AGENDA ITEM 6

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

Paper D : Late retirement factors

Initial paper submitted to DCLG

Local Government Pension Scheme

Late Retirement Factors

Issue

In 2016, new late retirement factors were introduced. These factors calculate the additional pension to be awarded to members who retire after attaining their normal pension age (NPA). The factors are applied at the date of retirement and applied to the period between NPA and retirement.

New factors had been prepared by the Government Actuary's Department (GAD) ready for publication by DCLG in April 2016. However, because of concerns raised about the significantly less favourable new factors and the impact this would have on members who had already given formal notice of their retirement based on the more favourable set of factors, the decision was taken to delay publication to allow for further consideration.

Following discussion between DCLG and the LGA, the decision was taken to publish the new factors later in 2016 with an effective date three months after publication. This would ensure that those members contemplating retirement after their NPA would be fully aware of what factors would be applied to calculate the amount of additional pension.

Despite this precaution, there was still some unrest about the way in which the new factors had been implemented. Concerns were also raised about the impact the unexpected implementation of less favourable factors could have on members planning their retirement date.

Because of these concerns, the local government Minister, Marcus Jones, wrote to the scheme advisory board on the 27th March asking it to come forward with recommendations for change by September 2017. In particular, the Minister invited specific recommendations on the future implementation of factors and the appropriateness of the salary growth assumption underlying them.

Background

The award of additional pension to members retiring after their NPA is provided under Regulation 30(4) of the Local Government Pension Scheme 2013 –
"30(4) A member who starts to receive payment of a retirement pension from a date after that member's normal pension age is entitled to enhancement of the pension by the amount shown as appropriate in actuarial guidance issued by the Secretary of State."

It is important to note that the regulation itself makes no reference to the way in which the additional pension is to be calculated. All the details are included in the actuarial guidance published under Regulation 30(4) which suggests that most changes resulting from recommendations made by the Board could be achieved by amendments made to the actuarial guidance leaving Regulation 30(4) as it is.

However, if the outcome is for additional pension to be awarded on an annual basis by way of additions to a member's pension pot, the scope of Regulation 23 of the LGPS Regulations 2013 may need to be extended to allow for additional pension awarded under Regulation 30(4) to be included. Other, related amendments to the regulations may be necessary.

Options for change

Options for change include –

- Extending the period between publication of new factors and their application from the 3 months adopted in 2016;
- Improving communication between DCLG and fund authorities to ensure that all affected scheme members are aware of any new factors;
- Encouraging GAD to introduce more regular reviews of actuarial factors;
- Reviewing the salary growth assumption underlying the factors, and
- Moving to an arrangement where additional pension is awarded on a more regulations basis rather than at the single point in time on retirement.

These options are described in more detail below.

Extending the effective date period

Extending the period between publication of any new factors and when they come into effect would help to overcome some of the communication issues referred to earlier in this paper but would do nothing to alleviate any unfairness of applying them at a single point in time for the duration of the period of membership after NPA or the underlying salary growth assumption. Extending the effective date period alone is therefore unlikely to address most of the concerns raised by stakeholders.

Improving communication

Steps have already been taken to ensure that the publication of actuarial guidance by DCLG is sent to the appropriate contact point in each fund authority. DCLG should, as a matter of good practice, review their distribution list on a regular basis and remind fund authorities of their responsibility to inform DCLG of any changes.

Regular review of actuarial factors
The review of actuarial factors must be left to the professional judgement of DCLG's GAD advisors. Clearly, the longer the period between reviews, the more likelihood there is of significant changes to the factors being made. This was certainly the case with the less favourable late retirement factors published last year though it is difficult to assess the extent to which this was due to changing circumstances since the previous review or the choice of the underlying salary growth assumption. But whatever the reason, the regular review of actuarial factors should be a matter of best practice.

Reviewing the salary growth assumption

The late retirement factors published last year were based on a salary growth assumption of 4.7% **[check with GAD].** With public sector pay continuing to be subject to pay freeze with average pay increases in the range of 1% per annum, concerns continue to be raised about the alleged unrealistic level at which future salary growth is being set and the effect this has in depressing the level of additional pensions being awarded to late retirees.

Regular award of additional pension

All of the above options for change would, to some extent, improve the way in which additional pension is awarded to late retirees but would do nothing to address the major concern of new factors, often less favourable, being applied retrospectively to the entire period of membership between NPA and retirement.
This could be overcome by a change in the actuarial guidance to award additional pension on a more regular basis, for example, by making annual additions to the member's CARE pension pot. Informal discussions with GAD suggests that this would be achievable and would represent a more equitable way of awarding additional pension to late retirees.

Conclusion

In order of priority, the following options for change are recommended –

- GAD is commissioned to prepare a paper to explain how the salary growth assumption impacts on the level of additional pension awarded under Regulation 30(4) and what options are available to set a different salary growth assumption. The paper should also cover the effect of different salary assumptions on both the fund and individual scheme members.
- GAD is commissioned to prepare a paper discussing the feasibility and implications of moving to a more regular award of additional pension;
- DCLG to establish a robust procedure to ensure that electronic communications with fund authorities are reliable and that contact details are updated on a regular basis
- GAD to ensure that all actuarial factors are reviewed on a timely and opportune basis.

Recommendation – that the committee approves the paper as a basis for ongoing discussions with DCLG and GAD