

**Local Government Pension Scheme
(England and Wales)**

Rule of 85 Fresh Assessment of Costs

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1 Introduction and Summary of Results

- 1.1 The Government Actuary's Department (GAD) has been asked by Communities and Local Government (CLG) to carry out an assessment of the cost of replacing tapered protection of the Rule of 85 with full protection to 2020.
- 1.2 This follows from a consultation exercise on the matter during 2007 and the subsequent decision of Ministers that a fresh assessment of costs and experience using the 2007 Scheme actuarial valuation data would be useful. The issues have also been discussed at meetings of the LGPS Policy Review Group.
- 1.3 The number of current active scheme members who are covered by the tapered protection is some 189,000. This represents just over 10% of the total active membership of the scheme (around 1.8 million members at 31 March 2007).
- 1.4 The capital cost of replacing tapered protection with full protection is estimated to be £575 million as at 31 March 2007.
- 1.5 Expressed as a percentage of pay, £575 million is equivalent to around 0.1% of total scheme pensionable pay over 20 years.
- 1.6 The cost expressed as a percentage of the pensionable pay of only those members affected by the change would be considerably higher than 0.1%, as the full cost would have to be met by this group rather than the whole scheme.
- 1.7 The actual cost per member affected will vary greatly between individuals, and will depend upon the choices and decisions made by them.

2 Existing Rules and Proposed Changes

- 2.1 The date that each member will satisfy the rule of 85 (the “Critical Retirement Date” (CRD)) was estimated.
- 2.2 Members born before 1 April 1956 who were an active member prior to 1 October 2006 are categorised as Group 1 members in the Early Retirement guidance issued by GAD. Their service accrued up to 31 March 2016 is unreduced if they retire on or after their Critical Retirement Date. However, if they remain in service on or after 1 April 2016, service after that date will be reduced if they retire before age 65. Those born before 1 April 1951 will reach age 65 before 1 April 2016 so will be unaffected by any changes to the early retirement guidance.
- 2.3 Members born between 1 April 1956 and 31 March 1960 who were an active member prior to 1 October 2006 and whose CRD is before 1 April 2020 are categorised as Group 2 members in the Early Retirement guidance issued by GAD. They receive tapered protection on their service from 1 April 2008 to 31 March 2020. The taper factor is based on their CRD. If the CRD is close to 1 April 2016, then they tend to be treated as if they have full protection to 2020. If their CRD is close to 31 March 2020, then they have little protection. Their service on or after 1 April 2020 is reduced if they retire before age 65.
- 2.4 Members born between 1 April 1956 and 31 March 1960 who were an active member prior to 1 October 2006 but whose CRD is after 31 March 2020 are categorised as Group 3 members in the Early Retirement guidance issued by GAD. All their service from 1 April 2008 is subject to full actuarial reduction if they retire before age 65.
- 2.5 The three tables below summarise the paragraphs above. In tables 3 and 4, the aspects that are proposed to be changed are indicated in bold.

Table 2: categorisation of members who were an active member prior to 1 October 2006

Date of Birth	CRD	
	before 1 April 2020	on or after 1 April 2020
Before 1 April 1956	Group 1	N/A
Between 1 April 1956 and 31 March 1960	Group 2	Group 3
After 31 March 1960	N/A	Group 3

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Table 3: treatment of service after 1 April 2008 under present guidance

Service	Group 1	Group 2	Group 3	
			born 1/4/56-31/3/60	Born 1/4/60-
1 April 2008-31 March 2016	CRD	Taper	65	65
1 April 2016-31 March 2020	65	Taper	65	65
1 April 2020-	65	65	65	65

Table 4: Proposed treatment of service after 1 April 2008

Service	Group 1	Group 2	Group 3	
			born 1/4/56-31/3/60	Born 1/4/60-
1 April 2008-31 March 2016	CRD	CRD	CRD	65
1 April 2016-31 March 2020	CRD	CRD	CRD	65
1 April 2020-	65	65	65	65

- 2.6 The proposed changes will not affect any member whose CRD is on their 65th birthday.
- 2.7 The proposed changes do not affect any of the benefits paid upon the death or ill health of a member since these are not affected by early retirement reductions.

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3 Data

- 3.1 Data from the 2007 valuations was requested for all members of England and Wales LGPS funds born between 1 April 1951 and 31 March 1960 who were active members on 31 March 2007 and who were also active members on 30 September 2006.
- 3.2 There are 93 funds and 89 administering authorities under the LGPS regulations in England and Wales. Four administering authorities operate two funds (Nottinghamshire, West Midlands, Suffolk and the Environment Agency).
- 3.3 Data was received and used in respect of 90 funds. There are no active members in the Environment Agency Closed Fund. Data was not received in respect of two Funds which are known to have active members. The data received represents about 99% of the affected membership and the results have been rated-up to allow for the two missing Funds.
- 3.4 The data contained records in respect of about 451 thousand members. Of these, 174 thousand had a critical retirement age of 65 so are unaffected by these proposals. A further 89 thousand Group 1 members will reach their CRD before 31 March 2016 and so are assumed to be unaffected by the proposals.
- 3.5 Table 5 summarises the data received in respect of the remaining 189 thousand members who are affected by the proposed changes, split by their treatment under the early retirement rules. Table 6 shows their average pensionable salaries. If a member works part-time, the part-time salary has been used.

Table 5 Number of members affected in the dataset (thousands)

	Men	Women	Total
Group 1 (born 1/4/51-31/3/56)			
CRD after 31 March 2016 but before 65 th birthday	7	33	40
Groups 2 and 3 (born 1/4/56-31/3/60)			
Group 3 member with CRD after 31 March 2020 but before 65 th birthday	9	47	57
Group 2 member (therefore with CRD before 1 April 2020 and before 65 th birthday)	37	55	92
Grand Total	53	135	189

Table 6 Average pensionable salaries (actual pay, not full time equivalent for part-timers)

	Men	Women	Total
Group 1 (born 1/4/51-31/3/56)			
CRD after 31 March 2016 but before 65 th birthday	23,000	16,600	17,700
Groups 2 and 3 (born 1/4/56-31/3/60)			
Group 3 member with CRD after 31 March 2020 but before 65 th birthday	22,600	15,700	16,900
Group 2 member (therefore with CRD before 1 April 2020 and before 65 th birthday)	28,500	21,500	24,300
Grand Total	26,800	18,300	20,700

- 3.6 The total number of people potentially affected by these changes is 189 thousand assuming that members retire at their CRD.
- 3.7 Total rate of pensionable pay at 31 March 2007 for the Funds for which data was received was £28.7 billion. This includes all active members of those Funds, not just

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the ones for which individual data was requested. Where a member is part-time, this is part-time pay.

- 3.8 Total employee contributions in 2006/07 for the Funds for which data was received were £1.74 billion and employer contributions were £0.02 billion for the remaining two Funds for which no data was received. It has been assumed that the ratio of total costs to the costs based on the data received is the same as the ratio for employee contributions. The employee contribution data was taken from the Pension Funds Performance Guide Local Authority Edition 2008 published by DG Publishing and the online published records of the two funds excluded from that publication (South Yorkshire Passenger Transport and West Midlands Passenger Transport). This source also shows that there were 1.78 million active members of the LGPS in England and Wales at 31 March 2007.

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4 Assumptions

- 4.1 The assumptions adopted for these calculations were the same as were used for GAD's costings of the LGPS new scheme. These were described in a note circulated to PRG in February 2008.
- 4.2 The key assumptions for these costings are:
- 4.2.1 Investment returns net of pension increases are 3.5% a year
 - 4.2.2 Investment returns net of general salary increases are 2% a year
 - 4.2.3 Male mortality in retirement: standard table PMA92 (C=2045) with an age adjustment of one year down
 - 4.2.4 Female mortality in retirement: standard table PFA92 (C=2045) with an age adjustment of one year down
 - 4.2.5 Members retire at the later of age 60 or at their critical retirement age (but no later than their 65th birthday). Thus, Group 1 members whose CRD is before 1 April 2016 are assumed to be unaffected by the proposed change.
 - 4.2.6 Death in service, ill health retirement and salary scale details are as described in the note.
 - 4.2.7 Working patterns are assumed to remain the same until a member leaves service. That is, full-timers remain on full-time hours and part-timers keep the same part-time percentage.

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5 Results

5.1 The capital cost of making the change to transitional protection is estimated to be £575 million as at 31 March 2007. Expressed as a percentage of pay, this is around 0.1% of pensionable pay over 20 years. The split of the costs into the affected groups of members and a summary of the proposed changes for each group is shown in the table below.

Table 1a Costs of improving transitional protection as at 31 March 2007

Group	Service affected	Change	Cost (£ million)
born before 1/4/1956	1/4/2016-31/3/2020	NRA65 to CRA	25
born 1/4/1956-31/3/1960 CRD after 1/4/2020	1/4/2008-31/3/2020	NRA65 to CRA	125
born 1/4/1956-31/3/1960 CRD before 1/4/2020	1/4/2008-31/3/2020	Taper to CRA	425
Total			575

5.2 The split of costs by male and female members is shown in the table below.

Table 1b Costs of improving transitional protection as at 31 March 2007

Group	Cost (£ million)
Men	250
Women	325
Total	575

5.3 The cost of £575 million expressed as a percentage of the pensionable pay of only those members affected by the change would be considerably higher than 0.1%; since, not only is the cost then being spread over a small subset of the members, but the average expected working lifetime of members expected to be affected by the removal of the taper would be less than 20 years (ie the period over which the cost would be spread is shorter).

5.4 The actual cost per individual affected will vary greatly between members. The greatest cost will be for members with a CRD of their 60th birthday and who were born close to 31 March 1960. Conversely, the cost in respect of members born soon after 1 April 1956 will be relatively low. The cost per individual will also depend upon the choices and decisions they make.