Committee/Meeting: Pensions Committee	Date: 9 June 2011	Classification: Unrestricted	Report No: PC/004/112

Report of: Corporate Director Resources Originating officer(s) Alan Finch, Service Head – Finance, Risk & Accountability ; Oladapo Shonola, Chief Financial Strategy Officer	Title: Hutton Commission Report Wards Affected: All

Lead Member	Cllr Anwar Khan, Chair of Pensions Committee
Community Plan Theme	All
Strategic Priority	All

1 SUMMARY

1.1. At the November 2010 meeting of the Committee, Members requested an update on the work of the independent Public Service Pensions Commission, led by the former Cabinet Minister John Hutton. This report provides that information.

1.2. The Hutton Commission was established by the Chancellor of the Exchequer in June 2010 to undertake a fundamental review of public service pensions provision by the time of the next Budget in April 2011. Having issued an interim report in October 2010, the Hutton Commission issued its final report in March 2011.

1.3. In the Budget, the Government announced "The Government accepts Lord Hutton's recommendations as a basis for consultation with public sector workers, trades unions and others…. The Government will set out proposals in the autumn that are affordable, sustainable and fair to both the public sector workforce and the taxpayer".

2 DECISIONS REQUIRED

The Committee is recommended to:-

2.1 Note the report into the work of the independent Public Service Pensions Commission and that officers will report back when there are any further developments on this issue of public sector pension reforms.

3 REASONS FOR THE DECISIONS

3.1 Members requested this report in order to update themselves on the work of the Hutton Commission.

4 ALTERNATIVE OPTIONS

4.1. No decision is required at this stage.

5 BACKGROUND

5.1. The issue of public sector pension provision has moved up the political agenda in recent years, largely because;

- The cost of all pension schemes has increased substantially due to increased longevity.

- The closure of many Company defined benefits schemes increasingly makes public sector schemes seem generous in comparison to the provision available to other workers.

- The nature of the schemes is such that responsibility for any deficit rests with the taxpayer and not with the beneficiary, so that the cost of the schemes for the taxpayer, whether now or in the future, has increased.

5.2. The Coalition Agreement committed the Government to establishing an independent commission to review the long term affordability of public sector pensions, while protecting accrued rights. Subsequently, in June, the Chancellor announced that the Commission would be set up, under Lord Hutton of Furness (John Hutton), the former Labour Secretary of State for Work and Pensions, to undertake a fundamental structural review of public service pension provision. The commission was asked to "make recommendations on how public service pensions can be made sustainable and affordable in the long-term, fair to both the public service workforce and the taxpayer, and ensure that they are consistent with the fiscal challenges ahead".

5.3. The Commission was asked to consider a range of issues including:

- the disparity between public service and private sector pension provision;

- the need to ensure that future pension provision is fair across the workforce;
- how risk should be shared between the taxpayer and employee; and
- wider Government policy intended to encourage adequate saving for retirement and longer working lives.

5.4. The Commission was asked to report in time for the next Budget, which has been announced for 23rd March 2011, and to issue an interim report in time for the Spending Review in October. The interim report was published on 7th October 2010 and the final report 10th March 2011.

6. Final Report

6.1. The final report makes 27 recommendations in all, but the main recommendation is for a move away from the existing final salary benefit scheme to a career average structure scheme. Although, he recommends that any accrued rights under the existing scheme should be preserved.

6.2 The report emphasises the importance of public service pensions but points out that most schemes were last substantially reformed in the 1970s, since which time the context within which they operate has changed substantially. In the early 1970s, the life expectancy at age 60 was 18 years, now it is 28 years. In addition, many more people reach the age of 60. A man who retires at 60 can now expect to live more than 40% of his adult life in retirement and the figure is higher for women.

6.3 Some limited reforms have taken place in recent years. These include;

- The change in indexation from Retail Prices Index (RPI) to Consumer Prices Index (CPI), which in the run will increase pension benefits by a lesser amount year on year.

- Increases in pensionable age, which in the Local Government Scheme means that staff will ultimately not receive access to their pension until the age of 65 (previously 60).

- Introduction of differential employee contribution rates in the Local Government scheme so that rates now increase from 5.5% to 7.5% with increasing pay (replacing the previous 6% standard rate).

6.4. The drawback is that most of these measures will not affect the costs of the schemes for many decades.

6.5. The Commission has set a number of principles for future public service pension provision;

- Affordability and sustainability

  The question of affordability is ultimately a matter for political choice, but this decision needs to be taken in the context of a sustainably and affordable scheme (i.e. not one that simply shunts costs onto later generations).

- Adequacy and fairness

  Pensions should provide an adequate retirement pension for public sector workers, maintaining a balance of fairness between workers, and between pensioners and taxpayers.

- Supporting Productivity

  The pension schemes should offer value for money and should not be a barrier to measures that improve productivity and efficiency, such as outsourcing or mutualisation.

- Transparency and simplicity

  Schemes should be widely understood by beneficiaries and taxpayers

6.6. The report recommends an increase in contribution rates as a means for savings in the short. The Commission said this should be done in such a way as it protects the low paid and does not impact significantly on opt out rates. The Government has already adopted this recommendation and plan to implement it in a way that ensures that increased contributions will fall more heavily on higher earners. Although, there is a danger that any significant rise in rates would simply lead to more staff leaving the schemes, which would be counter-productive in terms of one of the Commission's principles of sustainability.

6.7. The report has come down against pure defined contribution schemes which it says would not necessarily be cheaper to fund, result in uncertainty of benefits for scheme members, including the low paid, and not make the best use of the ability of the Government, as a large employer, to manage some of the schemes' risks.

6.8. Other notable recommendations include:

- the immediate increase of retirement age to 65 years for new entrants and to age 68 by 2046. Some research as shown that the proposed increase is not enough to keep pace with the rate of increase in longetivity

- Replacement of Pension Committees with Pension Boards with member nominees

- Regular analysis of the fiscal impact of the schemes by the office for Budget Responsibility

- No access to public service pension schemes b future non-public service workers – this could lead to significant reduction in fund membership.

6.9 The Final Report is available in full at the following website:

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

6.10 The Government has responded by accepting the report as a basis for consultation and stating that proposals will be issued in the Autumn

6.11 At the Tower Hamlets Council meeting in April, the Council passed a resolution that the Council write to the Chancellor of the Exchequer calling for the Government to rethink its proposed increases to LGPS member contributions and resolved to work with Trade Unions to ensure employees are made aware of the proposals for the LGPS and to encourage them to support the Council's representations to defend their pension scheme. This letter has been sent.

7. Officers Remarks

7.1. This section of the report comprises some general remarks by officers on the principles of the reforms as put forward by Hutton. It is important to note that the Hutton Commission is reviewing pension provision across the public sector as a whole and not just in Local Government. The LGPS differs from most other public sector schemes in that it is a funded scheme, although the majority of funds are not currently fully funded, and it is managed locally by trustees within each local authority (the Pensions Committee in Tower Hamlets). Some of the criticism of the public sector pension schemes has been levelled at 'pay as you go' schemes such as the civil service, teachers and NHS schemes, and the LGPS is not in the same category. Nevertheless it is a statutory, defined benefits scheme based on final salary and its costs have risen over the years as longevity has risen.

7.2. There can also be little doubt that change needs to take place in order to adapt the scheme to the conditions of the 21st Century. For example, the use of a final salary scheme in an era when senior public sector salaries have increased far beyond what they were when the schemes were established no longer seems tenable. Much of the bad publicity for the scheme arises from the apparent generosity of so-called 'gold plated' pensions for 'fat cats', which has skewed debate and distracted from the fact that most local government pensions are small amounts. (The average annual pension payment in the Tower Hamlets scheme in 2009/10 was £7,400). In principle, changing to a career average scheme will have more impact on higher paid staff, as for these staff their final salary is likely to be much higher than their career average. Graduated contribution rates also have more impact on the higher paid. These principles could therefore be seen as introducing greater fairness into the LGPS.

7.3. The alternative to reform along the lines of the Commission's principles would be to allow the schemes to be adapted piecemeal by successive Governments in a bid to control costs. Such piecemeal change has already taken place to some extent and arguably these changes do not receive appropriate scrutiny. For example the switch from RPI to CPI indexation has reduced the benefits that existing pensioners would otherwise have received in a way that is not very transparent. A reform package that establishes a fair, affordable and sustainable scheme for the foreseeable future is arguably preferable to employers, scheme members and taxpayers than a series of marginal changes to the scheme that lack clear accountability.

7.4 The Government has promised to protect accrued rights, (although changing indexation from RPI to CPI is a grey area) and it appears that this promise will be met. This could be seen as an important principle in terms of natural justice, since staff entitled to accrued benefits have already undertaken the work that earned them those benefits, although it does means that the benefits of pensions reform in terms of reduced costs will take quite some time to emerge. Furthermore the Hutton Commission has stated that it is not an option to reduce public service pension provision to the level of a lowest common denominator if the state is to attract a suitably motivated and trained workforce.

7.5. In view of the fact that public sector staff are also seeing a real terms reduction in pay as a result of the pay freeze and high rates of inflation, there is a risk that some staff will decide that they cannot afford to pay the additional contributions and leave the fund. If this happens on a large scale then the costs of maintaining the LGPS could increase in the short term, because the Fund would lose some of the liquidity benefit of employee contributions and investment performance would need to rise. For those staff who can be persuaded to take a longer view, however, the LGPS is likely to remain a good value, subsidised pension scheme in comparison to available alternatives.

7.6 The Chancellor welcomed the report and a consultation is expected to be launched that is likely to conclude in the autumn of 2011. Therefore, it is going to be some months before we have definitive answers as to which recommendations have survived and how Local Government Pension Scheme (LGPS) will look going forward.

7.7. Officers will report back to the Committee if there are any further developments in this area, prior to or after consultation has been concluded.

8 COMMENTS OF THE CHIEF FINANCIAL OFFICER

The Council contributes £39m a year to the Pension Fund which supports current and future benefits to around 5,100 existing members of staff and 9,600 former employees. At the time of the 2010 actuarial valuation, the scheme liabilities were valued at £1,077m and these were 70% funded by the market valuation of assets.

9 CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)

9.1 The LGPS is a national scheme, administered locally. The scheme is closely governed by a suite of regulations made pursuant to section 7 of the Superannuation Act 1972. The LGPS (Administration) regulation 2008 are particularly significant in the context of the Hutton Commission's work, as they deal with matters such as membership, contribution and payment of benefits. Any reform of the LGPS flowing from the Commission's recommendations would involve amendment of the statutory scheme. Advice can be provided about any such amendments as and when the details become available.

10 ONE TOWER HAMLETS CONSIDERATIONS

10.1 All employees of the London Borough of Tower Hamlets are entitled to join the Pension Scheme.

11 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

11.1 There are no direct SAGE implications.

12 RISK MANAGEMENT IMPLICATIONS

12.1 The governance of the Pension Fund has its own risk management arrangements. These are not directly affected by the issues raised in this report.

13 CRIME AND DISORDER REDUCTION IMPLICATIONS

13.1 There are no direct crime and disorder reduction implications.

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

No "background papers" were used in writing this report