Protection of retirement benefits for employees receiving a reduction to their salary

WARWICKSHIRE

pension fund

Local Government Pension Scheme (LGPS) in England and Wales

2013 Edition

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Warwickshire County Council

Working for Warwickshire

Introduction

This short guide sets out the protections available to members of the Local Government Pension Scheme who have a reduction in pay but continue in local government employment.

It is important to note that this information does not apply if you are changing to part-time work or reducing the number of part-time hours/ weeks you work. It applies only to situations where your level of pay is reduced for reasons other than a reduction in your hours.

Under the rules of the pension scheme, your benefits when you retire or leave the scheme are based on:

- your scheme membership;

  and

- your final pay.

Your scheme membership is the length of time you have paid into the pension scheme. Your final pay is the pay on which you have paid pension contributions (normally) during your last 12 months of service. Final Pay refers to pay for work undertaken during the year rather than all pay received in the year. Arrears of pay awards and lump sum honorarium payments are just two examples where the full amount of the payments may not always be included in final pay as outlined above. If you work part time, your final pay is the full time equivalent pay for the job but your membership is reduced to reflect the hours/ weeks you work.

The ‘best of the last three years’ rule

If you receive a reduced level of pay during your final year of service, then any of the previous two years pay figures (if either are higher than your final years pay figure) can be used as your final pensionable pay to work out your pension benefits. This is commonly called the ‘best of the last three years’ rule.

For example, if you were to leave the scheme on 31 July 2013 the pay you would normally use to calculate your benefits would be the pay for the period

01 August 2012 to 31 July 2013

Or if one of the following periods produces a higher pay figure, then that could be used instead;

1 August 2011 to 31 July 2012,

or

1 August 2010 to 31 July 2011

When using the ‘best of the last three years’ the final pay periods always end with the anniversary of the date of leaving the scheme.

This rule will protect you if you retire/leave within two years of a reduction in pay. However, after this two-year period, it begins to lose its effect, and after three years it has no advantage. This is shown in the example below.

Date of reduction of salary	**1st August 2011**
Salary received 1 August 2012 to 31 July 2013	£21,500
Salary received 1 August 2011 to 31 July 2012	£21,000
Salary received 1 August 2010 to 31 July 2011	£26,000

If you retire/leave the scheme on 31 July 2013, (within two years of the reduction in pay) the best of the last three years rule would have full effect, and the salary in the year up to 31 July 2011 (£26,000) would be used to work out pension benefits.

However, if you retire/leave the scheme on 31 January 2014 (2 ½ years after the reduction in pay), the period used to assess final pay would be the higher of 1 February 2013 to 31 January 2014, or 1 February 2012 to 31 January 2013, or 1 February 2011 to 31 January 2012. In this case, the three-year rule has only a limited period of benefit, because only 6 months of the highest pay falls within the 'best of the last three years period'. The remaining 6 months needed to calculate final pay would be on the reduced salary of £21,000.

If you retire/leave on or after 31 July 2014, i.e. 3 years since the drop in pay, then the 'best of the last 3 year' rule would not offer any protection.

Only pay with your current employer can be used to calculate your final pay, so if you have changed employer within the last 3 years and elected to combine your benefits the above options may not apply.

The best 3 year average in the last 13

As well as the option to use the pay in the last three years, the scheme also offers further protection if your pay is reduced or restricted:

a) because you choose to continue in employment with the same employer at a lower grade, or with less responsibility
b) for the purposes of achieving equal pay in relation to other employees of that employer
c) as a result of a job evaluation exercise
d) because of a change in your contract of employment which means payments or benefits specified as being pensionable payments either cease, reduce or are restricted
e) and the rate at which your rate of pay may be increased, is restricted in a way that is likely to adversely affect your retirement pension.

This does not apply where the reduction or restriction:

a) starts more than 10 years before your last day as an active member
b) immediately follows a temporary post on a higher rate of pay
c) is a choice made for the purpose of taking flexible retirement
d) occurs before 1 April 2008

If the terms of this protection apply to you, you may choose to have your final pay based on the average of any 3 consecutive years running from 1 April to the 31 March, within the last 13 years ending with the last day as an active member.

Once the 3 year average has been calculated it is increased in line with inflation to bring it to a current value.

To take advantage of this protection you must give notice in writing to the appropriate administering authority (Warwickshire County Council Pension Fund), no later than 1 month before you cease active employment.

How the calculations work

A member who received a reduction in pay in 2013 is retiring on 31 August 2020.

Best of the last 3 years

The first step is to establish the pensionable pay figures for the member's final 3 years.

1 September 2019 – 31 August 2020 =	£22,708.33
1 September 2018 – 31 August 2019 =	£22,416.67
1 September 2017 – 31 August 2018 =	£21,416.67

Under the best of the last 3 years the highest final pay figure is £22,708.33

Best 3 year average in the last 13

The option to take the average of the best 3 years in the last 13 only applicable where the downgrading applies on or after 1 April 2008.

The member's pay history for the last 13 years is as follows;

1 April 2019 – 31 March 2020 = £22,500

1 April 2018 – 31 March 2019 = £22,000

1 April 2017 – 31 March 2018 = £21,000

1 April 2016 – 31 March 2017 = £20,000

1 April 2015 – 31 March 2016 = £19,500

1 April 2014 – 31 March 2015 = £18,000

1 April 2013 – 31 March 2014 = £20,500

1 April 2012 – 31 March 2013 = £20,000

1 April 2011 – 31 March 2012 = £19,500

1 April 2010 – 31 March 2011 = £19,000

1 April 2009 – 31 March 2010 = £18,500

1 April 2008 - 31 March 2009 = £18,000

1 April 2007 – 31 March 2008 = £17,500

Which gives the following 3 year averages (Percentage inflation increases are assumed);

1 April 2017 – 31 March 2020 = £21,833.33 = £21,833.33

1 April 2016 – 31 March 2019 = £21,000.00 plus 1.6% = £21,336.00

1 April 2015 – 31 March 2018 = £20,166.67 plus 4.75% = £21,124.59

1 April 2014 – 31 March 2017 = £19,166.67 plus 5.55% = £20,230.42

1 April 2013 – 31 March 2016 = £19,333.33 plus 8.6% = £20,996.00

1 April 2012 – 31 March 2015 = £19,500.00 plus 11.87% = £21,814.65

1 April 2011 – 31 March 2014 = £20,000.00 plus 13.96% = **£22,792.00**

1 April 2010 – 31 March 2013 = £19,500.00 plus 15.47% = £22,516.65

1 April 2009 - 31 March 2012 = £19,000.00 plus 17.37% = £22,300.30

1 April 2008 – 31 March 2011= £18,500.00 plus 19.2% = £22,052.00

1 April 2007 – 31 March 2010= £18,000.00 plus 20.2% = £21,636.00

It can be seen that the 3 year average running from 1 April 2011 – 31 March 2014 provides the highest final pensionable pay figure.

Pensions increases

As shown in the example above, when using the average of the best 3 years in the last 13, the averages are adjusted to give them a current value.

This means that your pay is being calculated on a realistic and fair basis. The increases are added before making the comparisons and equal those added to actual pensions being paid. They reflect the annual increases in line with inflation.

The same increases are also relevant in applying the ‘best of the last three years’ rule. However, in these cases, comparison of each of the relevant years is made before pension increases are added. Once the highest final pay figure has been identified, pension increases are then added to the benefits from the end of the final pay period.

Certificate of protection of pension benefits (for reductions or restrictions in pay before 1 April 2008)

Before 1 April 2008 protection for certain reductions in salary were provided in the form of a certificate of protection. Here a certificate could be issued if a decision was taken by your employer to compulsorily reduce your pay, or your employer had taken a decision which meant that the way in which the future rate at which your pay may be increased was restricted and was likely to affect your retirement pension.

No new certificates can now be issued for reductions in pay that have occurred on or after 1 April 2008, however, if you have previously been issued with a certificate of protection it is still valid even after this date. Certificates of protection can still be issued after 1 April 2008 where the reduction or restriction of pay occurred before 1 April 2008.

Please note that your employer would not have been able to provide a certificate of protection if:

- it had been more than 12 months since your pay was reduced or restricted (although the employer may at their discretion extend this period);
- you chose to take the reduced pay; or
- the reduction was a result of a temporary increase in salary coming to an end.

The certificate of protection only remains valid if the reduction in salary occurred within 10 years prior to leaving the Scheme.

With a certificate of protection, the normal three-year rule is extended. This means that the period used to work out your retirement benefits can be:

- the best of any of the five years before you retire or
- the yearly average of any three-year period in the 13 years before you retire.

Whichever period is chosen it must end on the anniversary of your last day.

Separate retirement benefits

The best 3 year average in the last 13 is only of benefit if you retire within 10 years of your salary being reduced. It is therefore of little value if you are under 50 and your earliest possible retirement date (age 60) is more than 10 years away.

The exceptions to this would be:

- if you retired through ill-health or
- if you were allowed by your employer to take early retirement from age 55 within 10 years of your salary reduction or
- if you left work and were entitled to deferred benefits.

As a younger scheme member taking a reduced salary, you may benefit more from choosing separate retirement benefits. These protect your scheme membership up to the time of the reduction and make sure that it is related to your previous level of pay.

In order for you to be in a position to elect for separate benefits you must first "opt out" of the scheme ideally at the point your pay is reduced and then opt back in again as a separate new employment on your new reduced pay. This may mean opting back in the day after you have opted out.

This would mean that you are awarded:

- deferred benefits based on the salary you received in the 12 months up to your salary reduction and
- a second pension entitlement from the date of the reduction up to your retirement date.

When you retire you would then receive two sets of retirement benefits:

– one based on your membership and salary before the reduction

– one related to your membership after the reduction and your salary in the 12 months before you retire.

Please note that if you want to combine the two periods of service, you must inform us within 12 months of the change, unless your employer agrees to extend this period.

Separate benefits may be considered if a temporary promotion or secondment comes to an end, but again you must first opt out of the pension scheme for this option to apply.

Things to consider before opting out of the pension scheme

Before making a decision to opt out of the Scheme and rejoin, there are a number of factors that you must give full consideration to.

- Deferred benefits will increase in line with inflation, but salaries especially when the effects of promotions and career progression are considered often exceed inflation. It would only be in your best interest to keep the benefits separate if you are sure that the earnings in the lower paid post would not eventually increase to a higher level than the final pay plus inflation that the deferred benefits were based on.
- If you elect to opt out and receive a deferred benefit you will have 12 months from the date of opting out in which to effectively change your mind and have the benefits combined into a single ongoing period of membership. If you do not elect to combine during this period but, after 12 months decide you would have been better to do so your election cannot be reversed.
- If you elect for separate deferred benefits and at some point in the future you take up a new employment with the same or another Local Authority you will have the option to transfer any of your previous employments to your new post.
- You also need to consider how any 85 year rule protections that you may have, will be affected. If you have ongoing protection for the rule of 85, then by opting out, the protections will only apply to the deferred employment and not the ongoing continuing employment. This means you could choose to retire at age 60 and receive only the deferred benefits to which the full protection applies. You may receive the other set of benefits from the ongoing employment however an actuarial reduction will be applied for receiving the benefits early unless you defer drawing these benefits until age 65.

If you would like more information on protection of retirement benefits, please contact:

Treasury and Pensions Group
Warwickshire County Council
PO Box 3, Shire Hall, Warwick. CV34 4RH

E-mail: pensions@warwickshire.gov.uk
Or visit our website: www.warwickshire.gov.uk/pensions

Please note that nothing in this short guide can overrule the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007, The Local Government Pension Scheme (Administration) Regulations 2008 or the Local Government (Transitional Protections) Regulations 2008 (as amended).

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