Local Government Pension Scheme

Reduction in Pay - Guidance Note

Introduction

Because the Local Government Pension Scheme is a final salary scheme, any reduction or restriction in pay is likely to have an adverse effect on your retirement benefits.

This Guidance Note explains the ways in scheme benefits may be protected either through the granting of a Certificate of Protection of Pension Benefits or by "Ring-Fencing" the pre-reduction rights in the form of a Deferred Benefit.

When Can A Certificate Be Granted?

A **Certificate of Protection of Pension Benefits** is a device within the scheme which allows your rights to be protected if you suffer a reduction/restriction in pay through **the actions of your employer** (e.g. arising from a job evaluation exercise or the withdrawal of a pensionable element from your pay).

Your employer can grant a certificate without you applying for one.

If you apply for a certificate within 12 months of suffering the reduction or restriction, your employer is obliged to grant it.

If you do not apply for a certificate within 12 months, it is up to your employer to decide whether or not to grant it.

When Can a Certificate not be Granted?

A Certificate cannot be granted:

- if the reduction or restriction in pay has resulted from your actions as an employee, or
- if the reduction or restriction in pay is temporary, or
- if the reason for the reduction or restriction is ill health.

What Protection Does the Certificate Provide?

Where a Certificate has been granted, then, subject to certain conditions, it can allow your pension benefits – to some degree - to be calculated using your rate of pay prior to the reduction or restriction.

It is important to note that the protection offered by <u>a Certificate only lasts for 10 years</u>, counting forward from the date of the reduction / restriction. After 10 years, it ceases to have any value.

If you happen to leave the Scheme when the Certificate is still valid, then the protection is that you can elect to have your benefits based on:

- the best of your final 5 years' annual pensionable pays; or
- the best annual average of any 3 successive years' of annual pensionable pay from the last 13 years' of pensionable service.

In determining the best year or run of years, you cannot count any pensionable pay which arose more than 3 years prior to the restriction / reduction. Also, any assessment of the best year / run of years should be done after applying the rise in inflation between the date of reduction / restriction and the date of leaving the Scheme.

Ring Fencing Pension Rights with a Deferred Benefit

If you are worried that a certificate will expire before you are scheduled to leave the scheme (n.b. a Certificate lasts only 10 years from the date of any reduction/restriction), then it may be to your advantage to "ring fence" your rights up to the point of reduction in the form of a deferred benefit.

With deferred rights, your benefit is worked out on your membership and your pay up to the date your pay was reduced. You will then start to build up separate pension benefits in respect of your membership and pay following the reduction in pay. You should be aware that once a deferred benefit has been established, there are limited options to allow it to be combined again with your current rights.

Deferred benefits are available to be paid out at age 60, although they may attract a penalty reduction if paid out prior to age 65. They increase in line with the Consumer Price Index. To be eligible for a deferred benefit, you will need to have completed at least 2 years membership or have transferred in rights from another pension scheme.

Deferred Benefits can be created in two ways - by changing employments or by opting out.

<u>Change of Employment</u>

If your reduction in pay means that you have been given a new contract of employment, then you are entitled to a deferred benefit for the period of membership up to the point of reduction.

Having a deferred benefit however could be to your detriment, if you later get the chance to retire early (e.g. through voluntary severance). In that situation, only your new pension rights – not the deferred element - would be paid out early.

<u>Opting Out</u>

A deferred benefit can be created by opting out. Indeed, in order to maximise the protection that is afforded by a Certificate, it would be possible to opt out just before the Certificate is due to expire. This would result in your deferred benefit being based on membership and final pay as at the date of opting out.

Whilst opting out (and then re-joining) is quite legitimate, it could be to your detriment, if you later get the chance to retire early (e.g. through voluntary severance). In that situation, only your pension rights from the point of opting out – not the deferred element - would be paid out early. A further reason not to opt out is that if you died whilst you were not in the scheme, your death benefit would be considerably less than had you remained a scheme member.

In general terms, opting out is not a strategy to be encouraged and should only be undertaken after a careful consideration of all the facts and after consultation with both the Pensions Section and an Independent Financial Adviser.

n.b. A deferred benefit can only be paid out if you have left the employment from which you opted out.

What if I do not have a Certificate?

If you do not have a Certificate, or if you have a Certificate and it is no longer valid (i.e. more than 10 years have passed since you suffered the reduction or restriction in pay), then your annual pensionable pay will be the best of your final 3 years' annual pensionable pays.

Disclaimer

Nothing in these Guidance Notes can override the Scheme Rules which are set out in various statutory instruments issued by the Scottish Government.