FIREFIGHTERS' PENSION COMMITTEE

CPD AND LSI: PENSIONABILITY

Note by DCLG

1. The NJC have sought the agreement of the Department to:

   - CPD (Continual Professional development) being pensionable; and
   - Pension contributions paid on LSI (Long Service Increment) being reflected in pensions.

2. Ministers have agreed exceptionally that CPD should be pensionable. To meet the objections in a final salary scheme that it will be a temporary allowance, as payments will be subject to review and may be withdrawn, it will be treated as a separate entity for pension purposes, accruing separately to an ordinary pension.

3. At Appendix 1 is a note prepared by the Government Actuary's Department setting out how we envisage that the allowance will be pensionable.

4. Ministers have also asked officials to consider how the phasing out of LSI might be handled for pension purposes and we are currently considering how the treatment of CPD might be modified for this purpose.

5. At Appendix 2 is a Q&A brief.

6. The Committee is invited to discuss the proposals.

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Appendix 1

Pensionability of Continuing Professional Development (CPD) payments via an Additional Pension Benefits (APB) arrangement

Introduction

1. The Continuing Professional Development (CPD) Scheme is described in Circulars NJC/03/07 and NJC/05/07. The first payments under the scheme (which replaces Long Service Increment) will be made from 1 July 2007, in response to applications from eligible firefighters. Annex A of NJC/03/07 set out the level of CPD payments for each Fire and Rescue Authority (FRA). Each FRA is encouraged to explore ways in which the CPD payment can be brought up to as minimum level of £500 pa. CPD payments will be treated as basic pay for all pay-related purposes, including pensionability.

2. It is proposed that CPD would be pensionable via an Additional Pension Benefits (APB) arrangement. Roughly speaking, pension contributions derived from annual CPD payments would be available to purchase additional benefits, which would come into payment at the same time as, and in addition to FPS/NFPS benefits.

Example

3. Consider a firefighter aged 45, who receives a CPD payment of £500 on 1 July 2007. Suppose that total pension contributions on this payment are £113.50: ie. 22.7% of pay, of which £42.50 (8.5%) is payable by the firefighter. Suppose that £10 paid at age 45 is sufficient to secure a pension of £1 pa payable at age 65. Then the Additional Pension Benefit associated with this 2007 CPD payment would be a pension of **£11.35 pa**, payable from age 65.

Contributions

4. In this example, it is assumed that contributions would be payable at the same rates as applicable from time to time in FPS/NFPS. This is likely to be convenient for budgeting and payroll systems. Employers' and members' contributions would be paid into the local pensions account, alongside regular pension contributions.

Benefits

5. The amount of APB secured would be found by dividing the relevant contributions by the cost of an Additional Pension of £1 pa. This cost will depend on:
   - the age at which APB is payable – the later the age, the greater the benefit.
   - the terms under which APB is payable – the more generous the terms, the smaller the benefit.

6. It is envisaged that APB would be determined on the assumption that it becomes payable at Normal Benefit Age: ie. age 60 in FPS, age 65 in NFPS. In practice, however, APB would be payable at the same time as other FPS/NFPS benefits, with actuarial reduction if payable before age 65.

7. It is envisaged that APB would be determined on the basis of the following benefit terms:

> APB will be increased in line with the Retail Prices Index, both before and after coming into payment.
> Where a member becomes eligible for an ill-health pension, the full APB will come into payment immediately.
> A portion of the APB may be commuted for Lump Sum on the same terms as in FPS/NFPS.
> When a member's dependent becomes eligible for death benefits, the dependant's APB will come into payment.

Costs

8. It is expected that the basis underlying the APB costs will be derived from the basis for preparing Cash Equivalent Transfer Values (CETVs). This basis is reviewed from time to time, and the same will apply to the costs of securing APB. The costs may change following a review, but this would not affect APBs already secured by past payments.

9. A member who leaves pensionable employment will remain entitled to the APB secured to date.

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Appendix 2

<u>Questions & Answers</u>

Q1: What would be the contribution rates for CPD Allowance?

A1: One possibility would be to adopt the same member and employee rates as are currently paid for each firefighter in FPS or NFPS (as appropriate). This would be administratively more straightforward and easily understood by members.

Note: the employer's rate is the balance of the estimated average cost of firefighter pensions in each scheme. The rates can be reassessed and adjusted from time to time.

Q2: Could firefighters opt out of paying contributions on CPD allowance?

A2: No. We currently anticipate that the rules of FPS and NFPS will be amended so that CPD is pensionable as described here. Under these circumstances, firefighters would be eligible to opt out of FPS or NFPS as a whole.

Q3: How would firefighters know what would be the value of their CPD pension?

A3: The Additional Pension Benefit (APB), which we are proposing as the basis for making CPD payments pensionable, will be determined by dividing the relevant contributions (see above) by a factor for the cost of securing £1pa of pension.

Q4: How would the cost factors work?

A4: The factors would increase with age as the period before pension commencement diminishes. The cost of a female firefighter's pension would normally be expected to be greater on grounds of life expectancy. The factors would be reviewed from time to time. However, once each slice of APB is determined, the calculation would not be revisited.

Q5: Would there be a projection of the value of the pot at retirement?

A5: There would be no pot, but each CPD payment would give entitlement to a slice of index-linked Additional Pension. No assumptions could be made about future CPD payments for a scheme member.

Q6: What would APB be indexed to?

A6: RPI - in line with public service pension practice.

Q7: When would APB be paid?

A7: Additional Pension Benefit would be determined on the assumption that it becomes payable at Normal Benefit Age (i.e. age 60 in FPS and age 65 in NFPS). In practice, however, APB would be payable at the same time as other NFPS benefits, and its value assessed at the point at which it came into payment.

Q8: *Why should APB be reduced if paid at age 55/60 rather than 60/65?*

A8: It's a bit like pension debit/credit. A certain value is available now (i.e. contributions on CPD Allowance) which equates to a pension commencing in the future. This could be any age - the later the age, the larger the pension. Whenever the member retires, the amount is actuarially equivalent.

Q9: *What are the benefits of APB over final salary?*

A9: The benefit is not dependent on final earnings and are therefore attractive to scheme members whose earnings from CPD may be variable.

The level of benefits payable in the FPS and NFPS are based on the final salary of members times the number of years of pensionable service divided by 60, which is the accrual rate for both schemes.

CPD will be subject to annual review and there is no guarantee that members will receive it in the final three years of service. There may be reasons why a member may not receive it, e.g. promotion, sick absence, and using APB guarantees that a member receives a benefit for contributions paid.

Long Service Increment

Q10: *Members have paid contributions on LSI but will see no benefit.*

A10: In a final salary pension scheme, members and employers pay contributions on pay from time to time. There is no direct attribution of contributions to benefits. There is generally pay progression, plus some protection for members whose pay declines before retirement because benefits are based on the best of the last three years.

Other pay protection arrangements, e.g. the two pensions, or split pension, arrangement in rule 7 of Part 3 of the NFPS, provide protection but are no more effective than the best of the last three years arrangement if, as with LSI, the amount represent such a small percentage of final salary and will be exceeded by any pay rises during that period.

Q11: *This is unfair because members had an expectation that pension benefits would reflect contributions paid on LSI.*

A11: Although LSI was a permanent addition to salary, the method agreed for phasing it out treated it as though it was a temporary allowance. The effect has been that those in receipt feel that they will have a reduced pension. This is not the case, although it is recognised that they will receive less than they would have expected if LSI had not been phased out.

Q12: *Is it possible to compensate members for the loss of the extra pension they expected to receive?*

A12: It would be possible to use the APB arrangement which is proposed for CPD to provide additional benefits to compensate those who were in receipt of LSI.

This would be a potential additional cost to the pension fund because the FPS and NFPS are final salary schemes. The additional cost would be reflected in future revaluations of the two schemes.