in March and the Government accepted them as a basis for consultation with public sector workers and trade unions, where talks have now taken place. On the 17<sup>th</sup> June the Government responded to the Hutton Report but later announced they would hold separate negotiations with the

unions on reforms to the LGPS after acknowledging its funded status made it different to other public sector schemes.

Lord Hutton made it clear his recommendations were based upon ensuring the scheme remains good quality, is sustainable, and fair to both members and taxpayers.

The Government talks of reform that ensures public sector workers continue to receive among the best, if not the best, pensions available. And reform that ensures the cost of providing pensions to the workforce are affordable, not just now.....but in the decades to come.

# Public Sector Pensions Commission

The Government's response goes on to say: "It's a fact we are all living longer. That means more years spent in work, as well as in retirement. To keep the best pensions in the country, you will have to contribute more. Those contributions will support your pension, not subsidise the pensions of top earners. So when you do reach retirement age, the pension you receive will be broadly as generous for low and middle income earners, as it is now. At the same time we are protecting the pension that you have earned to date. We are reforming for the future, but we will not touch the pension that you have already earned."

"Public service pensions are important and a valued part of the remuneration offered to public servants and they ensure dignity in retirement."

The final report and the Government's response can be viewed on our website at [www.sypensions.org.uk/news](http://www.sypensions.org.uk/news) however, below are the Government's key proposals in more detail:

## Benefit Structure

Replacing the current final salary scheme with a defined benefit **career average revalued earnings (CARE)** scheme. The CARE scheme works by building up an amount of pension year on year based on a percentage of

# Public Sector Pensions Commission

pensionable pay in each year of membership. To reflect the effects of inflation, the pension earned is then re-valued upwards each year in-line with the national average earnings. After you retire, the pension would be inflation proofed in line with prices to maintain its purchasing power during retirement. The Commission says: “The design should benefit the majority of members who do not have the high salary growth that is rewarded in a final salary scheme.” Hutton has since commented that the recommendation to replace the final salary scheme with a career average was not based on making savings but simply to make the scheme fairer for

lower paid workers. A shift from a final salary to a career average pension scheme would protect the lower paid by ensuring members still get a good pension. This is because many lower paid public sector workers do not normally see significant salary hikes over their career.

In a CARE system, both the contributions paid and the pension accrued each year are directly based on the salary achieved in that year. This removes the unfairness in favour of high flyers who reach high salary levels towards the end of their career. In a CARE scheme all members may get a pension which is argued to be fairer

# Public Sector Pensions Commission

as it better reflects the earnings and contributions throughout a member's career.

However it's not all bad news for high earners as evidence shows that these members are likely to live longer and withdraw a benefit for a longer time than low earners.

The general perception is that the CARE scheme is not as good as a final salary scheme so on the page opposite we have provided an example of how CARE works so you can make your own mind up!

If a members salary increase each year is less than the average earnings then the pension under the CARE scheme

would be more than a Final Salary Scheme.

Members with short or broken careers, many of whom may be women, may have less career progression and therefore tend to benefit from CARE.

One point to note is that the recommendation to uprate pensions by average earnings is a good result for the LGPS as earnings are normally expected to increase faster than prices, particularly the CPI measure of price inflation the Government has recently implemented.


 ANNUAL SALARY **X**

 PENSION RATE **=**

 YEAR 1 PENSION

For example, Tom earns **£20,000** so his pension in year 1 is worked out as: **£20,000 x 1/60th = £333**

**Maintaining your pension's value**

  
**REVALUED BY 2% EACH YEAR (for illustration purposes)**

The **£333** that Tom earns in year 1 is revalued at the end of the next year. So at the end of year 2 this part of Tom's pension is **£333 x 1.02 = £339**

The pension continues to be revalued until you retire, eg  
 $333 \times 1.02 = 339$   
 $339 \times 1.02 = 346$  etc



Year 1 retirement pension- Tom's pension for year 1 is **£485** after **20 years** service.

**You receive a new pension 'pot' for each year you are a member**



**ADDING YOUR OTHER YEARS' PENSION POTS**

**Add up the pension you earned each year (after it has been revalued) to find your total pension**



Annual Pension at Retirement - if Tom has a **2%** salary rise each year, by adding all the other years' pension pots together, he could expect a pension of **£9,712** a year after **20 years' service**.

# Public Sector Pensions Commission

## Retirement Age

Members' normal pension age in the future will be linked to State Pension Age. Rising life expectancy has led to a large increase in the time members can expect to spend in retirement. The link to State Pension Age will address rising longevity, the main risk to the sustainability of the scheme.

Currently normal pension age in the LGPS is age **65**. Linking to State Pension Age will mean normal pension age of 66 for all by 2020. Members will still have the opportunity to retire early but benefits will be reduced to take into account early payment.

The Government intends to protect those benefits that have been built up in the scheme before the change, which includes protecting the date members can draw their benefits. As such, members could still draw the pension accrued up to the date of change, at the retirement age currently in force, age 65.

# Public Sector Pensions Commission

## Increased Contributions

Although the Government is looking to reform public sector pension schemes as a whole, the Government recognises that the LGPS is different to other public sector pension schemes and has agreed to hold separate talks with the Local Government Group and the trade unions on ways, other than increasing pension contributions by an average of 3.2 percent, to secure the necessary short term savings in the LGPS. Discussions will include protection from contribution increases for the lowest paid, as well as other issues important to the long term sustainability of the LGPS.

The Government remains committed to securing the full spending review savings, requiring each public sector scheme to find savings equivalent to a 3.2 percentage point increase.

Importantly, for **local government**, the Government recognises that the funded nature of the scheme puts it in a different position to other schemes such as the Teachers, NHS and Civil Service Pension scheme and will discuss whether there are alternative ways to deliver some or all of the savings. In particular, it is clear that some or all of the required shorter term savings could be delivered by other mechanisms than employee contribution increases.

# Public Sector Pensions Commission

The Secretary of State has requested the outcomes of the discussions between the Local Government group and the Trade Unions to be reported to him by 9<sup>th</sup> September. The formal statutory consultation exercise will begin at the start of October with scheme changes to be in place by 1<sup>st</sup> April 2012.

It's worth a mention at this stage that the Hutton report does not suggest a specific accrual rate for the new career average scheme; however, a change in accrual rate has been put forward as an alternative way of securing the savings that need to be made. Currently your pension is calculated at 1/60th of pay for each year of membership but this may

be an area under review. Keep an eye on our website, facebook and twitter pages for updates, news items will be posted as we receive them.

## Why are we different to other public sector pension schemes?

The LGPS is what's known as a funded scheme. This means that any shortfall between contributions and benefits is funded by investments held by the various local authority funds, such as SYPA. The total of these assets is a huge £140 billion nationwide.

While the idea that, employees pay more so Government Treasury pays less is relatively simple in the case of the

# Public Sector Pensions Commission

unfunded schemes like the NHS, Teachers and Civil Service pension schemes this is not the same in the LGPS because the Treasury contributes nothing directly to the scheme. Pension benefits are paid for by employee contributions, employer contributions (which include some central government funding) and the income from the assets held by LGPS funds.

## Existing Rights

The Government has made it clear that the pension promises that have been made will be honoured. This is important too in order to correct the widespread view that pension reform invariably

means losing pension rights that have already been accrued. It does not.

Maintaining the link to final salary for calculating pension benefits under the existing scheme will ensure fair treatment for members who have already built up rights in the scheme and will mean that members closest to retirement, perhaps in their 50s today, who have less time to adjust, at least retain the link to final salary for the years they have already accrued.

# Public Sector Pensions Commission

## When will changes be implemented?

The Government is keen to ensure the new scheme is up and running before the end of this Parliament in 2015.

This means there will be no cause for concern for members approaching retirement before then. Also the new scheme will have little impact on members coming up to retirement in the years immediately following the change and members with static or low career progression may even be better off.

However if pension contributions are to increase this is likely to take effect from as early as April 2012.

## Union - on LG pension talks

The Local Government Group (LG Group), Local Government Ministers and all the Local Government Pension Funds have a vital role in the scheme's future design and their involvement in the talks is essential.

Government will hold specific LGPS negotiations with union leaders so that we can design reform that is bespoke to the LGPS and ensure its sustainability. However we believe the Government's timetable of 2012 for short-term savings is unrealistic and unnecessary. Therefore we will be seeking a sensible timetable for talks which would allow us time to properly consider all the issues

# Public Sector Pensions Commission

and for further research to be carried out into the workings and costings of the LGPS.

## Final words from the Government

*Here is our promise to you:*

- we will honour your accrued pension rights in full;
- we will continue to provide a defined benefit pension; and
- we will ensure that public service pensions remain amongst the very best available, and will provide low and middle income workers with a pension broadly as good as what they have now.

At the same time, public service workers must understand that the current system has to be fundamentally reformed.

For that reason the proposals would mean that public service workers would:

- Contribute more to their pension.
- Work to a later age before drawing their pension.
- Move to a career average salary as the fairest basis to calculate the pension benefit.

# South Yorkshire Pension's thoughts

## It's still a great scheme!

It's not all bad! The Local Government Pension Scheme will remain excellent quality, despite proposed changes. Even with a longer working life and higher contributions, many would argue it would be impossible to find a defined contribution scheme that provided better or even comparable benefits at retirement than those of the LGPS. Whilst it is wrong of the media to say our pensions are gold plated we are still very privileged to be part of a scheme that provides guaranteed benefits independent of share prices and stock market fluctuations, and although initially you may be disappointed and upset by

the changes, the scheme still provides an excellent benefit package.

Things could be worse! Rather than a career-average scheme, Lord Hutton looked at alternatives such as a defined contribution scheme in which there is no direct link between pay and the eventual pension. Instead, the future pension would depend on how well pension savings perform while they are invested during a members working life. By being a member of a CARE scheme, members are still part of a defined benefit scheme. Members can work out what they will receive at retirement because payouts are based on earnings rather than savings performance.

# South Yorkshire Pension's thoughts

To conclude, there is much still to be decided and we are only at the start of the consultation process required to amend the pension scheme.

Our website proves to be the most effective way in which we can communicate to a broad audience quickly and effectively. We encourage all members who have an interest in South Yorkshire Pensions Authority, to regularly visit the website to check on any progress that is being made to ever-changing LGPS regulations. Full details are always uploaded prior to any hard copies being made available. However we do understand that not all members will have access to the internet and for

that reason we will continue to report in hard copy newsletters.

Don't forget you can also follow us on <http://www.sypensions.org.uk/facebook> and <http://twitter.com/sypensions>





# Focus on current LGPS Benefits

1. Pensions are payable for life and increased in line with inflation.
2. All members can take a tax free lump sum as part of their benefit package.
3. The scheme provides a lump sum death grant of three times your actual pensionable pay payable to whoever you nominate.
4. Protection for your loved ones in the form of pensions for dependants if you die.
5. Your employer shares the cost of providing your benefits.
6. A pension if you become permanently too ill to work, plus any appropriate enhanced membership.
7. There are no hidden fees or charges you just pay a fixed percentage of your salary.
8. Your retirement income is independent of share prices and stock market fluctuations. There is no investment risk to your benefits - you receive a guaranteed package of benefits, which are backed by law.
9. Tax relief on all pension contributions you make.
10. **SAVING FOR RETIREMENT IS CRUCIAL AND THE LGPS IS A GREAT CHOICE!**

