1. **Early Retirement and the Local Government Pension Scheme**
   Extensive use of discretionary early retirement has meant that over three-quarters of retirements are now earlier than normal.

2. **Why Is There Cause for Concern?**
   Early retirement can be expensive, and pension fund contribution rates are increasing.

3. **What Needs to be Done?**
   Good practice in early retirement decisions could reduce the future burden on pension funds.

4. **Looking to the Future**
   If good practice is not followed, questions might be asked about the long-term future of the Local Government Pension Scheme.
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© Audit Commission 1997

First published in November 1997 by the Audit Commission for Local Authorities and the National Health Service in England and Wales, 1 Vincent Square, London SW1P 2PN

Printed in the UK for the Audit Commission by Belmont Press.

ISBN 1 86240 055 5

Photographs: Hilary Shedel (Cover, pp5, 12, 30, 45), David Mansell (p15).

With thanks for additional data to Incomes Data Services, 77 Bastwick Street, London EC1V 3TT, 0171 250 3434.
Since the late 1970s there has been gradual, but fundamental and far-reaching, societal change. People live longer, suffer from fewer chronic diseases, and generally expect a higher standard of living, both while they are in work and during their retirement. These changes are having a profound impact on the national economy, and in particular have implications for the long-term funding of retirement pensions.

In the public sector, the cost of pensions and the loss of experience arising from increasing numbers of senior staff taking early retirement raise questions. For example, following a report by the National Audit Office, recent regulations have been designed to make the cost of early retirement for teachers more apparent to the schools concerned. In other parts of the public sector, particularly the fire and police services, both the Audit Commission and local government itself have expressed concern about the escalating cost of pensions and the impact on revenue budgets. Police and fire service pension payments are unfunded and the cost is met from the annual revenue budget; an increasing proportion of revenue is therefore being absorbed by pension payments, squeezing front-line operational expenditure (Refs. 1 and 2).

Pensions funding and administration for local government staff operate under a different regime from the schemes for uniformed police and fire officers. A pension scheme for local government has been in operation for many years, with roots in the Local Government and Other Officers’ Superannuation Act 1922 (and even earlier in London). The current legislation is set out in the Superannuation Act 1972, and the detailed operation of the Local Government Pension Scheme (LGPS) has been governed by successive sets of regulations dating back to 1974. (Appendix 1 sets out the background to the LGPS and summarises the operation of the scheme as it currently stands). A key feature of the scheme is that contributions from local government employers and employees are invested in pension funds to provide an income stream to pay for the pensions. But declining funding levels (the ratio of pension fund assets to liabilities) and increasing contribution rates in most authorities in England and Wales are a source of growing concern. These concerns have increased following the recent Budget which ended the tax credit on Advance Corporation Tax (ACT).

The Audit Commission and its auditors have a responsibility for ensuring regularity and probity in local government pension matters – for example, through the annual audit of pension fund accounts – and auditors have occasionally had to intervene following an investigation of unlawful pension payments. But the Commission also has an important role in relation to achieving value for money and the proper use of public finances.
This study takes a wider view of the operation of local government pension arrangements, focusing particularly on the planning and control of early retirement. The study has not examined pension fund administration – which has been the subject of a recent government scrutiny – or investment performance. Both of these can have an important bearing on pension funding but fall outside the study’s scope.

This report sets out the Commission’s findings and recommendations in order to promote the good practice already evident in some authorities. It is aimed at councillors and chief officers who are responsible for determining a council’s early retirement policy. Its findings are also likely to be of wider interest to anyone concerned with public sector finance. The report will be followed up by local audits throughout England and Wales, and the Commission will also produce a management handbook, designed for use by those officers in local government most directly concerned with early retirement matters. Much of the good practice identified may be equally applicable in other parts of the public sector – fire, police, education, health and the Civil Service. The Accounts Commission is undertaking a parallel review of the management of early retirement in Scottish local authorities.

The study findings are based on visits to 19 local authorities in England and Wales, augmented by questionnaire responses from nearly 150 others. A significant feature of the work has been the analysis of a very large database of individual pension fund members’ leaving details. Data was extracted, with permission from the employers concerned, from almost half of the pension funds, covering over 200 employing authorities and nearly 110,000 retirements in the last six years. Further details of the study methodology are provided in Appendix 2.

The study was carried out by staff within the Commission’s Local Government Studies Directorate: Greg Birdseye, Doug Edmonds, Paul Orrett and Rob Burns – with external assistance from Janet Paske and Ray Beatty and specialists Harry Wilkinson, Will Werry and Colin Jones. One of the major firms of local government actuaries, Hymans Robertson, facilitated the extraction of data from pension fund records and estimated the cost of each early retirement. Valuable advice and insight were provided by an advisory group drawn from the local government professions involved, central government and the private sector (see Appendix 3).

The Commission would like to thank all those who helped with the study for their contribution, together with all the local authorities and other bodies which provided information – through fieldwork and questionnaire responses – and those which allowed access to their pension fund data. While acknowledging this contribution, responsibility for the study’s findings and its recommendations rests with the Commission alone.
Early Retirement and the Local Government Pension Scheme

Local government staff are retiring earlier (and living longer). In part this reflects changing social attitudes; in part it reflects the recent history of local government – for example, compulsory competitive tendering, loss of services such as further education, and financial constraints.

One way for local government to make staffing adjustments is to allow early retirement. Of the 42,000 employees who retired in 1995/96, 32,000 (over three-quarters) went earlier than normal retirement age. Almost 40 per cent of retirements were on grounds of ill-health.
1. Pensions issues have become high profile in recent years, for several reasons:
   ● the ‘Maxwell’ scandal raised concerns about the security of non-statutory (or private sector) pensions, which the Pensions Act 1995 subsequently addressed;
   ● the ‘mis-selling’ of private pensions attracted much publicity and is an issue that has still not been resolved; and
   ● the Government has announced plans for a wide-ranging review of pension arrangements, looking particularly at the balance between the state scheme and occupational or private pension provision.

And the Local Government Pension Scheme (LGPS) has also been subject to pressures and changes which raise serious issues.

2. The provisions of the LGPS, with their roots in the local government of the 1970s, merit review in the 1990s. On the surface, today’s local government is very similar to that of 20 years ago. Councils are still responsible for education, environmental services and social services; the council still provides its citizens with recreational and sports facilities, and in most areas remains a big landlord. But a chief executive who retired several years ago – returning perhaps to his or her successor’s leaving party – would find that in many councils internal management, organisational arrangements and methods of service delivery have changed, in some cases beyond all recognition.

3. He, or she, might notice that some key areas of service delivery, such as further education, no longer fall within the remit of the council, and in others the direct influence of the council has diminished considerably (for example, through the local management of schools). A wide range of services such as refuse collection, street sweeping and the management of leisure centres is now delivered by external contractors, or stand-alone direct service organisations (DSOs). Government action, financial constraints and the demands of citizens for improved services have combined to influence further how local authorities are managed today.

4. Responding to these pressures has been a major challenge to local government, and particularly so given the constraints on resources. Since over half of local government expenditure is on staffing, the changes have been felt most sharply by the workforce that delivers or is responsible for services. There has been considerable cultural and organisational change - flatter management structures, the merging of traditional departments, setting up DSOs to meet competitive pressures, and so on. As a result, overall employment in local government has declined over the last 10 years, by around 8 per cent.
5. Changes of this sort result in some displacement of staff, as existing posts are abolished or responsibilities change. And there are inevitable stresses with which some staff are, unfortunately, unable to cope. Local government is not unique in the changes it has experienced or their consequences – other parts of the public sector and the private sector have also had to adjust, often painfully, to similar external and internal pressures.

6. One way for local government to make such staffing adjustments, in as painless a way as possible, is to use the discretion available in the LGPS under the Local Government (Discretionary Payments) Regulations 1996, and allow individuals to retire early. The key provisions relating to early retirement [BOX A, overleaf] provide authorities with the discretion to allow people to retire after the age of 50 but before their normal retirement age, either on grounds of redundancy or ‘in the interests of the efficient exercise of that authority’s functions’. Ill-health early retirement is available for staff at any age.

---

BOX A

Summary of Local Government Pension Scheme retirement provisions

Benefits of the Local Government Pension Scheme (LGPS)

Upon retirement, employees receive an annual pension equal to one-eighthieth of their final pensionable remuneration for each year of reckonable service, plus a lump sum equal to three times the first year pension.

Pensionable remuneration is currently defined as:

‘All salary, wages, fees, and other payments paid to him for his own use in respect of his employment, and the money value of any benefits provided for him by reason of his employment.’

Routes to retirement

(i) Normal retirement occurs at age 65, but can be between 60 and 65 provided that an employee has been a member of the scheme for at least 25 years.

(ii) Late retirement occurs after the age of 65. For local government employees, it is allowed only at the employer’s discretion.

(iii) Ill-health retirement occurs where an officer is certified by the employer’s medical practitioner as being permanently incapable of performing the duties of that employment because of ill-health.

(iv) Early retirement on the grounds of redundancy occurs where an officer aged 50 or over is in a job which is made redundant. (Redundancy under the age of 50 is covered by different regulations.)

(v) Early retirement on the grounds of efficiency occurs where an officer aged 50 or over has ceased to be employed ‘in the interests of the efficient exercise of that authority’s functions’.

Agreeing to leave early

Agreement from the employee is not needed for an early retirement to take effect. For early retirement, an officer must have contributed to the pension fund for at least two years to qualify for immediate payment of pension.

Enhancing (increasing) the value of the pension

When early retirement is given on the grounds of redundancy or efficiency, the employing authority may use discretion allowed for in the discretionary payments regulations to award enhancements in the form of ‘compensatory added years’ (also known as discretionary added years) to an individual’s service years. The enhancements have the effect of increasing the lump sum and annual pension. If employees are medically retired they automatically receive the maximum enhancements appropriate to their circumstances, provided that the individual has at least 5 years’ service.
Local government has used this discretion to allow early retirement widely in recent years, to the extent that over three in four staff retired before normal retirement age in 1995/96 [EXHIBIT 2]. In that year, over 32,000 staff retired early from local government. In some councils, over 90 per cent of all retirements were earlier than normal retirement age [EXHIBIT 3, overleaf]. This pattern of early retirements has been similar for several years, with perhaps a gradual increase in the proportion of ill-health retirements [EXHIBIT 4, overleaf].

Since then there has been the additional impact of local government reorganisation in many areas, particularly affecting Wales.

---

**BOX A (continued)**

No more than 10 added years can be awarded in any circumstances.

**Paying for the early retirement**

For redundancy and efficiency enhancements, the cost of the added years is charged to the employing authority’s revenue account. For ill-health retirements, the added years costs are met by the pension fund. The cost of paying the pension early falls on the fund and is taken into account in setting the employer’s contribution rate at the next valuation.

Source: Drawn from regulations made under the Superannuation Act 1972.
EXHIBIT 3
Incidence of early retirement, by council, 1995/96
In some councils over 90 per cent of all retirements were earlier than normal retirement age.

Source: Audit Commission analysis of pension fund data (1997)

EXHIBIT 4
Early retirement trends in local government, 1990/91 to 1995/96
There has been a gradual increase in the proportion of ill-health retirements.

Source: Audit Commission analysis of pension fund data (1997)
Authorities have used their discretion to allow early retirement because it:

- can be implemented quickly where volunteers can be found;
- allows local authority managers to circumvent possibly lengthy negotiations;
- reduces the likelihood of industrial action or legal challenge;
- avoids the problems of finding (often unwilling) departments to take on staff from other departments whose job has been made redundant;
- saves having to re-train people whose skills have been overtaken by events; and, most immediately
- can provide short-term budget savings, by deferring costs to future years.

Compulsory redundancy, by comparison, requires intensive management action and often results in problems with trades unions, possibly leading to industrial action which can interrupt essential services.

But the volume of early retirement decisions places growing strains on pension funds and calls into question the long-term sustainability of the LGPS itself (Ref. 3). The funds cannot become insolvent and current members are unlikely to lose their entitlement, since the scheme has statutory backing. But, for a scheme designed to provide pensions for most employees leaving at normal retirement age, questions must be raised about whether the funding of the scheme – given current levels of early retirement – can be sustained without its costs having an unacceptable impact on the capacity of councils to provide services to the public. The exercise of discretion under the regulations, originally intended as a solution to staffing problems, has now come to be a problem in itself. The next chapter analyses the causes of concern, drawing on the evidence collected from the Commission’s fieldwork and data analysis. Chapter 3 sets out the steps that authorities should take to address these concerns, illustrated with good practices that were identified in visits to fieldwork local authorities. Chapter 4 raises some longer term questions about the operation of the LGPS.
Why Is There Cause for Concern?

Early retirement can be expensive, and the volume of early retirements in recent years is putting an increasing burden on pension funds. Discretion that was intended to be used in certain limited circumstances has become almost the norm. Of particular concern is the proportion of ill-health retirements.

Actuaries have estimated the total capitalised cost commitment (net present value) of early retirement decisions taken over the last six years to be in the region of £5.7 billion.
11. This chapter examines whether concern about the LGPS is alarmist or well founded. The first part reviews the extent of early retirement in local government and its causes, as compared with other organisations. The chapter then reviews the benefits awarded to people who retire early, and looks at how local government pensioners fare as compared with others. Having compared early retirement levels and benefits, the chapter then analyses their cost and impact on the local authority pension funds.

12. Chapter 1 showed that, in recent years, fewer than one local government employee in four has left at their normal retirement age. Moreover, nearly 40 per cent of all retirements were on the grounds of ill-health. These facts should be of concern to both local authorities and central government, because early retirement is expensive and may not be the best use of public funds.

13. One way of determining whether concern is well founded is to look at the behaviour of local government compared with other organisations. When making these comparisons, there are four aspects that need to be considered:
- the extent of early retirement;
- the causes of early retirement (ill-health, redundancy or efficiency);
- the basic pension provision; and
- enhanced benefits for early retirement.

The extent of early retirement

14. Local authorities are not the only organisations with high levels of early retirement. Throughout the labour market the percentage of males in the workforce at age 55 has been steadily falling. Although there has been a corresponding rise in female employment, the cost of the reduction in male employment has been paid, in part, through pension funds. In 1993, Incomes Data Services (IDS) concluded that ‘Early retirement is now the norm’ (Ref. 4). In 1997, IDS updated its survey

EXHIBIT 5

Participation in the workforce
Throughout the labour market the percentage of males in the workforce at age 55 has been steadily falling.

Source: A New Social Atlas of Britain, Daniel Dorling, 1995
and found that over 55 per cent of all retirements in the sample of employers occurred before the age of 60 (Ref. 5). The overall average age of retirement in local government is now 56, lowered because of the large proportion that retire early, at an average age of 54.

15. Early retirement is not applied equally for all groups of local government staff. Male non-manual staff are most likely to retire before their normal retirement age, while female manual workers are most likely to work until normal retirement age [EXHIBIT 6]. This pattern is at variance with overall changes in local government staffing [EXHIBIT 7]. In the last 10 years, manual staff numbers have fallen by around 30 per cent, while numbers of non-manual staff – particularly senior staff – have risen by around 15 per cent. Yet it is among non-manual staff, where staff numbers have been rising, that the most early retirement has occurred, raising questions about the claim that the need for staff reduction is the fundamental cause of the increase in early retirement.

**The causes of early retirement**

16. The early retirement typology (redundancy, interests of efficiency, or ill-health) differs markedly between local government and other organisations. Although there are many other differences between the public and private sector, a significantly higher proportion of local government staff leave through ill-health retirement than do staff in most other organisations [EXHIBIT 8, overleaf]. For male manual staff, 55 per cent of retirements in 1995/96 were for reasons of ill-health.

EXHIBIT 6

*Retirement by staff group and gender, 1995/96*

Male non-manual staff are most likely to retire before normal retirement age.

Source: Audit Commission analysis of pension fund data (1997)
EXHIBIT 7

Change in local government staff numbers, 1987 to 1995

Non-manual staff numbers have risen while the number of manual staff and overall staff totals have fallen.

Source: Adapted from The Melody Lingers On, Audit Commission, 1996 (Ref. 6)
More LGPS staff retire due to ill-health than in any of the schemes in the IDS sample of employers.

17. There is wide variation about these averages - in some local authorities, over two-thirds of retirements in 1995/96 were for reasons of ill-health [EXHIBIT 9]. Some authorities fall within the general range of private sector experience, with ill-health retirement at 20 per cent or less. But for the majority of employers in the IDS survey, ill-health retirements are substantially below this level, whereas in the majority of local authorities they are above it. This poses the question as to why rates are so high in these authorities. High levels are clearly not inevitable for LGPS employers, and may be attributable in part to the way discretion under the regulations is being exercised. Manual workers are more likely to suffer from ill-health than non-manual staff, but a contributory factor to such high levels may be the rules of the scheme. For example, ill-health retirement has no impact on a DSO’s accounts. By contrast, some of the cost of efficiency and redundancy retirements does fall on the accounts and therefore managers have an incentive to classify early retirement as ill-health in order to improve the competitiveness of their DSO.
In some councils over two-thirds of retirements were on grounds of ill-health.

Source: Audit Commission analysis of pension fund data (1997)

18. In April 1997, an article in the British Medical Journal (Ref. 7) reviewed ill-health provision in a number of pension schemes. It concluded that ‘the granting of ill-health retirement ... may not be determined by illness’. In looking at local government, the United Kingdom Steering Committee on Local Government Pensions (UKSC) said:

‘There are significant differences between authorities ... the range shown ... seems, prima facie, more likely to reflect different management practices rather more than markedly different incidence of ill-health and stress within the workforce’ (Ref. 8).

19. The LGPS regulations relating to ill-health have now been amended on the advice of the UKSC. The impact of the changes, to come into effect in April 1998, has yet to be seen, and opinion is divided on whether they go far enough. The revised regulations require certification by an independent doctor approved by the fund administering authority, but there will still be scope for the exercise of discretion. The use of that discretion will be critical. Its effect needs to be monitored closely and further action taken if the expected effect is not achieved. Even without considering the cost of providing pensions, any employer with a workforce that is experiencing ill-health problems causing more than half of all retirements should be seeking urgently to investigate the reasons. If the LGPS regulations are being used inappropriately, corrective action should be taken without delay.

20. While ill-health retirement is gradually increasing, it appears that the proportion of early retirements on grounds of redundancy is also increasing, and that for efficiency is decreasing. However, these trends may be more apparent than real. Further analysis shows that the two routes to redundancy are not used with any consistency: for example,
some metropolitan districts have almost no redundancies and high levels of efficiency retirements while others have the exact opposite [EXHIBIT 10]. Even allowing for particular local circumstances, it would be surprising if authorities were so different in their characteristics and problems that the split between redundancy and efficiency retirements arose from an objective and consistent interpretation of the early retirement regulations.

**Basic pension benefits**

21. A detailed comparative analysis of the benefits of different pension schemes has been carried out by Union Pension Services Ltd (UPS) (Ref. 9). The analysis consists of a regular evaluation of nearly 200 major pension schemes. A ‘benefits ratio’ is calculated according to the value of the basic pension benefits and the value of employers’ and employees’ contributions for current members. Taking 100 as an ‘ideal’ pension, the analysis shows the LGPS in a middle-ranking position [EXHIBIT 11].

22. But this analysis is of the basic scheme only, which assumes retirement at the normal retirement age. The comparisons also need to take account of how pension scheme benefits are applied and look particularly at the use of discretion in awarding enhancements to the basic pension. Against this criterion, the problems facing the LGPS become more apparent.

**Enhanced benefits for early retirement**

23. In local government, pensions are ‘enhanced’ in two ways:

- by not reducing the pension to take account of the fact that early payment means the employee will get their pension for a longer period; and

- by increasing the number of years on which the employee’s pension is based (‘compensatory added years’). I

I A glossary of terms is provided at the end of this report.
24. In contrast, most private sector organisations reduce the pension to cover the cost of early payment. In a recent survey of early retirement terms, Independent Research Services (IRS) reported [Ref. 10] that:

‘The most common method of calculating early retirement benefits in voluntary redundancy situations is to take the accrued pension and reduce it to take account of the fact that the pension is being paid early.’

25. This finding was reflected in a breakdown of private sector pension schemes examined by IRS. Even when redundancy is compulsory:

- 48 per cent of organisations reduce the accrued pension to cover the cost of early payment;
- 35 per cent of organisations provide a reduced pension for those under a certain age, and an unreduced pension for those over that age; and
- only 17 per cent of organisations provide an unreduced accrued pension for all early retirements.

26. Union Pension Services has also analysed the practices of organisations that reduce pensions in this way. Over half of the 100 pension schemes surveyed reduce pensions by 4 per cent or more for each year of early payment [EXHIBIT 12, overleaf].
EXHIBIT 12

Reduction in pensions for early retirement

When awarding an early retirement pension, more than half the organisations surveyed reduce the value by 4 per cent or more for each year of early payment.

Source: Union Pension Services, 1996 (Ref. 9)

27. The purpose of reducing or ‘abating’ (sometimes known as ‘actuarially reducing’) a pension is to ensure that pension fund members receive benefits relating only to the sum that has been contributed to the fund by them and on their behalf. Unlike many of their private sector counterparts, councils do not abate, instead using their discretion to increase pensions by way of added years. As a result, the cost of early retirement in local government can be very high. IDS has estimated that the practice of non-abatement adds as much as 60 per cent to the value of a pension, even without any added years’ enhancement (Ref. 5). Added years’ enhancement will increase the cost of early retirement still further.

28. Thus, while for basic benefits the LGPS seems to be an average scheme, the enhancements that people receive when they leave local government service early make the scheme more attractive for the three-quarters of staff who retire early, at an average age of 54.

29. Such practices are clearly expensive. Calculating the exact cost of early retirement for any one individual is impossible because their life expectancy is unknown. However, by looking at retirements in aggregate it is possible to forecast the costs of discretionary enhancements and early payment with a high level of accuracy. This is what actuaries do. The recent impact of early retirement can be estimated by considering:

- the components of the retirement benefit package;
- the average cost; and
- the actual total cost of early retirement 1990/91 to 1995/96.

The current regulations do allow councils to actuarially reduce pensions in individual cases where an employee over the age of 60 wishes to be allowed early retirement but does not have 25 years of contributions in the scheme. However, an analysis of a sample of over 100,000 retirements over the last six years (perhaps 40 per cent of the total) shows few instances where this provision has been applied – mainly low-paid female staff with relatively short lengths of service.
The components of the cost

The cost of early retirement comprises a number of elements:

● the outflow from the pension fund for early payment of the accrued pension and associated lump sum, for the years up to normal retirement age (this is referred to as the ‘strain’ on the fund);

● the loss of investment income to the fund on the money paid out early; and

● the direct cost of the added years’ enhancements to the pension, and the associated lump sum, until the death of the retiree and the ending of any claim that their dependants may have.

Under the regulations, the cost of the first two elements falls on the pension fund itself; the last has to be paid directly from an authority’s revenue budget (except for an ill-health retirement, when again the fund bears the cost). But because the fund will eventually need to be reimbursed from revenue, all three have an adverse impact on the authority’s resources and hence its service spending options.

The average cost

Actuaries have developed a method for determining the long-term cost of an early retirement decision. Using estimates for variables such as life expectancy, investment returns and salary inflation relative to prices, it is possible to determine ‘factors’ of full ‘capitalised’ cost (or net present value) of a decision taken today as a result of which pension payments will continue until the death of the pensioner (and their dependants). For each early retirement, the actuaries can estimate the additional cost, over and above those costs to the fund of retirement at normal retirement age, which are already allowed for in the pension fund. Over 32,000 LGPS employees were allowed early retirement in 1995/96. The average capitalised cost, calculated using these actuarial factors, is over £35,000 per retirement [EXHIBIT 13, overleaf].

Staff leaving because of ill-health and on grounds of efficiency are likely to be replaced, but in some redundancy cases the cost will be offset by a reduction in the salary bill. For a genuine redundancy with no replacement there is an immediate saving which is greater than the annual pension. But in a significant number of redundancy cases, some councils operate what they term a ‘bumped’ redundancy system, whereby an individual seeking early retirement is in effect ‘transferred’ to a post to be declared redundant elsewhere in the authority (most often of a lower grade). When the latter post is made redundant, the savings from the redundancy are much reduced if there is a wide disparity between the grades of the retiree and the redundant post.

These figures are calculated by the actuaries, Hymans Robertson - one of the major firms involved with pension funds in local government - on the basis of factors determined prior to the July 1997 change in the tax credit on Advance Corporation Tax. Actuaries are currently estimating the impact of the change.
EXHIBIT 13

**Average capitalised cost of early retirement, 1995/96**

An average early retirement costs over £35,000 more than a normal retirement.

Source: Audit Commission analysis of pension fund data (1997) based on cost calculations by local government actuaries, Hymans Robertson

34. Thus a great deal of the expenditure on early retirement is unlikely to result in savings. The Staffing Watch figures shown in Exhibit 7 suggest that most of the non-manual staff retired early must have been replaced, in some cases with different responsibilities, so that the overall local government paybill has continued to rise.

35. The average cost of providing early retirement to an individual disguises some wide variations. Depending on final salary, age, and the number of added years, individual cases can be very expensive [TABLE 1].

<table>
<thead>
<tr>
<th>TABLE 1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Examples of the total capitalised cost of allowing early retirement, for a range of salaries</strong></td>
</tr>
</tbody>
</table>

| Final pensionable remuneration (£) | 21,000 | 33,400 | 43,400 | 52,800 | 61,500 |
| Age at retirement | 51 | 54 | 55 | 53 | 53 |
| Reckonable service | 33.3 | 31.5 | 33.6 | 34.4 | 33.8 |
| Added years | 6.7 | 5.7 | 6.4 | 5.6 | 6.2 |
| Capitalised cost of added years (£) | 48,600 | 44,800 | 64,000 | 70,100 | 89,500 |
| Capitalised cost of early payment (£) | 72,400 | 54,700 | 63,200 | 106,300 | 122,000 |
| Total capitalised cost of allowing early retirement (£) | 121,000 | 99,500 | 127,200 | 176,400 | 211,500 |

Source: Actual cases taken from the Audit Commission’s database of pension fund records (1997)
The total cost of early retirement

36. Given the number of early retirements from local government in recent years and the financial implications of allowing early retirement (in most cases with enhancement), the overall potential impact on spending has been significant. In 1995/96, early retirement decisions resulted in a future commitment (capitalised cost) of £1.1 billion in England and Wales. Over the six years for which the Commission has collected information, the capitalised cost has been roughly constant at around this level of £1 billion per year. Thus, during the period 1990/91 to 1995/96, the total figure amounted to £5.7 billion [TABLE 2] - a sum sufficient to clear the capital repairs backlog for all schools in England and Wales and bring all local authority maintained roads up to standard (Ref. 11). The early payment element accounted for £2.2 billion (nearly 40 per cent) of this total.

37. Early retirement costs money: the statutory nature of the LGPS means that pension payments and pension fund contributions have first call on resources. Where an authority allows early retirement, it is accepting an implicit trade-off, since higher early retirement costs mean fewer resources to provide services to its citizens. Although the cost of early retirement might be offset in the short term by a reduced overall salary bill, authorities are mortgaging the future in the long-term. Where a postholder is retired early, there is a knock-on reduction in front-line services. And the cumulative financial impact of early retirement is now being felt by the pension funds to a significant degree.

The impact of the cost on pension funds

38. The impact of large numbers of high-cost retirements has had a measurable impact on the local authority pension funds. This is reflected in:

- declining funding levels; and
- rising contribution rates.

---

**TABLE 2**

Total commitments arising from early retirement decisions, 1990/91 to 1995/96

<table>
<thead>
<tr>
<th>Year</th>
<th>Early payment (£million)</th>
<th>Added years (£million)</th>
<th>Total (£million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990/91</td>
<td>250</td>
<td>420</td>
<td>670</td>
</tr>
<tr>
<td>1991/92</td>
<td>350</td>
<td>550</td>
<td>900</td>
</tr>
<tr>
<td>1992/93</td>
<td>410</td>
<td>660</td>
<td>1,070</td>
</tr>
<tr>
<td>1993/94</td>
<td>400</td>
<td>620</td>
<td>1,020</td>
</tr>
<tr>
<td>1994/95</td>
<td>350</td>
<td>570</td>
<td>920</td>
</tr>
<tr>
<td>1995/96</td>
<td>450</td>
<td>700</td>
<td>1,150</td>
</tr>
<tr>
<td>Total</td>
<td>2,210</td>
<td>3,520</td>
<td>5,730</td>
</tr>
</tbody>
</table>

Notes:
1. The figures do not include offsetting savings (see para. 33).
2. Total commitment grossed up from a 40 per cent sample of all retirements in the period.
3. The commitment falls partly on the pension funds and partly on local authority revenue accounts (see Appendix 1).

Source: Audit Commission analysis of pension fund data (1997) based on cost calculations by local government actuaries, Hymans Robertson.
Declining funding levels

39. Every three years, actuaries estimate the value of the fund’s assets and long-term liabilities. When the forecast liabilities and assets are equal, the ‘funding level’ is 100 per cent. The funding level is calculated by dividing the forecast assets of the fund by the forecast liabilities for current pensioners, staff in post and ‘deferred’ pensioners (those who no longer work for the employer but have retained their pension entitlement). The LGPS regulations (Ref. 12) do not attempt to define ‘solvency’; instead, the actuary specifies a contribution rate ‘so as to ensure [the fund’s] solvency’. There is no minimum funding requirement as required for private sector pension funds by the Pensions Act 1995 [BOX B], but there must be an expectation that funds will, over time, achieve 100 per cent funding.

BOX B

The Pensions Act 1995

Some provisions of the Act do not apply to the LGPS, which is a statutory scheme with detailed regulations setting out how it operates. However, it would be consistent with the terms of reference of the Government’s recently announced review of pensions that consideration be given to whether some aspects of the Act should be replicated in relation to the LGPS: in particular, the safeguard of a minimum funding requirement (MFR) and a strengthened statutory role for pension fund trustees.

- The setting of an MFR for private sector pension funds, to be achieved within a defined number of years as stipulated by the Pensions Act, imposes a discipline on fund administrators to require up-front payments to the funds by employers when they allow early retirement.
- The statutory role of trustees provides a safeguard against any pressure to act in a way that does not provide protection for fund employers and employees. In the LGPS the council itself acts as quasi-trustees, delegating fund oversight to councillors operating under such titles as a ‘pension fund investment advisory panel’ or a ‘superannuation fund investment subcommittee’. These arrangements do not fulfil the equivalent role of trustees in private sector pension schemes. Such panels do not become involved in the decisions by employing authorities to allow early retirement, or in the level of discretion exercised – these decisions are normally taken by Personnel Committees, not the investment panels, which are more concerned with financial management of the funds. Some panels do include trades union representatives or employing authority councillors, but very often these people have observer status only.
40. Despite the requirement to ensure solvency, significant shortfalls in pension funding have emerged from the most recent actuarial valuations (March 1995). At that time, the funding level for individual funds ranged from below 70 per cent to over 110 per cent; but it had declined in four out of every five funds compared with the previous valuation at March 1992 [EXHIBIT 14]. The average funding level in March 1995 was 89.7 per cent compared with 96.7 per cent in 1992. The next full valuation results (as at March 1998) are unlikely to be available until 1999. Given the continuing pattern of early retirement, the position will have deteriorated in many funds, further accelerated by recent tax changes [BOX C]. A full-scale interim valuation would be costly, but an indication of any general trend may be available from the valuations of the Scottish funds currently in progress.

EXHIBIT 14
Change in funding levels, 1992 to 1995
Funding levels have decreased, for most funds, since 1992.

Source: Audit Commission analysis of DETR data, 1996

BOX C
Advance Corporation Tax

UK companies pay a proportion of their corporation tax when they pay dividends. This is called Advance Corporation Tax (ACT) and it represents 25 per cent of the dividend. UK pension funds have historically been able to reclaim this in the form of a ‘tax credit’, which helped them reduce the cost of providing a pension.

In the 1993 Budget the tax credit available to pension funds was reduced to 20 per cent. In the July 1997 Budget the tax credit was abolished. Before the 1997 Budget, therefore, a dividend of 80p was actually worth 100p to a UK pension scheme, since it could reclaim 20p in tax credits. After the Budget the same 80p dividend is now worth only 80p. The rationale cont./
It has been argued that the decline in funding levels has little to do with increasing early retirement, and instead arises from a variety of factors outside the control of local government. One pension fund administering authority – Essex County Council – has analysed the reasons for the deterioration in its funding level [CASE STUDY 1].

CASE STUDY 1

Breakdown of funding level deterioration

Background

The Essex pension fund experienced a fall in funding of 13 percentage points between 1992 and 1995 – from 97 to 84 per cent.

Action

In conjunction with the fund’s actuary, Essex carried out an analysis of the pension fund and concluded that the fall in funding level could be explained by a number of factors. The largest items subject to management decisions were ill-health and early retirement.

Reasons for the increase in deficit, 1992 to 1995:

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance Act 1993 - reduction in Advance Corporation Tax credit from 25 per cent to 20 per cent</td>
<td>4 per cent</td>
</tr>
<tr>
<td>Early retirement (redundancy and efficiency)</td>
<td>3 per cent</td>
</tr>
<tr>
<td>Ill-health retirement above previous estimate</td>
<td>2 per cent</td>
</tr>
<tr>
<td>Phasing-in of contributions</td>
<td>1 per cent</td>
</tr>
<tr>
<td>Salaries rose higher relative to prices</td>
<td>1 per cent</td>
</tr>
<tr>
<td>Longevity</td>
<td>1 per cent</td>
</tr>
<tr>
<td>Other factors</td>
<td>1 per cent</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>13 per cent</strong></td>
</tr>
</tbody>
</table>

Source: Essex County Council
42. Some funds have experienced an even greater fall than the Essex fund, and there is no reason to suppose that the breakdown for Essex is atypical. The most significant reason, outside the control of local government, for the fall in funding was the 1993 reduction in Advance Corporation Tax credit. But other factors, at least in part the result of management decisions under the control of local government, accounted for a significant part of the change:

- use of discretion to allow redundancy and efficiency early retirements, which cannot be taken into account in setting future contribution rates (3 per cent of the change); and
- ill-health retirements exceeding expectations (2 per cent).

## Rising contribution rates

43. Some of the shortfall in funds in 1992 was caused by the previous government’s decision in 1989 (Ref. 13) to reduce the funding level requirement to 75 per cent, in part to cushion the impact of pension fund payments on community charge levels. Some authorities chose to take a ‘contributions holiday’ by making lower or even zero contributions until the funding level fell to the 75 per cent level. Others decided to reduce gradually to that level and were thus in a better position when the relaxation was rescinded in 1992. Since then, local authorities have been seeking to rebuild funding levels. Many local authorities, in negotiation with their actuaries, have put in place 6-, 9- or even 12-year recovery plans, often on a stepped basis, with contributions set at a low level in the early years. Partly because of this, funding levels in 1995 were on average, seven percentage points lower than in 1992.

44. To remedy this situation, in 1992 and 1995, councils with low funding levels should have agreed with their actuaries to increase their pension fund contributions, for two reasons:

- to ensure that contributions were sufficient to cover liabilities accruing because of staff currently employed; and
- to catch up for past liabilities for which there are insufficient assets in the fund.

45. Some councils that were experiencing tight financial constraints secured agreement with their actuaries to establish a stepped recovery plan, with an initial three-year contribution rate lower than that needed to meet even the current liabilities. As a result, the deficit in the fund continued to increase. At one fund examined by the Audit Commission’s study team, the council continued to pay less into the fund than it needed to meet even current liabilities, despite a poor target funding position at the 1992 valuation. In 1995 the funding level was down by a further 12 per cent. Despite this outcome, the council continued to project paying less into the fund than was needed to meet accruing liabilities.

46. This council was not alone in following such a policy. At best, this approach can only delay the time when payment must be made. At worst, the sum that must eventually be paid (to meet past liabilities) will be even
Employers’ contribution rates are set to increase to an average of almost 12 per cent of the overall salary bill by the year 2000.

47. Employers’ contributions to the pension funds have increased recently. In 1995/96, local government employers paid £1.16 billion into their pension funds (and employees £0.89 billion) compared with £0.90 billion and £0.81 billion respectively in 1994/95 [EXHIBIT 15].

48. The Commission’s survey gathered data on employers’ future contribution rates: in recovery plans agreed with the actuaries at the 1995 valuation, employers’ contribution rates are set to increase to an average of almost 12 per cent of the overall salary bill by the year 2000. Some councils will pay substantially above this level [EXHIBIT 16] (almost 19 per cent in the most severe case in the Commission’s survey).

49. The need to increase employers’ contribution rates will be exacerbated for those councils which have delayed putting recovery plans in place, because of the decision to remove the tax credit on Advance Corporation Tax in the July 1997 Budget. Actuaries have estimated that some councils could face additional employer’s contribution rates of as much as 3 per cent of the salary bill as a result of the Budget. The removal of ACT credits is expected to reduce LGPS pension fund asset values (calculated on the basis of discounted future dividend income streams) by as much as £1 billion (Ref. 15) compared with a market value of funds in England and Wales of £54.6 billion at the end of March 1996 (Ref. 14). As a result, some employing authorities will be paying a sum equivalent to over 20 per cent of their total salary bill into the pension funds.

EXHIBIT 15
Contributions to pension funds by employers and employees
Employers’ contributions have increased recently.

<table>
<thead>
<tr>
<th>Year</th>
<th>Employee Contributions (£ billion)</th>
<th>Employer Contributions (£ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993/94</td>
<td>1.52</td>
<td>0.48</td>
</tr>
<tr>
<td>1994/95</td>
<td>1.72</td>
<td>0.53</td>
</tr>
<tr>
<td>1995/96</td>
<td>2.05</td>
<td>0.57</td>
</tr>
</tbody>
</table>

Source: SF3 Data, Department of Employment, Transport and the Regions (Ref. 14)
Changes in employers’ contribution rates

Employers’ contribution rates are set to rise significantly.

Source: Audit Commission survey, 1996/97

fund by the year 2000. The longer that action is delayed, the greater the likely financial consequences.

50. Over recent years, ill-health early retirements have run ahead of actuaries’ assumptions. Outflows from the funds have been greater than forecast. Consequently, almost from the start of the new actuarial valuation period, many councils are likely to fall even further behind. Without appropriate urgent action, contribution levels may have to increase still further.

Conclusion

51. Early retirement on the present scale, with its impact on funding levels and consequently on contribution rates, poses searching questions. The LGPS is vulnerable to criticism, not for its basic benefit provisions, but because of the way that discretionary benefits have typically been applied. Discretion designed to cater for exceptional circumstances has come to be regarded by local government employees as a right. While statutory and structural changes to local government are understandable reasons why councils have used early retirement to ease organisational change, the current extent of early retirement in local government is of an order far in excess of that which can be justified by such changes and has continued long after major changes have been absorbed. Early retirement has come to be expected by all except those whose personal financial circumstances mean that they cannot afford to leave early. The losers are the future beneficiaries of the scheme, who can no longer be confident that the scheme can continue to exist in its present form, and the taxpayers who in one way or another are called upon to meet deficits in the fund and costs to the employer.

52. The role of the Audit Commission, and its auditors, is to encourage good management practices to answer these challenges. The steps that should be taken are set out in the next chapter.
What Needs to be Done?

Local government faces an unavoidable problem; the costs of early retirement decisions to date are already committed. But local government can bring the situation under tighter control for the future. Early retirement should be seen as a last resort, not an automatic right or a response to every management challenge. And where early retirement is allowed, enhancements to pensions do not have to be at the maximum provided for by the regulations.
Councillors need to be familiar with the cumulative effect of decisions being taken by them or on their behalf.

53. High levels of expensive early retirement have added to the financial problems of local government. An increase in employer contributions is now unavoidable, but urgent action can prevent the position worsening even further. It is not enough to argue that authorities have merely been exercising their lawful discretion under the regulations. Authorities must also act in a reasonable way to safeguard the best interests of taxpayers. In particular councils, as employers, should address two points:

- ensure that early retirement is the last, not the first, option to be considered; and
- where early retirement is unavoidable, ensure that the use of discretion is reasonable, affordable and properly exercised.

54. These issues can be managed within a framework which covers:

- accountability;
- financial prudence; and
- management supervision.¹

Accountability

55. There are two aspects to accountability: councillor involvement and management responsibility.

Councillor involvement

56. Allowing staff to retire early entails a substantial commitment of public money. Even if the costs of individual decisions are modest, a large number of small cases can quickly add up to a significant total, and there needs to be full accountability for such decisions. Councillors need to be familiar with the cumulative effect of decisions being taken by them or on their behalf. Yet in around one-third of authorities there is little or no councillor involvement, even for those with responsibility for such matters. For ill-health retirements, council members are involved in decision-making – as opposed to simply receiving information – in only 18 per cent of cases [EXHIBIT 17, overleaf]. This position is not tenable in the light of the very high levels currently experienced in some authorities. The degree to which LGPS discretion is being used has clearly changed from the time when the scheme was devised. It is the responsibility of officers to make councillors aware of the changed circumstances in their authority so that they can decide on their appropriate level of involvement in decision-making.

57. Councillors should be given enough information to enable them to take an informed decision [CASE STUDY 2, overleaf]. For lower paid staff, summary information would be sufficient, with the decision procedure being devolved to managers. Appendix 4 outlines the sort of summary information that should be provided to councillors, both on an annual basis and to monitor trends over time; say, for a rolling five-year period.

¹ The good practice outlined in this chapter will be covered more fully in the Commission’s management handbook on planning and control of early retirement, to be published in 1998.
Councillor involvement in decision-making

In many cases, particularly ill-health retirement, lead councillors are not involved in decision-making.

Source: Audit Commission survey, 1996/97

It is important that councillors are made aware of the cumulative financial consequences of the pattern of early retirement in the authority. When higher paid staff, perhaps those with salaries greater than £30,000, are allowed discretionary early retirement, councillors should consider such decisions in their entirety. Analysis shows that the highest paid 20 per cent of people leaving early are responsible for incurring over 40 per cent of the cost of early retirement [EXHIBIT 18]. This proportion is not surprising, given the salary structure of local government, and the fact that lower paid staff may not be able to afford to retire early, but scrutiny by councillors will protect senior officers from external criticism. In particular, councillors should be provided with information on the financial implications of allowing ‘bumped’ redundancies, whereby savings to authorities may be much reduced.

In some councils, councillors are not shown details of early retirement cases on the grounds that they relate to the personal financial circumstances of individuals. But the commitment of large sums of public money means that such arguments are not convincing. It is precisely because such sums are discretionary that the decision should be subject to proper scrutiny. Otherwise, councils are vulnerable to allegations of doing deals ‘behind closed doors’. In all but the cases of very senior officers, information could be presented on an anonymised basis in order to protect individuals.
Cost of early retirement and proportion of leavers

The highest paid 20 per cent of all leavers account for over 40 per cent of the cost.

Source: Audit Commission analysis of pension fund data (1997)
59. Where councillors are not directly involved in detail, they should define clear policy guidelines within which officers operate, setting out, for example, the circumstances in which early retirement can be considered. Yet one in eight authorities responding to the Commission’s survey did not have any written policy guidelines covering early retirement. Even where policies exist, they need to be reviewed and updated regularly for changing circumstances.

Management responsibility

60. It is not only councillors who need to be accountable for their decisions – managers’ decisions should be transparent. Where those making a decision are responsible for its consequences, the quality of decision-making is likely to improve. At present, such links are weak in most councils, since the costs of an early retirement often fall on central budgets, or will accrue to the pension fund at some unspecified future date. In many cases the budget of the department allowing an early retirement will benefit from any savings, but will not have to carry the cost of that decision. This arrangement means that departments tend to focus only on the potential savings to them – and ignore the long-term cost to the council and the pension fund. The full revenue and pension fund cost should be charged to the department that is making the decision. Even when the pension fund has a funding level that allows the council adequately to cover the cost of the early retirement, the department making the retirement should still fund it through its own budget. Experiencing the financial consequence of the decision will lead departments to take all factors into account and search for alternatives. There will be occasions when departments – particularly smaller ones – will find this difficult. In these instances, if the benefits can be demonstrated to outweigh the cost, then it may be appropriate to increase their budgets, albeit temporarily. And occasionally a council may decide on a large-scale redundancy exercise, for which there could be some degree of corporate funding.

Financial prudence

61. Accountability will improve the quality of decisions, but such decisions should be governed by the imperative of financial prudence. Financial prudence requires councils to ensure that the full cost of early retirement is taken into account, and that the cost is met in a reasonable period of time.

Full cost information

62. All too often, even where councillors do take decisions on early retirement, there is little or no information on the true cost or where it will fall. In the absence of such information, councillors cannot be sure that the decision was reasonable given the financial circumstances of the council. In these matters, as in all council management, councillors must demonstrate that they have exercised due diligence and prudence.
The financial implications of early retirement can be lost in the small print of the annual budget papers or, in the worst cases, the information is incomplete. It is common to report only the cost of the added years’ pension enhancement – the part which falls immediately on the revenue account of the council. This typically represents only around half of the final cost. The cost of paying the pension early, which falls on the pension fund, is not usually reported. Employing authorities should always request this information from the pension fund administering authority, which should set up systems to ensure that the information is provided promptly so that decisions are not delayed.

All early retirement decisions should be properly recorded, particularly the financial implications, with a full ‘audit trail’, so that any concerns can be quickly investigated. The Commission’s study team and its appointed auditors have found incomplete records in some authorities, particularly where responsibilities are split between finance and personnel departments.

**Paying for early retirement in a reasonable time**

The cost of discretionary early retirement (on grounds of redundancy or efficiency) should be recovered by the time any savings to the employer expire. At the very latest this should be within five years or the date of the retiree’s normal retirement age, whichever is earlier. A contribution to the fund should be made either at the time of retirement or over this period (with ‘interest’ added to cover the cost of payment spread over the period). The figure of five years is based on the assumption that, within that time, the necessary savings would be secured through normal turnover. Five years represents a sensible pay-back period for the ‘investment’ in early retirement.

Where the fund is significantly below 100 per cent funding level – say, less than 90 per cent (the minimum funding requirement for private sector pension funds) – then a tighter timescale of three years – the inter-valuation period – would be more appropriate. The United Kingdom Steering Committee on Local Government Pensions (UKSC) has also advised councils to give urgent consideration to the introduction of a lump sum payment – alternatively phased over three years – to cover the strain on the pension fund from early retirement (Ref. 16). When a council’s funding level is greater than 100 per cent, then it may prefer to allow the funding level to drop nearer to 100 per cent than make a payment into the pension fund (provided that the excess has not already been taken into account by the actuaries in setting the contribution rate). Even when this is so, the department making the early retirement should be expected to pay the cost via a budget adjustment.
67. Essex County Council has introduced this approach [CASE STUDY 3] and Wycombe District Council has adopted a similar practice [CASE STUDY 4].

68. However, additional contributions into the fund to cover the cost of early payment of pension are only one part of the solution. There is, in addition, the ongoing charge to the revenue account of the added years, for the lifetime of the pension. Councils could consider setting up provisions to cover these costs during the period where savings will accrue from the early retirement decision, to be released over the subsequent lifetime of the pensioner in order to off-set the increased pension payments.¹

### CASE STUDY 3

**Meeting the cost of early retirement in Essex**

**Background**

The County Council was concerned about the growing deficit in the pension fund (see Case Study 1).

**Action**

In order to recover the adverse funding position, the County Council, in its role of pension fund administrator, decided to require participating employers to pay the cost of discretionary early retirement into the fund within three years of the early retirement taking place. This is now paid either as a lump sum at the time of the retirement or in a series of 36 monthly instalments.

**The outcome**

The requirement to pay the cost of early payment may have contributed to a drop in the number of redundancy and efficiency retirements.

<table>
<thead>
<tr>
<th></th>
<th>1995/96</th>
<th>1996/97</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of redundancy and efficiency retirements</td>
<td>311</td>
<td>219</td>
</tr>
<tr>
<td>Number of ill-health retirements</td>
<td>287</td>
<td>282</td>
</tr>
</tbody>
</table>

In 1996/97, an additional £3.3 million was paid into the pension fund by the participating employers to cover the costs of early payment for redundancy and efficiency retirements, with a further £1 million due in each of the next two years to cover the outstanding balance.

¹ The Chartered Institute of Public Finance and Accountancy (CIPFA) is currently considering the accounting issues arising from the Audit Commission’s study, and other pension-related matters.
The operation of the early retirement scheme needs regular review and supervision to ensure that costs are no higher than they need to be. There are four key aspects of review and supervision:

- seeking alternatives to early retirement;
- determining the appropriate degree of enhancement (redundancy and efficiency);
- adherence to criteria for granting ill-health retirement; and
- monitoring the position of the pension fund.

Seeking alternatives to early retirement

It will be possible to minimise the use of early retirement only if alternatives are actively sought. Well-managed councils will always seek to avoid early retirement. Councils with a caring attitude to their staff should see it as a last resort, when the search for other alternatives has failed. In any case councils should, in accordance with the Disability Discrimination Act 1995, be striving to keep people in employment. A survey by Bargaining Report (Ref. 17) of 83 workplaces, covering 200,000 employees, shows that both public and private organisations already use many different approaches to reduce costs, yet avoid redundancies [Exhibit 19, overleaf]. At the London Borough of Islington, changes in employment terms have helped to reduce staff costs, thereby avoiding the need for as many redundancies [Case Study 5, overleaf]. Bexley Council has introduced a systematic redeployment policy [Case Study 6, overleaf].

CASE STUDY 4

Prudent management at Wycombe District Council

Background

The Council is concerned to ensure that the cost of early retirement is justified by the benefits, and that that cost is recovered within a reasonable period of time.

Action

Wycombe District Council requires that the full cost of early retirement is given to allowing it. The Council is organised along the lines of business units; if a unit wishes to allow an early retirement (redundancy or efficiency) it has to pay for the cost itself.

The capitalised cost of the lump sum and early payment is paid by the department within three years of the early retirement. The ongoing added years’ cost is carried by the department by making a permanent reduction to the departmental cash limits.

The outcome

Business units act responsibly and allow an early retirement only when they can demonstrate that the benefits really do outweigh the cost. There are few early retirements: in 1996/97, three people left on early retirement.

Management supervision

The operation of the early retirement scheme needs regular review and supervision to ensure that costs are no higher than they need to be. There are four key aspects of review and supervision:

- seeking alternatives to early retirement;
- determining the appropriate degree of enhancement (redundancy and efficiency);
- adherence to criteria for granting ill-health retirement; and
- monitoring the position of the pension fund.

Seeking alternatives to early retirement

It will be possible to minimise the use of early retirement only if alternatives are actively sought. Well-managed councils will always seek to avoid early retirement. Councils with a caring attitude to their staff should see it as a last resort, when the search for other alternatives has failed. In any case councils should, in accordance with the Disability Discrimination Act 1995, be striving to keep people in employment. A survey by Bargaining Report (Ref. 17) of 83 workplaces, covering 200,000 employees, shows that both public and private organisations already use many different approaches to reduce costs, yet avoid redundancies [Exhibit 19, overleaf]. At the London Borough of Islington, changes in employment terms have helped to reduce staff costs, thereby avoiding the need for as many redundancies [Case Study 5, overleaf]. Bexley Council has introduced a systematic redeployment policy [Case Study 6, overleaf].
EXHIBIT 19

Alternatives to redundancy

There are many different approaches to reduce costs yet avoid redundancies.

Source: Bargaining Report 169 (February 1997) (Ref. 17)

CASE STUDY 5

Reviewing employment terms at the London Borough of Islington

Background

Islington Council needed to make savings of about £15 million in 1997/98.

Action

After negotiations with the staff side, the Council agreed changes in employment conditions. These included:

- the notice period for displaced staff will be the longer of statutory or contractual notice, with a minimum of 4 weeks, up to a maximum of 12 weeks, dependent on service (previously all staff were given 12 weeks);
- where staff are redeployed to a suitable alternative job at a lower grade, and it is deemed appropriate to grant grade protection, the grade will be frozen until the appropriate wage/salary for the grade of the new job catches up (previously two years’ pay protection was allowed, including pay rises, before freezing);
- car allowances for designated car-users will be reimbursed in accordance with the lowest band of the nationally agreed rates (previously the lowest two bands were used); and
- no payment will be made for any untaken annual leave at an employee’s last day of service (except where the employee is retired on the grounds of permanent ill-health) (previously this leave was paid for in all cases).

Savings in other non-contractual provisions were also agreed relating to, for example, the staff nursery, overtime and use of agency staff and consultants.

The outcome

£1.95 million is being saved on an annual basis, alleviating the need to reduce staff numbers by redundancy or early retirement measures.
CASE STUDY 6

Bexley Council’s redeployment policy

Background
Bexley Council has a policy to redeploy employees who are potentially redundant. When an employee is redeployed their training and development needs are assessed, with reasonable retraining costs met by the former employing department.

Action
Managers are expected to contribute to the authority’s initiatives by:

- ensuring that efforts are made to redeploy their own employees who would otherwise be made redundant, and
- implementing measures to avoid redundancies in other parts of the Council.

Corporate redeployment initiatives are overseen by the Redeployment Group. This consists of departmental personnel officers and an officer from the central personnel department who meet monthly to review the scope for matching potentially redundant employees with existing or likely vacancies across the organisation.

Employees are asked to provide personal and employment details in conjunction with their manager, who is asked to complete an assessment of the employee’s capabilities, skills and potential. These details are added to the register of potentially redundant staff.

The Group has to be informed of any vacancies to which there is an intention to recruit. Potentially redundant employees are given priority over the internal candidates and external candidates where the employee’s skills and experience meet the maximum criteria for the job.

Staff who are likely to be redeployed are also helped to complete a personal development plan based on employee preferences (including jobs and area of work), skills required by such new jobs, and areas for improvement (skills that may be relevant to new jobs but which the employee does not currently have to the standard required).

Other measures that are recommended include:
- anticipating the implications of organisational change and employing any new staff on temporary or fixed-term contracts until the new structure is introduced;
- reducing overtime;
- terminating temporary contracts;
- retiring employees who are beyond retirement age; and
- liaising with other organisations such as the job centre, neighbouring authorities, and local employers.

Employees who are recognised as being unlikely to be redeployed have access to counselling and outplacement services. However, redeployment is considered for all employees until the last day of employment. The counselling aims to help employees to find new work outside the Council.

Determining the appropriate degree of enhancement

Where early retirement is unavoidable, some councils provide the maximum enhancements allowed within the regulations in every case; others are more circumspect in the exercise of their discretion [EXHIBIT 20, overleaf]. In redundancy cases some councils award 10 added years, the maximum possible; others allow only 5 years, even after 30 years’ service. In cases of efficiency some councils do not allow any enhancement. This suggests that many councils are incurring the maximum cost when the same outcome could be achieved at a lower cost. Because of the accumulated cost, more progressive councils have reviewed their policy and reduced the enhancements that they award. Although employees
EXHIBIT 20

Enhancement of pension: added years for redundancy, using 5 and 10 years' service as examples

Some councils award maximum added years, others none.

Source: Audit Commission fieldwork, 1996/97

may have been disappointed by this development, the councils have still been able to identify sufficient volunteers to achieve their objectives.

72. Some authorities have argued that their policy of maximum enhancement represents part of the contract of employment and hence cannot be easily changed. The UKSC acknowledges (Ref. 8) that some authorities have written agreements with trades unions undertaking to pay the maximum (or an agreed minimum) number of added years but advises that the exercise of councils' discretion need not be bound by custom and practice or written agreements. Rigid adherence to custom and practice is more likely to prove unlawful than regularly to review that custom and practice. Where a council is given discretion in the exercise of a duty or responsibility, any action that it takes to constrain the exercise of that discretion may be unlawful.

73. Therefore, councils should review regularly the added years that they provide. How generous they are should depend on the seriousness of the need to reduce or restructure, and the current financial constraints facing the council. Councils should not continue to offer maximum added years simply because they have historically done so, or because they wish to avoid conflict with trades unions. They should not adopt blanket policies that leave no scope for taking account of the individual's circumstances.
Indeed, if councils are making staff redundant because they cannot afford to keep them on, it has to be questioned how they can afford to offer added years.

**Adherence to criteria for granting ill-health retirement**

74. Councils have no discretion concerning the enhancement of ill-health retirement. When reviewing this area, councils should ensure that the decision to allow early retirement is made exclusively on medical grounds. Ill-health retirement costs have grown faster than others, and represent the most common path for an employee to retire from local government service. Since added years are mandatory in cases of ill-health, councils cannot reduce costs by reducing added years in these cases. Thus, if a council is to make a significant improvement to its pension fund position, decision-making in relation to early retirement on the grounds of ill-health must be brought under scrutiny.

75. Some councils take the view that the growth in ill-health retirement is almost beyond their control. But variations between councils, together with published papers by medical experts, suggest that the use of ill-health retirement is often a matter of management policy rather than unavoidable incapacity. One factor that may help to reduce ill-health retirement is the recent advice provided by the UKSC (drawn up by the Association of Local Authority Medical Advisers) (ALAMA) (Ref. 18). It not only provides general advice, but covers some of the more ambiguous areas of ill-health, such as back pain and stress, and the likely duration of the incapacity.

76. To be effective, the guidance needs to be applied rigorously, using professional medical assessors. However, it has the status only of advice. During fieldwork visits, the Commission found that the standard of evidence of incapacity varied widely. In some councils, the opinion of a GP was sufficient to generate an ill-health retirement. Other pension funds insisted that the individual should have an independent assessment, conducted by a specialist occupational health physician or a standing panel [CASE STUDY 7, overleaf]. Such schemes could be run by administering authorities, with employing authorities contributing towards the cost on the basis of use. It is good practice to review periodically the medical condition of those who have retired, to check whether the retiree has taken up employment with another local authority, in which case the pension should be reduced.
CASE STUDY 7

Use of a medical adviser at the West Midlands Pension Fund

Background

The West Midlands Pension Fund Authority wanted to make sure that people being proposed for ill-health retirement by the scheme employers were subject to fair medical assessment.

Action

The administering authority now requires that any individual being considered for ill-health retirement is seen by a medical practitioner who is studying for or holds an appropriate qualification in occupational health. Additionally, applications for ill-health retirement are referred to a consultant physician engaged by the administering authority in order to identify whether there are grounds for appeal against the employer’s decision.

The outcome

A rigorous and consistent approach to assessment is one of the reasons given for the low level of ill-health retirements compared to other funds using the same actuary [EXHIBIT 21].

EXHIBIT 21

Rates of ill-health retirements from the West Midlands Pension Fund

The West Midlands fund has a lower level of ill-health retirements

Ill-health as percentage of all retirements

![Graph showing rates of ill-health retirements from 1979/84 to 1992/95 for All Mercer’s local government clients and West Midlands Pension Fund.]

Source: Audit Commission presentation of data from local government actuaries, William M Mercer
Crucially, it is how the discretion is exercised at the local level that will be important.

77. Revised regulations, including those covering ill-health retirements, will come into force in April 1998 as part of a comprehensive review by the Department of Environment, Transport and the Regions (DETR). In general, the regulations will increase the flexibility available to local authorities. Crucially, it is how the discretion is exercised at the local level that will be important. Increased discretion will improve the quality of decision-making where authorities behave responsibly, but this has not been the case at all councils in recent years. Without tighter control of early retirement in all councils, there is a danger that use of the discretion could bring further problems.¹

Monitoring the pension fund

78. It is not always easy for a council to be sure of the full effect of its actions, and this is particularly true in the case of its pension fund. The fund is valued every three years and, in the past, few actuaries provided sufficient information for authorities to exercise proper control of the position between valuations. Employing councils need to know the assets and liabilities of their part of the fund, as well as assumptions about each type of early retirement and their resulting contribution rates. To be sure that the situation is improving - not getting worse - pension funds should be monitored.

79. One way to make sure that councils remain on track during the inter-valuation period is to carry out annual reviews of a selection of key indicators, which could form part of a council’s cycle of performance management. Although actuaries would charge for such a review, it should be significantly cheaper than a full valuation. It need not cover investment performance, for example, but it should look at:

- variance between actuaries’ assumptions about ill-health and actual trends;
- whether the contributions to the fund are sufficient to cover current liabilities and make up some of the past service deficit; and
- whether any macro-economic factors have had a detrimental impact on the fund (such as the ACT changes).

80. A number of funds have adopted this approach. Each year a mini-review of key performance indicators is conducted and, if necessary, steps are taken to ensure that the position does not deteriorate. The Commission would commend this practice to all local authorities. There are signs that actuaries are moving in this direction. The most recent actuarial reports available cover Scotland, and most now provide more detailed information than previously.

¹ DETR will shortly produce guidance on the revised regulations for all local authorities in England and Wales and all other LGPS interests. The guidance will emphasise the importance of proper analysis, value for money and prudence, where discretions are available. The Commission encourages all authorities to follow this guidance.
81. In addition, there needs to be greater openness to public scrutiny. The annual pension fund accounts should report on changes to the funding level arising from the mini-review, together with key statistics relating to numbers, types and cost implications of early retirement decisions.

82. Taken together, these actions form a viable management framework. The starting point is for councils and actuaries to make realistic assumptions concerning future fund performance and projected early retirement. Councils should then develop staffing plans to avoid early retirement, but when this is unavoidable, strive to contain the cost [EXHIBIT 22].

83. The practical steps outlined in this chapter can start to bring the situation under control. But for some councils there are longer term questions that will need to be answered. These are explored in the final chapter.
Looking to the Future

If councils do not exercise tighter control over early retirement so that it is used only where fully justified, unpalatable options may need to be considered. These could include reducing the benefits of the scheme to future pensioners, removing some or all of the discretion available, or increasing contribution rates for employees.

But if councils follow the good practice already evident in some councils, then most should be able to redeem the situation.
For many years, the LGPS has provided local government and its staff with valuable benefits. Employees have had the reassurance and the security of being part of a well-funded ‘defined benefit’ pension scheme (based on final salary and years of service). Employers have been able to use the scheme to encourage good quality staff to remain with local government, and as a management tool to help restructure and reorganise as external circumstances required.

However, in recent years some councils have used the scheme to meet objectives other than those for which it was originally devised. The use of early retirement has drifted from being exceptional to becoming expected. The LGPS was designed on the broad assumption that employees would contribute for 40 years and benefit for perhaps 20. With large numbers of staff retiring early, this balance has shifted to nearer 30:30, placing great strain on funds. Certainly there are few businesses that could afford to provide such generous early retirement terms – to three-quarters of their retirees. Average ill-health retirement at 39 per cent, let alone almost 70 per cent (as is the case in some councils) is difficult to defend. But this pattern is not universal. Some councils do act responsibly when awarding early retirement and a majority of their employees leave at normal retirement age. Some funds are already over the 100 per cent funding level, and some are employing the good practice set out in this report.

For most other councils it is not too late to rescue the situation. A prudent council, following the good practice outlined in the previous chapter, should be able to ensure that the pension fund remains well funded, and future beneficiaries can remain confident that they will receive a secure and fair pension. However, the signs of recognition that change is needed have to be spread further. The pension scheme is being used as a substitute for sound management decision-making, and has come to be regarded by some as a scheme that provides compensation for a lost career. A speaker at a recent conference commented that:

‘...for a significant group of former members, the pension scheme has turned into ... a long-term sickness benefit or loss of earnings scheme rather than ... a pension scheme ... The Inland Revenue might even start asking questions about the actual validity of the pension arrangements’ (Ref. 19).

Local government has to some extent been able to cushion the impact of early retirement on its pension funds by buoyant investment returns in the mid-1990s. This level of return cannot be guaranteed in future and, particularly in the light of tax changes, authorities cannot rely on fund performance to compensate for inappropriate decision-making. Unless councils improve their stewardship of the LGPS, then the future is bleak, and a threatening spectre emerges. Faced with inexorably declining funding levels and rising contribution rates, councillors and central government would have to consider some stark choices:
● to revise the LGPS regulations, reducing or removing discretion from local authorities; or
● to increase the contribution rates for employees and reduce benefits to future pensioners; or
● to change the basis of the scheme by following the private sector trend and convert the LGPS to a scheme where the benefits more closely reflect the contributions (for example, a ‘money purchase’ scheme).

It is not the scheme itself that has required consideration of these options; rather it is the unrestrained use of the discretion available in the scheme that is challenging its continuing financial sustainability.

Conclusion

88. The LGPS is fundamentally a sound scheme that has served local government well for many years. The substantial changes imposed on local government in recent years came with a cost, and the discretion allowed within the LGPS has been one of the mechanisms for achieving change. But the use of discretion in the LGPS far exceeds that needed to manage statutory change and has continued after such changes have come to an end. It would be regrettable if, because that discretion has been used to excess by some authorities, the scheme’s benefits were jeopardised. It provides security for all local government staff, but such security is particularly valuable to the lower paid staff who are less able to make their own pension provision. All staff should expect to retain this security and be able to look forward to a comfortable retirement. But, if current practices continue, the very basis of the LGPS scheme will have to be reviewed, possibly leading to its closure or replacement by one offering fewer benefits. Without firm action, the ‘sins of the minority’ may come to be visited on the majority.

89. Local and central government should act swiftly to defend the scheme from further damage. Once its finances are regularised, there will be a case to review the scheme to meet the needs of the twenty-first century. As employment practices change, so the pension scheme should be re-aligned to match changing working patterns. But the immediate priority is to stabilise its viability within current procedures. The trend to shorter working times may continue. How this is to be achieved at affordable cost is a challenge to be addressed. The necessary actions are outlined below [RECOMMENDATIONS, overleaf]. In particular, councillors should raise specific questions about the operation of the LGPS in their authorities. Councillors and officers may be of a naturally ‘retiring nature’ in discussions of pension-related matters, perhaps because the topic is seen as of technical interest only. But if the reticence is because of potential embarrassment over past excesses, then those matters need to be brought into the light of day. Only when decisions can stand up to full scrutiny will there be assurance that early retirement is under proper control, and that future services to the public are safeguarded.

I As has happened recently for new employees joining the BBC pension scheme, for example.
Early Retirement in Local Government

Recommendations for councillors and managers

**Accountability**

1. To improve their accountability, councillors need to be informed about early retirement decisions, both individual high-cost proposals as well as the cumulative effect of all decisions.

2. To ensure accountability, the departments that wish to allow an early retirement should pay for the full cost of that early retirement.

3. Councils should regularly update their early retirement policy, taking account of their ability to pay for enhancements.

**Financial prudence**

4. To ensure that the real cost of an early retirement is appreciated, the full cost – including enhancement and strain on the pension fund – should be made available to councillors when the decision is taken.

5. To improve the quality of decision-making, the cost of a discretionary early retirement should be paid by the time the benefits of that early retirement expire; this means by the normal retirement age or within five years, whichever is sooner. Where the funding level of the pension fund concerned is below 90 per cent, a three-year period would be appropriate.

**Management supervision**

6. Councils should tackle the culture of expectation that has led to staff seeing early retirement as a right.

7. Councillors should apply the advice of the Association of Local Authority Medical Advisers (ALAMA) rigorously when making ill-health retirement decisions.

8. Pensions administering authorities should make use of in-house or contracted occupational health advisers who follow the ALAMA guidelines. Employing authorities should pay for the service on the basis of use, with the aim of achieving a standard approach to ill-health retirement across their fund.

9. Councils should develop staff plans with the objective of avoiding early retirement. These should incorporate alternatives to early retirement such as redeployment, retraining, freezing recruitment and, when appropriate, dismissal rather than automatic early retirement.

10. Councils should make effective management of early retirement part of the normal performance management system.
Recommendations for councils, the Government and actuaries

1. Councils and their actuaries should introduce a system for monitoring the pension fund between valuations. This will involve actuaries providing each employing authority with information covering their assets and liabilities, ill-health assumptions, cash value of individual contribution rates, etc. All information should be provided in advance, not retrospectively.

2. Councils with funding levels below 100 per cent should implement a real recovery plan. No council with less than 100 per cent funding should have a negative individual contribution rate.

3. The legislation governing the LGPS was designed to address the needs of the 1970s. It should now be reviewed in the context of the needs of the 1990s and beyond.
Appendix 1

1. The LGPS has its origins in 1922, when councils were given permissive powers to set up superannuation schemes. In 1937 the permissive power became a requirement. In 1972 an Act was passed that allowed the Secretary of State to lay down regulations; hence the scheme could be amended without the need for primary legislation. These regulations have been amended many times since. In 1995 the rules governing the administration of local authority pensions were consolidated and revised in the Local Government Pension Scheme Regulations 1995. There were further changes in 1996 and 1997. New regulations (SI 1997 No. 1612) will come into force in April 1998.

2. Employees’ contributions are fixed at 6 per cent for ‘officers’, 5 per cent for ‘manual workers’ (although the rate will be unified, at 6 per cent, for new employees from April 1998). Local authority employers are required to contribute the balance of the resources, over and above investment income, needed to support the members’ benefits as defined in the regulations. Employees can also benefit from full transfer of service years within the public sector pensions club.

Organisation

3. In local government in England and Wales, the LGPS is run by nearly 90 ‘administering authorities’ – shire counties, London boroughs and some of the new unitary authorities and metropolitan authorities acting as ‘lead’ authorities. These administering authorities are ultimately responsible for paying local government pensions. There is no central government guarantee. Shire, district and unitary councils use the county schemes as ‘scheme employers’ and other organisations such as schools, colleges, magistrates courts and charities can be ‘admitted’ members. Civilian staff of the fire and police services and non-teaching staff in schools are also eligible to join LGPS funds. But fire and police officers have their own, unfunded, pay-as-you-go schemes (that is, pensions are paid from the service revenue accounts) and the scheme for teachers has a notional fund.

Membership

4. DETR returns for 1995/96 showed that there are over two million members [TABLE 1] of the LGPS, one million of whom are ‘active’ (contributing) current employees. Over 700,000 are pensioners and 300,000 have deferred pensions (that is, they have left local government service but retain pension rights in the scheme).

5. In July 1995 membership was extended to all local authority staff with regular contracted employment, including part-time staff, and by March 1996, active membership had increased by 21 per cent. The newcomers, although probably with below average pay, represent a
**Financial situation**

7. In 1995/96 the schemes paid £3 billion in benefits and received contributions of £0.9 billion from employees and £1.2 billion from employers. Investment income of £2.2 billion was generated from year-end assets of £54.6 billion (market value). Year-on-year employers’ contributions increased 28 per cent, and employees’ contributions increased by only 8 per cent – despite the 21 per cent increase in membership.

8. Early retirement costs for efficiency and redundancy are divided into two types, the cost of paying the pension early, which falls on the pension fund, and the cost of enhancing the pension, which falls on the revenue account of the council. All the costs associated with ill-health retirement fall on the pension fund. Some part of the ill-health cost is ‘pre-funded’; that is, actuaries include an estimate of future costs in the contribution rate. Where ill-health retirements turn out to be above the actuaries’ estimate, the additional costs needs to be made up following the next valuation. Typically, about half the cost of ill-health retirements is pre-funded. As a result of the new regulations to be introduced in April 1998, the cost of enhancing the pension for redundancy and efficiency retirements may fall on the pension funds.

**Role and responsibility of actuaries**

9. The LGPS is a funded scheme. Unlike the teachers’ or fire-service schemes, the scheme has an investment fund, financed by employer and employee contributions. The intention is that the value of assets in the pension fund should be sufficient to cover the value of future liabilities. These values are determined by the fund actuary who values the fund...
every three years. There are four main actuaries involved in local
government: Watson Wyatt, Hymans Robertson, Bacon and Woodrow,
and William M Mercer. These actuaries make a range of assumptions in
their valuation of assets and liabilities. Assets are usually valued at
discounted future dividend income. Pension liabilities are estimated by
using assumptions on salary increases, investment returns, etc.

10. The LGPS regulations require each local authority to obtain:
• an actuarial valuation of the assets and liabilities of its pension funds
every three years (the next valuation date in England and Wales is
31 March 1998);
• a report by an actuary; and
• a rates and adjustment certificate.

11. The rates and adjustment certificate must contain the ‘common
contribution rate’ and individual adjustment rates for each council, which
reflect the accrued assets and liabilities of each fund and hence any action
that is needed to adjust funding levels.

Role and responsibility of councillors

12. Because the LGPS is a statutory scheme (that is, it is set out by
Parliament as opposed to being a private scheme governed by the 1995
Pensions Act) there are no trustees as such. However, it is considered that
the duties of councillors on the administering authority (not the scheme
employer) are in many ways similar to the legal responsibilities of
trustees. This would extend, potentially, to all councillors, not just those
serving on pensions panels or any designated service committees.
Appendix 2

Study methodology

a) Pension fund data analysis

1. In the summer of 1996, all local authorities in England and Wales were invited to take part in the Commission's study. They were asked to allow Hymans Robertson, one of the major firms of local government actuaries, to extract data from pension fund records for all retirements for the six years from 1990/91, in order to calculate the capitalised cost of those retirements. The intention was to obtain data for the equivalent of two complete valuation periods. Data for a three-year period only might not have shown a complete picture.

2. The software to extract the data was developed by Heywood, who supply the system used by the majority of pension funds. Fund administering authorities sent the data directly to Hymans Robertson, which incorporated all of the data in one database. A total of nearly 110,000 cases were included in the final database [TABLE 1, overleaf]. The data was provided in an anonymous format, the only identifier being each individual’s national insurance number. These were removed from the database as soon as it was received.

3. Analysis of the database is primarily presented in the form of a percentage of retirements by type for each year. There are alternative presentations, for example, to show:
   - the actual number of retirements year by year;
   - retirements as a percentage of staff in employment at year end; and
   - retirements as a percentage of staff in defined age bands.

In practice, the pattern of retirements is broadly similar in each case over the six-year period and, for simplicity, the approach showing percentage by type has been adopted.

4. Hymans Robertson, like all actuaries, estimates the life-cost of an individual’s pension using factors that take account of demographic and financial trends. More information on these factors can be found in the Audit Commission’s forthcoming management handbook. Using these factors the actuaries calculated, for each individual, the capitalised cost or net present value of the cost of retiring early and enhancements awarded in the form of added years.

5. The database contains around 40 per cent of the total number of retirements from local authority pension funds over the six-year period. The figures have, therefore, been grossed-up to reflect this. The grossing-up factors have been calculated using the DETR SF3 return (Ref. 14) for 1995/96 [TABLE 2, overleaf].
b) Audit Commission survey

6. In October 1996 a questionnaire, designed to gather additional information on funding levels, contribution rates and the management of early retirement, was sent to 148 authorities in England and Wales. The sample consisted of approximately 50 per cent of all administering authorities and one-third of employing authorities, stratified by size. Table 3 shows a breakdown of the response - almost two-thirds overall.

c) Fieldwork

7. The study team visited a total of 19 councils [TABLE 4] to collect information and interview relevant staff including chief executives, directors of finance and personnel (plus some other service chief officers) and pensions specialists. In the shire and metropolitan areas the fieldwork authorities were 'paired' as far as possible by including administering and employing authorities.
### TABLE 3
**Response to the Audit Commission's survey**

<table>
<thead>
<tr>
<th></th>
<th>Administering authorities</th>
<th>Employing authorities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total number of authorities</td>
<td>Sample size</td>
</tr>
<tr>
<td></td>
<td>Number</td>
<td>per cent</td>
</tr>
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<td><strong>London borough / metropolitan areas</strong></td>
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<td>21</td>
</tr>
<tr>
<td><strong>Counties</strong></td>
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<td>17</td>
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<tr>
<td><strong>English and Welsh unitaries</strong></td>
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<td>6</td>
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<tr>
<td><strong>Subtotal</strong></td>
<td>36</td>
<td>44</td>
</tr>
<tr>
<td><strong>Metropolitan districts</strong></td>
<td>30</td>
<td>14</td>
</tr>
<tr>
<td><strong>English and Welsh unitaries</strong></td>
<td>24</td>
<td>9</td>
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<tr>
<td><strong>Shire districts</strong></td>
<td>274</td>
<td>81</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>328</td>
<td>104</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>414</td>
<td>148</td>
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</table>

**Note:** Counties, London boroughs and some of the metropolitan districts and new unitary authorities are both administering and employing authorities.

### TABLE 4
**Authorities visited by the study team**

<table>
<thead>
<tr>
<th>Administering authority</th>
<th>Employing authority</th>
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<tr>
<td>Cornwall County Council</td>
<td>North Cornwall District Council</td>
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<td>Leicestershire County Council</td>
<td>Charnwood Borough Council</td>
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<tr>
<td>Derbyshire County Council</td>
<td>Derbyshire Dales District Council</td>
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<td>Essex County Council</td>
<td>Braintree District Council</td>
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<tr>
<td>--</td>
<td>Wycombe District Council</td>
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<tr>
<td>Gwynedd</td>
<td>Conwy County Borough Council</td>
</tr>
<tr>
<td>South Yorkshire Pensions Authority</td>
<td>Rotherham Metropolitan Borough Council</td>
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<tr>
<td>Tameside Metropolitan Borough Council</td>
<td></td>
</tr>
<tr>
<td>Wolverhampton Metropolitan Borough Council</td>
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</tr>
<tr>
<td>The London Borough of Tower Hamlets</td>
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<tr>
<td>The London Borough of Islington</td>
<td></td>
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<tr>
<td>The London Borough of Bexley</td>
<td></td>
</tr>
<tr>
<td>The London Borough of Hammersmith and Fulham</td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**

1. Counties, London boroughs and some of the metropolitan districts and new unitary authorities are both administering and employing authorities.

2. A number of other councils provided additional information, including Cherwell District Council.
## Appendix 3

### Members of the study Advisory Group

<table>
<thead>
<tr>
<th>Name</th>
<th>Position and Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roger Blackmore</td>
<td>Director of Finance, Tameside Metropolitan Borough Council</td>
</tr>
<tr>
<td>Gordon Brown</td>
<td>Principal Policy Consultant, Corporate Resources, Kent County Council</td>
</tr>
<tr>
<td>Harold Chapman</td>
<td>Director of Finance and Administration, North Cornwall District Council</td>
</tr>
<tr>
<td>Paul Coen</td>
<td>Chief Executive, Surrey County Council</td>
</tr>
<tr>
<td>Terry Crossley*</td>
<td>Head of Local Government Pensions Unit, DETR</td>
</tr>
<tr>
<td>Steve Evans</td>
<td>Director of Local Government Studies, Accounts Commission, Scotland</td>
</tr>
<tr>
<td>Malcolm Gray*</td>
<td>Director of Finance, Railpen Investments</td>
</tr>
<tr>
<td>Peta Hodge</td>
<td>Editor, Employee Benefits</td>
</tr>
<tr>
<td>Anthony J Knights</td>
<td>Director of Finance, Royal Borough of Kingston upon Thames</td>
</tr>
<tr>
<td>Terry Murphy</td>
<td>Ex County Personnel Officer (recently retired), Berkshire County Council</td>
</tr>
<tr>
<td>Keith Neale**</td>
<td>County Treasurer, Essex County Council</td>
</tr>
<tr>
<td>Mike Neilson*</td>
<td>Director of Corporate Services, Chester City Council</td>
</tr>
<tr>
<td>Peter Scales*</td>
<td>Chief Executive, London Pensions Fund Authority</td>
</tr>
<tr>
<td>Peter Thompson</td>
<td>Head of Pensions and Investments, Strathclyde Pension Fund</td>
</tr>
<tr>
<td>Sir Peter Kemp</td>
<td>Audit Commission member</td>
</tr>
<tr>
<td>Sir Ron Watson</td>
<td>Audit Commission member</td>
</tr>
</tbody>
</table>

Other contributions were made by:

- Graeme Muir | Hymans Robertson
- Brian Russell | Former Principal Administrator, UKSC

* Member of the CIPFA Pensions Panel
† Member of the Officer Advisory Group of the UKSC
Appendix 4

Information for councillors

1. For cases involving senior staff (say, those earning more than £30,000 a year) councillors should be provided with sufficient information at the point of decision to enable them to evaluate the full costs and benefits of allowing an early retirement. Information (anonymised if necessary) should consist of:
   - age of applicant;
   - normal retirement age;
   - final pensionable remuneration (split between basic pay and any special allowances or enhancements);
   - whether the application is on grounds of ill-health, redundancy, or in the interests of efficiency;
   - a table showing, for a range of added years (from zero to the maximum allowable under the regulations), the capitalised cost of the added years pension and associated lump sum;
   - for reference, a copy of the council’s policy for added years in relation to reckonable service on a sliding scale, for redundancy and efficiency;
   - for ill-health retirements, a copy of the medical certificate supported by an opinion from a specialist occupational health physician;
   - for redundancy applications, any proposals for restructuring for a ‘bumped’ redundancy, which may reduce the potential savings in salary and on-costs;
   - for redundancy applications, a report from the appropriate chief officer that all alternatives to the proposed redundancy have been investigated;
   - where statutory redundancy pay is given, a statement that the individual does not have another job to go to; and
   - for efficiency applications, justification in terms of the benefits, financial and non-financial, which would arise as a result of allowing the early retirement application (that is, the advantage of allowing the retirement over retaining the applicant in post).

2. Where proposals have been considered by officers under delegated powers (that is, for applications from lower-paid staff) councillors should be given a summary of the above information at the point of decision when significant numbers are involved.

3. In addition, at year end, an annual report should be presented to the appropriate committee, summarising the number of cases and the full cost implications for both the council’s revenue account and the pension fund. Where appropriate, comparison should be made with estimated early retirement levels for the year in question and with the actual numbers of early retirements in previous years. The report should also summarise all retirements by type of retirement in percentage terms and as a function of the total number of staff, again compared with previous years.
4. Tables 1 and 2 show a suggested pro forma for the annual report, for the cost of early payment and pension enhancements.

**TABLE 1**
Annual report of the cost of early payment of pensions (‘strain’ on the pension fund)

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D=B-C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of early retirements in year</td>
<td>Total capitalised costs of financial strain of these early retirements</td>
<td>Payments (other than per cent contributions) made to pension fund to discharge financial strain liabilities</td>
<td>Outstanding liability in pension fund for financial strain due to these early retirements</td>
</tr>
<tr>
<td>Redundancy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interests of efficiency</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other early retirements(^1)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^1\) From April 1998, under the new regulations.

**TABLE 2**
Annual report of the cost of pension enhancements

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
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<td>Cost of added years’ pension given</td>
<td>Cost of added years’ lump sum given</td>
<td>Total capitalised costs of added years’ pension and lump sum given</td>
<td>Annual cost of other added years in payment this period</td>
<td>Total annual cost of added years’ pension in payment</td>
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<td>Interests of efficiency</td>
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<td>Other early retirements(^1)</td>
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Glossary

Accrued pension  Reckonable service x final pensionable remuneration / 80

Accrued lump sum  3 x accrued pension

Compensatory added years (CAY)  Additional equivalent years of service awarded in cases of redundancy or in the interests of efficiency, which have the effect of adding to the accrued pension

CAY lump sum  3 x CAY pension

Final pensionable remuneration  Typically, an individual's final salary, but may include other benefits provided to the individual. The remuneration is currently based on the best year of the last three years of employment.

Normal retirement age (NRA)  The age, between 60 and 65, when 25 years' qualifying service will have been completed. The maximum NRA is usually 65, even if 25 years of contributions have not been made.

Reckonable service  The number of years that an employee has contributed to the pension fund, including service with previous authorities or employers which has been transferred into the fund.
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