DRAFT REGULATORY IMPACT ASSESSMENT (RIA)

LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND) AMENDMENT (No. 2) REGULATIONS 2006

Scottish Public Pensions Agency
29 June 2006

Title of Proposal

IMPLEMENTATION OF REGULATIONS IN RESPECT THE REMOVAL OF THE RULE OF 85 AND PROVISION OF PROTECTION FOR EXISTING MEMBERS

Purpose and Intended Effect of Measure

Objectives

1. To remove the Rule of 85 from the Local Government Pension Scheme (Scotland) Regulations 1998 to comply with EC Directive 2000/78/EC, to provide protection for existing scheme members and to introduce tax changes following the Finance Act 2004.

Background

2. 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.

3. 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.

4. This Regulatory Impact Assessment (RIA) accompanies the draft Local Government Pension Scheme (Scotland) Amendment (No. 2) Regulations 2006, which 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 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. In addition, the draft regulations introduce significant and well supported flexibilities into the scheme's legal framework to reflect the simplified tax regime provided by the Finance Act 2004. These changes are not included in the scope of this RIA as they were addressed in the assessment carried out for the Finance Act 2004. This RIA focuses specifically on the proposals to remove the Rule of 85 and to provide transitional protection for existing members.

Rationale for government intervention

5. An explanation of how the 85 year rule provision operates, how it discriminates on grounds of age and why it must be removed from the Scheme is outlined in Annex A.

Consultation

6. Consultation on the draft regulations 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 across Scotland and on a UK basis.

Options

7. This RIA considers options for the extent of the continuation of the 85 year rule and transitional protections. A numbers of options have been identified, which could be implemented in combination or singly:

The extent of the continuation of the 85 year rule:
1) Do nothing
2) Remove the Rule of 85 from 1 October for all scheme members

Transitional protection for existing scheme members:
3) Do nothing
4) Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2013
5) Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2016
6) Protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2020
7) Protect all existing members until 31 March 2008. ie this would effectively provide existing members with another 18 months of service accrual under the 85 year rule. Any actuarial reduction would therefore be in relation to future service accrued on or after 1 April 2008.

8. The draft regulations describe the Scottish Executive's preferred option, which is a combination of options 2, 6 and 7. Having taken into account all the circumstances, the Scottish Ministers believe that it is appropriate to provide transitional provisions in respect of some existing members in order to protect reasonable expectations they may have regarding the application of the Rule of 85. The Scottish Ministers believe that options 6 and 7 amount to a proportionate way to balance those expectations against the need to remove the discriminatory provision.

Costs and benefits

<u>Breakdown of costs and benefits</u>

The extent of the continuation of the 85 year rule

Option	**Total cost per annum Economic, environmental, social**	**Total benefit per annum Economic, environmental, social**
1 – do nothing	**Economic** – A cost of 3% of pensionable payroll p.a. for funds in Scotland over longer term until 85 year rule is removed. **Environmental** – None **Social** – Continuation of a discriminatory provision, risk of challenge.	**Economic** – None **Environmental** – None **Social** – No change to benefit provision – this would be supported by existing scheme members.
2 – remove the rule from 1 October for all scheme members	**Economic** – None **Environmental** – None **Social** – If they still wished to retire early, some scheme members would retire on a reduced pension where under the 85 year rule they would have been able to retire early unreduced.	**Economic** – would save 3% of pensionable payroll p.a. over longer term for funds in Scotland. Could potentially increase the proportion of LGPS members age 50 plus who are economically-active. **Environmental** – None **Social** – Step towards equality proofing the scheme.

Transitional protections for existing scheme members

Option	**Total cost per annum Economic, environmental, social**	**Total benefit per annum Economic, environmental, social**
3 – do nothing	**Economic** – None. **Environmental** – None. **Social** – Existing scheme members might have a reasonable expectation that there should be transitional protection following removal of the Rule.	**Economic** – approximately £352m to £367m p.a. would be available for recycling elsewhere in the scheme. This refers to the cost of the Executive's preferred option as outlined in the draft regulations. **Environmental** – None. **Social** – Providing no protections could be seen as the most equitable way forward between existing and future members of the

		scheme as it would not involve the continuation of a discriminatory measure.
4 – protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2013	**Economic** – Approximately £97m for provision in Scotland. Less money available in the new-look scheme for benefit improvements. **Environmental** – None. **Social** – Continuation of a discriminatory provision until 2013 for those who will benefit from it.	**Economic** – None. **Environmental** – None. **Social** – Would protect scheme members within 7 years of retirement following removal of Rule who would find it difficult to make alternative arrangements.
5 – protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2016	**Economic** – Additional approximate £75m in Scotland in addition to the 2013 protections. Less money available in the new-look scheme for benefit improvements. **Environmental** – None. **Social** – Continuation of a discriminatory provision until 2016 for those who will benefit from it.	**Economic** – None. **Environmental** – None. **Social** – Would protect scheme members within 9.5 years of retirement who would find it difficult to make alternative arrangements – a larger group than would be protected under option 4.
6 – protect those who would otherwise have satisfied the 85 year rule and reach age 60 by 31 March 2020	**Economic** – Approximate £105m-£120m in Scotland in addition to the 2013 and 2016 protections. Less money available in the new-look scheme for benefit improvements. **Environmental** – None. **Social** – Continuation of a discriminatory provision until 2016 for those who will benefit from it.	**Economic** – None. **Environmental** – None. **Social** – Would protect scheme members within 13.5 years of retirement who would find it difficult to make alternative arrangements – a larger group than would be protected under options 4 and 5.
7 – protect all existing members until 31 March 2008. This would effectively provide existing members with another 18 months of service accrual under the 85 year rule. Any actuarial reduction would therefore be in relation to future service accrued on or after 1 April 2008.	**Economic** – Approximately £75m for provision in Scotland. Less money available in the new-look scheme for benefit improvements. **Environmental** – None. **Social** – Continuation of a discriminatory provision until 2008 for all existing scheme members.	**Economic** – None **Environmental** – None. **Social** – Would provide an additional 18 months of service accrual under the 85 year rule for all existing scheme members to allow a smooth transition to a new-look scheme in April 2008. This reflects reasonable expectations of existing members.

Sectors and groups affected

9. All staff eligible for the Local Government Pension scheme could be affected and their employers. The changes also apply to former employees entitled to deferred benefits (since the current Rule of 85 also applies to 'quasi-service' accrued after leaving employment). However, members in this group are given the opportunity to elect to opt-out of changes, as required by section 12(4) of the Superannuation Act 1972.

Race equality assessment

10. There are no such considerations in respect of this proposal.

Health impact assessment

11. The Normal Retirement Age for the LGPS is 65. However, the 85 year rule allows Scheme members who choose to retire from age 60, or from age 50 with employer's consent to take an unreduced pension if their age plus service equals 85 years. There has been some anecdotal concern that there may be more instances of ill health retirement if the Rule of 85 is removed and the LGPS employees have to work longer, however no evidence has been supplied, at this stage, to support this assertion. If the 85 year rule is removed from the Scheme, any increase in ill-health retirements will become apparent at the next tri-ennial actuarial valuations of the funds.

12. It is intended that flexible retirement provisions would help to mitigate this risk. Flexible retirement will allow Scheme members to continue working at reduced hours/grade, and accruing pension benefit whilst starting to draw their pension. This would remove the current cliff edge where a Scheme member moves from full time work to retirement.

Rural considerations

13. A review of demographic patterns by actuaries shows people living in rural areas live longer than those in urban areas. Therefore the increasing longevity will have greater impact on cost pressures facing LGPS funds which cover predominantly members living in rural areas.

Small Firms' Impact Test (SFIT)

14. The proposals relate in the main to the public sector. As part of the consultation process, fund administering authorities are obliged to notify their membership, which includes staff of admission bodies who may be in the private sector.

Competition Assessment

15. This is not required for these proposals.

Enforcement, Sanctions and Monitoring

Enforcement

16. This is not required for these proposals.

Sanctions

17. This is not required for these proposals.

Monitoring and review

17. All LGPS funds undergo an actuarial valuation every three years. The last valuation assessed the state of the funds as at 31 March 2005. LGPS administering authorities' are required to manage and invest their pension funds in accordance with the terms of statutory regulations, and are required to produced Funding Strategy Statements which must be regularly reviewed.

ANNEX A

RATIONALE FOR REMOVING THE RULE OF 85

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.