Local Government Pension Scheme

Reduction in Pay - Guidance Note

Introduction

Because the Local Government Pension Scheme is a final salary scheme, any reduction or restriction in pay is likely to have an adverse effect on your retirement benefits.

This Guidance Note explains the ways in scheme benefits may be protected either through the granting of a Certificate of Protection of Pension Benefits or by "Ring-Fencing" the pre-reduction rights in the form of a Deferred Benefit.

When Can A Certificate Be Granted?

A **Certificate of Protection of Pension Benefits** is a device within the scheme which allows your rights to be protected if you suffer a reduction/restriction in pay through **the actions of your employer** (e.g. arising from a job evaluation exercise or the withdrawal of a pensionable element from your pay).

Your employer can grant a certificate without you applying for one.

If you apply for a certificate within 12 months of suffering the reduction or restriction, your employer is obliged to grant it.

If you do not apply for a certificate within 12 months, it is up to your employer to decide whether or not to grant it.

When Can a Certificate not be Granted?

A Certificate cannot be granted:

- if the reduction or restriction in pay has resulted from your actions as an employee, or
- if the reduction or restriction in pay is temporary, or
- if the reason for the reduction or restriction is ill health.

What Protection Does the Certificate Provide?

Where a Certificate has been granted, then, subject to certain conditions, it can allow your pension benefits – to some degree - to be calculated using your rate of pay prior to the reduction or restriction.

It is important to note that the protection offered by <u>a Certificate only lasts for 10 years</u>, counting forward from the date of the reduction / restriction. After 10 years, it ceases to have any value.

If you happen to leave the Scheme when the Certificate is still valid, then the protection is that you can elect to have your benefits based on:

- the best of your final 5 years' annual pensionable pays; or
- the best annual average of any 3 successive years' of annual pensionable pay from the last 13 years' of pensionable service.

In determining the best year or run of years, you cannot count any pensionable pay which arose more than 3 years prior to the restriction / reduction. Also, any assessment of the best year / run of years should be done after applying the rise in inflation between the date of reduction / restriction and the date of leaving the Scheme.

Ring Fencing Pension Rights with a Deferred Benefit

If you are worried that a certificate will expire before you are scheduled to leave the scheme (n.b. a Certificate lasts only 10 years from the date of any reduction/restriction), then it may be to your advantage to "ring fence" your rights up to the point of reduction in the form of a deferred benefit.

With deferred rights, your benefit is worked out on your membership and your pay up to the date your pay was reduced. You will then start to build up separate pension benefits in respect of your membership and pay following the reduction in pay. You should be aware that once a deferred benefit has been established, there are limited options to allow it to be combined again with your current rights.

Deferred benefits are available to be paid out at age 60, although they may attract a penalty reduction if paid out prior to age 65. They increase in line with the Consumer Price Index. To be eligible for a deferred benefit, you will need to have completed at least 2 years membership or have transferred in rights from another pension scheme.

Deferred Benefits can be created in two ways - by changing employments or by opting out.

<u>Change of Employment</u>

If your reduction in pay means that you have been given a new contract of employment, then you are entitled to a deferred benefit for the period of membership up to the point of reduction.

Having a deferred benefit however could be to your detriment, if you later get the chance to retire early (e.g. through voluntary severance). In that situation, only your new pension rights – not the deferred element - would be paid out early.

<u>Opting Out</u>

A deferred benefit can be created by opting out. Indeed, in order to maximise the protection that is afforded by a Certificate, it would be possible to opt out just before the Certificate is due to expire. This would result in your deferred benefit being based on membership and final pay as at the date of opting out.

Whilst opting out (and then re-joining) is quite legitimate, it could be to your detriment, if you later get the chance to retire early (e.g. through voluntary severance). In that situation, only your pension rights from the point of opting out – not the deferred element - would be paid out early. A further reason not to opt out is that if you died whilst you were not in the scheme, your death benefit would be considerably less than had you remained a scheme member.

In general terms, opting out is not a strategy to be encouraged and should only be undertaken after a careful consideration of all the facts and after consultation with both the Pensions Section and an Independent Financial Adviser.

n.b. A deferred benefit can only be paid out if you have left the employment from which you opted out.

What if I do not have a Certificate?

If you do not have a Certificate, or if you have a Certificate and it is no longer valid (i.e. more than 10 years have passed since you suffered the reduction or restriction in pay), then your annual pensionable pay will be the best of your final 3 years' annual pensionable pays.

Disclaimer

Nothing in these Guidance Notes can override the Scheme Rules which are set out in various statutory instruments issued by the Scottish Government.

FALKIRK COUNCIL PENSION FUND
LOCAL GOVERNMENT PENSION SCHEME (LGPS)

CERTIFICATE OF PROTECTION OF PENSION BENEFITS - FACTSHEET

The LGPS is a final salary pension scheme with benefits based on a member's level of pay and the length of time they have been in the scheme. These elements are usually referred to as "final pay" and "membership".

This factsheet gives a brief description of "final pay" or, as it is sometimes called, "annual pensionable pay" or "final salary". The factsheet also shows how final pay may be calculated where a member has been granted a Certificate of Protection of Pension Benefits.

Final Pay
Final pay is normally the pay on which a member has paid contributions during their last year of employment. However, the actual Scheme rules allow pension benefits to be calculated on the best year's pay in the final three years of service. (Where a member is part time, then it is the full time equivalent pay that is taken into account).

More complicated rules apply if a Certificate of Protection of Pension Benefits has been granted. For a full description of these, please refer to the attached Guidance Note.

Examples
The following examples show the different ways in which final pay may be calculated.

Example 1 – Final Pay based on best of final 3 years – final year is best
Emma leaves the Scheme on 30 November 2013 and her pay in her final three years is as follows:

01/12/2012	to	30/11/2013	=	£20,000
01/12/2011	to	30/11/2012	=	£19,000
01/12/2010	to	30/11/2011	=	£18,000

As Emma's pay in her final year of employment is the highest of the final three years, her final pay is the £20,000 she earned in the year to 30 November, 2013.

Example 2 – Final Pay based on best of final 3 years – final year is not best
Joe leaves the Scheme on 30 November 2013 and his pay in his final three years is as follows

01/12/2012	to	30/11/2013	=	£19,000
01/12/2011	to	30/11/2012	=	£18,000
01/12/2010	to	30/11/2011	=	£20,500

Applying the best of the final three years' rule, Joe's final pay is the year to 30 November, 2011.

Example 3 – Final Pay based on best of final 5 years – Certificate Granted
Trevor suffers a reduction to his pensionable pay from 1 July, 2013 and is granted a Certificate.

Certificates are only valid for 10 years, so the latest Trevor can retire (or otherwise leave the scheme) and still take advantage of the Certificate is 30 June 2023. Trevor actually retires on 30 June 2015. His pay history is as follows:

01/07/2014	to	30/06/2015	=	£33,500	x	1.00*	=	£33,500
01/07/2013	to	30/06/2014	=	£33,000	x	1.00*	=	£33,000
01/07/2012	to	30/06/2013	=	£34,000	x	1.03*	=	£35,020
01/07/2011	to	30/06/2012	=	£33,500	x	1.06*	=	£35,510
01/07/2010	to	30/06/2011	=	£31,500	x	1.09*	=	£34,335

*Estimate of Inflation for illustration purposes only

Because a Certificate has been granted, Trevor can elect to have his benefits based on the best of his final 5 years earnings. In this case, final pay is based on the year to 30/06/2012 since this produces the highest value after taking inflation into account.

Example 4 – Final Pay based on best annual average of 3 years – Certificate Granted
Fiona suffers a reduction to her pensionable pay from 1 July, 2013 and is granted a Certificate. She decides to retire on 30 June, 2020.

Because she has a Certificate and is retiring within the 10 year lifespan of the Certificate, she can elect to have her benefits based on the best of her final 5 years or the best annual average of any three consecutive years in her final 13 years (always bearing mind that you cannot consider any periods that fall more than three years prior to the date of reduction or restriction in pay). As more than 5 years have passed since Fiona's reduction in pay, it is more likely that the annual average of 3 successive years will produce the best final pay for her as shown in the following example.

Her pay history is as follows:

				Pensionable Earnings	Three Year Average				
01/07/2019	to	30/06/2020	=	£39,000	£38,500	x	1.00*	=	£38,000
01/07/2018	to	30/06/2019	=	£38,500	£38,000	x	1.01*	=	£38,380
01/07/2017	to	30/06/2018	=	£38,000	£37,500	x	1.03*	=	£38,625
01/07/2016	to	30/06/2017	=	£37,500	£37,000	x	1.05*	=	£38,850
01/07/2015	to	30/06/2016	=	£37,000	£36,500	x	1.06*	=	£38,690
01/07/2014	to	30/06/2015	=	£36,500	£36,833	x	1.08*	=	£39,779
01/07/2013	to	30/06/2014	=	£36,000	£37,166	x	1.10*	=	£40,882
01/07/2012	***to***	***30/06/2013***	***=***	***£38,000***	***£37,200***	***x***	***1.12****	***=***	***£41,664***
01/07/2011	to	30/06/2012	=	£37,500	N/A				
01/07/2010	to	30/06/2011	=	£36,100	N/A				

*Estimate of Inflation for illustration purposes only

In this case, the three year period ending on 30/06/2013 is the one giving the best result. Aggregate earnings for the three years to 30/06/2013 are £111,600 (£36,100 + £37,500 + £38,000) and dividing by three gives an annual average is £37,200. Once inflation is added, this gives a Final Pay of £41,664.

Although the terms of a Certificate allow earnings from 13 years to be considered, the years prior to 01/07/2010 cannot be considered here, as they would fall more than 3 years prior to the date of reduction.

IMPORTANT

This factsheet has been written based on our current understanding of the scheme rules. Nothing in the factsheet can override the scheme rules themselves.

The Pensions Section cannot provide financial advice. If you need advice before making a decision regarding your pension benefits, you may wish to contact an Independent Financial Adviser.

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