LPP
Local Pensions Partnership
Administration

Protection following a reduction in pay

This leaflet sets out the protections available to members of the Local Government Pension Scheme who have had a reduction in pay but continue in local government employment. These protections only apply to members who joined the scheme before 01 April 2014.

The information given in this leaflet **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/rate of pay is reduced for reasons other than a reduction in your hours.

Under the rules of the pension scheme (for pre 01 April 2014 benefits), 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, though at a reduced length if you do not work full time.

Your final pay is the pay on which you have paid pension contributions (normally) during your last year 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.

The best of the last 3 years' rule

If you receive a reduced level of pay during your final year of service, then either of the previous two years pay figures (if higher than your final year's pay figure) will be used as your final 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 March 2023 the pay that we would normally use to calculate your benefits would be the pay for the following period:

- 1 April 2022 to 31 March 2023

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

- 1 April 2021 to 31 March 2022, or
- 1 April 2020 to 31 March 2021

When using the 'best of the last three years' rule the final pay periods always end on the anniversary of the date of leaving the scheme.

This rule will protect you if you retire/leave/opt out 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	1 April 2023
Salary received 1 April 2022 to 31 March 2023	£21,500
Salary received 1 April 2021 to 31 March 2022	£21,000
Salary received 1 April 2020 to 31 March 2021	£26,000

If in the above example, you retire/leave /opt out of the scheme on 31 March 2023*, (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 March 2021 (£26,000) would be used to work out your pension benefits.

However, if you retire/leave/opt out of the scheme on 30 September 2023 (2 ½ years after the reduction in pay), the three-year rule offers limited protection against the reduction in pay as only 6 months of the higher pay falls within one of the final three year periods. The remaining 6 months needed to calculate final pay would be on the reduced salary of £21,000.00

If you retire/leave/opt out of the scheme on or after 31 March 2024, i.e. 3 years after the drop in pay, then the 'best of the last 3 year' rule would not offer any protection.

Pay earned with a previous employer will be used when determining the 'best of the last 3 years' final pay, if the previous membership has been combined with the latest employment.

Please note that 'best of last 3 years' protection is automatically considered for all leavers.

The best 3 years average in the last 13

As well as the option to use the pay in the last 3 years, the scheme also offers further protection if your pay is reduced or restricted due to one of the following reasons:

- you choose to continue in employment with the same employer at a lower grade or with less responsibility;
- for the purposes of achieving equal pay in relation to other employees of your employer;
- as a result of a job evaluation exercise;
- 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; or
- 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 **<u>does not</u>** apply where the reduction or restriction -

- starts more than 10 years before your last day as an active member;
- immediately follows the cessation of a temporary post on a higher rate of pay; or
- is a choice made for the purpose of taking flexible retirement

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 pay 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 LPPA no later than 1 month before you cease active membership of the scheme.

Pension increases

'Best of the last 3 years' rule

Pensions increases are ordinarily applied using the day after leaving as the effective date. Where the 'best of the last 3 years' rule has been applied the effective date for pension increases would be the day after the end date of the relevant period (the period that has provided the best pay). Unlike with the best 3 years in the last 13, the 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 year in which the highest pay was earned.

'Best 3 years in the last 13'

When using the average of the best 3 years in the last 13, the averages are adjusted to give them their current value.

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

Split retirement benefits

The best '3 year average in the last 13' rule is only of benefit if you retire within 10 years of your salary being reduced or restricted. It is therefore of little value if you are not within 10 years of retirement at the point that your pay is reduced/restricted. However, there are a variety of reasons where you may leave the scheme earlier than anticipated for a variety of reasons, for example on:

- Ill health grounds
- Redundancy
- Flexible retirement
- Employer consent, or
- If you left work with entitlement to deferred benefits:

in which case the '3 in 13' rule may still apply, providing the retirement/leaving date is within 10 years of your salary being reduced or restricted.

As a younger scheme member taking a reduced salary, you may benefit more from choosing separate retirement benefits. This would protect your scheme membership up to the time of the reduction/restriction by valuing it using your previous pay and the resultant benefits would be deferred in the scheme until retirement.

In order for you to be in a position to elect for separate benefits you must first "opt out" of the scheme and then opt back in again, which would cause the membership thereafter to be valued against your new reduced pay. It may be possible for you to opt out and back in again with no break.

When deciding at what point you should opt out, you may wish to review the earlier sections covering the best of the last 3 years' rule and the best 3 year average in the last 13 rule (depending on your eligibility).

If you choose separate retirement benefits, you would receive two sets of benefits at retirement. One would be based on your membership up to the date you opted out using a final pay figure which would include an element of your previous higher level of pay, and the other would be based on your benefits accrued thereafter.

Separate benefits may be considered if a temporary promotion or secondment comes to an end where the '3 in 13' protection would not apply, but again you must first opt out of the pension scheme and back in again for this option to apply.

Things to consider before opting out of the LGPS

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. You should, therefore, consider the likelihood of your current pay overtaking your previous pay (increased by inflation) prior to leaving the scheme.
- If you elect for separate benefits, by opting out of the scheme (post April 2014), you will not be able to combine the deferred benefits with your new active pension account.
- The decision to opt out of the pension scheme can be made anytime up to 2 years after your reduction/restriction in pay for the protection of the 'best of the last 3 years' rule to fully apply.

Further details on the points to consider when making a decision to elect for separate benefits are contained in the 'Combining' section of the website. If you would like more information on protection of retirement benefits, please contact LPPA.

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Contacting LPPA

The easiest way to get in touch is by completing the online member form on the Contact us page of our website:

www.lppapensions.co.uk

Acknowledgement and disclaimer

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