

Our Ref:

Your Ref:

The Right Honourable George Osborne MP  
Chancellor of the Exchequer  
HM Treasury  
1 Horse Guards Road,  
London,  
SW1A 2HQ

Direct Line: 0151 242 1390

Please ask for: Peter Mawdsley

Date: 23 February 2011

Dear Mr Osborne,

**Local Government Pension Scheme - Proposals to increase employee contribution rates**

I write on behalf of Wirral Council as the Administering Authority for the Merseyside Pension Fund, in response to the HM Treasury proposals to increase employee contributions to the Scheme by 3.2%.

Wirral Council is responsible for the administration of the Merseyside Pension Fund, which is part of the Local Government Pension Scheme (LGPS). The Merseyside Pension Fund deals with the LGPS pension administration and investments on behalf of the five Merseyside District Councils, and over 100 other employers on Merseyside and elsewhere throughout the UK.

It has over 49,000 active contributing members, 41,359 pensioners and over 34,000 deferred pensioners. It is responsible for the investment and accounting for a fund of £4.9 billion.

I am aware of the letters dated 16 February 2011 on this subject sent to you by the Local Government Group (LGG) and dated 9 February 2011 by Tameside MBC and wish to support their requests that the proposed arbitrary increase in employee contributions be reconsidered. I feel that the best approach for a funded public sector scheme which currently has a positive cash flow is to consider the total make up of the scheme in terms of benefits and contributions and not just to focus on one aspect i.e. contributions.

The LGG and Tameside have made a strong case that an arbitrary increase in contributions will lead to an increase in the numbers opting out of the Scheme which would undermine the attempt to raise the target additional income of £900 Million.

The risk of higher than expected optant-outs will be increased further if following the Hutton Commission Final Report there are proposals that the existing benefit arrangements are drastically altered. In a time of pay restraint many people will be unlikely to be willing or able to pay considerably more in contributions for a pension scheme which may offer what may be considered by many employees an inferior pension package.

In a survey undertaken with the Fund membership as part of our response to Lord Hutton's request for evidence 39% of the 1,952 respondents indicated that if it were proven that there was justification for such a change that they would be willing to pay additional contributions to retain the existing final salary benefits package. This indicates that our membership clearly appreciate the relationship between the contributions paid and the benefits received.

In applying an arbitrary increase to employee contributions across all of the public sector schemes, the distinctive nature of each of those schemes is ignored. The LGPS already has higher employee contributions than most of the unfunded public sector schemes, indeed the Local Government Group make the case that "highly paid members of some other public service schemes will be paying a lower contribution rate than the lowest paid workers in local government".

Relevant factors particular to the LGPS for consideration are:

#### **The LGPS is a funded scheme**

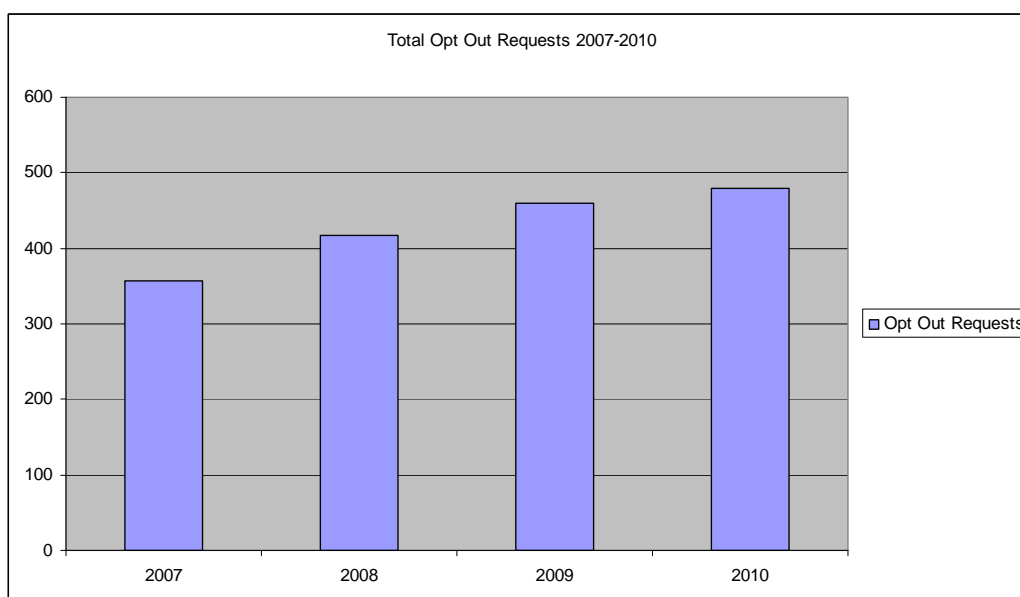
This means that any change in benefit structure or change in retirement age will have an immediate impact on employer costs. This was illustrated by the change in the measure of inflation from RPI to CPI and taking account of the pay freeze in determining the 2010 actuarial valuation assumptions. Funding levels improved and employer contribution rates were lower than would have otherwise been the case. Thus significant cost savings have already flowed through into the costs of the LGPS in a way that will not have occurred within the Pay as you Go public sector schemes.

#### **The demographics of the LGPS are different**

The nature of the work undertaken in local government and employees' work patterns, means that the benefits earned by LGPS members are on average, a lower value than other public sector schemes and the proportion of staff on lower pay bands is greater. The contribution rates for part time employees in the Scheme (many of whom are female) are determined based on the full time equivalent pay. The consequences of these demographic differences and the starting point of banded employee contribution rates means that if consistent protection for those on lower pay scales across public sector schemes is applied, then the necessary increases for employees on higher pay must be correspondingly higher for LGPS scheme members.

## Increasing employee contribution rates – impact on members opting out

This means that employees on similar pay levels in different public sector organisations are likely to be paying materially different employee contribution rates and thus, those on higher rates will have a greater incentive to opt out. In reaching a decision, on any increases in employee contributions, it is important to consider cross-public sector comparisons and fairness. The Fund has analysed the number of members requesting to opt out of Merseyside Pension Fund over recent years and as can be seen from the chart below this already demonstrates a trend of increasing numbers of employees opting out faced with increased living costs and the impact of a pay freeze.



In summary, the Fund believes that the potential scale of increase to employee contributions in the LGPS will have a long term adverse impact on the sustainability of the Scheme and that it will not generate the target level of additional income. A better way forward would be to develop the LGPS to create a revised scheme that best meets the needs of Government, employers, employees and other stakeholders. The work of Lord Hutton should create a framework for progressing this review.

The Merseyside Pension Fund supports the call of the Local Government Group and others for the Government to enter into a dialogue with employers and unions in order to consider further how best to achieve the Government's aims.

Yours sincerely

**Director of Finance**