



Government Actuary's Department

The LGPS Scheme Advisory Board

III Health Regulatory Framework Review – Initial costings

Date: 4 June 2015

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Introduction

1. DCLG, at the request of the LGPS Scheme Advisory Board ('SAB'), have asked GAD to cost various possible reforms to the LGPS ill health benefits. As requested, these have been done on data, methodology and assumptions consistent with those used for the scheme reform calculations (as described in Ian Boonin's letter to Bob Holloway of 30 May 2012). We have based the scenarios to be costed on Lynda Jones paper of 11 November 2014 (attached as Annex B) and discussions with DCLG and LGA.
2. The data, methodology and assumptions are discussed further in the report below. Annex A contains limitations

Results - Baseline

3. Table 1 shows the cost of providing the current ill health benefits (over and above the cost of providing those members with a deferred pension) broken down by Tiers.
4. The 0.81% cost corresponds to the 0.80% cost shown in GAD's note *Build up of costs and cost reconciliation tables for scheme reform*.¹ The difference is due to us modelling Tier 3 explicitly and other minor modelling differences.

	Assumed distribution between tiers	Total net cost of ill health benefits	consisting of cost of:	
			enhancement to benefits	immediate payment
Tier 1	75%	0.75%	0.55%	0.20%
Tier 2	10%	0.04%	0.02%	0.02%
Tier 3	15%	0.02%	0.01%	0.01%
Total	100%	0.81%	0.58%	0.23%

5. The Tier 3 cost includes the cost of the 20% of Tier 3 retirements who we assume eventually move to Tier 2. This is not double counted in the Tier 2 cost. The cost of enhancement of benefits under Tier 3 is in respect of this 20%.

¹ 30 May 2012, provided in conjunction with Ian Boonin's letter of the same date.



Results – Benefit change options

6. We have costed the following options from the 11 November 2014 paper:
- > Baseline – the current cost of ill health benefits, modelled in more detail
 - > Option 1 – Tier 3 is removed. We have assumed that all those who would be eligible for Tier 3 receive Tier 2 benefits instead.
 - > Option 2 – Tier 3 removed and the eligibility condition widened. As with Option 1 we have assumed that all those who would have received Tier 3, and those newly eligible receive Tier 2 benefits.
 - > Cost saving option A – we have modelled the saving from removing pensions from ill health retirees who return to public sector work
 - > Cost saving option B – we have modelled the saving from only giving enhanced ill health benefits to members who have at least 5 years service.
7. Table 2 shows the relative cost or saving of the various proposed options. The savings were calculated relative to option 1 for simplicity. We would not expect there to be a material difference if we calculated them relative to option 2 or the current benefits.
8. For those options where we do not have sufficient data to set a robust assumption we have shown a number of scenarios in order to give an indication of the sensitivity to the assumption and the order of magnitude cost impact of the benefit change.

Table 2 – additional cost or saving of proposed options

Variant options	cost (saving) as % of pay
Option 1 – remove Tier 3	0.05%
Option 2 – remove Tier 3 and widen eligibility criteria	
assuming 5% more members eligible	0.07%
assuming 10% more members eligible	0.09%
assuming 25% more members eligible	0.15%
Saving option A - Cease pensions to ill health retirees who later rejoin the public sector	
assuming 1% rejoin	not material
assuming 10% rejoin	(0.04%)
Saving option B - No enhancements paid to members with less than 5 years service	(0.10%)

9. The removal of Tier 3 is implicitly assumed in all the costs and savings shown in Table 2.



10. We have not costed the effect of changing deferred members' eligibility for an ill health, as this is not material to the overall cost of the ill health benefits.
11. Although we do not have data to set a robust assumption, we would expect the most likely scenarios of those shown to be:
- > for Option 2, the variant where the number of eligible members increases by 10%, and
 - > for Saving option A, the variant where 1% of ill health retirees rejoin the public sector.

Results – Paying for the increase in benefits

12. Table 3 shows the reduction that would be required in the enhancement tiers to pay for these changes, ie so that these changes would have no net effect had they been implemented together at the time of scheme reform.
13. We have shown Table 3 in three parts.
- > With the reduction to Tier 1 benefits only,
 - > With the reduction to Tier 2 benefits only, and
 - > With the reduction to both Tiers proportionately.
14. Note that we have not shown saving option A as an offsetting option as the likely saving from that option would be immaterial. The effect will be the same (up to materiality) as where there is no offsetting option.
15. In the tables below:
- > 'Not required' means that the offsetting saving more than compensates for the additional costs of option 1 or 2 respectively. So there is no need to also reduce the enhancement to balance the costs.
 - > 'Not possible' means that no amount of reduction in the enhancement would offset the additional cost of option 1 or 2 respectively. .



Table 3A – effect of recovering costs by reducing enhancements on Tier 1 only

Variant options	Offsetting option	Tier 1	Tier 2
Current benefits		100%	25%
Option 1 – remove Tier 3	None	91%	25%
Option 2 – remove Tier 3 and widen eligibility criteria			
assuming 5% more members eligible	None	87%	25%
assuming 10% more members eligible	None	83%	25%
assuming 25% more members eligible	None	71%	25%
Option 1 – remove Tier 3	Saving option B - 5 years service	Not required	Not required
Option 2 – remove Tier 3 and widen eligibility criteria			
assuming 5% more members eligible	Saving option B - 5 years service	Not required	Not required
assuming 10% more members eligible	Saving option B - 5 years service	Not required	Not required
assuming 25% more members eligible	Saving option B - 5 years service	88%	25%



Table 3B – effect of recovering costs by reducing enhancements on Tier 2 only

Variant options	Offsetting option	Tier 1	Tier 2
Current benefits		100%	25%
Option 1 – remove Tier 3	None	Not possible	Not possible
Option 2 – remove Tier 3 and widen eligibility criteria			
assuming 5% more members eligible	None	Not possible	Not possible
assuming 10% more members eligible	None	Not possible	Not possible
assuming 25% more members eligible	None	Not possible	Not possible
Option 1 – remove Tier 3	Saving option B - 5 years service	Not required	Not required
Option 2 – remove Tier 3 and widen eligibility criteria			
assuming 5% more members eligible	Saving option B - 5 years service	Not required	Not required
assuming 10% more members eligible	Saving option B - 5 years service	Not required	Not required
assuming 25% more members eligible	Saving option B - 5 years service	100%	6%



Table 3C – effect of recovering costs by reducing enhancements both Tiers proportionately

Variant options	Offsetting option	Tier 1	Tier 2
Current benefits		100%	25%
Option 1 – remove Tier 3	None	92%	23%
Option 2 – remove Tier 3 and widen eligibility criteria			
assuming 5% more members eligible	None	88%	22%
assuming 10% more members eligible	None	85%	21%
assuming 25% more members eligible	None	75%	19%
Option 1 – remove Tier 3	Saving option B - 5 years service	Not required	Not required
Option 2 – remove Tier 3 and widen eligibility criteria			
assuming 5% more members eligible	Saving option B - 5 years service	Not required	Not required
assuming 10% more members eligible	Saving option B - 5 years service	Not required	Not required
assuming 25% more members eligible	Saving option B - 5 years service	91%	23%

Next Steps

16. These costings should enable SAB together with DCLG to decide which of these options they wish to consider further. We would be very happy to provide further advice as required.



Data, methodology and assumptions

17. Except as described below, the data methodology and assumptions used are as used for the scheme reform costings as described in Ian Boonin's letter to Bob Holloway of 30 May 2012.

Data

18. This is the same as that used in the scheme reform costings and was taken from the 2010 National Model Fund work and is summarised in the table below.

	Number	Total FTE Salaries (£ billion pa)	Average Age
Males	495,000	14.0	46.2
Females	1,286,000	28.5	44.8
Total	1,781,000	42.5	45.3

Methodology

19. Conceptually the results in this report represent answers to the question “had the LGPS adopted this scheme design for reform, what difference would that have made to the scheme reform calculations?” For the avoidance of doubt we have not updated these results for new data or assumptions, such as those adopted for the 2013 valuation under HMT directions.

20. However, these results have required in some cases more detailed modelling than would be appropriate when modelling the costs of the scheme as a whole; some small effects are material in this context but would not be when considering the cost of all the benefits in aggregate. Therefore we have had to make some adjustments to the methodology and adopt some additional assumptions. For example we have modelled the cost of Tier 3 benefits explicitly.

21. Further, in order to avoid artificially changing the overall mortality assumption we have carried out calculations using the ill health member mortality assumption when calculating the cost of ill health and deferred benefits for relevant members. Conceptually this is to say that allowing more members to retire, or changing the structure of benefits won't affect members' life expectancy.

22. In modelling the options and scenarios we have assumed that the age and gender profile of membership is the same for all the tiers and for all additional ill-health retirements. We have further implicitly assumed that changing the benefits has no effect on member behaviour or experience.



Assumptions

23. However for some of these costings we need additional assumptions which were not required for the scheme costings (either because of greater detail in the modelling or new benefit designs being considered).
24. We have used additional assumptions for:
- > The proportion of Tier 3 Ill health pensioners who move onto Tier 2. We have used 20% in line with our assumption used for factors work.
 - > The effect of widening the ill health criteria: We don't have much evidence for setting this assumption. The limited data DCLG helpfully provided to us from one LGPS Fund shows that experience is quite volatile but the effect ranges between about a 5% and about a 20% increase in numbers eligible, in the years for which data is available. Therefore we show the effect of increasing ill health retirements rates by 5%, 10% and 25%, all of which are in Tier 2.
 - > The proportion of ill health retirees who return to public service employment. Based on limited evidence from the scheme we estimate that broadly 1% of Ill Health retirees may return to public service. We also show the effect of allowing for 10% to return to indicate the potential impact of this assumption.
 - > We have assumed that where such members return to public sector employment they do so after three years.



Annex A – Limitations

25. In preparing this report, GAD has relied on data and other information for the scheme reform costings as described in Ian Boonin's letter of 30 May 2012. GAD has relied on the general completeness and accuracy of the information supplied without independent verification.
26. This note has been prepared for the DCLG, on the understanding it will be shared with SAB. We are content for DCLG to release this note to third parties, provided that:
- > it is released in full
 - > the advice is not quoted selectively or partially, and
 - > GAD is identified as the source of the note.
27. Third parties whose interests may differ from those of the Department should be encouraged to seek their own actuarial advice where appropriate.
28. Other than the DCLG and SAB, no person or third party is entitled to place any reliance on the contents of this note, except to any extent explicitly stated herein, and GAD has no liability to any person or third party for any act or omission taken, either in whole or in part, on the basis of this note. If any contents of this note are to be used to inform any Government policy decisions GAD should be consulted before those decisions are made.

Annex B – Paper specifying options to be costed

Local Government Pension Scheme

Review of the LGPS ill health regulatory framework – draft proposals to be submitted to GAD for costing against the expected cost envelope for ill health benefits, currently 0.8% of the 19.5% of payroll for the 2014 scheme future costs.

The LGPS shadow advisory board, administration and communications sub committee, is reviewing the current ill health regulatory framework as part of the introduction of the 2014 Scheme. Their aim is to better align the framework to the diverse occupations within the Scheme membership and reduce any unnecessary administration and appeals. DCLG has an observer role and GAD is commissioned on behalf of DCLG and the shadow advisory board.

These proposals form a basis for a further discussion when indicative costs have been established. These are not final proposals but will inform the decision making process going forward.

Proposed scheme design for ill health retirement regulatory framework

This would be a new framework to take effect when a statutory instrument is made and laid. There would be no retrospective effect and the effective date, for costing purposes, should be deemed as 1 April 2015.

Option 1 to be costed

Eligibility criteria

1. An active member who has qualifying service for a period of two years and whose employment is terminated by a Scheme employer on the grounds of ill-health or infirmity of mind or body before that member reaches normal pension age, is entitled to, and must take, early payment of a retirement pension if that member satisfies the conditions below.
2. Normal pension age is the member's state pension age.
3. The first condition is that the member is, as a result of ill-health or infirmity of mind or body, permanently incapable of discharging efficiently the duties of the employment the member was engaged in.
4. The second condition is that the member, as a result of ill-health or infirmity of mind or body, is not immediately capable of undertaking any gainful employment.

5. Gainful employment means paid employment for not less than 30 hours in each week for a period of not less than 12 months.

Option 2 to be costed

Eligibility criteria

6. An active member who has qualifying service for a period of two years and whose employment is terminated by a Scheme employer on the grounds of ill-health or infirmity of mind or body before that member reaches normal pension age, is entitled to, and must take, early payment of a retirement pension if that member satisfies the condition below.
7. Normal pension age is the member's state pension age.
8. The condition is that the member is, as a result of ill-health or infirmity of mind or body, permanently incapable of discharging efficiently the duties of the employment the member was engaged in.

There would be two tiers of retirement benefits regardless of the conditions to be satisfied

9. Tier 1 - A member is entitled to Tier 1 benefits if that member is unlikely to be capable of undertaking gainful employment before normal pension age.
10. Tier 2 - A member is entitled to Tier 2 benefits if the member is likely to be capable of undertaking gainful employment at some point before the member's normal pension age.

Decision making in both option 1 and option 2

11. The Scheme employing authority makes the decision whether or not to terminate employment on the grounds of ill-health or infirmity of mind or body but only after the administering authority has obtained a certificate from an IRMP as to whether the member satisfies the conditions and, if so, whether the member is likely, or unlikely, to be capable of undertaking gainful employment before their normal pension age and, having considered the IRMP's certificate, confirmed to the Scheme employing authority whether the member meets the criteria for an award of an ill health pension and, if so, the Tier to be awarded.

12. Following the termination of employment by the Scheme employing authority, the administering authority awards the relevant retirement benefits.
13. All decisions should be made while the member is an active member. The member should receive notification of termination of employment and confirmation of the type of benefits to be awarded (e.g. deferred benefit, Tier 1 ill health pension or Tier 2 ill health pension) at the same time and, where Tier 1 or Tier 2 benefits are to be awarded, the benefits become payable from the day after the date of termination of employment.
14. The independent registered medical practitioner (IRMP) is asked to provide a signed certificate giving their opinion as to whether a member meets the criteria for early payment of immediate retirement benefits and, if so, which tier the member qualifies for.
15. The IRMP is also asked to give an opinion where a member has within the previous 12 months continuous membership (or such longer period of membership as the employer may specify) reduced their contractual hours (or has moved to a job on a lower grade or with less responsibility) and has had reduced pay as a consequence of that change. The IRMP's opinion should state whether that change in circumstances was wholly or partly as a consequence of the ill-health or infirmity of mind or body which resulted in the current assessment for the release of ill health retirement benefits.

Reviews

16. There will be no Tier 3 entitlements. For the purposes of costing these proposals, there will be no review of a Tier 1 or Tier 2 award. To note that this may be subject to change at a later stage should it be decided that a review mechanism is required for one or both of Tiers 1 and 2 following consideration by Ministers, Treasury or officials.

Entitlements if conditions met:

17. Tier 1 benefits– full enhancement to normal pension age - are calculated by adjusting the active member's pension account by adding an amount to the balance in the account for the year in which the member's employment was terminated, equivalent to the amount of earned pension the member would have

accrued between the day following the date of termination and normal pension age, if that member had been treated as receiving assumed pensionable pay for each year and fraction of a year in that period and treating any election under the 50/50 option as lapsed at the date of the termination of the member's employment. The retirement pension is payable to the member as if the member had reached normal pension age on the date the member's employment was terminated.

18. Tier 2 benefits – 25% enhancement to normal pension age - are calculated by adjusting the active member's pension account for the year in which the member's employment was terminated by one quarter of the sum calculated for a Tier 1 award and the retirement pension is payable to the member as if the member had reached normal pension age on the date the member's employment was terminated.

Reduction in pay following a reduction of hours as a result of the condition that lead to an ill health retirement

19. In calculating the assumed pensionable pay for the ill health enhancement calculation, no account of the reduction in pay will be taken if the IRMP certifies that, in their opinion, the reduction of pay was attributable to the ill health condition being considered, provided the reduction in pay began within the previous 12 months continuous membership (or such longer period of membership as the employer specified).

Cost implications for removing Tier 3

20. There are some options for meeting that additional cost which are:
- by how much would the Tier 1 enhancement be reduced if all the additional cost was recovered by a reduction in the level of Tier 1 enhancement?
 - by how much would the Tier 2 enhancement be reduced if all the additional cost was recovered by a reduction in the level of Tier 2 enhancement?
 - by how much would both the Tier 1 and Tier 2 enhancements be reduced if all of the additional cost was recovered by a proportionate reduction in the level of Tier 1 and Tier 2 enhancements?

- what would be the level of savings if entitlement to an enhanced ill health pension only arose after 5 years of LGPS membership but only an accrued pension were granted to members who had met the 2 year vesting period but had less than 5 years LGPS membership?

Request from a deferred member for early release of retirement benefits on ill health grounds. [No reference to deferred pensioner member is made as this category of members would cease to exist].

Eligibility criteria

21. A deferred member who, because of ill-health or infirmity of mind or body becomes permanently incapable of discharging efficiently the duties of the employment that the member was engaged in at the date the member became a deferred member and is unlikely to be capable of undertaking gainful employment before normal pension age, may ask to receive payment of a retirement pension whatever the member's age.
22. A request must be made by the member in writing to the administering authority that made the deferred award. The relevant administering authority must obtain a certificate from an IRMP which gives the IRMP's opinion as to whether or not the member is suffering from a condition that renders the member permanently incapable of discharging efficiently the duties of the employment that the member was engaged in at the date the member became a deferred member and, as a result of that condition, the member is unlikely to be capable of undertaking gainful employment before normal pension age.
23. The administering authority determines, based on the IRMP certificate, whether the conditions are met and retirement benefits can be released. If the conditions are met, the retirement benefits payable are the amount of the retirement pension that would have been payable to the member if that member had reached normal pension age on the date from which benefits are awarded (ie there is no enhancement).
24. Additionally, what savings would be realised if the criteria for a deferred member was not that set out in paragraph 21 but was, instead, that the member has to be suffering from ill-health which makes the individual unlikely to be able (otherwise than to an insignificant extent) to undertake gainful work (in any capacity) before

reaching pensionable age. This is the HMRC 'severe ill health test' in section 229(3) (a) & (4), section 279(1) Finance Act 2004. This is requested as the relationship between the former LGPS employer and the member may have been severed many years earlier (and there may no longer be a job description detailing the work the member undertook for the former LGPS employer).

Return to public sector work

25. If the pensioner member becomes re-employed in the public sector, DCLG Minister's policy intention is that the pension should be abated. In the absence of a definition of 'public sector job', the initial costing exercise should be based on when a member returns to any public sector job and costed on the basis that abatement applies when the sum of the ill health pension in payment plus pay of the new employment, exceeds the 'assumed pensionable age' upon which the ill health enhancement had been determined. [Any definition could be linked to the Government's proposals for recovery of public sector exit payments]

DCLG/SSAB November 2014