LGPS 2014 – A CAREER AVERAGE PENSION

LGPS 2014 is proposed to be a career average scheme. You may also hear the terms 'CARE' or, to give its full title, 'Career Average Revalued Earnings'. When used in relation to the LGPS 2014, all these terms refer to the same method of calculating your pension as described below.

Before we start it is worth reminding you that this new method will only apply to your pension built up from 1st April 2014. All pension earned before that date will continue to be calculated using current scheme rules.

Final salary schemes generally offer a significantly better pension to some members (e.g. those whose pay is substantially increased in the run up to retirement) than to the average member. LGPS 2014 is fairer for the majority of members because it removes the potential for pensions to be disproportionately increased in these circumstances.

A DEFINED BENEFIT

Like the LGPS 2008 and the LGPS 1997 before it, the LGPS 2014 will still be a defined benefit scheme. Defined benefit pension schemes - including career average pensions - calculate pensions using a set formula. In the case of LGPS 2014 that formula is as follows:

Pension = Membership x Accrual Rate x Pensionable Pay

In a final salary scheme it is the pensionable pay at the end of the period of membership that is used in the calculation. With career average the pensionable pay for each year is used to calculate a pension for that year. Each year's pension is then revalued (i.e. increased) by inflation. Each year's revalued pension is then added together to arrive at the total pension. So the total pension builds up as follows:

Pension for year 1 x revaluation plus
Pension for year 2 x revaluation plus
Pension for year 3 x revaluation plus
And so on….until plus
Pension for final year

So let's look at each element in the above formula…

MEMBERSHIP

This is normally the amount of time you are contributing to the pension scheme and is also known as pensionable service. It is measured in days, although for the sake of simplicity the examples below assume whole years.

ACCRUAL RATE

The accrual rate is the proportion of pensionable pay that each year of membership adds to your pension. The rate is normally expressed as a fraction (although some schemes show it as a percentage). For the LGPS 2014 the accrual rate is 1/49th (or 2.04% if expressed as a percentage). This means that for each year of membership you will build up a pension of 1/49th of your pensionable pay for that year. You may see the terms 'accrue' or 'accrual' used. These just mean the amount of pension that has been built up for the year or in total.

PENSIONABLE PAY

Pensionable pay is the amount you earn for hours worked including non contractual overtime and, for part-timers, 'additional hours'. This is the amount you pay contributions on and the amount your benefits are based on

THE BASIC CALCULATION

To explain how your pension builds up and is revalued let's take one step at a time. We have already said that each year's pension is a fraction of that year's pensionable pay. The example below shows how that builds up over time to create the total pension.

EXAMPLE 1

Evelyn has a pensionable pay of £10,000 this year so will 'accrue' 1/49th of that pay towards her pension i.e. **£10,000 x 1/49 = £204.08**

If Evelyn was in membership for 5 years and there were no pay rises or inflation to take into account, her pension would build up as follows:

Year	Pensionable Pay	Pension
1	£10,000	£204.08
2	£10,000	£204.08
3	£10,000	£204.08
4	£10,000	£204.08
5	£10,000	£204.08
Total		£1,020.40 per year

However, pay does normally rise over time and there is inflation to consider, so we will see how revaluation is needed to ensure the pension does not lose its value.

REVALUATION

One of the most important features of LGPS 2014 is the way that your pension is revalued as it builds up. This is significant as there could be a period of 40 years or more between your first year's pension saving and your retirement date. Over this period of time the real value of the early years' pension will have been reduced by the effects of inflation.

To stop this, the LGPS 2014 will revalue each year's pension build up in line with inflation (CPI).

EXAMPLE 2

If Evelyn receives no pay rises but inflation is 3% each year, then her pension would be revalued as follows. The further in the past the pension is earned, the more multiples of 3% it is increased by. This results in an increased total pension when compared with Example 1:

Year	Pensionable Pay	Pension	Revalued Pension
1	£10,000	£204.08	£229.70
2	£10,000	£204.08	£223.01
3	£10,000	£204.08	£216.51
4	£10,000	£204.08	£210.20
5	£10,000	£204.08	£204.08
Total			£1,083.50 per year

You can see that compared with Example 1, the first 4 years of pension built up have been increased to take account of inflation. Year 1 has been increased by the most as it is furthest in the past and so its needs a greater increase to retain its value against inflation.

EXAMPLE 3

Finally, let us assume that Evelyn did receive pay rises in which case the pensionable pay for each year would increase before revaluation is applied. With inflation at 3% each year and a consistent pay increase of £500 per year, the calculation of her total pension would be as follows:

Year	Pensionable Pay	Pension	Revalued Pension
1	£10,000	£204.08	£229.70
2	£10,500	£214.29	£234.16
3	£11,000	£224.49	£238.16
4	£11,500	£234.69	£241.73
5	£12,000	£244.90	£244.90
Total			£1,188.65 per year

So in this example both increases in pensionable pay and inflation have been built into the calculation of Evelyn's pension. Another way to represent the above pension build up would be to show the revaluation applied each year as follows:

Pensionable Pay	Revalued Pension				
	No revaluation	1 years revaluation	2 years revaluation	3 years revaluation	4 years revaluation
£10,000	£204.08	£210.20	£216.51	£223.01	Year 1 £229.70
£10,500	£214.29	£220.71	£227.34	Year 2 £234.16	
£11,000	£224.49	£231.22	Year 3 £238.16		
£11,500	£234.69	Year 4 £241.73			
£12,000	Year 5 £244.90				

As you can see the first year's pension gets 4 years of revaluation, the second gets 3 years and so on until the final year which needs no revaluation. Adding all these years together gives us Evelyn's total annual pension of £1,188.65

CAREER AVERAGE VERSUS FINAL SALARY

For a significant proportion of members the LGPS 2014 will produce a better pension than they would have got under a continued final salary scheme. Final salary suits some career patterns, usually those with a structured promotional scale. Career average is a better fit for those whose opportunity for promotion is limited. Individual circumstances differ but there is nothing automatically worse about career average schemes. In fact the improved accrual rate in the LGPS 2014 could mean many members build up better pensions.

TAX FREE CASH LUMP SUM

You can trade some of your annual pension for a cash lump sum on retirement. For every £1 of annual pension given up you will get £12 of cash. Up to 25% of your LGPS benefits (including any Additional Voluntary Contributions but subject to some HMRC limits) can be traded in this way.

EXAMPLE 4

Evelyn's total pension after 5 years is £1,188.65. Presuming this is her only pension saving (other than the state pension) she could take a maximum of £5,094.21 as a lump sum leaving her with an annual pension of £764.13.