# PENSIONS NEWS LETTER

Spring 2013

## Introduction

Welcome to the latest edition of the Northumberland LGPS Newsletter. The main purpose of this edition is to give scheme members an update on the changes which will be made to the LGPS in April 2014. We will however be covering some changes to the current scheme and some general pension topics.

## Changes to the Current LGPS

### Revised Earnings bands Tiered Contributions

Employee rates of pension contribution are determined by the amount of their annual pensionable pay. The earnings bands are to be reviewed annually and increased in line with CPI inflation. The revised bands which apply from 1st April 2013 are:-

| Band | Earnings Range | Contribution Rate |
|---|---|---|
| 1 | £0-£13,700 | 5.5% |
| 2 | More than £13,700 up to £16,100 | 5.8% |
| 3 | More than £16,100 up to £20,800 | 5.9% |
| 4 | More than £20,800 up to £34,700 | 6.5% |
| 5 | More than £34,700 up to £46,500 | 6.8% |
| 6 | More than £46,500 up to £87,100 | 7.2% |
| 7 | More than £87,100 | 7.5% |

An LGPS member must be allocated to a band and pay the contribution rate specified e.g. an employee earning £25,000 a year would pay a contribution of 6.5% on **all** pensionable earnings; an employee earning £50,000 a year would pay a contribution of 7.2% on **all** pensionable earnings.

## Part-Time Employees

The contribution percentage of a part-time employee is determined on the basis of what the person would have earned had they been a whole-time employee.

**Membership Rules** - Until recently the LGPS was only available to employees who had a contract of employment for 3 months or more. This restriction has now changed and employees with contracts of employment for less than 3 months will now have the option to join the LGPS if they so wish. They would not be subject to automatic enrolment into the scheme but can opt to join it if they so wish. Employees with short-term or casual contracts should be advised of their right to join the scheme if they wish.

# The 2014 LGPS

As from the 1st April 2014 it is the intention that the LGPS will change from a "final salary" pension scheme to a "Career Average Revalued Earnings" pension scheme or CARE scheme.

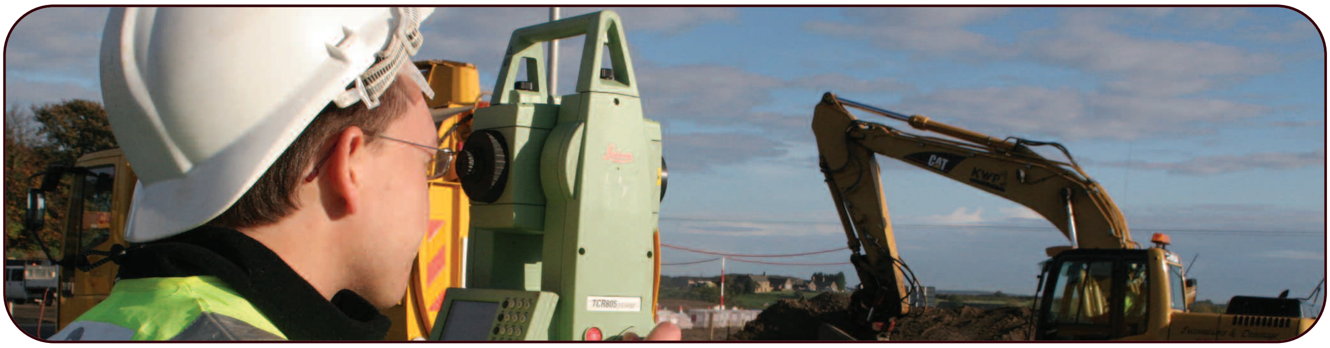
- This change will only apply to pension rights earned in the LGPS from the 1st April 2014. LGPS rights earned prior to this will retain their final salary status i.e. those rights will be based upon the person's final years pensionable pay as now.
- Additional to this for members who were aged 55 or over as at 1st April 2012 if they retire at age 65 there will be an "underpin" to the effect that their pension will be no less than it would have been had they remained subject to the current final salary scheme.

The table below looks at the main provisions of the current scheme and compares them with what is proposed in the 2014.

| | LGPS 2008<br>The Current Scheme | LGPS 2014<br>The New Scheme |
|---|---|---|
| Type of Scheme | Final Salary | Career Average Revalued Earnings (CARE) |
| Accrual Rate | 1/60th | 1/49th |
| Revaluation Rate | Based upon Final Years Pensionable Earnings | Consumer Price Index (CPI) |
| Pensionable Pay | Pay *Excluding* Non-Contractual Overtime | Pay *Including* Non-contractual Overtime |
| Employee Contribution Rates | Earnings up to £13,500 5.5%<br>£13,501 to £15,800 5.8%<br>£15,801 to £20,400 5.9%<br>£20,401 to £34,000 6.5%<br>£34,001 to £45,500 6.8%<br>£45,501 to £85,300 7.2%<br>More than £85,300 7.5% | Earnings up to £13,500 5.5%<br>£13,501 to £21,000 5.8%<br>£21,001 to £34,000 6.5%<br>£34,001 to £43,000 6.8%<br>£43,001 to £60,000 8.5%<br>£60,001 to £85,000 9.9%<br>£85,001 to £100,000 10.5%<br>£100,001 to £150,000 11.4%<br>More than £150,000 12.5% |
| Employee Contribution Flexibility | None | Scheme members can opt to pay 50% of the normal contribution and accrue 50% of the pension i.e. a person who would normally pay 5.8% in employee contributions can opt to pay 2.9% and for the years they paid that rate they would be earning pension at a 1/98th of pay and not the normal 1/49th. |

| | LGPS 2008<br>The Current Scheme | LGPS 2014<br>The New Scheme |
|---|---|---|
| Normal Retirement Age | 65 | Equal to the individual member's State Pension Age (but no younger than 65) |
| Death In Service Lump Sum | 3 x Pensionable Pay | 3 x Pensionable Pay |
| Death in Service Survivor Pensions i.e. widows and widowers pensions etc. | 1/160th of final year's pensionable pay for each year of scheme membership and added years to age 65 e.g. for a person who dies aged 45 with 10 years scheme membership the pension would be based upon 30 years (10 years + 20 added years). | 1/160th of final year's pensionable pay for each year of scheme membership and added years to State retirement Age (SPA) e.g. for a person who dies aged 45 with 10 years scheme membership and an SPA of 66 the pension would be based upon 31 years (10 years + 21 added years). |
| Early Retirement At Employees Option | Only available from age 60 as a right. The employer can allow early retirement from age 55 but consent needed prior to age 60. Pension Benefits may be subject to early payment reductions | Available as a right from age 55 i.e. no employer consent needed but Pension Benefits subject to early payment reductions. |
| Early Retirement On Redundancy Grounds | Pension paid as a right where redundancy termination happens on or after age 55 | Pension paid as a right where redundancy termination happens on or after age 55 |
| Lump sum options | Can convert (subject to HMRC limits) pension to lump sum with every £1 of pension given up providing £12 of lump sum. | Can convert (subject to HMRC limits) pension to lump sum with every £1 of pension given up providing £12 of lump sum. |
| Indexation Of Pension In Payment | Based upon CPI | Based upon CPI |
| Qualifying Period | A person with 3 months or more scheme membership qualifies for a pension | A person with 2 years or more scheme membership qualifies for a pension |

| | LGPS 2008<br>The Current Scheme | LGPS 2014<br>The New Scheme |
|---|---|---|
| Ill Health Pensions | **Tier 1 (not able to work again)** Pension based upon actual scheme membership and added years equal to the period to age 65 e.g. a person aged 45 at retirement with 10 years scheme membership would get a pension based upon 30 year's service.<br><br>**Tier 2 (permanently unable to do local authority job – likely to be able to do some work before age 65 but not within 3 years of retirement).** Pension based upon actual scheme membership and added years equal to 25% of the period to age 65 e.g. a person aged 45 at retirement with 10 years scheme membership would get a pension based upon 15 year's service i.e. 10 years + (20 years x 25%)<br><br>**Tier 3 (permanently unable to do local authority job – likely to be able to do some work within 3 years of retirement).** A temporary pension for up to 3 years based on actual scheme membership only. | **Tier 1 (not able to work again)** Pension based upon actual scheme membership and added years equal to the period to age State Pension Age (SPA) e.g. a person aged 45 at retirement with 10 years scheme membership and an SPA of 66 would get a pension based upon 31 year's service.<br><br>**Tier 2 (permanently unable to do local authority job – likely to be able to do some work before age 65 but not within 3 years of retirement).** Pension based upon actual scheme membership and added years equal to 25% of the period to SPA e.g. a person aged 50 at retirement and an SPA of 66 with 10 years scheme membership would get a pension based upon 14 year's service i.e. 10 years + (16 years x 25%)<br><br>**Tier 3 (permanently unable to do local authority job – likely to be able to do some work within 3 years of retirement).** A temporary pension for up to 3 years based on actual scheme membership only. |



# An example of a CARE Pension Calculation

This example is based on a person who has been a member of the CARE scheme for 5 years and assumes CPI inflation at about 3%.

| Year | Pay | Accrual Rate | Cumulative Inflation Factor | Pension Earned |
|---|---|---|---|---|
| 1 | £17,000 | X 1/49th | X 1.15 | = £399 |
| 2 | £18,000 | X 1/49th | X 1.11 | = £408 |
| 3 | £19,500 | X 1/49th | X1.06 | = £422 |
| 4 | £19,900 | X 1/49th | X 1.03 | = £418 |
| 5 | £23,000 | X 1/49th | X 1.00 | = £469 |
| | | Total Due | Pension | = £2,116 |

If he/she had still been subject to the old final salary LGPS his pension for 5 years based upon final earnings of £23,000 would have been:-

**£23,000 ÷ 60 x 5 years scheme membership = £1,916**

As this example illustrates, it is certainly not the case that everyone will be worse off under the CARE arrangements, some staff on low earnings could well pay less in and get more out under these proposals.

## Let’s look at an example of the above person but assume that they have 10 years membership prior to April 2014.

- This person therefore has 4 years in the pre 2008 “80ths Scheme”.
- 6 years in the post 2008 “60ths Scheme”
- 5 years in the post 2014 CARE Scheme.

The membership prior to April 2014 would still attract rights based upon the final year’s pensionable salary (as defined in the 2008 scheme).

His/her pension would be:-

| | |
|---|---|
| **£23,000 ÷ 80 x 4 years in the *80th scheme** | **= £1,150** |
| **£23,000 ÷ 60 x 6 years in the 60th scheme** | **= £2,299** |
| **Post 2014 CARE Pension (see earlier example)** | **= £2,116** |
| **Total Annual Pension** | **= £5,565** |

The person would also be entitled to an automatic lump sum of

**£1,150 x 3 = £3,450 in respect of the 80th scheme.**

The person would have the option of converting some of the £5,565 pension into lump sum (within limits imposed by the tax authorities) with every £1 converted giving a lump sum of £12 i.e. if the person gave up £1,000 pension they would get an additional tax free lump sum of £12,000.

# Financing The New 2014 Scheme

The costs of pension provision is a concern throughout the western world, basically as people live longer the costs of pension provisions rise and this situation is compounded by the current economic problems e.g. poor investment returns. Part of the introduction of the new 2014 scheme will be to put a mechanism in place to deal with these issues and potentially share additional costs, coming from such things as increasing longevity, between the employees and the employer. These negotiations are on going at a national level between Government, employers and the unions and as things develop in this area we will advise scheme members accordingly.

## Nominations

Where a LGPS member dies in service a lump sum of 3 times pay is due. For example a scheme member has pensionable earnings of £40,000 and dies in service. In this case a lump sum of £120,000 would be paid.

Lump sums payable on death are additional to any widow's, widower's or partners pension due.

The LGPS allows a member to nominate who they would wish to receive any lump sum due in the event of their death. If you have not made a lump sum nomination, please consider doing so. If you have made a nomination please consider whether or not it still reflects your wishes. On more than one occasion we have had to deal with a situation where a person had nominated their spouse to receive the lump sum due to death but had divorced their spouse by the time they died.

Nomination forms are available from the Pension Section

# Survivor Pensions Nominations

When a scheme member dies, in service, on pension, or whilst entitled to a deferred pension, a survivor pension can be paid to:

- 1. their spouse, including a civil registered same sex partner,
- 2. an unmarried partner, who has been nominated to receive a pension upon the death of the scheme member, and who meets the qualifying conditions,

With regard to unmarried partners (including same sex partners who have not entered into a civil partnership), a formal nomination in favour of the partner **must** be in place, if it is not then **in no circumstances** will a pension be awarded to your unmarried partner. Please don't get confused with the provision which allows a member to nominate a person to receive any lump sum due on their death. These are two entirely different things. If you live with an unmarried partner and you want them to receive a pension on your death you must make a partners pension nomination in their favour. If you also want them to receive any lump sum due on your death you should also completed an additional lump sum nomination i.e. you will need to make **two separate nominations.**

The pension payable to a surviving **unmarried** partner (including a same sex partner where the couple have not entered into a civil partnership) is based upon service accrued from 6th April 1988. Persons making a partner nomination can now elect to pay additional contributions to convert any service prior to 6th April 1988 to count for partner pension purposes if they so wish. An election to pay such additional contributions must be made within 12 months of completing a partner pension nomination. If you have already made a partner pension nomination and would like to convert any pre 6th April 1988 service you have to count for partner pension purposes you have until 30th September 2013 to make an election to pay such additional contributions.

# Tax rules which govern pension schemes

The HMRC are planning to make further changes to the tax rules governing all UK pension schemes as follows:-

- The Annual Allowance (the amount by which the value of a person's accrued pension rights can grow in one year before they incur a tax charge) will be reduced from £50,000 to £40,000 in April 2014.
- The Lifetime Allowance (the total allowable capital value of a person's pension at retirement before they incur a tax charge) will reduce from £1.5M to £1.25M from April 2014.

Of these, the change to the annual allowance is likely to have the biggest impact upon LGPS members.

## The Annual Allowance

In a final salary scheme, like the LGPS, we do not allocate an individual a pension fund value. In such schemes the tax authorities have determined that the growth in your accrued pension rights will be taken as 16 times the amount by which your accrued pension increases in a year (i.e. as compared with the previous year) **plus** any increase in your retirement lump sum **plus** any AVC's paid.

**Example**

John has 25 years in the LGPS. At the year ended 31st March 2012 his accrued pension was £14,000 and his lump sum £40,000. During the year ended 31st March 2013 he gets a large pay increase and the knock on impact upon his accrued pension means it is now £19,000 and his lump sum £54,000.

In this case the value of his accrued pension for the purposes of the annual allowance check has increased by:-

| | |
|---|---|
| **£19,000 - £14,000 = £5,000 x 16** | **= £80,000** |
| **Plus: the increase to his lump sum £54,000 - £40,000** | **= £14,000** |
| **Increase in the value of his pension** | **= £94,000** |

As the increase exceeds the current annual allowance of £50,000 by £44,000 John could effectively be looking at tax charge on £44,000. Had this increase taken place in the 2013/14 tax year, tax would have been due on £54,000 (the excess over the revised £40,000 allowance).

**(This example is simplified, in practice inflation is taken into account when comparing the value of accrued pensions in one year with the next and John would also have been able to carry forward any unused annual allowances, if any, from the previous 3 years to offset his tax bill.)**

Clearly where a person gets a large pay increase the annual allowance can be an issue. Also what this example illustrates is that if John had been paying AVC's these would have been **added** to the £94,000 increase in the value of his pension and therefore the AVC's would potentially have increased his tax bill.

The £50,000 annual allowance should however not present a problem for the majority of scheme members. Having said that scheme members paying AVC's will need to monitor their position as will anyone who gets a salary or pay increase in excess of CPI inflation.

One further issue on the annual allowance, when a person is awarded enhanced ill-health benefits that can cause the value of the persons pension to increase and potentially in some cases can lead to the person paying an annual allowance tax charge, the tax authorities have allowed an annual allowance exception which will mean that those retiring with severe ill-health (e.g. unable ever to work again) would be exempt from any annual allowance tax charge. The exemption will not however apply in all LGPS ill-health cases.


Under these new tax arrangements individual scheme members are responsible for reporting any tax liability they have under annual allowance rules to HM Revenue and Customs via the self assessment tax arrangements.

## The Lifetime Allowance – Protection

We understand that where scheme members have pension pots worth or close to £1.25m they may have the option to apply to the tax authority and have their current entitlement protected subject to them only accruing further pension rights with prescribed limits e.g. pension rights not to rise by more than CPI inflation. The terms for such protections are yet to be announced by HMRC.

To put the £1.25M limit into context a person would have to have a right to an LGPS pension of over £50,000 a year to have any chance of breaching this limit.

## Pension Liberation Schemes

There are certain organisations which are advertising services which  claim to enable people with pension rights to transfer the capital value of their pension pot to a scheme overseas. They then claim that this gives the person access to the pension earlier than would be available under UK law or to take a lump sum from the pension pot which would be in excess of that allowable under UK tax law. These schemes are potentially illegal and both the UK tax authorities and the Pension Regulator are investigating such transactions.

There are also potentially considerable risks involved when transferring funds outside of UK jurisdiction in this way and persons effecting such transfers could be leaving themselves open to the risk of criminal and fraudulent activity.

We would recommend that any person contemplating such a transfer should consider taking independent financial advice from a legitimate UK financial advisor.

## Pension Auto Enrolment

As you may be aware from recent correspondence, press and the media, employers will have to start automatically bringing employees into a pension scheme. This is being phased in over a number of years starting from 1st October 2012. The LGPS is a "qualifying scheme" for the purposes of auto enrolment and therefore auto enrolment will have no impact upon your membership of the LGPS.

## Customer Service Excellence Award

The Northumberland Pension Team has undergone a review of their Customer Service Excellence Award accreditation and retained the award. The Customer Service Excellence Award is a central government initiative which recognises excellence in the delivery of a public service.

## Application of the Scheme Regulations

This leaflet is intended to give general information only and it does not confer any rights upon the reader. In all cases pension rights earned in the Local Government Pension Scheme will be determined in accordance with the statutory regulations governing the Local Government Pension Scheme.

## Contacting The Pensions Team

The Pensions Team are there to help you with any matter relating to your LGPS pension entitlement. You can contact them by phone, letter and online. Contact details are as follows: -

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