

# **JOINT TRADE UNION SUBMISSION TO THE INDEPENDENT PUBLIC SERVICE PENSIONS COMMISSION LOCAL GOVERNMENT PENSION SCHEME**

## **INTRODUCTION**

This submission is on behalf of Unison, GMB and Unite in response to Lord Hutton's request for further evidence for the Commission's full report. It is in light of the unique context of the Local Government Pension Scheme which we do not think has been fully recognised that we are making this joint submission.

Collectively we represent 1.2m current, contributing members of the LGPS throughout the UK and many more with deferred pensions or pensions in payment.

Our two major concerns are: firstly that the **specific nature** of the LGPS is not being properly considered and solutions purporting to address issues with unfunded schemes are simply being applied to the funded LGPS without any consideration of the particular impact that will result on the scheme's four million members; and secondly that the announcement in the CSR relating to employee contributions fundamentally threatens the continued existence of the LGPS as a viable and sustainable pension scheme for the local government workforce.

## **INTERIM REPORT**

While we appreciated the Commission's determination to reject the 'race to the bottom' approach to public sector pensions we are concerned that the Commission's view of admission agreements in the context of Fair Deal undermines this principle. The unions maintain that the only way to achieve a level playing field in terms of providing pensions for outsourced services is for open admission agreements to be the standard with pass through of relevant costs agreed between the contractor and authority at the outset.

The interim report stated that the most effective way to make short term savings is to increase members' contributions. This is not the case in the LGPS which, as a funded scheme, is actuarially valued every three years when assumptions of income and expenditure are set for the following three years and reflected in employer contribution rates. Changes to benefits are therefore as able to result in short term savings as employee contribution increases and, we argue, have a much less devastating effect on scheme sustainability.

## **COMPREHENSIVE SPENDING REVIEW**

The Chancellor in the CSR announced what is in effect a 3% increase in employee contributions as part of a policy to save £1.8bn from the Annual Managed Expenditure (which relates to what are generally known as the 'Pay As You Go' schemes). Explicitly included in this policy is the LGPS, despite the fact that as a funded scheme the LGPS does not play a part in Annual Managed Expenditure and no automatic savings would be forthcoming as a result of the LGPS's inclusion. The 3% increase is therefore nothing more than a tax. The cash equivalent of 3% will be deducted from the settlement grant to local authorities so there will be no benefit to the scheme or employers. In fact the localised nature of the scheme means that the grant reduction will not accurately reflect the increased yield from employee contributions as that yield differs from fund to fund.

The unions believe the impact of the 3% increase in employee contributions will have devastating consequences on the sustainability of the LGPS. Our main reasons for this view are as follows:

1. Unlike other parts of the public sector, members covered by the LGPS have not only had their pay frozen but there have been pay cuts. In addition the protection for those earning less than £21,000 does not apply in local government leading to a specific effect on the capacity of LGPS members to increase their contributions to the scheme or to a pension 'levy'.
2. Protecting the lowest paid from the levy means the pressure on moderate earners will be intolerable for many. The membership profile for the LGPS is notably different to that of the other public sector schemes: 68.2% of members earn less than £22,000 a year while 87.3% of members earn less than £30,000 (full time equivalent). Unions estimate that in order to generate the 9.4% yield required by the Chancellor's announcement and protect only the lowest paid – those earning less than £18,900 – contribution rates for those earning more may have to almost double with a member earning £20,000 being required to pay 12%, an annual increase of more than £1,000 while someone on £33,000 would be contributing at a rate of 12.5% an increase of almost £2,000 a year. The limited number of members at the top of the earnings scale means that their contributions will have to increase still further, to 13.4% for someone earning £40,000 (a £2,280 annual increase in contributions) and to 14% for someone earning £100,000 (a £6,500 annual increase).
3. The volume of part time employees in the scheme, approximately 75% of members, will exacerbate the number of members opting out on grounds of affordability. Members' actual earnings can be low but because their contribution band is assessed on the basis of full time equivalent earnings they may well find themselves paying an unaffordable 12% of a low salary. Many of these scheme members, like those on moderate earnings will not be able to sustain membership and will therefore stop saving. Those on higher earnings may well find that a combination of high contribution rates and a career average scheme means that they no longer see merit in saving in the LGPS and they will seek other options for their retirement provision.
4. The consequence of increased opt-outs should not be underestimated. Not only will this mean an overall decline in pension saving but it will also make it more difficult to generate the 3% increase in yield targeted, potentially leading to even higher contribution rates as more money is sought from fewer members.
5. As GAD confirm that the future service cost of the LGPS is falling as was planned in the 2008 reforms (from 19.1% to 18.6% between 2007 and 2010), this increase in employee contributions alone means that employees will be paying more than employers for the current benefit. In addition, the saving from the cut in indexation from RPI to CPI is not included in GAD's assessment of the future service cost. This effect is likely to result in a substantial reduction as indicated by the PPI report in November 2010, however even using the same basis as the Pension Protection Fund, this would reduce the total future service cost of the LGPS to around 17.3% with the employee paying on average 9.4% and the employer ultimately paying 7.9%. This is also not the end of the story as there are further savings due from the reforms already in place.
6. If the Commission's final report advocates a further reduction in the scheme's value then despite being a defined benefit scheme, the LGPS's effective value to members will fall well below private sector comparators.
7. The unions believe to be sustainable the LGPS must be affordable for **both** employees and taxpayers. If savings must be made, and the case for savings in the LGPS has not been made, then there are more appropriate means of achieving the goal that do not undermine the scheme's viability. Benefit

changes could occur in the LGPS leading to savings ahead of the supposed yield from the phased introduction of the contribution increase from April 2012. As we showed in the creation of the 2008 scheme, unions and employers can develop a package of reforms that balance contribution changes and benefits.

We urge the Commission to recognise the particular impact the CSR announcement will have on the LGPS, to reflect this in its final report and recommend that any savings are made through a combination of member contribution adjustments and benefit changes *not* purely added to the employee contribution yield.

### **FURTHER REFORM**

The CSR announcement is a major barrier to longer term reform of the LGPS. Previously, the unions were prepared to enter into discussions on future reforms to the LGPS, this now significantly more difficult. With an average contribution of 9.4%, the LGPS will no longer be an affordable scheme for many who would otherwise be saving for retirement. In this context the future design of the scheme will be different as large sections of the workforce will be excluded.

Nevertheless, we are supportive of the consideration of a move to a career average model of defined benefit provision going forward providing this is a scheme of no less overall value than the current LGPS. However, for the reasons outlined above, any move towards a career average scheme is severely hampered by the impact of the member contribution levy and, as outlined in previous union submissions, the experience of unilateral change in the revaluation mechanism in *nuvos*.

We do not believe a hybrid option is appropriate for the LGPS. As demonstrated above, relatively few members earn more than a moderate salary and the administration and complexity a part defined benefit - part defined contribution arrangement would necessitate does not seem of benefit to the taxpayer anymore than it would for the members. A hybrid option would be the worst of both worlds.

The unions are keen to explore potential savings from shared services or fund mergers in relation to administration and investment management costs. We do not believe this is a simple exercise as performance varies widely between funds in both these areas and a blunt decision without due investigation could actually generate more cost. We would highlight however, that for the most part the LGPS is very efficiently administered with average administration costs for example of £18.88 per member compared with £47 per member for in-house private sector administration costs and a cost of £41 per member for outsourced private sector administration.

### **CONCLUSION**

The LGPS trade unions have worked hard with funds, actuaries, employers and others over the last few years to make the scheme sustainable and relevant to employers and employees. We urge the Commission to pay specific attention to the **specific nature** of the scheme, the biggest in the public sector with more than £150bn in assets and a membership of more than four million. It is a scheme that accounts for around 5% of the average taxpayer's council tax yet provides on average a little over £4,500 (£2,870 for women) for the pensions of dinner ladies, classroom assistants, carers, social workers and many other professionals providing front line services to the most vulnerable people in society.

The LGPS is one of the few public sector schemes that are funded and therefore requires specific consideration. Reform is possible but it must be appropriate and when a scheme is run well this should be recognised.