Coventry City Council

9.3.14

Public report
Cabinet Report

Cabinet 15th March 2011

Council 22nd March 2011

Name of Cabinet Member:
Cabinet Member (Corporate and Neighbourhood Services) - Councillor Townshend
Cabinet Member (Strategic Finance and Resources) – Councillor Duggins

Director approving the report:
Director of Customer and Workforce Services and Director of Finance and Legal Services

Ward(s) affected:
None

Title:
Government Proposals to Change the Local Government Pension Scheme

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Is this a key decision?

No

The Government is considering significant increases to employee contributions to the Local Government Pension Scheme. These changes, if implemented, will threaten the viability of the scheme and have a major impact on the future financial welfare of thousands of City Council employees. Cabinet and Council are being recommended to consider whether to make representations to Government on these changes and in particular whether they wish to support a national campaign to influence the Government's decisions on these matters.

Executive summary:

The Government published the Hutton Report on Pensions Provision on 10th March 2011. The report makes a number of recommendations for the future of public service pensions in the UK including proposals that include the Local Government Pension Scheme. The report's stated principles for public service pensions include the expectation that pensions' provision should be fair, adequate, sustainable and affordable.

Ahead of the report's publication, a number of discussion documents have been in circulation in connection with the Local Government Pension Scheme (LGPS). These have been the subject of debate amongst the pensions' community, commentators on public sector issues, public sector trades unions and representative organisations such as the Local Government Association (LGA). The key focus of recent debate has centred upon proposals to require some members of the LGPS to increase their employee contributions to the scheme by between 50% and 100% above existing levels.

Most analysts recognise the need for long-term reform of pensions on a national level although there is a wide range of views on the best methods of doing this. A number of changes have already been implemented in the LGPS in the last few years or are in the process of being put in place. The view of LGPS administrators is that these changes will continue to ensure the affordability of the scheme.

The scale of the proposed increases in employee contributions outlined in this report is so large that concerns are now being expressed that this will result in wide-scale opt-out of employees from the LGPS. This in turn is likely to result in a very real possibility that the scheme's viability will come under threat. This possibility is the key theme of a letter from the LGA to the Chancellor of the Exchequer, George Osborne sent on 16th February 2011. The purpose of this report is to present the current facts and officer analysis on these issues and to request Cabinet and Council to consider whether they wish to support the LGA's stance.

Recommendations:

The Cabinet is recommended to consider whether to refer to this matter to Council with a view to making representations to the Government's proposals as set out in section 2.3, in the light of the information set out in the report.

Council are recommended to consider whether to agree to the proposed representations to Government in section 2.3 and to authorise the Director of Finance and Legal Services, in consultation with the Leader of the Council to send a letter containing the key messages indicated and communicate with the local Trades Unions as described.

Appendix Letter from the LGA to the Chancellor of the Exchequer

Other useful background papers:

None

Has it or will it be considered by scrutiny?

No

Has it, or will it be considered by any other council committee, advisory panel or other body?

No

Will this report go to Council?

Yes – subject to Cabinet approval.

Report title:
Response to Proposals to Change the Local Government Pension Scheme

1. Context

1.1 The purpose of this report is to inform members of the significant increases to employee pension contributions that are anticipated will be proposed by the Government. The report's conclusions are that if these changes are implemented they will have a detrimental financial impact on employees and will threaten the financial viability of the Local Government Pension Scheme (LGPS). Cabinet and Council are being asked whether, in the light of this information, they wish to support a national campaign to influence the Government to change these proposals.

1.2 The Government's Spending Review 2010 published on October 19th 2010 included some initial statements on public sector pensions. The Review:

- Pledged the Government to "seek progressive changes to the level of employee contributions that will deliver an additional £1.8 billion of savings a year by 2014-15."
- Stated that "there is a clear rationale for public servants to make a greater contribution if their pensions are to remain fair to taxpayers and employees and affordable for the country."
- Concluded that £1.8 billion of savings was equivalent to an average of three percentage points (of employee pay) to be phased in from April 2012. Approximately half of this relates to local government schemes.

Given the massive changes included elsewhere within the Spending Review, these statements did not receive much attention in the period that followed the Review's publication.

1.3 The Spending Review also included a proposal for the future indexation of pension benefits to be switched from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). These two indices measure different baskets of goods and services and over the long-term the CPI is widely considered to increase at a lower rate than the RPI. The consensus view amongst analysts is that this change will decrease the rate at which public sector pensions are increased to take account of future inflation. This will reduce the value of pensions that are paid to public sector employees. The positive aspect of this change from a macro-economic view is that it should make public sector pension schemes more financially viable and reduce the need to increase employer or employee contributions or make other changes to reduce pension benefits.

1.4 In terms of employee contributions, the Local Government Association (LGA) understands that HM Treasury has indicated that a 3.2% increase is required in employee contributions to the Local Government Pension Scheme (LGPS), equivalent to an additional £900 million by 2014/15. A DCLG paper indicating how the increase in employee contributions to the LGPS could potentially be achieved was set out as follows.

Band	Salary	Current rate	2012/13	2013/14	2014/15
1	> £12,600	5.5%	5.5%	5.5%	5.5%
2	£12,601-£14,700	5.6%	5.6%	5.6%	5.6%
3	£14,701-£18,000	5.9%	5.9%	5.9%	5.9%
4	£18,001-£24,000	6.5%	6.5%	6.5%	6.5%
5	£24,001-£31,500	6.5%	7.8%	9.1%	9.7%
6	£31,501-£42,000	6.8%	8.5%	10.2%	11.0%
7	£42,001-£75,000	7.2%	9.5%	11.8%	13.0%
8	£75,001-£100,000	7.5%	10.1%	12.7%	14%
9	£100,001-£150,000	7.5%	10.3%	13.1%	14.5%
10	£150,001 >	7.5%	10.5%	13.5%	15%

1.5 The LGA has subsequently written to the Chancellor of the Exchequer, George Osborne on 16th February 2011 with their concerns about the scheme. The letter is attached as an appendix to this report. Amongst the concerns raised were:

- With only 6.5% of the LGPS membership earning in excess of £42,000 and with protection for lower paid employees (40% of the LGPS workforce earn less than £18,000), the main burden of the 3.2% increase will fall on middle earners;
- There is strong evidence to suggest that the opt-out rate will be far greater than the 1% envisaged in the Spending Review announcement.
- There are real concerns over the disparity between public sector schemes meaning that, for example, highly paid members of some other public service schemes will be paying a lower contribution rate than the lowest paid workers in local government.

1.6 The GMB, Unison and Unite Unions have issued a combined press release which included the following key messages:

- That an average increase of 3% in employee contributions would lead to between 39% and 53% of members opting–out of the scheme depending on how the increases were distributed amongst different salary bands.
- That the increased revenue generated by the additional contributions would be paid direct to the Government rather than contributing to the LGPS.

This latter point of detail remains unclear. The Spending Review contains a specific saving relating to this increase in employee contributions. However, in normal circumstances such an increase would be paid directly into individual pension funds. If this route was followed, the Government would need to surcharge pension schemes separately or insist on reduced employer contributions and recover an equivalent amount through reductions in Formula Grant over and above those in the Spending Review.

1.7 The Chair of the Greater Manchester Pension Fund Management Panel has written directly to the Chancellor in a letter containing the following points:

- The LGPS is a funded scheme (this means that pension benefits are funded entirely by employee and employer contributions – the Treasury is not required to fund any shortfall as it is in other public sector schemes).
- Recent measures (including the move from RPI to CPI as the inflation index) have already improved the financial position of the scheme and reduced any pressure to increase employer contributions.
- Opt out rates have already increased in 2010 and the impact of salary freezes and high inflation are likely to increase the financial pressure on individuals. A further increase in employee contributions is likely to further accelerate this.

1.8 Like all other local government schemes the West Midlands LGPS is fully funded by employee and employer contributions. The scheme is assessed every three years by a specialist pensions' actuary and recommendations are made to ensure that the scheme remains financially robust. Recent years have proved challenging for all such schemes due to a combination of low investments returns, low interest rates and people living longer. For these reasons and because of the way that we are required to account for pensions, most schemes currently show a notional deficit position. However, actuaries have taken a long-term view on sustainability of schemes and changes have been introduced over the last ten years that in Coventry's case have seen;

- An end to additional pension years being granted to early retirees,
- All early retirement costs needing to be funded up-front rather than being funded by the pension fund,
- Differential increases to employee contribution rates introduced several years ago,
- Increases in employer rates (although the recent review appears to have broadly capped employer contributions at existing rates),
- Minor changes to reduce the cost of employee benefits,
- The current proposed move to CPI from RPI as the measure used to inflate future pension benefits.

1.9 These changes have served to ensure that the West Midlands scheme remains viable and the same or similar measures will have been made to local government schemes across the country. The way these schemes work means that there is no external funding pressure on the Treasury. However, the financial viability of the scheme is heavily dependent on the continued contributions of existing members and an influx of new members. It is fair to say that there was something of a gap in the past between the contributions into the scheme and the value of the benefits that now-retired members are drawing. This differential between current employer and employee contributions on the one hand and likely future benefits for current members on the other has been closed in recent years by the measures indicated above. Although the Hutton Report has reaffirmed the need for tiered contribution rates, it has also has emphasised that the Government should consider the impact of opt-outs when setting contribution levels and is clear on the advantages to having senior managers as members of the scheme. The report does not say anything specific about how steeply tiered contributions should increase. The overall conclusion from these facts is that it is essential that the scheme retains its existing membership and attracts new members. If the opt-outs predicted by the range of commentators above materialises then the viability of the West Midlands scheme could be compromised by a shortage of current and future members. There is a real risk that the DCLG proposals to increase employee contributions in the way outlined could trigger this.

1.10 As outlined in section 1.6, a lack of clarity remains over whether the proposed increases in employee contributions will be retained within the scheme or paid separately to the Treasury. If contributions are paid into the scheme then there is no direct financial benefit to the Government of the sort envisaged in the Spending Review. If the contributions are paid directly to Government or indirectly through a surcharge on the LGPS or via a reduction in Formula Grant then this would appear to be a punitive specific tax on local government pension scheme members without clear justification.

1.11 The context in terms of pensions paid to local government workers is that the majority are relatively low paid female workers. On retirement and on average, local government workers can expect to receive a pension of £4,000 a year. The figure for female local Government workers is £2,600. Often, these payments will help former local government workers out of the benefits system and so represent a saving to the Treasury.

2. **Options considered and recommended proposal**

Do Nothing

2.1 Many bodies including the LGA, the public sector unions and individual pensions authorities have already submitted contributions to the pensions debate. Cabinet and Council could choose to rely upon these submissions and not contribute the Council's individual position.

Draw Up an Individual Submission

2.2 Cabinet and Council could opt to draw up representations to the proposals that reflect Coventry's individual position. The wording would need to be agreed at Council or delegated to the appropriate Cabinet Members and senior officers.

Agree Submission Proposed by the GMB Union

2.3 The GMB Union has circulated a 'Model Council Motion' to local authorities entitled "Defending the Local Government Pension scheme". The precise wording is shown below. The view of officers is that the words in the first two paragraphs are either statements of fact or reflect the conclusions that can reasonably be drawn from the evidence. Notwithstanding that the Hutton Report has now been published, there remains some merit in writing to Government with the messages contained within the paragraph entitled 'Council resolves'. Therefore, the Cabinet is recommended to consider whether to refer to this matter to Council with a view to making the proposed representations to Government as set out below in the light of the information set out in the report.

Council are recommended to consider whether to agree to the proposed representations to Government in section 2.3 and to authorise the Director of Finance and Legal Services, in consultation with the Leader of the Council to send a letter containing the key messages indicated and communicate with the local Trades Unions as described.

Council notes:
The LGPS is a sustainable, good quality pension scheme that benefits from being funded and locally managed. It is valuable to employers and employees alike. Successive governments have failed to recognise the distinctiveness of the LGPS in setting policy, most notably in the proposal announced by the Chancellor in the last CSR to impose an extra 3.2% contribution tax on scheme members, increasing scheme average member contributions from 6.6% to 9.8%. This tax does not benefit the scheme or scheme members or employers. This proposal is in addition to pension reductions caused by being indexed against CPI instead of RPI and is in advance of expected benefit reform recommendations from the Hutton Review.

Council agrees:
An increase in member contributions as proposed will lead to mass opt outs from the LGPS and that would be undesirable and damaging. The views expressed by the LGA in its letter to the Chancellor dated 16 February 2011 on this subject are also the views of this Council.

Council resolves:
Council will write to the Chancellor of the Exchequer and the Chief Secretary to the Treasury and the Secretary of State for Local Government within the next month stating this Councils support for the LGA letter referred to above and calling for government to rethink its proposed increases to LGPS member contributions. Council will work with Trade Unions to ensure employees are made aware of the proposals for the LGPS and

encouraging them to support the Council's representations to defend their pension scheme.

3. Results of consultation undertaken

3.1 None.

4. Timetable for implementing this decision

4.1 The proposed changes to employee contribution rates are planned to take effect from 1st April 2012.

5. Comments from Director of Finance and Legal Services

5.1 Financial implications

The proposed increase in employee contribution rates has no direct impact upon the City Council. However, if the proposed increases in employee contributions is approved and this leads to significant opt-out of the LGPS there is likely to be an increasing residual liability within the scheme. The risk is that such a residual liability emerges and needs to be managed in the future by local authorities within the scheme.

5.2 Legal implications

There are no specific legal implications.

6. Other implications

6.1 How will this contribute to achievement of the council's key objectives / corporate priorities (corporate plan/scorecard) / organisational blueprint / LAA (or Coventry SCS)?

No specific impact.

6.2 How is risk being managed?

These matters will be determined on a national basis. Sending a submission along the lines recommended in the report is the only way that we can seek to manage the risk at present.

6.3 What is the impact on the organisation?

Lord Hutton has recognised the value of the existing LGPS as part of the overall remuneration package for local government workers. Any significant degradation of the scheme through significantly increased contribution rates threatens the attractiveness of local government as an employer. Even at a time of relatively high unemployment such a move is likely to reduce the ability of local government to attract the best candidates to a range of posts in the salary ranges proposed to be affected by the increase in contributions. The risk is that over a period of time there is an overall reduction in the quality of new employees taken on by the Council.

6.4 Equalities (Equality Impact Assessments)

There are no equalities impacts resulting directly from this report's recommendations.

6.5 Implications for (or impact on) the environment

No specific implications.

6.6 **Implications for partner organisations?**
No specific implications.

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Members: Cllr Townshend	Cabinet Member (Corporate and Neighbourhood Services)		11/3/11	14/3/11
Members: Cllr Duggins	Cabinet Member (Strategic Finance and Resources)		11/3/11	14/3/11

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Rt Hon George Osborne, MP
Chancellor of the Exchequer
The Correspondence & Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

16 February 2011

Dear Chancellor,

Local Government Pension Scheme – Proposed increase in employee pension contributions

In the public sector Spending Review statement in October 2010 the Government announced its intention to increase employee pension contributions in the public service pension schemes (other than the Armed Forces Pension Scheme) by, on average, 3%. The increases would be introduced progressively over the period 2012/13 to 2014/15 but with protection for the lower paid.

We understand that the Department for Communities and Local Government (DCLG) has been informed by HM Treasury that a 3.2% increase is required in employee contributions to the Local Government Pension Scheme (LGPS), equivalent to an additional £900 million by 2014/15. DCLG has provided us with a paper setting out how the increase in employee contributions to the LGPS could potentially be achieved i.e.

Band	Salary	Current rate	2012/13	2013/14	2014/15
1	> £12,600	5.5%	5.5%	5.5%	5.5%
2	£12,601-£14,700	5.6%	5.6%	5.6%	5.6%
3	£14,701-£18,000	5.9%	5.9%	5.9%	5.9%
4	£18,001-£24,000	6.5%	6.5%	6.5%	6.5%
5	£24,001-£31,500	6.5%	7.8%	9.1%	9.7%
6	£31,501-£42,000	6.8%	8.5%	10.2%	11.0%
7	£42,001-£75,000	7.2%	9.5%	11.8%	13.0%
8	£75,001-£100,000	7.5%	10.1%	12.7%	14%
9	£100,001-£150,000	7.5%	10.3%	13.1%	14.5%
10	£150,001 >	7.5%	10.5%	13.5%	15%

The Local Government Group are very concerned that the implications for local authorities, their workforce and the wider economy may not have been fully considered by HM Treasury. These include:

- with only 6.5% of the LGPS membership earning in excess of £42,000 and with protection for lower paid employees (40% of the LGPS workforce earn less than £18,000), the main burden of the 3.2% increase will fall on middle earners;

- there may be pressure during pay negotiations to recoup, via the pay settlement, the effects of any increase in contributions (or loss of future pension rights upon opting out);

- the demographics of the Scheme's membership makes it difficult to produce a set of tariff tables that are fair and progressive across all salary bands;

- there is strong evidence to suggest that the opt-out rate will be far greater than the 1% envisaged in the Spending Review announcement. Neither is there any evidence to suggest that full account has been taken of the likely reductions in the local government workforce over the Spending Review period, a large proportion of which will be scheme members;

- there is a considerable risk therefore that the £900 million target additional income by 2014/15 will not be achieved unless even greater increases are imposed on those scheme members who remain (leading to the possibility of a vicious circle of even higher opt-out rates);

- a significant increase in employee contributions at a time of pay restraint / pay cuts and increasing inflation is likely to lead to a significant worsening in industrial relations;

- such an increase in contributions will lead to a further dampening of employee spending power at a time when the Government is seeking to promote economic recovery;

- there are real concerns over the disparity between public sector schemes meaning that, for example, highly paid members of some other public service schemes will be paying a lower contribution rate than the lowest paid workers in local government;

- there are consequential recruitment, retention and promotion implications. The pension scheme as an element of the reward package will be less attractive and the cliff edges contained in the above table may act as a disincentive to seek promotion (e.g. an employee earning £24,000 who receives a £1 increase would pay an extra 3.2% on all of their earnings, reducing their take-home pay to significantly less than it was prior to the promotion);

- part-time employees, who constitute the overwhelming majority of low paid workers in local government, have their contribution rate assessed by reference to their whole-time equivalent salary. Thus, many of those part-time employees with part-time salaries below the low pay protection threshold will, in fact, not benefit from the protection (because their wholetime equivalent salary is greater than £24,000);

- a significant level of opt outs would result in:

    i. a serious and detrimental impact on the Scheme's future sustainability and viability;

ii. LGPS Funds would become more mature leading to a move away from equities into bonds. This could distort the bond market and a move out of UK equities (in which the LGPS Funds have significant holdings) could have an impact on the UK investment sector (FTSE).

iii. fewer employees would be making adequate pension provision for themselves, ultimately leading to further reliance on the State via means tested benefits in retirement.

The LGPS is different to the other public sector schemes in that it is a funded scheme and currently has a positive cash flow.

For some years the LG Group has pursued a policy position of the LGPS being sustainable and affordable. In our opinion these proposals seriously undermine these principles. All political Groups within the LGA strongly urge that this is recognised and that the Government enters into dialogue with employers and unions in order to consider further how best to achieve the Government's aims ahead of the outcomes from the report of the Independent Public Service Pensions Commission.

We are prepared to consider amendments to Scheme benefits with CLG as regulator and the trade unions to try and find alternatives to mitigate the rising cost of pensions to the public purse.

Yours sincerely,

Eaton

Baroness Eaton DBE DL
Chairman, Local Government Association

Mayor Sir Steve Bullock,
Chair, Workforce Programme Board.

Cc:
Rt Hon Eric Pickles, MP – Secretary of State for Communities and Local Government
Rt Hon Danny Alexander, MP – Chief Secretary to the Treasury