

# *Firefighters' Pension Scheme Circular*

<b>Circular Number:</b>	FPSC 11/2009	<b>Date Issued:</b>	9 <sup>th</sup> December 2009
<b>Action:</b>	For Information and comment		
<b>Title:</b>	<i><b>FIREFIGHTERS' PENSION SCHEME 1992 AND NEW FIREFIGHTERS' PENSION SCHEME 2006 - DEFINITION OF PENSIONABLE PAY</b></i>		
<b>Issued by:</b>	Martin Hill Workforce Pay and Pensions Division		

<b>Summary:</b>	This circular sets out concerns about the treatment of pay for pension purposes and invites comments on options for amending the pension arrangements to ensure more equitable arrangements in future. It recommends that authorities should not introduce new pensionable payments until decisions have been taken.
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<b>Addressed to:</b>	<b>Please Forward to:</b>
The Clerk to the Fire and Rescue Authority	Pension and human resources managers
The Chief Fire Officer	Treasurers
	Finance Directors
	Active members

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## **FIREFIGHTERS' PENSION SCHEME 1992 NEW FIREFIGHTERS' PENSION SCHEME 2006**

### **CONSULTATION ON PENSIONABLE PAY, EMOLUMENTS AND ALLOWANCES**

The purpose of this consultation is to seek comments on proposals for introducing new arrangements for managing, and regulating, the pensionability of allowances and other emoluments paid to members of the Firefighters' Pension Scheme 1992 (FPS) and the New Firefighters' Pension Scheme 2006 (NFPS).

We have discussed the matter with the Firefighters' Pension Committee (FPC) who are supportive of our objective and the options outlined in this paper reflect comments made by Committee members.

The FPC have asked us to recommend to Fire and Rescue Authorities that, while consultations are in progress and pending decisions on the definition of pensionable pay and the pensionability of allowances, they should not take any action which would introduce new allowances which are treated by them as pensionable; that is that new allowances can be introduced but that they should not be pensionable.

#### **1. Background**

1.1 Pensionable pay is defined in both the FPS and the NFPS. The FPS definition is contained in Rule G1. The definition which was originally included in the 1992 version of the scheme rules, and in force until 2004, was that the pensionable pay of a regular firefighter is "the amount determined in relation to the performance of the duties of his rank". The definition was amended with the substitution of "rank" with "role" in 2004 to reflect the changes within the Fire and Rescue Service as part of the modernisation agenda. The current wording of Rule G1 is

the pensionable pay of a regular firefighter is the aggregate of—

- (a) the amount determined in relation to the performance of the duties of his role (whether as a whole-time or part-time employee); and
- (b) the amount (if any) paid to him in respect of his continual professional development.

1.2 The NFPS definition is contained in Rule 1 of Part 11. This states

the pensionable pay of a firefighter member is the aggregate of—

- (a) his pay in relation to the performance of the duties of his role except any allowance or emoluments paid to him on a temporary basis, other than payments in respect of his continual professional development (see rule 7B of Part 3), and
- (b) his permanent emoluments (including, in the case of a retained firefighter, any retaining allowance).

1.3 The drafting of the NFPS reflected concerns at the time over the way in which the pensionability of pay was being handled by FRAs and was an attempt to clarify the position so that the main element of pensionable pay would be the

basic pay for position, regardless of whether the accepted term was “rank” or “role”. It also spelt out that only permanent emoluments could be aggregated with basic pay to form pensionable pay, the intention being that temporary allowances should be excluded.

- 1.4 The expression “temporary allowance” for this purpose was intended to apply to an allowance awarded for a particular responsibility or activity that is subject to review and withdrawal at any time, for example, when the responsibility or activity ceased.
- 1.5 It has come to our attention that, as FRAs respond to the need for changes to meet new operational demands, new allowances and emoluments are being introduced on a localised basis. These allowances and emoluments are frequently being designated as pensionable even though some are clearly of a temporary nature as defined above.
- 1.6 Furthermore, we recently asked pension administrators within the Fire and Rescue Service to identify those elements of pay that their fire and rescue authorities regard as pensionable. From the responses we have identified that there is some disparity between FRAs, particularly in the treatment of allowances and temporary emoluments for pension purposes.
- 1.7 In retrospect, it is clear that we did not take a firm enough line in 2004 - 06 when we were developing the new pension arrangements.

## **2. Reasons for concern**

- 2.1 The assessment of the value of the two schemes, including the level of contributions from employees and employers required to finance the scheme, is based on the cost of providing the benefits to be paid to an average new entrant over the course of his/her career. Any new element of pensionable pay immediately creates an additional pension liability which includes, not only a future cost in terms of an increased level of pension payments, but a past cost that has not been covered by pension contributions and which cannot be covered by future pension contributions.
- 2.2 The impact of these past service costs is most severe when scheme members receive new or increased pensionable payments in the latter stages of their active service. The extra benefits derived can be considerable: for example, a firefighter aged 49 who receives a pensionable allowance in his final year of service and who subsequently retires at age 50 with 30 years’ pensionable service will receive additional pension of £666.67 for every extra £1000 of pensionable pay before commutation, or £500 plus £3166.73 lump sum. The pension costs of such payments made at the end of a firefighter’s service cannot be reflected in the contributions paid over the working life of the member but will create an index-linked liability for, possibly, decades in the future. Whilst this is a very good return for the investment by the employee who might expect to receive pension payments worth well over £10,000 for just £110 of pension contributions, it is a very poor outcome for the taxpayer.
- 2.3 Because the FPS and NFPS are unfunded schemes, pension costs have to be met from a pension account maintained by each FRA into which all employee and employer contributions are paid with any deficit covered by a “top-up” grant drawn from the total Central government funding of the Fire and Rescue Service. Any additional net pension costs, i.e. those that cannot be covered by

employee and/or employer contributions, might not immediately feed through into the “top-up” grant required (ie the cash deficit), but does nevertheless represent an additional threat to the long term affordability and sustainability of both the 1992 and 2006 Schemes.

- 2.4 Aside from the cost implications, the implications for scheme members in receipt of an allowance must also be considered. An important consideration when determining whether an allowance or emolument should be pensionable is the likelihood of whether, once awarded, it will continue to be a permanent feature of a person’s aggregate pensionable pay. Both the FPS and the NFPS are “final salary schemes”. This means that the scheme benefits are based on the pensionable pay in the best of the final three years of pensionable service (termed average pensionable pay in the FPS and final pensionable pay in the NFPS). A member who has paid pension contributions on an element of pay which then ceases before the final three years of pensionable service gains no benefit from those contributions. This was the situation that would have arisen following the abolition of the Long Service Increment and became a possibility with the introduction of the Continual Professional Development allowance; and precipitated the introduction of the LSI and CPD Additional Pension Benefit provisions.
- 2.5 Clearly, allowances or emoluments that are paid in addition to a firefighters’ basic pay for the role and are temporary in nature, i.e. are specifically time limited; do not normally feature in pay; are subject to review and withdrawal, **should not be pensionable.**

### 3. Current position

- 3.1 Concerns over the interpretation of scheme rules with regard to pensionable pay and the proliferation of new pensionable allowances was raised with the Firefighters’ Pensions Committee (FPC) in a paper in May of this year<sup>1</sup>. The paper identified some possible options for dealing with the concerns. Comments were received and, as a result the two favoured options were presented to the FPC in a discussion paper at the November meeting<sup>2</sup>.

### 4. Proposals

- 4.1 Option 1: Introduce an approvals process to assess and mitigate against cost implications for the schemes.
- 4.2 This option would allow FRAs to continue to determine whether new allowances or emoluments should be pensionable (having regard to the scheme regulations on pensionable pay) with the result that any such allowances featuring in average/final pensionable pay at retirement would be reflected in pension benefits. However, as regulator of the finance arrangements, CLG would need to be consulted at an early stage when any proposals which may affect pension costs were being considered. FRAs would be required to provide sufficient information to CLG to enable it to consult the Government Actuary’s Department about the impact on the pension fund and calculate an additional contribution which would be levied on the relevant FRA to cover the past service costs should they still decide to proceed with making the allowance pensionable.

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<sup>1</sup> FPC(09)4, discussed at the 30<sup>th</sup> Meeting

<http://www.communities.gov.uk/fire/working/firefighterpensions/firefighterspensioncommittee/fpcpapers09/>

<sup>2</sup> Annex to FPC(06)6, discussed at the 32<sup>nd</sup> Meeting

- 4.3 Option 2: Adopt Additional Pension Benefit (APB) arrangements similar to those introduced in 2007 for CPD payments.
- 4.4 This option would involve applying a more restrictive definition of pensionable pay so that only basic annual pay for role would be pensionable under “final salary” arrangements and that APB arrangements should apply to all pensionable allowances or emoluments. The amount of additional contributions paid in a year would receive an actuarially valued pension which would be index-linked and come into payment on retirement alongside the main pension benefits.
- 4.5 The two options are not necessarily exclusive. It would be possible to regard some allowances as pensionable but to provide that in any case when a person starts to receive such an allowance, the past service costs are calculated and the fire and rescue authority is required to pay them.

## 5. FPC preferred Option

- 5.1 The Committee were in agreement that swift action was necessary. It was recognised that local decisions by FRAs that placed an additional burden on a scheme that was heavily subsidised by the tax payer and could impact on funding of the service overall could not be allowed to continue. In addition to the concerns over the cost implications, which could ultimately threaten the future viability of the pension schemes, there was also concern that pension scheme benefits were being offered inappropriately, through allowances and emoluments, as an inducement to employees to accept changes to terms and conditions without due consideration of costs or general pension legislation.
- 5.2 Following discussion, there was a clear direction from the Committee that Option 2 was preferred. The Committee made the following points:
- adopting APB arrangements would allow any new pension liability to be borne by the employer and the member in direct proportion to the value of the allowance or emolument;
  - the option would provide FRAs with the necessary flexibility to determine emoluments and allowances locally for their staff.
  - members who receive temporary allowances which did not feed into their final salary would still receive a benefit
  - adequate protection should be put in place to ensure that any benefits already accrued for scheme members would be protected.
  - there were some allowances and emoluments, such as Flexible Duty Allowance, London Weighting and pay for Temporary Promotion, that had long been treated as pensionable and some protection for members in receipt of these might be necessary.

## 6. Protection of accrued benefits

- 6.1 There is no intention of adversely affecting the pension of a scheme member who has a legitimate expectation that their pension will reflect income from allowances currently received by them and, in any event, under the terms of section 12 of the Superannuation Act 1972 accrued rights are protected. We would go further and propose that where a right has been agreed in respect of

any individual prior to 18<sup>th</sup> November 2009<sup>3</sup> it should continue to be treated as part of pensionable pay.

- 6.2 Some allowances or emoluments cannot be guaranteed to feature in average/final pensionable pay, e.g. because of a subsequent change in role, and in such cases protection through the existing two (split) pension provisions may be appropriate but in other cases an APB would need to reflect the elements of pay which would otherwise have been part of final pensionable pay at the point at which the new arrangement comes into operation (in a similar way to the treatment of LSI payments at 30 June 2007).
- 6.3 However, in respect of any other person such an allowance should only be regarded as pensionable under APB arrangements.

## **7. Adopting APB arrangements**

- 7.1 Before implementing any new APB arrangements, CLG would need to discuss the detail with the Scheme Actuary to determine, for example, an appropriate methodology for calculation including index linking and suitable factors.
- 7.2 Some administrators have previously raised concerns with CLG over the administrative burden that CPD APB has placed on FRAs. The opportunity would therefore be taken to ensure that the new arrangements were as simple and straightforward as possible, particularly with regard to index-linking which FRAs have found particularly cumbersome in the current arrangements.
- 7.3 Otherwise decisions on the pensionability of existing allowances or emoluments would be a matter for determination by the fire and rescue authority and would be covered by the APB arrangements.
- 7.4 In addition to meeting the needs of the service, we would need to satisfy the requirements of HM Treasury and HM Revenue and Customs.

## **8. Purchasing additional service or additional pension**

- 8.1 If option 2 were adopted, it would provide an opportunity to move from purchasing additional service to additional pension arrangements.
- 8.2 At the present, both the FPS (Rule G5) and the NFPS (Part 11, Chapter 2), provide for the purchase of additional service for the purpose of securing increased benefits. Under these arrangements, a member may pay either by lump sum or by periodic contributions.
- 8.3 Added years are available only to scheme members who will not be able to build up 30 (40 in the NFPS) years' service by the age of 55 (60). The actual amount of pension being bought will not be known until the member's final salary is known and the extra pension bought cannot be used to boost the pension beyond the 30 (40) year maximum. The cost to members of buying added years needs to cover the possibility not only of their living a long time but also of their significantly increasing their salary before retirement. This may work very well for those with prospects of promotion but it is less advantageous for those who do not rise far through the ranks.

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<sup>3</sup> The date of the 32<sup>nd</sup> meeting of the FPC when they agreed to recommend that authorities should not treat allowances as pensionable until the question of pensionability had been settled.

- 8.4 The key feature of added pension, which is replacing added years in public service pension schemes, is that it is a set amount of annual pension which any member who is contributing to a pension may buy to increase their main pension. Unlike added years, this facility is not restricted to those who cannot build up the maximum pension before expected retirement. The amount being bought will move each year in line with pensions increase and be paid with the member's pension on retirement.
- 8.5 The introduction of added pension would therefore be accompanied by the closure of the added years schemes for new elections, although existing contracts would continue unaltered.
- 8.6 In line with other public service schemes we would expect there to be a life-time limit of about £5,000 or its equivalent in terms of pension plus automatic lump sum. The starting limit would then be revised each year in line with the retail price index in common with public service pensions generally. As with other public service schemes, members could buy added pension by periodical payments or a lump sum. The amount paid for the added pension would depend on the age of the member at the time of starting payments. Again, in line with other schemes periodical payments would be limited to a 20-year period in order to keep payments at a reasonable level and to give all a good chance of reaching their target sum before retirement or leaving the service. Some schemes require the amount bought to be in multiples of £250 but this would be a matter for discussion and might not be seen as consistent with APB arrangements generally under the FPS and NFPS. Our initial view is that this is an unnecessary limitation on choice.
- 8.7 Comments are invited on the proposal.

## **9. Financial implications**

- 9.1 The FPS and NFPS are essentially "pay as you go" schemes and, although administered locally by fire and rescue authorities, since April 2006 the financial arrangements for English authorities have been nationally based so that decisions taken locally will impact on the cost of the schemes nationally and not on an authority's operating account.
- 9.2 The aim of any change would be to ensure that decisions taken locally are paid for locally on a fair value for money basis and do not impact on the overall long-term finances of the scheme or the budget of any other authority.
- 9.3 It is inevitable that introducing APB arrangements will give some savings to the pension fund because moving allowances away from final pensionable pay arrangements means that unfunded and unplanned past service costs will not now have to be met. However, this will be offset by the fact that those whose careers progress beyond payment of an allowance would have a preserved APB benefit reflecting the period in which the allowance was received and contributions paid.
- 9.4 It is intended that APB arrangements should as far as possible be self-financing and not be an additional burden on the pension fund.
- 9.5 The cost of providing pensions for members of the two firefighter schemes is increasing and the current annual deficits for all English fire and rescue authorities has increased from one hundred and forty million pounds (£140m) in

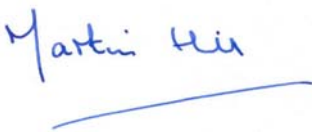
2006/7 to an estimated two hundred and seventy million pounds (£270m) in 2009/10 (adjusted to remove the cost of backdated commutation payments). Whilst this is a matter of cash-flow and not underlying costs, it is indicative of the problems that we are seeking to address.

## 10. Conclusion

10.1 Comments are now invited on the options mentioned above although respondents are welcome to make any comments or suggestions on the issue. As mentioned, the introduction of APB arrangements is the option favoured by the FPC and comments would therefore be particularly welcome on the following proposals:

- (i) FRAs should have discretion to determine whether an allowance or emolument is pensionable.
- (ii) Additional Pension Benefits (APB) arrangements should apply to any pensionable allowances or emoluments which an FRA determines should be pensionable.
- (iii) a member of the FPS or NFPS in receipt of any allowance or emolument which has been treated as pensionable before 18 November 2009 should be entitled to have this regarded as part of pensionable pay.
- (iv) pension benefits accrued on pensionable allowances or emoluments should be protected.
- (v) arrangements for purchasing additional pension should replace those for purchasing additional service.

10.2 Comments are required by **22<sup>nd</sup> January 2010**. Responses will be considered and a formal response document issued before there is consultation on draft amendments to the two pension schemes.



**Martin Hill**