

LOCAL GOVERNMENT PENSION SCHEME EARLY RETIREMENT COSTS



Background

In 1997 the Audit Commission issued a report called 'Retiring Nature – early retirement in local government'. The main purpose of the report was to highlight the changing face of retirement in local government and to publish the findings of a study into when local government employees retire and the cost to pension funds of releasing pension entitlements earlier than the normal retirement age.

The report stated that 'the majority' of staff retired early and that there were growing concerns about the cost of pensions, the impact of early retirement on pension funds and, in some areas, the large number of ill health retirements from the Local Government Pension Scheme (LGPS).

The Audit Commission put forward a number of recommendations:

- Seeking alternatives to early retirement;
- Identifying the true cost of early retirement; and
- Ensuring the continued health of pension funds.

As a direct result of this report, changes were made to LGPS regulations and employers became directly responsible for meeting pension fund costs arising from their decisions to release early the retirement benefits of their employees.

Since 1998, all Scheme employers associated with the Royal County of Berkshire Pension Fund have been required to meet the costs (known as capital costs or strain costs) of releasing benefits early on the grounds of redundancy, business efficiency, with employer consent or as a result of flexible retirement.

The Local Government Pension Scheme Regulations

Regulation 68(2) ('*Employer's further payments*') of the LGPS Regulations 2013 (as amended) states:

"An administering authority may require the Scheme employer concerned to make additional payments to the appropriate fund in respect of any extra charge on the fund resulting from retirement benefits becoming immediately payable to a member under regulation 30(6)(flexible retirement) or 30(7) (early leavers on grounds of redundancy or business efficiency), including the cost as calculated by an actuary appointed by the administering authority, as a result of a waiver of any reduction under regulation 30(8)".

For reference the regulations mentioned above are reproduced below:

Regulation 30(6) '*Flexible retirement*':

"An active member who has attained the age of 55 or over who reduces working hours or grade of employment may, with the Scheme employer's consent, elect to receive immediate payment of all or part of the retirement pension to which the member would be entitled in respect of that employment if that member were not an employee in local government service on the date of the reduction in hours or grade, adjusted by the amount shown as appropriate in actuarial guidance issued by the Secretary of State."

Regulation 30(7) 'Early leavers on grounds of redundancy or business efficiency'

"Where an active member who has attained the age of 55 or over is dismissed from an employment by reason of redundancy or business efficiency, or whose employment is terminated by mutual consent on grounds of business efficiency, that member is entitled to, and must take immediate payment of:

- (a) retirement pension relating to that employment payable under regulation 16 (additional pension contributions), adjusted by the amount shown as appropriate in actuarial guidance issued by the Secretary of State; and*
- (b) any other retirement pension relating to that employment payable under these Regulations, without reduction.*

Regulation 30(8) 'Waiver of actuarial reduction'

"A Scheme employer, former employer which is a Scheme employer, or, where a member's employer or former employer has ceased to be a Scheme employer, the appropriate administering authority, may agree to waive in whole or in part any reduction that would, apart from this paragraph, be required by paragraphs (5) or (6)".*

*NOTE: Paragraph (5) refers to regulation 30(5) which states:

A member who has not attained normal pension age but who has attained the age of 55 or over, may elect to receive immediate payment of a retirement pension in relation to an employment if that member is not an employee in local government service in that employment, reduced by the amount shown as appropriate in actuarial guidance issued by the Secretary of State".

Therefore, in accordance with regulation 30(8) an employer can agree to waive all or part of any actuarial reduction that may be applied to a member's benefits payable in accordance with regulation 30(5).

It is also worth noting that a Scheme employer would be required to make a payment to the Pension Fund if it uses its discretion to award a member additional pension in accordance with regulation 31. Scheme employers are required to produce a policy statement in relation to this regulation but for completeness regulation 68(3) is replicated below:

Regulation 68(3) ('Employer's further payments') of the LGPS Regulations 2013 (as amended) states:

"Other than where regulation 64(6) (special circumstances where revised actuarial valuations and certificates must be obtained) applies, a Scheme employer making an award under regulation 31 (award of additional pension) must pay a sum into the appropriate fund to meet the cost of any additional pension, in accordance with actuarial guidance issued by the Secretary of State".

How costs arise

Redundancy and business efficiency

When a scheme member is retired early with the immediate release of pension benefits an employer cost will almost certainly arise commonly referred to as the capital cost. A capital cost arises as a result of the member's statutory benefits being released early i.e. the accrued benefits as at the early retirement date. This is sometimes referred to as the strain cost i.e.

there is a strain on the pension fund to pay benefits early (i.e. before normal retirement age) and therefore for a number of years longer than anticipated.

An additional cost can also arise where a Scheme employer has awarded a Scheme member additional pension in accordance with Regulation 31 but for the purposes of this guide and due to that particular discretion rarely, if ever, being used, no further reference will be made to it.

It is important to note, scheme regulations dictate that benefits cannot be actuarially reduced when the reason for their early release is redundancy or business efficiency.

Since 1 April 2014 and the changes made to the LGPS at that time, it has become more difficult to assess the circumstances under which a capital cost will definitely arise as Scheme members' benefits and the protections afforded to them under former Scheme regulations, impacts on the actuarial reductions that would normally be applied to different parts of their benefits if drawn early.

However, it is fair to say that a capital cost would normally be expected to arise in cases of redundancy and business efficiency retirements and so Scheme employers should always contact the pension administrators for an estimate of the costs prior to taking any final decisions in respect of redundancy or business efficiency cases.

Flexible retirement

Where a Scheme employer agrees to release a scheme member's pension benefits early in accordance with their flexible retirement policy, the pension benefits may be reduced to reflect their early payment subject to certain protections afforded to the Scheme member under former pension scheme regulations.

Where an employer uses their discretion to waive all or part of any actuarial reduction applied to a scheme member's benefits, a capital cost will always be calculated so it is important that a Scheme employer always requests an estimate of the likely capital cost that may arise before making their decision to allow an employee the right to flexible retirement.

Voluntary retirement from the age of 55

With effect from 1 April 2014 Scheme regulations have provided Scheme members with a right to elect to receive the immediate payment of all or part of their accrued benefits without the need for employer consent.

Subject to certain protections afforded to certain Scheme members under the former '85-year rule' Scheme employers have discretion to 'switch on' the 85-rule protections thereby agreeing to waive in full or in part the actuarial reduction that would otherwise be applied to the member's pension benefits.

Where a Scheme employer uses their discretion to waive all or part of the actuarial reduction, a capital cost will always arise and so employers need to have a clear policy setting out the circumstances under which they may consider waiving all or part of that reduction.

Calculating capital costs

A standard approach to calculating capital costs has been devised by the Association of Consulting Actuaries so that there is a consistent method of determining the costs at a national level.

There are a number of factors that go into each calculation and employer's are advised to obtain details of any potential capital costs when requesting estimates of benefits from the

pension administrators for members who they are looking to make redundant, retire on business efficiency grounds, allow to draw benefits as result of flexible retirement or agree to waiving all or part of any actuarial reduction where a Scheme member elects to voluntary draw their benefits early.

Paying the capital cost to the pension fund

Once the member's final benefits have been calculated an invoice will be raised by the administering authority and emailed to the Scheme employer's pension liaison officer (or alternative officer where agreed between the employer and the pension fund).

The payment due has to be paid in full and within 21 days from the date of the invoice.

Disclaimer

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