

Summary of responses to the consultation document

“REPORT OF THE WORKING GROUP ON POLICE PENSIONS FINANCE REFORM”

Part 1 – Introduction

On 24th March 2005, the Home Office published the “Report of the Working Group on Police Pensions Finance Reform”. This consultation document set out the Government’s proposals for replacing the existing system of police pensions financing with a new system, moving from a pay-as-you-go scheme to a notionally funded method. Under the new financial arrangements Police Authorities will retain responsibility for administering and paying pension but from a new, separate pensions account. Payments will be made into this account in the form of employee contributions, new employer contributions and the account will either be topped up by a grant from Central Government or any surplus be returned to Central Government as necessary. The new arrangements will be cost neutral at an aggregate level.

The consultation document sought views on the proposals as a whole, and in particular on 12 key issues identified within the text. This document summarises the responses to the proposals and sets out the conclusions drawn by the Home Office as a result.

Part II – The Consultation Exercise

The consultation period ran for three months between 24th March 2005 and 17 June 2005. In total we received 35 responses. We are grateful to all who studied these proposals and responded with comments. These responses have assisted in informing progress towards the new system of police pensions financing.

A full list of respondents can be found at Annex A.

Part III - Responses

The consultation document asked a series of questions regarding key issues, which had been identified as impacting on the proposed new system of police pensions financing.

Respondents were invited to express their views and comment on any part of the report but comments were particularly invited in relation to the 12 key issues. They were also invited to make further comments or raise awareness of other issues not specifically mentioned with the text of the consultation document that they considered pertinent to the setting up of the new financing system.

Please note that the paragraph references referred to below relate to the Home Office consultation document entitled "Report of the Working Group on Police Pensions Finance Reform". This report was published on 24 March 2005 and a copy can be found on the Home Office website.

The consultation document was placed on the Home Office website and copies were sent directly to all forces and key stakeholders inviting comments. The overall number of returns was sufficient to provide a good cross section of views on the proposals. It was encouraging to note that the consultation document was generally well-received and positive feedback was given upon the proposals it contained.

ISSUE 1

The Working Group recommends [paragraph 2.13] starting the new system in 2006/7. Is this feasible in your view?

Respondents were virtually unanimous in understanding the reasons for change and supporting the proposed system of police pensions financing. However, respondents did express some concerns about the achievability of the timescale both nationally and locally and the level of funding and grant to be awarded.

Naturally the Home Office have drawn up a detailed project timetable to ensure that targets are met.

The concerns surrounding the timescales for local implementation focused on the risk that the necessary software would not be in place before April 2006. In relation to the timescales for pensions contractors, the Police Centre of Procurement Excellence has issued a draft specification as a precursor to going out to tender for a pensions administration service for interested authorities and anticipates being able to meet the April 2006 timescales.

Some expressed acceptance of the timeline only if the changes to funding were 'cost neutral'. In response, the transition to the new system is cost neutral for police authorities as a group since the amount taken out of the Settlement for the top-up grant is for paying back to the authorities. Moreover arrangements have been agreed with Office of the Deputy Prime Minister (ODPM) for a system to damp excessive variations in distribution as a result of the funding formula being applied to the Settlement.

ISSUE 2

The Working Group recommends [paragraph 4.11] a single employer contribution rate covering both the current and new Police Pension Scheme-do you think this more practical than police authorities having to pay separate rates for the old and new schemes at the same time?

The overwhelming majority of respondents supported a single contribution rate that covers both the current and the new scheme. However this support was not unanimous and some respondents argued that there should be separate rates for the current and new schemes. It is agreed that the value of the pension scheme will need to be reviewed regularly to ensure that the contribution rates reflect the true cost of accruing pensions and the mix of officers who are contributing members of the current and the less expensive new scheme.

There were suggestions that the review is triennially to tie in with the review of the Local Government Pension Scheme or the Spending Review which are supported although there can be no certainty about the frequency of spending reviews.

There were also arguments for a separate rate for each authority but that was considered an unnecessary complication.

ISSUES 3 and 4

The Working Group recommends [paragraph 5.17] that ill-health pensions should be paid entirely out of the pensions account but on the basis that the police authority will pay a capital equivalent charge into the account in order to make up for the added cost to the scheme of the ill-health pension. Do you agree that this is the most effective way of paying ill-health pensions under the new system?

**The Working Group recommends [paragraph 5.21] that the capital-equivalent payments be set at twice the average pensionable pay of the officer being retired and spread over four years by even instalments. Do you think this is:
a reasonable amount; and
are you in favour of the four year spread to avoid lumpiness in such expenditure?**

Whilst some respondents felt that there were sufficient safeguards with the present system to keep the incidence of ill-health retirement under control the overwhelming number of respondents to the consultation (on both the police and the separate fire scheme consultation) made reference to the incentives offered by the revised approach.

Issues were raised in relation to the need for periodic actuarial assessment. We can confirm that there will be periodic actuarial assessment of the reasonableness of the level of capital equivalent payment. It was also suggested that the individual payments should be actuarially calculated. However, because the actuarially calculated cost would depend on individual circumstances it would re-introduce a further element of volatility to authorities' budgets that would be undesirable. Additionally it is worth noting that the Audit Commission considered that the proposals should encourage greater consistency of approach between forces and that the costs of funding

ill-health pensions and injury awards (the latter of which will continue to be paid out of the operating account) will be considerably less than the total pension costs that forces have to fund currently.

There was concern raised about the level of compliance with PNB guidelines. It should be noted that the proposals do not in any way affect decision making as to entitlement. They are simply an approach to accounting for the retirements.

The point was made by a number of respondents that spreading the capital equivalent payment over a period of four years dilutes the incentive.

Respondents also sought clarification of the accounting implications of spreading the lump sum over a four year period. It is anticipated that there will be a requirement for full accrual of the liability in the operating account. These considerations have made the more attractive option to be requiring forces to pay the charge in one instalment in the year in question despite the risk of lumps in the cost.

It was questioned whether a variable charge might be introduced at the first valuation stage. However, given the size of the scheme there is an advantage in keeping the rate as simple and robust as possible. The proposal is that the employer's contribution rate is set at an average rate that is sufficient to meet the full costs of liabilities being accrued in respect of serving officers.

A query was raised as to the robustness of the calculations used to arrive at the figure of twice average pensionable pay. This calculation is not based on precise actuarial figures but represents a broad average of the capital-equivalent costs of ill-health retirements over and above the costs of leaving the service at the same point with a deferred pension. The actuarially calculated costs are shown in Annex D to the Working Group report. As previously stated there is a commitment to regular review.

ISSUES 5 and 6

The Working Group recommends [paragraph 7.45] that the central agency which has an officer seconded to it should reimburse the sending force with the full cost of the officer including employer and employee's contributions. Since such agencies either do not have to make both or such payments at present or may pass on only the officers' contributions the Group recommends a way to finance this new burden [paragraph 7.67] i.e. out of the total set aside for top-up grant. Are you content with the way it is proposed to enable the central agencies to meet their new costs?

The Working Group recommends [paragraph 7.12] a method for financing the added costs which central agencies will incur in switching to a system based on paying pensions contributions into a new pensions account. Are you content with the way it is proposed to enable the central agencies to meet their new costs?

A number of points were raised in relation to key issues five and six and these are to be considered together for the purposes of this summary.

It was questioned as to how secondments will be funded in the second year of the new system (07/08). It is proposed that there will be a transfer from police grant Departmental Expenditure Limits (DEL) to central bodies' DEL for both 06/07 and 07/08. The transfer will be based on the estimated added cost to the Centre as a result of the new system in reimbursing sending forces for contributions in respect of their seconded officers. This two-year transfer, which will not recur after 07/08, will enable the relevant bodies to manage the transition period before they become responsible, from 1 April 2008, for including the potential need to make such payments in the process of agreeing their operational budgets.

Some respondents felt that no consideration had been given to the impact of an ill health retirement that occurred during the period of the secondment. This point is accepted and it is not now the intention to increase the employer's contribution rate paid by central agencies by 1.3%. The extra 1.3% being retained by the force in its operating account to help pay its capital-equivalent charges for ill-health retirement.

Some respondents contended that specific grants used to fund police officers e.g. Crime Fighting Fund, will need to be increased to cater for the pensions on-cost. The need to reflect all costs relevant to the provision of extra officers on any future grant is recognised.

Some Police Authorities contended that given that the pension will eventually be paid from the pension account of the home force and be adjusted by a top up grant anyway for any deficit the new system adds an unnecessary complication and as such is not supported. However the advantage of the proposed approach is that the pensions costs of the home force and the relevant central agency are separately identified and accounted for. This then aids management decision making e.g. should a role be filled by a police officer or a member of police staff or by external contract?

Some asked if the additional costs of the central agencies could not be added to their annual budget/grant settlement. However the approach proposed by the Working Group is consistent in that the top up applies to agencies as well as police authorities allowing separate identification of pensions costs.

ISSUE 7

The Working Group recommends [paragraph 8.7] a method for identifying the amount of resources needed for the central top up grant. Do you think this is a fair way of ensuring that a fair share of resources for the cost of pensions in payment between Central Government on the one hand and police authorities on the other? If not what alternative way do you suggest?

The feedback received suggested general acceptance that the approach proposed is fair and transparent.

However concern was raised regarding the reliance on Government Actuary's Department (GAD) estimate and possible differences with police authority estimates and whether these estimates would be available for viewing. The position of the Home Office on this issue is that these estimates and exemplifications will be reviewed critically by the Finance Reform Working Group. It is expected that the paper showing the GAD estimates compared with the forces' own estimates will be made available after consideration by the Working Group.

Concern was also expressed over the Police Authorities' ability to sustain their current levels of operational expenditure. It is confirmed that funding the top-up grant will not be dependant on the overall level of police grant. The new system will not affect the Police Authorities' operating costs.

The Welsh Police Finance Group also questioned whether future increases in pensions expenditure are to be met from a further top slice of Police Grant or from a top-up of Annually Managed Expenditure (AME) Grant. Similarly some sought commitment that the government would provide any additional necessary funding. It is confirmed that funding the top-up grant will not be dependant on the overall level of police grant.

ISSUE 8

The Working Group recommends [paragraph 8.26] that the outcome of the modelling exercise based on 2003/4 figures shows that the degree to which authorities may be winners or losers is manageable, given the long term benefits of moving to the new system. Do you; agree with this unreservedly?

Or agree because you expect that the general damping mechanisms likely to be in place for 2006/7, coupled with use of your reserves, should be enough to smooth winners and losers?

Or want additional damping mechanisms in place and, if so, what mechanisms?

Not surprisingly although there is clearly overall support for change few respondents gave their unreserved approval to the manageability of the changes.

Respondents commented on the need for further consultation, there were also comments on the need for a modelling exercise for the medium term which includes data from forces for 2006/7 to 2008/9. It is stated that it is only at this stage that any definite view can be taken on whether grant changes will be manageable. More up to date data have been collected from forces which have enabled the impact on individual forces to be more clearly identified and these data have been considered by the Working Group. A damping mechanism has been agreed with ODPM which will avoid excessive

variations in distribution of grant as a result of the new system. It is understood that the proposal has been given general support by police authority treasurers.

A small number of respondents advocate additional damping or alternatives, whereas some stated that additional damping mechanisms are unlikely to add further protection but will add to the complexity. Some respondents comment that if there is to be additional damping it should be for a transitional period. However this would protect one element of the funding formula at the expense of others.

The Area Cost Adjustment (ACA) currently applies to the non pensions element of the funding formula. A number of respondents have commented on the implications of its application to the total formula allocation. These include a response to the effect that a £20m adjustment in favour of the Metropolitan Police may be giving a double benefit when the impact of ACA is taken into account. The ACA issue is identified in the Working Group report. After further consideration it has been concluded that it is not feasible to adjust the ACA.

Concern has been expressed that the figures in the modelling exercise appear to understate the costs remaining within Forces' revenue accounts under the new system. These comments have been considered by the Working Group whose views are that the comments underscore the need for forces to ensure injury awards are excluded from any estimates of pensions expenditure, since they will not be covered by top-up grant but be paid out of the operating account.

The comments that a review will be necessary are acknowledged, the report in its 'next steps' recommends a review of the new financial arrangements within 3 to 5 years.

ISSUE 9

The Working Group recommends [paragraph 9.3] that the introduction of the new system is not accompanied by transfer of formal responsibility for the payment of police pensions to the Home Office. Do you agree this is the most practical solution for the time being?

An overwhelming number of respondents agreed that the Working Group recommendation is the most practical solution for the time being.

Many respondents commented on the potential efficiency gain from inter-force collaboration. In response to requests from the service the recently formed Police Centre of Procurement Excellence has issued a draft specification as a precursor to going out to tender for a pensions administration service for interested authorities with effect from April 2006.

ISSUE 10

The Working Group recommends [paragraph 9.8] a timetable for bidding for and receiving top-up grant. Are you content with what is proposed?

Overall this proposal was accepted by the respondents. However some suggestions were made for alternatives, as detailed below.

There was a suggestion that there is a need to reconvene the Working Group in the autumn to quality assure the data collection exercise and verify that the top-slice from police grant has been calculated accurately and fairly. This has been done.

The observation that there should be integration of the payments/recovery process with the main police grant is accepted. Similarly it accepted that the suggestion that the audit arrangements should comply with the specific grant thresholds recently introduced by the audit commission is sound.

There was concern that the 80% reimbursement in July was too low and would adversely affect operating costs. However the Working Group Report considers this should be adequate to ensure, to a reasonable extent, that there is no negative impact on cash flow.

There was a suggestion the deadline for the auditing of the pensions account be delayed until the 31 December to allow for other final grant returns. Pending final Home Office confirmation this point is accepted. Additionally the Home Office undertakes to ensure that adequate information is provided by December 2005 to ensure compliance with the given timeline.

ISSUE 11

The Working Group recommends [paragraph 10.7] a classification of the different types of pension payments which should be separately identified in the pensions account. Do you think this strikes the right balance between precision on the one hand and being over detailed on the other?

The Working Group recommendations are almost unanimously supported with a number of responders commenting that to include further items would open up the opportunity for creative accounting.

The Police Authority Treasurers' Society and Association of Police Authorities' response suggests consideration should be given to the use of an earmarked reserve to address year-on-year fluctuations. These reserves may need to be held by authorities for capital-equivalent payments for ill-health retirements and injury awards. It is noted that authorities are being allowed to keep any accrued pension resources.

The need for the Chartered Institute of Public Finance and Accountancy (CIPFA) to be consulted was identified as an issue. The Working Group report

states that CIPFA and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) are likely to be consulted towards the end of 2005 on the revisions to the Statement of Recommended Practice (SORP) to apply from 1 April 2006 at which time Authorities will have an opportunity to comment formally on any proposed changes to accounting treatment. It is confirmed that the matter is with the relevant CIPFA panel who will consult on their proposals.

ISSUE 12

The Working Group recommends [paragraph 12.3] a list of issues to be reviewed after 3 to 5 years. Do you agree with this timescale and do you have any further items to add to the list?

As with Issue 1 there were comments that a firm timetable needs to be set out, this is accepted. The consensus amongst respondents is for review within the timescale of three to five years after implementation and this is accepted.

It was commented that there is a need for early publication of any CIPFA/LASAAC proposals or decisions. This is accepted.

It was asked by several respondents that there be a review by a fully representative panel. This is seen as a sound request.

Concerns were raised over several issues that have already been touched on in this summary. There was concern over conflict between the four year evaluation and three year spending review cycle and over the practicality of the reviews, for responses please refer to Issue 2. Similarly the suggestion that there be an annual review to determine whether pensions be administered centrally has been examined in Issue 9.

Part IV - Conclusion

The Government confirms that it will introduce the proposed new system of financing in April 2006 in view of the strong overall support for this from the Association of Police Authorities, from individual police authorities and forces in England and also from the Welsh Assembly Government and the Welsh Police Finance Group on behalf of police authorities and forces in Wales.

There will be one rate for employer contributions for both the new and the old schemes. This will be reviewed to ensure it reflects pensions costs.

Ill-health pensions will be paid entirely out of the pensions account as recommended by the Working Group. Based on a broad average of the calculations by GAD the capital-equivalent payments will be set at twice the average pensionable pay of the officer being retired. These will be paid in one instalment in the year in which the ill-health retirement falls.

The method of identifying the amount of resources needed for the central top up grant will be that which was recommended by the Working Group, however a paper showing the GAD estimates and Police Authority figures used in this method will be made available to Police Authorities.

It is confirmed that the new arrangements will not affect operational funding.

The damping mechanisms agreed with ODPM should provide a smooth transition between the two arrangements, although the use of reserves may be necessary in some instances. The ACA will not be adjusted. There will be a review of the arrangements in the next 3 to 5 years.

Under the new system responsibility for paying and administering pensions will remain with the Police Authority and will not be transferred to Central Government. The latter will be one of the key points to be reviewed later.

The timetable for the bidding for and receiving of top up grants will be as suggested by the Working Group although the deadline for auditing the new pensions accounts will be moved to the 31 December to allow for other final grant returns.

There will be a classification of the different types of pension payments which should be separately identified in the pensions account.

There will be a review of key issues after 3 to 5 years.

Annex A - List of Respondents

Association of Police Authorities
Audit Commission
Chartered Institute of Public Finance and Accountancy
Cheshire Police Authority
Cumbria Police Authority
Derbyshire Police Authority
Dorset Police and Police Authority
Essex Police Authority
Gloucestershire Police Authority
Greater Manchester Police and Police Authority
Hampshire Police Authority
Hertfordshire Police Authority
Humberside Police Authority
Lancashire Police Authority
Lincolnshire Police
Merseyside Police Authority
Metropolitan Police Authority
Norfolk Constabulary and Police Authority
Northamptonshire Police Authority
North Yorkshire Police
Northumbria Police Authority
Nottinghamshire Police Authority
Police Authority Treasurers Society
Police Negotiating Board – Staff Side
South Yorkshire Police Authority
Staffordshire Police Authority
Suffolk Police Authority
Sussex Police Authority
Thames Valley Police Authority
Warwickshire Police Authority
Welsh Assembly Government
Welsh Police Finance Group
West Midlands Police Authority
West Yorkshire Police and Police Authority
West Mercia Police

