

**COST MANAGEMENT, BENEFIT DESIGN
AND ADMINISTRATION COMMITTEE
– 18 May 2017**

**Paper C : Ill-health retirement working
group**

Background

- 1.1 At their meeting in March 2017, SAB agreed with the committee's recommendation that a working group should be established to take forward the work initiated by the former Contributions and Administration sub-committee on simplifying and improving the scheme's ill-health retirement operation. The group also considered whether additional work on the early payment of a deferred benefit on ill-health grounds should also be recommended.
- 1.2 A working group was established comprising :-
- Annemarie Allen (Barnett Waddingham)
 - Emma Mayall (GMPF)
 - Alan South (Bath & NE Somerset)
 - Glyn Jenkins (UNISON)
 - George Georgiou (GMB)
 - Con Hargraves (LGA)
 - Lorraine Bennet (LGA)
 - Bob Holloway (Chair) Pensions Secretary
- 1.3 The group met on 11th May to discuss the two papers on removal of the third tier and centralisation of the IRMP arrangement approved by the committee on the 18th February. The purpose of the meeting was to agree a set of proposals and recommendations for consideration at the next committee meeting on 18th May. It is important to note that the proposed solutions under each heading below will impact across the board and therefore need to be considered holistically as well as individually.

Removing the third tier

- 1.4 Attached at **Annex A** is a paper setting out in broad terms the three tier arrangement in the 2013 Regulations and the new arrangement proposed by the former Contributions and Administration committee. A table showing the incidence of ill-health retirements under each of the current three tiers is attached at **Annex B**.

- 1.5 The group agreed that communication would be key to any successful implementation of any new proposal and that any change would need to be evidence based. **Recommendation – that the group prepares a clear policy objective based around fairness, affordability and efficiency and undertakes an analysis of IDRP, Pensions Ombudsman and related data to evidence the deficiencies of the current arrangement.**
- 1.6 The group had serious concerns about the proposal to introduce a new vesting period of 5 years as the gateway to the proposed tiers 1 and 2. The view was taken that a member suffering serious ill-health should not be denied enhanced ill health retirement benefits because they had not served more than 5 years membership. The group were advised that the 5 year proposal was made to ensure that any change would be cost neutral and that according to GAD, the saving would represent 0.10% of pay. **Recommendation – that given the very marginal cost of moving back from the proposed 5 year vesting period for any level of enhancement to a 2 year vesting period in all cases and the unfairness of a differential vesting period arrangement, all entitlements to ill-health benefits should be subject to a 2 year vesting period. Furthermore, GAD should be commissioned to undertake a new costing once the group and committee have firmed up their proposal.**
- 1.7 The group discussed arrangements in the other major public service pension schemes and agreed that two levels of ill-health benefit represented the best way forward, both to simplify the process and to reduce the potential for inconsistency in decision making. A consensus was reached that the lower level (the group preferred the term “level” rather than “tier”) should apply to those members who are permanently incapable of performing efficiently their former duties with the upper level applying to those members who satisfy the lower level but who are also incapable of gainful employment before reaching their normal retirement age. The group felt that more work should be done, including costings and impact assessment, before any firm proposal is made regarding the level of entitlement at both the lower and upper level. **Recommendation – that the new arrangement should comprise a lower and upper level with a common vesting period of 2 years and that the group should be tasked to undertake further work to confirm the proposed level of entitlement at both levels.**
- 1.8 The group then discussed transitional arrangements. Given that a different, less favourable level of enhancement in the upper level may be contentious, the group concluded that some consideration should be given to the timing of any change in the scheme’s provisions. One option would be a period of protection for existing members, say 10 years, or making it applicable to new members only from the date of implementation. No conclusion was reached but it was agreed that more work should be undertaken to assess these and other options. **Recommendation – that the group should examine in more detail how the transition to any new arrangement should be undertaken.**

- 1.9 A question was also raised about gainful employment and whether it was in the group's remit to propose removing it from the ill-health retirement provisions. There were mixed views on this but it was agreed that subject to the committee's agreement, the Pensions Secretary should seek an informal view from HM Treasury on the possibility of removing the condition relating to gainful employment. **Recommendation – that HM Treasury should be approached informally on the scope for removing incapacity of gainful employment as a condition for enhanced benefits.**
- 1.10 The group also considered the first gateway in the current regulations which requires the employment to have been terminated on the grounds of ill-health or infirmity. There was general agreement that this was unnecessarily restrictive and potentially allowed scheme employers to manipulate decision making to control the level of ill-health benefits. One option would be to return to the earlier condition which simply required entitlement to be considered when a person suffered ill-health or infirmity. The group also agreed that consideration should be given to introducing a regulatory timeframe within which ill-health retirement decisions had to be made. **Recommendation - that the group should undertake further work and return to the committee with a firm proposal.**

Centralisation of the IRMP arrangement

- 1.11 There was a unanimous view that the current arrangement where each individual scheme employer is required to appoint their own IRMP is ineffective, costly, administratively complex and likely to be unfair with inconsistent decision-making. However, it was agreed that more work was needed to evidence these shortcomings. **Recommendation – that the group should undertake further work to establish how the current arrangement is working in practice and whether the assertion that it results in inconsistent and unfair decision making is borne out by evidence.**
- 1.12 Subject to the outcome of the above recommendation, the group agreed that the proposal should be for the IRMP arrangement to be transferred away from individual scheme employers to a national panel where costs, expertise and experience can be focussed at a single point. Centralisation would also enable experts across a range of medical issues to be accessed more readily. **Recommendation – that the group should assess how this might work at a national level and approach other public service pension schemes who operate such arrangements to evidence the case for change.**
- 1.13 Discussion then focussed on whether the final decision on entitlement should reside at scheme employer level (as it does currently); administering authority level or the proposed national arrangement. The group quickly rejected the idea of the final decision resting with administering authorities but opinion was divided on whether it should

remain with scheme employers or reside at national level as part of the IRMP arrangement. **Recommendation – that the committee should discuss the pros and cons of either option and advise the group on their preference.**

Early payment of deferred benefits on ill-health grounds

- 1.14 A paper setting out the background, the relevant regulatory provisions and options for change is attached at **Annex C**.
- 1.15 The majority of the group agreed that the current arrangements were unsatisfactory and that the recent decision from the Pensions Ombudsman concluding that scheme employers had a wide discretion to deny the payment of deferred benefits on grounds other than ill-health should be investigated. **Recommendation – that the group should be tasked to prepare a paper on this issue and report back later in the Summer**

Annex A – Scheme ill-health provisions

A : LGPS Regulations 2013

Main conditions :-

- +2 year vesting period
- Employment terminated on the grounds of ill-health or infirmity
- Member has not reached normal retirement age (NRA)
- The conditions renders the member permanently incapable of discharging efficiently the duties of their former employment
- The member is not immediately capable of gainful employment

Tier 1 = Unlikely to be capable of gainful employment before NRA (100% enhancement)

Tier 2 = Not entitled to Tier 1 benefits; unlikely to be capable of undertaking gainful employment within 3 years of termination but likely to be capable of gainful employment before reaching NRA (25% enhancement)

Tier 3 = Capable of undertaking gainful employment within 3 years after termination (entitlement to benefit for so long as the member is not in gainful employment)

B Recommendation of former Administration and communications sub-committee

Main conditions :-

- + 2 year vesting period

- Employment terminated on the grounds of permanent ill-health or infirmity rendering the member incapable of performing their former duties

Member entitled to immediate payment of unreduced benefits

But, if the member has a 5 year vesting period :-

Tier 1 = and is incapable of gainful employment before NRA, the member is entitled to 100% enhancement as at NRA, or

Tier 2 = is incapable of only performing their former duties, the member is entitled to 25% enhancement

Annex B - Incidence of ill-health health retirement

Retirement Data : SF3 Return 2015/16

Ill-Health retirement	Tier 1	2,082	75%	}	7%
	Tier 2	235	8%		
	Tier 3	474	17%		
Redundancy		13,627			35%
Normal retirement		22,655			58%
39,073					

Annex C – Early payment of deferred benefits on ill-health grounds

EARLY PAYMENT OF DEFERRED AND PENSIONER BENEFITS ON GROUNDS OF ILL-HEALTH

Issue

1. Regulation 38 of the Local Government Pension Scheme Regulations 2013 enables a scheme employer to agree to an application from a deferred member for their benefits to be released early on the grounds that they have become permanently incapable of performing gainful employment for reasons of ill-health. The regulation requires an Independent Registered Medical Practitioner (IRMP) to certify whether the medical criteria under the 2013 regulations are satisfied.

2. Following the recent Pensions Ombudsman decision in Mrs R v Trafford (<https://www.pensions-ombudsman.org.uk/wp-content/uploads/PO-9309.pdf>), there has been a call for greater clarity about the discretionary element in Regulation 38 of the 2013 Regulations referred to in the determination. The issue is whether the determination of

applications for the early payment of deferred benefits on ill-health grounds, independent of any certification by an IRMP, can be objectively justified and if not, whether DCLG should be recommended to consult on scheme amendments to make the position clear.

The Regulatory Background

3. Prior to 2007, the early payment of a deferred member's benefits on ill-health grounds was covered by Regulation D11 of the Local Government Pension Scheme Regulations 1995 -

"D11 (1) If a member who ceases to hold a local government employment -

(a) is not entitled under [regulation D5](#), [D6](#), [D7](#) or [D9](#) to retirement benefits which are payable immediately on his ceasing to hold that employment; and

(b) fulfils one of the following requirements, namely -

(i) he has a statutory pension entitlement; or

(ii) he is treated by virtue of regulation K23(2) as having ceased to hold the employment on becoming subject in it to an approved non-local government scheme;

*then, subject to [regulation D13](#), **he becomes entitled** in relation to that employment to a standard retirement pension and a standard retirement grant payable from the appropriate date; and in these regulations benefits to which a person becomes entitled under this paragraph by virtue of fulfilling one of the requirements mentioned in paragraph (b) and which have not yet become payable are called "preserved benefits".*

(2) For the purposes of paragraph (1) "the appropriate date", in relation to any person, is his 65th birthday or, if earlier, the earliest of the following -

(a) his NRD;

*(b) **any date on which he becomes permanently incapable, by reason of ill-health or infirmity of mind or body, of discharging efficiently the duties of the employment he has ceased to hold;***

(c) any date after he has attained the age of 50 years from which the employing authority determine on compassionate grounds that the benefits are to become payable;

(d) in the case of a person who has attained the age of 60 years, has ceased to be employed in local government employment and has duly elected to receive payment from the relevant date, that date.

(3) An election under paragraph (2)(d) shall be made by notice in writing to the employing authority given within the period of three months beginning with the relevant date.

(4) In this regulation "relevant date", in relation to any person, means -

(a) the date on which he attains the age of 60, or

(b) if later, the date of his ceasing to be employed in local government employment”

5. It is clear from the wording of Regulation D11(1) (“...he becomes entitled in relation to that employment...”) that a deferred member who elected to receive the early payment of their benefits on ill-health grounds and who satisfied the necessary medical criteria, was entitled to receive such payment. Regulation D11 made no allowance for the scheme employer to exercise any discretion as to whether or not that payment should be made. Similar provisions were later carried forward into the Local Government Pension Scheme Regulations 1997.

6. However, the scheme regulations which came into effect in 2007 significantly changed the terms and conditions under which the early release of preserved benefits on ill-health grounds could be made. Regulation 31 of those regulations no longer made any reference to entitlement -

“31.—(1) This regulation applies to—

a) a member who has left his or her employment before he or she is entitled to the immediate payment of retirement benefits (apart from this regulation), or

b) a member who has left his or her employment and is a pensioner member with deferred benefits under regulation [20\(9\)](#).

*(2) Subject to paragraphs (3) and (4), if a member to whom paragraph (1)(a) applies becomes permanently incapable of discharging efficiently the duties of that employment because of ill-health or infirmity of mind or body, the member **may ask to receive payment** of their retirement benefits whatever the member’s age.*

(3) A request under paragraph (2) must be made to the member’s former employing authority or appropriate administering authority where the member’s former employing authority has ceased to be a Scheme employer.

*(4) **Before determining whether to agree to a request** under paragraph (2), the member’s former employing authority or appropriate administering authority as the case may be, must obtain a certificate from an IRMP as to whether in the IRMP’s opinion the member is suffering from a condition that renders the member permanently incapable of discharging efficiently the duties of that employment because of ill-health or infirmity of mind or body and, if so, whether as a result of that condition the member has a reduced likelihood of being capable of undertaking any gainful employment before reaching normal retirement age, or for at least three years, whichever is the so*

(5) In the case of a member to whom paragraph (1)(b) applies, if the member becomes permanently incapable of undertaking any gainful employment, the member may ask to receive payment of their retirement benefits, whatever the member’s age.

(6) A request under paragraph (5) must be made to the member’s former employing authority, or appropriate administering authority where the member’s former employing authority has ceased to be a Scheme employer.

(7) Before determining whether to agree to a request under paragraph (5), the member’s former employing authority, or appropriate administering authority as the case may be, must obtain a certificate from an IRMP as to whether in the IRMP’s opinion the member is suffering from a condition that renders the member permanently incapable of undertaking any gainful employment.

(8) In this regulation, “gainful employment”, “IRMP” and “permanently incapable” have the same meaning as given to those expressions by regulation [20\(14\)](#).”

7. Regulation 31(2) certainly confers a discretion on the deferred member to apply for early payment which makes perfect sense given that there is no requirement on the former scheme employer to track the health of deferred members. But that in itself does not necessarily confer any discretion on the scheme employer to consider non-medical issues in determining whether early payment should be made.

8. However, the words “Before determining whether to agree to a request under paragraph 2” where they appear in Regulation 31(4), clearly infers that scheme employers enjoy a degree of latitude in deciding whether or not early payment should be made, independent of the medical opinion from the Independent Registered Medical Practitioner.

9. These provisions were carried forward into Regulation 38 of the Local Government Pension Scheme 2013 –

“38. —(1) A deferred member who, because of ill-health or infirmity of mind or body—

- (a) becomes permanently incapable of discharging efficiently the duties of the employment that member was engaged in at the date the member became a deferred member, and
- (b) is unlikely to be capable of undertaking gainful employment before normal pension age, or for at least three years, whichever is the sooner,

may ask to receive payment of a retirement pension whatever the member’s age.

(2) A request under paragraph (1) must be made in writing to the deferred member’s former Scheme employer or appropriate administering authority where the member’s former Scheme employer has ceased to be a Scheme employer.

(3) **Before determining whether or not to agree to a request** under paragraph (1), the deferred member’s former Scheme employer, or administering authority, as the case may be, must obtain a certificate from an IRMP as to whether the member is suffering from a condition that renders the member—

- (a) permanently incapable of discharging efficiently the duties of the employment the member was engaged in because of ill-health or infirmity of mind or body; and, if so,
- (b) whether as a result of that condition the member is unlikely to be capable of undertaking gainful employment before reaching normal pension age, or for at least three years, whichever is the sooner.

(4) A deferred pensioner member who, because of ill-health or infirmity of mind or body, is unlikely to be capable of undertaking gainful employment before normal pension age, may ask to receive payment of a retirement pension at any time before the member’s normal pension age.

(5) A request under paragraph (4) must be made to the deferred pensioner member’s former Scheme employer, or appropriate administering authority where the member’s former Scheme employer has ceased to be a Scheme employer.

(6) Before determining whether to agree to a request under paragraph (4), the deferred pensioner member’s former Scheme employer, or administering authority, as the case may be, must obtain a certificate from an IRMP as to whether the member, as a result of ill-health

or infirmity of mind or body, is unlikely to be capable of undertaking [gainful employment](#) before normal pension age.

(7) If the Scheme employer is not the deferred or deferred pensioner member's appropriate administering authority, it must obtain that authority's consent to the appointment of an IRMP under this regulation.

(8) An IRMP appointed under paragraph (6) may be the same IRMP who provided the first certificate under regulation 36(1) (role of the IRMP). ”

10. Although both the 2007 and 2013 Regulations conferred a discretion of some kind on scheme employers over whether or not deferred benefits should be released on ill-health grounds, neither regulations offer any indication about the scope or nature of that discretion.

11. This is at odds with similar discretions listed at Regulation 60 of the 2013 Regulations where scheme employers are required to publish their policy on how the prescribed discretionary powers are to be exercised –

“60. —(1) A Scheme employer must prepare a written statement of its policy in relation to the exercise of its functions under regulations—

(a) [16\(2\)\(e\)](#) and [16\(4\)\(d\)](#) (funding of additional pension);

(b) [30\(6\)](#) (flexible retirement);

(c) [30\(8\)](#) (waiving of actuarial reduction); and

(d) [31](#) (award of additional pension),

and an administering authority must prepare such a statement in relation to the exercise of its functions under regulation 30(8) in cases where a former employer has ceased to be a Scheme employer.”

Conclusions

12. Although it is possible, as did the Pensions Ombudsman, to conclude that the changes made in the 2007 and 2013 Regulations altered the basis of whether or not deferred benefits should be released early on ill-health grounds from one of entitlement to one of discretion, it is perhaps anomalous that nowhere in the regulations are deferred members made aware of the factors that their former scheme employer may take into account in refusing an application for early payment.

13. The 2013 Regulations require the scheme employer to obtain a certificate from an IRMP before they are able to consider whether or not to agree to the early payment, but what other factors could a scheme employer take into account?

Scope of discretion

14. A scheme employer is subject to general public law and must act fairly, reasonably and honestly in exercising any discretion conferred on them. In general, this means that they should not rely on any irrelevant factors and must not reach any decision that is so unreasonable that no reasonable person could have come to the same decision. In his

determination, the Pensions Ombudsman also cited case law to demonstrate that a scheme employer was entitled to take into account its own financial circumstances when exercising a discretion. On that basis, one option would be to leave the 2013 Regulations as they are and rely on the scheme's Internal Dispute Resolution Procedure, the Pensions Ombudsman and ultimately, the Courts, to consider and resolve any perceived injustice.

15. If Regulation 38 is left as it is to allow scheme employers a discretion over the early payment of deferred benefits in line with the Pensions Ombudsman's determination, it would nevertheless be helpful to deferred members, scheme employers and those responsible for reviewing any decision not to award early payment, to amend Regulation 60 of the 2013 Regulations to require scheme employers to include the exercise of their discretion under Regulation 38 as part of their written statement. This would help to ensure that all interested parties are aware of the factors a scheme employer will take into account when considering applications for early payment. In particular, it would give deferred members an early indication of what their former scheme employer will take into account to help formulate their decision about applying for the early payment of their deferred benefit.

16. Guidance could also be published by the Scheme Advisory Board to assist scheme employers prepare that part of their written statement regarding the exercise of their discretion under Regulation 38 of the 2013 Regulations.

17. That said, an interesting question is whether Regulation 38 would allow a scheme employer to exercise their discretion to award the early payment of a deferred benefit in cases where the IRMP had certified that the deferred member was not permanently incapable of performing the duties of their former employment. Regulation 32(10) of the 2013 Regulations may offer a clue. It provides that a pension to be paid under Regulation 38 can only be paid from the date of the determination that the member is permanently incapable under that regulation. It is questionable therefore whether a scheme employer would be acting lawfully if it went against the IRMP's opinion that the deferred member was not permanently incapable and awarded a deferred member the early payment of their pension.

18. A supplementary question is whether Regulation 38 has things in the right order. If it is accepted that an application for early payment can be refused on the grounds of cost or any other relevant and rational non-medical factor, why should the employer and deferred member be required to go through the IRMP process and incur costs where the scheme employer has already decided to refuse the application on non-medical grounds? The counter argument is that contemporaneous and independent medical opinion will always be valuable if the deferred member seeks redress against any decision by the scheme employer, whether decided on medical grounds or not, to refuse the application.

19. Consideration is next given to whether affording scheme employers an element of discretion in determining applications under Regulation 38 can be justified in policy terms.

Is the discretionary element defensible?

20. DCLG officials have been asked to confirm that the change in wording in the 2007 and 2013 scheme regulations was a deliberate shift in policy. To date, no such confirmation has been forthcoming. It is also clear from recent discussions that DCLG officials are unwilling to approach Ministers with advice to remove the discretionary element of Regulation 38.

21. It is relevant to compare the LGPS 'position against those of other major public service pension schemes. As can be seen below from the examples of the Teachers, Civil Service and Police pension schemes, the LGPS is alone in affording scheme employers a discretion to overrule the opinion of the independent medical examiner. In every case apart from the LGPS, entitlement to the early payment of deferred benefits on ill-health grounds is solely dependent on the decision of the medical examiner whose decision, subject to appeal, is final.

Teachers' Pension Scheme –
“Entitlement to ill-health pension

*110.—(1) A member (P) **is entitled** to payment of an ill-health pension from the entitlement day if—*

- (a) P is qualified or re-qualified for retirement benefits;*
- (b) P has not reached normal pension age;*
- (c) P has left all eligible employment;*
- (d) P has applied under regulation 162 for payment of an ill-health pension;*
- (e) P has not applied under that regulation for payment of any other retirement pension; and*
- (f) the scheme manager is satisfied after consideration of a medical report—*
 - (i) if paragraph (2) applies, that P meets the incapacity condition and the total incapacity condition; or*
 - (ii) if paragraph (3) applies, that P meets the incapacity condition.”*

Civil Service Pension Scheme –
“8.5. What happens after an EPPA application is sent to the Scheme Medical Adviser?

When they have considered the case a Certificate either supporting or turning down the application will be sent to the employer (or MyCSP). MyCSP can award benefit from ‘the day the request for early payment was received by the employing department’ (Pensions Manual, Members’ Benefits volume 2, Para. 3.3.17., Table 2).”

Police Pension Scheme –

“Referral of medical questions for purpose of early payment of a full retirement pension on grounds of permanent medical unfitness

76.—(1) Before considering whether a deferred member of this scheme **is entitled to early payment** of a full retirement pension on grounds of permanent medical unfitness, the employer must refer the following questions to a selected medical practitioner for decision—

- (a) whether the member is medically unfit for performing the ordinary duties of a member of the police force;*
- (b) whether that medical unfitness is likely to be permanent;*

(c) whether the member is medically unfit for engaging in any regular employment; and

(d) whether that medical unfitness is likely to be permanent.

(2) The selected medical practitioner must—

(a) examine or interview the member as the selected medical practitioner thinks appropriate;

(b) decide the questions referred to the selected medical practitioner under paragraph (1); and

(c) give the employer and the member a report containing a decision on those questions.

*(3) **That report is final**, subject to—*

(a) an appeal under Schedule 1 against the decision of the selected medical practitioner; or

(b) the referral under Schedule 1 of the decision of the selected medical practitioner for reconsideration.

(4) For the purpose of paragraph (1), “early payment” means payment before the member reaches the member’s state pension age⁽¹⁾. “

22. There is anecdotal evidence to suggest that DCLG’s decision in 2007 to introduce a discretionary element into the regulations governing the early payment of deferred benefits on ill-health grounds was based on the premise that the former scheme employer has no say in any application being made by the deferred member in contrast to an active scheme member where the scheme employer is responsible for both terminating the employment on ill health grounds and determining entitlement to ill-health benefits.

23. It is clear, however, that no other major public service scheme has seen fit to emulate the changes made to the LGPS in 2007. It is reasonable therefore to assume that the other schemes are content to allow the final decision to rest with the decision of the independent medical examiner and to make entitlement to the early payment of benefits on ill-health grounds subject to that decision and that decision alone.

24. Serious questions must therefore be asked of DCLG why it was felt necessary to afford scheme employers a wide discretion to refuse early payment on non-medical factors, for example, cost.

25. One possible explanation is that as a funded scheme, the payment of ill-health benefits is a direct cost on scheme employers which is not the case in the other unfunded schemes.

Should cost be a relevant factor?

26. Regulation 68(1) of the 2013 Regulations provides that :-

“Employer’s further payments

68. —(1) *Any extra charge on the appropriate fund resulting from a member becoming entitled to benefits under regulation 35 (early payment of retirement pension on ill-health grounds) or 38 (early payment of retirement pension on ill-health grounds: deferred and deferred pensioner members) must be paid into the fund by the Scheme employer concerned.*”

The key words here are “further” and “extra” which clearly indicates that there is some other charge made to cover the cost of employers’ ill-health retirement cases over and above what has been set aside in the valuation process and employers’ contribution rates. Although the practice may differ between the four actuarial firms, it is understood that the general approach is for the fund actuary to make an assumption about the incidence of ill-health retirement at fund level at each triennial valuation and for this cost to form part of the contribution rate calculated for each employer.

27. In the recent case of *Mrs R v Trafford Council*, the Pensions Ombudsman referred to the fact that the GMPF had calculated a capital cost allowance for ill-health retirements for each of their employers, including Trafford, and that any cost above that allowance would need to be paid to the fund by Trafford. It is reasonable to assume that the GMPF are relying on the provisions of Regulation 68 to make such charges.

28. If this is correct, the position is that in some cases, the early payment of deferred benefits would not attract an extra charge under Regulation 68 because the capital allowance has not been exceeded, whereas in other cases, a charge would need to be made in those cases where the allowance had been exceeded.

29. In the case of *Mrs R v Trafford*, the capital cost of paying her benefits early was said to be £400,000. The amount of the capital allowance that the GMPF allowed Trafford for its ill-health retirements was not disclosed, but whatever the amount, it is clear that determining an application for early payment on the basis of whether or not the employer would need to make an “extra charge” under Regulation 68 would depend almost entirely on the irrelevant fact of when the application was made. It is more than reasonable to assume that applications made early in the valuation period are unlikely to incur this “extra charge” with the cost being subsumed in the employers’ contribution rate set out in the rating and adjustment certificate. On the other hand, an application made later in the valuation period is more likely to attract an “extra charge” and be refused on the grounds of cost.

30. And what if the capital cost of paying a deferred benefit early is said to be £400,000, but the employer in question has £200,000 left in their capital allowance for ill-health retirements? Does the deferred member only get half their benefits or does the employer refuse the application on the grounds that it has incurred an extra charge, though not the full extent of the capital cost?

31. It is therefore difficult not to come to the conclusion that consideration of how ill-health benefits are paid for under the 2013 Regulations in determining whether or not an application should be granted is both unfair and perverse.

32. Returning Regulation 38 of the 2013 regulations back to the pre-2007 position of entitlement would be one solution. Another would be to remove early payments under Regulation 38 from the remit of Regulation 68. In other words, employers would only be faced with the prospect of making “extra charges” under regulation 68 where ill-health benefits have been awarded to active members. This would of course depend on tie

comparative numbers of ill-health retirements between active and deferred members and whether removing “extra charges” from early pensions paid under Regulation 38 would represent an unfair and disproportionate cost to other employers in the fund through higher employer contribution rates.

33. Work should also be undertaken to assess the extent to which “extra payments” under Regulation 68 are being made to fund ill-health retirements above employers’ capital allowance. It is possible that the allowances for ill-health retirements in the valuation process are generous enough to prevent “extra charges” being made by administering authorities under Regulation 68.

34. Making individual employers responsible for the cost of unusually high levels of ill-health retirements was a key response to the Audit Commission’s “Retiring Nature” back in the 1980s but it is unlikely that it was ever intended to use the funding mechanism described above as the basis for determining whether or not deferred benefits should be paid early on ill-health grounds. Ideally, a way should be found in the regulations to remove any arbitrary or unfair exercise of the discretion in Regulation 38 without disturbing the discipline of employers meeting the costs of high levels of ill-health retirements.

Recommendation

35. That the Cost Management, Benefit Design and Administration Committee considers this paper with a view to recommending to SAB that DCLG is asked to review Regulations 38 and 68 of the 2013 Regulations to clarify their policy position and, in particular, whether the cost implications for an employer approving the early payment of deferred benefits on ill-health grounds is an appropriate factor in determining whether or not to agree to an application.

36. Before any representations are made to DCLG, work should be undertaken by the secretariat to evidence both the extent to which discretion is being exercised by scheme employers under Regulation 38 and the basis on which ill health benefits under that regulation are funded either as part of their employer contribution rate or “extra payments” under Regulation 68 of the 2013 Regulations.

37. The Cost Management, Benefit Design and Administration committee may also wish to consider whether the circumstances in which deferred benefits are brought into payment early on ill-health grounds should form part of the proposed wider review of ill-health retirement under the 2013 Regulations.

Bob Holloway
Pensions Secretary
Local Government Association

20 February 2017