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To the listed addressees

Your ref:
Our ref: LGT/01/17/00

29 June 2006

Dear Sir/Madam

THE LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND) AMENDMENT (No. 2) REGULATIONS 2006 - REMOVAL OF RULE OF 85

1. I enclose, for your comments no later than **31 July 2006**, draft regulations to amend the Local Government Pension Scheme (Scotland) Regulations 1998 (the "principal regulations"). This timetable will allow the regulations to be made and come into force on 1 October 2006.

2. This period of statutory consultation follows the earlier 12-week consultation on proposed changes to the Local Government Pension Scheme in Scotland, that commenced in September 2004, as well as the detailed ongoing discussions between the key stakeholders. The consultation period for these draft regulations has to be completed by 31 July to enable the regulations to come into force on 1 October. This is a shorter consultation period than normal, however this has enabled extensive discussions to continue with representatives of the local government trades unions and COSLA.

Background

3. Occupational pensions is a reserved matter and therefore the responsibility of the UK Government, although Scottish Ministers have executively devolved powers to make changes to public pension schemes in Scotland (except for the civil service and the MOD). In practice this generally means ensuring that scheme regulations are consistent with Scottish administrative and legal requirements. However, Ministers can choose to use executively devolved powers to make more substantial changes (which of course must comply with UK and EU law), such as the development of a Scottish solution to the removal of Rule of 85 from the LGPS. Notwithstanding the above, changes to public pension schemes in Scotland need to remain in line with UK and European legislation.

4. The LGPS already has a normal pension age of 65, but under the Rule of 85 members who decide to leave employment before that age and who meet the requirements of the Rule can receive an unreduced pension if they satisfy the Rule. However, both England and Wales Ministers and Scottish Ministers consider that the Rule will breach the terms of the EC Directive on equality in the workplace, which deems that provisions in the rules of occupational pension schemes which are

discriminatory on age grounds are unlawful unless they fall within limited exceptions. The Directive requires that such rules are removed by December 2006 at the latest, and the UK has announced plans to implement by October 2006. The Executive intends that the Rule will be removed from the scheme regulations in Scotland from the same date.

5. In relation to the provision of protection following removal of Rule of 85, there has been extensive discussions with representatives of local government trades unions and CoSLA in search of a solution for Scotland. As a result, the Scottish Executive is now consulting on the terms of the transitional protection to be provided for existing scheme members when the Rule is removed.

6. The draft Local Government Pension Scheme (Scotland) Amendment (No. 2) Regulations 2006 outline the intention to remove the 85 year rule from the Scheme from 1 October 2006, in order to comply with Council Directive 2000/78/EC. The draft regulations provide full protection to all existing members until 2008, and for existing scheme members who will be 60 and who satisfy the 85 year rule by 31 March 2020. They also introduce significant and well supported flexibilities into the scheme's legal framework to reflect the simplified tax regime provided by the Finance Act 2004**,** as well as a number of other changes to ensure compliance with age discrimination legislation, and inserting the Scottish Police Services Authority into the Schedule of Scheme Employers to allow civilian staff of the new body access to membership of the scheme. Ministers have concluded that these draft regulations are both affordable and legal.

Draft Regulation details

7. The LGPS has had a normal retirement age of 65 since the 1920s. However, the 85 year rule currently allows scheme members whose age plus service equals 85 to retire from 60 (or from 50 with employer consent) on an *unreduced pension.* Any scheme member can retire from 60 (or from 50 with employer consent), but if they do not satisfy the 85 year rule, they will face a reduction in their pension to reflect the fact that it is coming into payment early, and is therefore likely to be in payment for longer.

8. The Scottish Executive believes that the 85 year rule is age discriminatory and must, therefore, be removed from the Scheme. Further explanation of the 85 year rule and why it is deemed to be age discriminatory is contained in Annex B. The 85 year rule will therefore be removed from 1 October 2006. These regulations also introduce protections for existing scheme members. The new-look Scottish LGPS (to be introduced in 2008) will not include options that assume any 85 year rule rights, except for those existing scheme members who satisfy the protections below.

9. The proposals under consultation would have the following effects:

a. existing active scheme members at 30 September 2006 would continue to accrue service under the 85 year rule until 31 March 2008, in order to provide continuity with the start of the new-look Scottish scheme at 1 April 2008; and

b. protection for existing members who will be 60 by 31 March 2020 and satisfy the 85 year rule would be provided to 31 March 2020. This provides protection for those scheme members closest to retirement, ie those within 13.5 years of retirement, who are likely to have insufficient time from the date of the removal of the rule of 85 to make alternative arrangements for their retirement.

10. Details of costs and benefits are outlined in the Regulatory Impact Assessment (RIA) accompanying this consultation. This consultation is based on the Government's preferred option.

Schedule Contents

The regulations have been divided into four Parts.

Part 1: General

This Part relates to the citation, commencement, interpretation and application of the regulations. Some provisions have retrospective effect to 6 April 2006, as set out in regulation 1.

Part 2: The tax regime

This Part of the SSI relates to measures which result from the simplification of the tax regime for pension schemes under the Finance Act 2004. This consultation follows an earlier exercise conducted from July to September 2005, which set out the planned amendments to the Local Government Pension Scheme (Scotland) Regulations 1998, in order that they comply with provisions as set out in the Finance Act 2004.

The Finance Act 2004 provisions introduced a single tax regime from 6 April 2006 which will:

- Allow the maximum sum an individual can put into their pension scheme in a single tax year (from 2006) to be a sum equal to their annual salary (up to a maximum of £215,000). If the maximum amount is exceeded then a tax charge will fall due;
- Introduce a capital limit of £1.5 million which may be built up over a person's working lifetime. Where the total capital value of an individual's pension rights breaches this lifetime limit, a tax recovery charge will be made. (To put this into context, only employees earning in excess of £130,000 per annum and with 40 years membership of a scheme, with accrual rates as per the current LGPS, would be affected. This follows from the method of calculating the capital value which is based on multiplying pension by 20 and adding any lump sum);
- Require that the definition of “eligible child” be amended so as to restrict children’s pensions to under 23’s (subject to some transitional payments for those currently in full time education or where the relevant member’s pension is already being paid);
- Allow individuals to contribute towards concurrent pension arrangements in respect of the same employment;
- Require that benefits start to be drawn by age 75.

The Act also allows the following changes and these are included in the draft Regulations:

- The release of a pension from a scheme operated by an employer by whom they are still employed;
- The removal of maximum number of years which can be used in calculation of benefits – These limits on contributions will be removed, but a limit will be placed on the amount of added years that can be purchased from the Scheme.
- Up to 25% of annual pension (including AVC benefits) to be paid as a lump sum;
- The removal of the 15% limit on contributions;
- The deletion of age restrictions which applied under the former tax regime;
- The removal of the earnings cap;
- The introduction of new provisions for the calculation of benefits and tax liabilities for high earners.

Some mandatory tax changes are backdated to 6 April 2006.

Part 3: The 85 year rule

This Part removes the 85 year rule from the Scheme. It will come into force from 1 October 2006.

Part 4: Miscellaneous

This part contains miscellaneous provisions and relates to transitional protections and savings, and the right to opt out. It also consults on the proposal to include the **Scottish Police Services Authority** (SPSA) within Schedule 2. The Police, Public Order and Criminal Justice Bill (which is expected to receive Royal Assent shortly) provides for the establishment of the SPSA. The Authority is to be fully operational from April 2007, but certain staff, including the Chief Executive, are to be appointed in autumn 2006.

As well as recruiting its own support staff, the SPSA will inherit support staff from the current Common Police Services (CPS), namely The Scottish Police College, Scottish Police Information Strategy, The Scottish Criminal Records Office and The Scottish Drugs Enforcement Agency, along with staff from the four forensic science laboratories in the Strathclyde, Grampian, Tayside and Lothian and Borders forces, and possibly also identification bureaux and Scenes of Crime staff from the Central, Fife, Dumfries and Galloway and Northern forces.

Support staff working in the existing CPS and the forensic science laboratories are currently entitled to membership of the LGPS. The intention is that they should continue to have access to the Scheme, and will remain with their current fund authority. It is expected that the SPSA will initially have its headquarters in Glasgow and therefore, for all new staff recruited by the Authority post-April 2007 it is likely that the appropriate fund authority for them will be the Strathclyde Pension Fund, administered by Glasgow City Council, although no decision has been taken on this as yet.

Part 4 will come into effect from 1 October 2006.

Schedule: Transitional Provisions

The Schedule outlines the form of transitional protections in relation to removing the Rule of 85. It will come into effect from 1 October.

<u>Wider Scheme developments</u>

11. In relation to the UK context, the UK Government's White Paper published in June 2003 "Simplicity, security and choice: working and saving for retirement" outlines the challenges and longer term solutions for pension provision. The paper examines the challenges arising from rising longevity and actions to reform occupational pensions to address these concerns. The paper proposes to improve member protection, make pension provision easier for employers, and enable individual to better plan for retirement.

12. Consultees will be aware that considerable effort has already gone into the consideration of a new Scottish LGPS. This will continue, and will focus on the costing and design of various options for the reform of the Scottish LGPS and the development of new arrangements for 2008. These will take full account of the implications for the Scheme of this consultation package, and how the cost of extending protections has resource implications for the new Scheme. The recent Department for Work and Pensions White Paper proposals for the reform of state pensions will also need to be taken into account in the design process.

13. The Scottish Executive's strategic policy for the Scheme is to provide good quality pensions for local authority workers which are affordable, viable and fair to both scheme members and taxpayers. The intention is to consult widely, by the end of the year, on costed, realistic option(s) for

a new LGPS specifically for Scotland, with the objective of having modernised arrangements in place for April 2008. Subsequently, draft amending regulations are programmed to come forward for consultation as part of the development process.

Responses

14. Your comments should be sent in the first instance to Jean Steel, Policy Officer, Scottish Public Pension Agency, 7 Tweedside Park, Tweedbank, Galashiels TD1 3TE (tel: 01896 893229). Electronic responses can be sent to jean.steel@scotland.gsi.gov.uk

15. A summary of responses to this consultation will be published on the Agency's website in due course.

16. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information (Scotland) Act 2000 (FOISA) and the Data Protection Act 1998 (DPA) .

17. If you want the information that you provide to be treated as confidential, please be aware that, under the FOISA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

18. The Department will process your personal data in accordance with the DPA and in the majority of circumstances; this will mean that your personal data will not be disclosed to third parties.

19. As previously advised, please find enclosed a draft set of regulations for consideration. I should be grateful if any comments could be sent to Jean Steel, Policy Officer, at the above address, by **Monday 31 July 2006.** It is our intention to have these regulations coming into force on 1 October 2006.

If you wish to discuss this proposal in more detail please do not hesitate to contact either myself on 01896 893227 or Joanne Crone on 01896 893212 or send any queries by e-mail to david.lauder@scotland.gsi.gov.uk.

Yours faithfully

D Lauder

D Lauder
Policy Manager, LGPS

Addressees
COSLA
TGWU
GMB
STUC
UNISON
AMICUS
Secretary, LGPC
Union of Construction, Allied Trades and Technicians
Strathclyde Passenger Transport Authority
Audit Scotland
National Association of Pension Funds
Scottish Local Government Pension Scheduled Bodies
Scottish Local Government Pension Funds
CIPFA
Women's National Commission
Other Relevant Government Departments.

Lump sum payments under amended regulation 19: An explanation

- Scheme members may currently take 3 times the amount of their final pension, as a tax-free lump sum, when they retire.

- The current 3 times final pension permitted in the LGPS equates to roughly 15% of the capital value, using the HM Revenue and Customs stipulated conversion factor of multiplying annual pension by 20.

- From 1 October 2006, Scheme members will be able to increase this amount up to a maximum of 25% of the capital value of their pension fund.

- Any amount taken above the current three times limit would be paid for by the Scheme member commuting part of their final pension, e.g. swapping pension for tax-free cash at a commutation rate of 12:1. This means for every £1 of pension the Scheme members foregoes, they will receive £12 of tax-free cash.

- Only an amount taken above the current three times limit would be commuted.

- Any attached spouse's pension would be unaffected.

- The following illustrative examples may help:

  - Under the current rules Scheme member A is set to receive £4,000 pension per annum, with £12,000 lump sum. From 1 October if they chose to take the maximum 25% available they would receive £3,300 pension per annum, with £20,400 lump sum.

  - Under the current rules Scheme member B is set to receive £10,000 pension per annum, with £30,000 lump sum. From 1 October if they chose to take the maximum 25% available they would receive £8,500 pension per annum, with £48,000 lump sum.

  - Under the current rules Scheme member C is set to receive £30,000 pension per annum, with £90,000 lump sum. From 1 October if they chose to take the maximum 25% available they would receive £25,000 pension per annum, with £150,000 lump sum.

Part 3: The 85 year rule

The normal retirement age for Scheme members is 65.

The 85 year rule currently allows Scheme members, from aged 60, to voluntarily retire on an unreduced pension where the sum of their age plus service equals 85 years. Scheme members satisfying the rule between age 50 to 60 may also retire with no actuarial reduction to pension, but they need their employers' consent.

The Executive considers that the rule of 85 in the Scottish Local Government Pension Scheme Regulations is inconsistent with Directive 2000/78/EC. The purpose of the Directive is to set out a general framework for equal treatment, including combating discrimination on age grounds in employment and occupation. The Rule of 85 in the Local Government Pension Scheme for Scotland clearly discriminates on age grounds because two members with the same length of service but different ages who retire on the same day are affected differently. Depending on their age, one would receive an unreduced pension (as they satisfy the rule), whilst the other would not. This therefore amounts to less favourable treatment on the grounds of age

The following example may be useful in demonstrating the age-discriminatory aspects of the rule: Two Scheme members are in comparable situations but for their age; one is aged 61 and the other is aged 63; they both have 22 years service and wish to retire; the 63 year old would receive a full pension, as they satisfy the 85 year rule (63 + 22 = 85), whereas the 61 year old would suffer an actuarial reduction to their pension (61 + 22 = 83), as they do not satisfy the rule. The reason for the different pension entitlement is on the basis of age; therefore the rule is age discriminatory.

Article 6.1 of the Directive allows for differences of treatment on age grounds in some circumstances where a Member State can establish that the differences are objectively and reasonably justified by a legitimate aim, and the means it chooses to achieve that aim are proportionate. Hence, in order for the Rule of 85 (which is considered to be discriminatory on age grounds) to be allowed to continue beyond the Directive's deadline, it must be an objectively justifiable means of meeting a legitimate aim. No such legitimate aim has so far been identified that would be consistent with the Directive.

In addition, the Directive provides that age discrimination in relation to pensions may be allowed to continue under Article 6.2 in specific, narrow circumstances. However, the Executive does not consider that the Rule of 85 falls within the terms of Article 6.2. The Rule is not a provision for fixing the age of entitlement to retirement benefits nor is it an actuarial calculation. It also has a disparate impact on the grounds of sex (as proportionately more males would qualify under the rule than females, who tend to have shorter service). Article 6.2 cannot be used to continue an age discriminatory provision which also discriminates on grounds of sex. The Rule therefore cannot be retained under this article of the Directive.