Pension Planning

October 2011

Welcome to the latest edition of Pension Planning, the newsletter for active members of the Cambridgeshire Pension Fund. This newsletter provides up to date information on the Local Government Pension Scheme (LGPS) and the wider world of pensions.

A big development in the world of public sector pensions, of which the LGPS is part, is the structural review by the Independent Public Service Pensions Commission, chaired by Lord Hutton. This newsletter will provide you with information on Lord Hutton's findings and the recommendations that may impact on the LGPS.

This newsletter also mentions some possible shorter term changes to the LGPS as a result of the Government Spending Review in October last year.

There have been some important changes to the tax relief that individuals can receive on pension savings. This newsletter summarises these changes and how they might affect you.

The final article is a reminder of the ill health provisions of the LGPS, which changed significantly as a result of the new Regulations effective from April 2008. Recent legislation has resulted in further changes to these provisions.

The Cambridgeshire Pension Fund website contains a wealth of information for members of the LGPS, including the latest information on changes affecting the Scheme. Please visit it regularly at:

www.cambridgeshire.gov.uk/lgps

I hope that you find this newsletter informative. We are always looking to improve the service that we provide to all our members and would welcome any comments you have on the articles in this newsletter or the service we provide. Contact details are on the back of this newsletter.

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Local Government Pension Scheme

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Newsletter from the Cambridgeshire Pension Fund

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You will probably be aware from media coverage that Lord Hutton was appointed to chair the Independent Public Services Pension Commission. The Commission undertook a review of public sector pension provision, including the LGPS, in time for the 2011 Budget.

During the 2011 Budget speech, the Chancellor, George Osborne, announced that the Government accepts Lord Hutton's recommendations as a basis for consultation with public sector workers, trades unions and others. The Government will be setting out detailed proposals soon.

Long term changes

The main recommendation of the report is that existing final salary public service pension schemes, such as the LGPS, should be replaced by new schemes, where an employee's pension entitlement is still linked to their salary but is related to their career average earnings whilst in the new scheme, with appropriate cost of living adjustments in each year so that benefits maintain their relative value.

Other key recommendations in the report affecting the LGPS include:

- Linking Normal Pension Age (NPA) to the State Pension Age;

The Hutton Review of ctor pensions

- Setting a clear cost ceiling for public service pension schemes – the proportion of the cost that taxpayers will contribute to employees' pensions – with automatic stabilizers to keep future costs under more effective control;
- Honouring the pension rights already built up by scheme members and maintaining the final salary link for past service for current members;
- Introducing more independent oversight and much stronger governance of all public service pension schemes;
- Encouraging greater member involvement in consultations about the setting up of new schemes, and in the running of schemes; and
- Overhauling the current legal framework for public service pensions to make it simpler.

The HM Treasury website contains comprehensive coverage of this topic, including Lord Hutton's full report, details on the recommendations and a set of Frequently Asked Questions:

http://hm-treasury.gov.uk/indreview_johnhutton_pensions.htm

The Commission believes that the new schemes could be put in place before the end of the current Parliament in 2015. The intention is for legislation to be in place by April 2014 and the new schemes, introducing the fundamental long term changes outlined above, to be effective from 1 April 2015.

Short term changes

Furthermore, the Government undertook a Spending Review in October 2010. The outcome of this was the requirement for employee pension contributions in public service schemes to rise for those earning £15,000 or more in order to deliver cost savings by the end of the 2014/15 financial year roughly equivalent to 3.2% of pensionable pay.

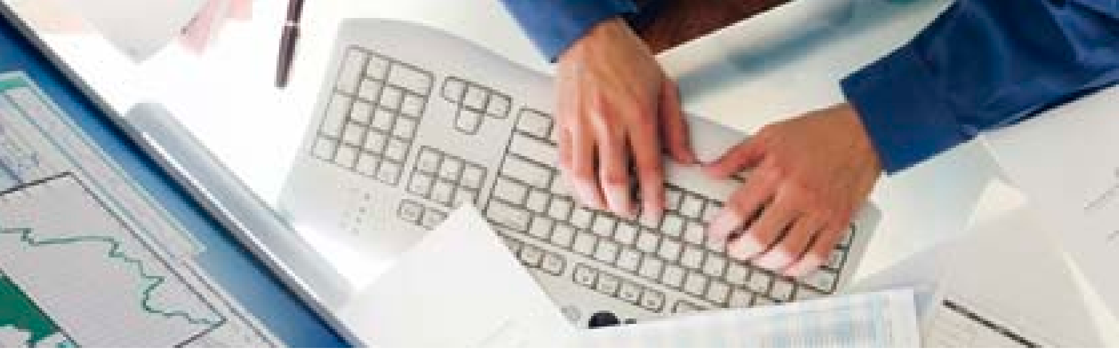
Due to the funded nature of the LGPS, the Local Government Group (LGG) and Trades Unions were given the opportunity to submit a joint proposal that delivered the required cost savings. As agreement could not be reached LGG put forward their own proposals which aim to minimise the impact on the lower paid whilst giving choice to individuals. Details of these proposals can be found at the following link:

http://www.lge.gov.uk/lge/core/page.do?pageId=13667990

The Department for Communities and Local Government has issued a statutory consultation document outlining their proposals on how the required cost savings can be met, which can be found at the following link:

http://www.communities.gov.uk/publications/localgovernment/pensionconsultation

The Cambridgeshire Pension Fund website will keep you up to date on further developments.



New limits on pensions

There are two limits set by HM Revenue and Customs (HMRC) that determine the amount of tax relief you can receive on your pension savings; the Lifetime Allowance and the Annual Allowance.

Lifetime Allowance

The Lifetime Allowance (LTA) is the capital value of benefits that an individual can build up within HMRC registered pension schemes without incurring additional tax charges when payment commences. This value is currently £1.8 million but is reducing to £1.5 million with effect from 6 April 2012.

> The valuation of benefits in the LGPS is based on the following:
>
> Annual Pension x 20, plus any Lump Sum Retirement Grant and AVC fund value.

Despite this reduction, most people will not be affected by the lifetime allowance change, as their pension scheme benefits will have a capital value of less than £1.5 million. However, for those that may be affected by the lower limit the Government has set in place 'Fixed Protection'. An application for this to apply must be with HMRC by 5 April 2012 and you may also need to opt out of the LGPS by that date to avoid losing the protection due to the 'benefit accrual' restriction.

Further guidance on LTA can be found on the HMRC website, which includes the suggestion to consider seeking independent professional advice before making any decision on applying for protection.

Annual Allowance

The Annual Allowance (AA) is the maximum amount of pension saving, or 'Pension Input', that may benefit from tax relief in each tax year. If your Pension Input is more than the AA you may have to pay a tax charge on the amount over the AA. This charge is called the Annual Allowance Charge (AAC). You are normally personally responsible for paying any AAC, but in some cases, if you ask, the scheme pays and reduces your benefits.

For a final salary scheme such as the LGPS, the Pension Input calculation is based on the increase in the value of your pension benefits over the 'Pension Input Period' (PIP), which for LGPS is the year ending on 31 March.

However, even if the Pension Input is greater than the AA in a year, there may still be no AAC to pay if you have not used your entire AA in the immediately preceding three tax years. Effectively, you can carry forward unused AA from these previous tax years.

From 6 April 2011 the AA will decrease from £255,000 to £50,000. The reduction in AA is expected to affect considerably more individuals than the reduction in LTA.

The number of variables that affect Pension Input, e.g.

- length of membership and full time equivalent (fte) pensionable pay that benefits are based upon (including any enhancement awarded on retirement on ` ill health grounds)
- level of AVCs paid
- value of pension from paying Additional Regular Contributions (ARCs)
- rate of Consumer Prices Index (CPI)
- transfers of membership from another LGPS job in England and Wales,

make it difficult to generalise about who may incur an AAC and what they can do to affect this. Some of the elements you will have more control over, such as how much you pay in AVCs, transferring membership within the LGPS and potentially the level of your fte pay. It is therefore important for you to consider the potential Pension Input and AAC implications of these if your Pension Input could be greater than £50,000.

To calculate your Pension Input you need to:

1. Calculate the opening value of benefits. Start with benefits at the end of the previous PIP, so Standard Annual Pension x 16; add any Standard Lump Sum. Add the amount of AVCs in that PIP. Then increase this total by the rate of increase in CPI over the year to the September before the start of the current PIP.

2. Calculate the closing value of benefits. Start with benefits at the end of this current PIP, so Standard Annual Pension x 16; add any Standard Lump Sum. Add the amount of AVCs paid in this current PIP.

3. Deduct the opening value from the closing value to get the Pension Input.

Example

A member with a salary of £50,000 and 30 years of membership in the LGPS as at 31 March 2011 gets a promotion on 1 April 2011 increasing his salary to £60,000. The Pension Input for the PIP ending 31 March 2012, which falls in the 2011/12 tax year is £76,945.62 calculated as follows:

Opening Value (i.e. as at 31 March 2011):

Standard Annual Pension:	
£19,375 x 16 =	£310,000.00
Standard Lump Sum	£50,625.00
Total	**£360,625.00**
Plus CPI increase to	
September 2011 (3.1%)	£11,179.38
Opening Value	**£371,804.38**

Closing Value (i.e. as at 31 March 2012):

Standard Annual Pension:	
£24,250 x 16 =	£388,000.00
Standard Lump Sum	£60,750.00
Closing Value	**£448,750.00**

£448,750.00 - £371,804.38 = £76,945.62

Clearly, £76,945.62 is greater than the AA of £50,000. If individual tax years were looked at independently the member would have an AAC to pay (of 40% in this example) on the excess above £50,000 which would be £10,778. However if, based on the new lower AA and pension factor of 16 rather than the actual higher AA and old pension factor of 10, the member has unused AA to carry forward from the preceding three tax years, i.e. 2008/9, 2009/10, and 2010/11, this can be used to reduce the excess over the AA in 2011/12. If it were at least £26,945.62, it reduces the excess to nil and no AAC would be payable.

Further information on the Annual Allowance can be found on the HMRC website:

http://www.hmrc.gov.uk/pensionschemes/annual-allowance/index.htm

If you think you may exceed either the LTA or the AA, you may wish to seek independent specialist advice.

Ill health benefits

In 2008 new three-tiered ill health retirement benefits were introduced into the LGPS. Recent amending regulations have made some changes to these benefits which are detailed here. But first a quick reminder on what the tiered ill health benefits are in the LGPS assuming that you meet the basic qualification for an ill health pension, i.e. you have at least 3 months membership, or have transferred membership in, have been certified by an approved independent doctor as being incapable of your final job until at least age 65 due to ill health, have been dismissed on this basis and have a reduced likelihood of being capable of gainful employment* before age 65.

Tier	Qualification	Benefit Payable
Tier One	If you have no reasonable prospect of being capable of gainful employment* before age 65.	Ill health benefits are based on the membership you would have had if you had stayed in the Scheme until age 65.
Tier Two	If you are unlikely to be capable of gainful employment within 3 years of leaving but you may be capable of doing so before 65.	Ill health benefits are based on your membership built up to leaving plus 25% of your prospective membership from leaving to age 65.
Tier Three	If you are likely to be capable of gainful employment within 3 years of leaving, or before age 65 if earlier.	Ill health benefits are based on your membership at leaving. Payment of these benefits will be stopped after 3 years, or earlier if you are in gainful employment or become capable of such employment, subject to an 18 month medical review.

* Gainful employment means paid employment for not less than 30 hours in each week for a period of not less than 12 months.

If you retire on tier three benefits you will have your pension suspended after a maximum of 3 years. You can now claim your suspended pension from age 60 (or age 55 if your previous employer consents to this).

If the pension restarts before age 65 it is reduced for early payment, but your employer can decide to waive this reduction on compassionate grounds. If a death grant becomes payable during the period of suspension it is calculated as five times the pension minus the pension and lump sum that has already been paid.

Previously, if you were a tier three ill health pensioner you could have your level of benefit raised to a tier two benefit subject to a medical review and without any time restrictions. Now, this must happen within three years of the tier three benefit being suspended, or before age 65 if that is sooner. If you reach age 65 the pension then in payment becomes permanent.

If a member returns to local government employment following receipt of an ill health award, any future ill health benefits that may become payable will be restricted to the total benefits that would have been awarded had a tier one benefit been awarded on the first medical retirement.

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