Office of the
Deputy Prime Minister
Creating sustainable communities

Guidance for Fire and Rescue Authorities on new financial arrangements for firefighter pensions with effect from April 2006

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SECTION ONE

Introduction

1.1 Until the end of March 2006 each Fire and Rescue Authority is responsible for paying the pensions of its former employees on a 'pay-as-you-go' basis. This means that employees' contributions are paid into Fire and Rescue Authorities' operating accounts from which pensions awards are made. Authorities receive funding from Central Government as part of general Formula Grant to support payments of pensions.

1.2 The reasons why FRAs ask us to examine the way pensions were financed prior to 1 April 2006 include:

- volatility as a result of significant fluctuations in the number of firefighters retiring in any given year, which has fed into council tax precept increases; and

- lack of transparency, as the high proportion of expenditure by FRAs on pension payments obscures the actual level of resources available for service delivery. Over time, as the number of pensioners and – in real terms – their pension costs increase, the proportion of authorities' expenditure on pension payments will increase.

1.3 FRAs requested that the Government review the current arrangements with a view to making changes. As a result between February and May 2005 we consulted on proposals for new financial arrangements for firefighter pensions. A copy of the consultation document is on the ODPM website – www.odpm.gov.uk/fire – 'consultation papers'.

1.4 Thirty-eight FRAs, and three representative bodies, responded to the consultation. We have considered these responses carefully and this guidance is the result of that consultation.

Who is this guidance for?

1.5 This document is intended to provide guidance for Fire and Rescue Authority Finance directors, pension administrators and other practitioners to enable them to introduce and administer new financial arrangements for firefighter pensions in 2006.

What does this guidance contain?

1.6 This guidance sets out detailed information on the new financial arrangements including:

- A summary of the arrangements.

- Employer and employer contribution rates.

- Ill-health early retirements.

- Secondees and transfers.
- Funding arrangements and requirements.
- Impact on FRAs.
- Legislative requirements.
- Next steps.

What is the status and purpose of this guidance?

1.7 This guidance contains information on what is required in order that FRAs are able to introduce and administer the new financial arrangements for firefighter pensions. This will be required by an amendment to the Firefighters' Pension Scheme Order 1992 and the proposed new Firefighters' Pension Scheme Order under section 34 of the Fire and Rescue Services Act 2004. It specifically includes information on:

- Payments that will be made into and from a Fire and Rescue Authority's pension fund; and
- Payments that the Secretary of State will make into and surpluses the Secretary of State will recoup from a Fire and Rescue Authority's pension fund.

Who is responsible for what?

FRAS

1.8 FRAs are responsible for making the necessary changes in order to introduce the new financial arrangements on 1 April 2006.

1.9 FRAs continue to have formal responsibility for paying firefighter pensions.

1.10 FRAs are responsible for ensuring that they meet all administrative, accounting and audit requirements applying to FRAs as set out in this guidance.

CENTRAL GOVERNMENT

1.11 The Secretary of State will make a statutory instrument which, subject to Parliamentary procedure allow Central Government to be responsible for paying the new top-up grant to FRAs to the agreed deadlines based on estimates provided by FRAs. Central Government will adjust top-up payments and recoupment of surpluses based on FRAs un-audited and audited accounts by the deadlines agreed.

1.12 Central Government is responsible for providing funding in support of employer contributions and ill-health charges through Formula Grant.

How should Fire and Rescue Authorities act on this guidance?

1.13 FRAs need to act on this guidance in order to make the necessary changes to ensure the new financial arrangements can be introduced and administered from 1 April 2006.

1.14 Contact names and numbers are provided at the end of the guidance if further clarification or other support is required.

SECTION TWO

Summary of the new arrangements

2.1 The new financial arrangements are for both the 1992 and proposed 2006 Firefighter Pension Schemes. The new financial arrangements have no impact on the terms and conditions of either scheme.

2.2 From 1 April 2006 FRAs will continue to administer and pay firefighter pensions, as well as any future pensions for new entrants but this is from a new separate local firefighters' pension fund.

2.3 Employee contributions and a new employer's contribution are paid into the pension fund from which pension payments are made. The fund is topped up by Government grant if the contributions are insufficient to meet the cost of pension payments. Any surplus in the fund is recouped by Government. The underlying principle is that employer and employee contributions together will meet the full costs of pension liabilities being accrued in respect of currently serving employees while central Government will meet the costs of retirement pensions in payment, net of employee and the new employer contributions.

2.4 The financing of pension payments will be taken out of the Formula Grant which instead will take into account the funding needed to support the cost of the employer contributions and lump sum charges, in respect of ill-health retirements.

2.5 Overall the change to the financial arrangements for firefighters pensions is 'cost neutral', notwithstanding that the cost of pensions in payment is rising. There will however, be individual winners and losers resulting from changes made to the formula used to distribute grant.

2.6 Annex A shows a flow-diagram of the new financial arrangements.

FRAs' pension funds

STATUS OF THE FUND

2.7 The pension fund will appear as a separate income and expenditure statement in an Authority's Statement of Accounts. A separate pension fund balance sheet will be required. The pension fund will be ring-fenced to ensure accounting clarity. It is through the pension fund that each Fire and Rescue Authority will discharge its responsibility for paying the pensions of retired officers, their survivors and others who are eligible for benefits under the new and existing pension schemes.

2.8 Under the new financial arrangements the funds that would be paid into and out of authorities' pension fund are:

Income

- Employee contributions.
- Employer contributions.
- Incoming transfers from other pension schemes.
- Charges in respect of ill-health early retirements.
- Top-up from Central Government to meet any deficit.

Expenditure

- Pension payments to retired firefighters and other beneficiaries.
- Outgoing transfers to other pension schemes.
- Payments to Central Government, if an authority's fund is in surplus at the end of the accounting year.

Employee and Employer Contributions

2.9 The purpose of the employee and employer contribution rates under the new arrangements is to meet the accruing pension liabilities of currently serving firefighters. This means FRAs will meet all the costs of employing a firefighter, including the cost of future pension liabilities, at the time of employing them.

2.10 Separate employer contribution rates will apply to the 1992 Firefighter Pension Scheme and the proposed 2006 Firefighter Pension Scheme.

2.11 The current estimate of the value of the 1992 Firefighters' Pension Scheme is that it represents 37.5% of pensionable pay, so given that firefighters pay 11%, the total contribution made by employers would be 26.5%. This figure includes the estimated cost of ill-health retirements. The employer contribution rate which FRAs will pay into their pension fund will be reduced to take account of the additional charges paid by individual authorities towards ill-health retirements. Further details of the ill-health charges are in paragraphs 3.4–3.6.

2.12 From 1 April 2006 the reduced rate for the flat rate employer contribution for the 1992 Firefighter Pension Scheme will be 21.3%.

2.13 From April 2006 we are proposing to introduce a two tier system of ill-health awards into the Firefighters' Pension Scheme. This follows the proposal set out in paragraph 3.5 of 'Proposals for amendments to the Firefighters' Pension Scheme' which was published in October 2004. In order to qualify for a higher tier ill-health award, a firefighter must be permanently disabled from taking regular employment: the pension is enhanced. The lower tier award will be paid to those who are able to take alternative regular employment: the pension is based on actual pensionable service and there is no enhancement. On the assumption that only 25% of ill-health retirements attract higher tier benefits, this is estimated to reduce the aggregate value of the Firefighters' Pension Scheme to 35.5% of pensionable pay.

2.14 The current estimate of the value of the new 2006 Firefighters' Pension Scheme is that it represents 22.7% of pensionable pay, so given that firefighters pay 8.5%, the total contribution made by employers is 14.2%. This figure includes the estimated cost of ill-health retirements. The employer contribution rate which FRAs pay into their pension fund is reduced to take account of the additional charges paid by individual authorities towards ill-health retirements. Further details of the ill-health charges are in paragraphs 3.4–3.6.

2.15 From 1 April 2006 the reduced rate for the flat rate employer contribution for the new 2006 Firefighters' Pension Scheme is 11%.

2.16 The value of both firefighter pension schemes will need to be reviewed regularly by actuaries to ensure that the contribution rates reflect the true cost of accruing pensions. The pension reviews will need to provide up to date information for spending reviews and the move to three year settlements. If the spending review cycle remains as every two years with a year overlap between reviews, the pension schemes will be reviewed every four years to tie in with every other spending review. The attached flow chart shows how the spending review, pension review and three year settlement cycles fit together in this instance. This takes account of the fact that in 2007 a Comprehensive Spending Review will take place spanning three years with no overlap year. Mini-reviews will be held, for example to track the level of ill-health retirements, when necessary.

2.17 In line with other public service pension schemes the SCAPE (Superannuation Contributions Adjusted for Past Experience) methodology is used to set the employer and employee contribution rates, including the initial rates. The SCAPE methodology is summarised in Annex B. A central feature of SCAPE is that the costs charged to employers are adjusted to reflect real world influences on accruing pension costs such as changes in mortality/longevity; trends in pay and rates of pay progression, shifts in retirement ages, and the incidence of ill-health retirement. For example, if it is concluded at the four yearly actuarial review that firefighters are actually living longer than was previously assumed, contribution rate going forward will be increased to cover the extra costs; similarly if the number of ill-health retirements continue to fall and overall costs reduce contribution rates could reduce.

2.18 Rule F2(2) of the Firefighters' Pension Scheme permitted a FRA to allow a scheme member to reckon as pensionable service any period of absence from duty without pay; the member was only required to pay the contributions which he/she would otherwise have paid. It is proposed to provide in the 2006 Firefighters' Pension Scheme, and to make the necessary amendment to the existing FPS from 1 April 2006, to require members to pay both the employee and employer contributions.

Pensionable Pay

2.19 Pensionable pay is defined by Rule G1 of the 1992 Firefighters' Pension Scheme as "the amount determined in relation to the performance of the duties of his role". A similar provision will be made in the new Firefighters' Pension Scheme.

ACTIONS FOR FRAS

From 1 April 2006 it is intended that Fire and Rescue Authorities are required to:

- **Set up a firefighter pension fund;**
- **Make an employers' contribution, as a percentage of pensionable pay towards the future pension liability for all serving members, i.e. all firefighters but not pension credit members, of the 1992 Firefighters' Pension Scheme, and the proposed 2006 Firefighters' Pension Scheme when it is introduced, into their pension fund;**
- **Pay the employees' contribution, the percentage of pensionable pay paid by all serving members, i.e. all firefighters but not pension credit members, of the 1992 Firefighters Pension Scheme and the proposed 2006 Firefighters Pension Scheme when it is introduced, towards their future pension liability into the authority's pensions fund; and**
- **Organise the pension administration systems to provide full valuation data within two months of the validation date.**

SECTION THREE

Ill-health early retirements, efficiency retirements and injury awards

Ill-health early retirements

3.1 Early ill-health retirements are possible under the 1992 Firefighters Pension Scheme and will be possible under the proposed 2006 Firefighters Pensions Scheme.

3.2 Since 2004 the definition of firefighter in the Firefighters' Pension Scheme 1992 has allowed members to remain in the scheme if they are required to perform other duties appropriate to their role other than, or in addition to, fire-fighting. It also placed an obligation on FRAs to use independent medical assessment before determining whether to grant an ill-health award.

3.3 From 1 April 2006 ill-health pensions, like all other pension costs, will be paid from authorities' new pension fund. In order to ensure equity between FRAs, some of which have a better record in relation to ill-health retirements than others, employer payments towards the future costs of ill-health retirements will come from a combination of a flat rate employer contribution applicable to all authorities, and from an individual charge payable by the relevant authority where an ill-health retirement occurs.

3.4 From 1 April 2006 authorities will be required to make a payment into their pension fund of 4x average pensionable pay in respect of all higher tier ill-health retirements and 2x average pensionable pay in respect of all lower tier ill-health retirements.

3.5 Average pensionable pay is defined by Rule G1(3) of the 1992 Firefighters' Pension Scheme as the aggregate of the firefighter's pensionable pay for the year ending with the last day of service.

3.6 A multiple of 4x average pensionable pay gives a charge which is comparable with three years' outgo for a male pensioner with a higher tier award. Three years' outgo is a lump sum of 2½x average pensionable pay, plus 3 years' pension of ½x average pensionable pay, totalling 4x pensionable pay.

3.7 There is no enhancement of service on lower tier ill health retirement. A multiple of 2x average pensionable pay gives a charge which is comparable with three year's outgo on retirement after 20 years' service.

3.8 These charges are intended to represent the additional cost of personal ill-health retirements. They are not intended to cover any potential costs of dependents' pensions. Pension awards for dependents however, are also paid from authorities' pension fund. Their cost will be covered by the flat-rate employer contribution.

3.9 There will be an opportunity to reassess the level of the charges at the time of the actuarial valuation.

3.10 From 1 April 2006 it is intended that funding in Formula Grant, at an aggregate level, will take account of the local charges towards ill-health retirements across England.

3.11 These ill-health retirement charges could reintroduce some in-year financial volatility, as the number of firefighters who retire on grounds of ill-health varies from year to year. To deal with this volatility authorities will be required to spread the charges equally over a period of three years. The initial tranche of the payment is to be made at the time of retirement. Later tranches are to be made, without the addition of interest, on 1 April of each financial year until all the payments have been made. It is intended that regulation 30 of the Local Authorities (Capital Finance and Accounting) (England) Regulations (SI 2003 No 3146) should ensure that the three tranches need only be taken into account in council tax calculations in the year they fall due, and we will consider whether any changes to the 2003 Regulations are needed to achieve this.

3.12 When a higher tier award is cancelled following a review and a lower tier award is substituted the FRA can receive a refund in its operating account from the pension fund equal to the difference between the higher tier ill-health charge and the lower tier ill health charge. The repayment of ill health charges occurs over a three year period so a refund will only be necessary if more than 1 tranche payment has been made.

3.13 If however, the FRA has only made one or no tranche payments then they will be expected to pay to the pension fund any outstanding amount on the basis of any recalculation as determined below:

The new cost of a lower tier ill health retirement **(2X average Pensionable Pay)**	–	**The amount already paid into pension fund in relation to the ill health retirement (when previously calculated at 4X average Pensionable Pay)**	=	**The outstanding ill health contribution to the pension fund the FRA is required to make**

3.14 The outstanding ill health contribution to the pension fund, are to be made without the addition of interest, on 1 April of the next financial year. This is the same for all ill health charges payable over three years the outstanding ill health contribution to the pension fund are to be made without the addition of interest.

3.15 When an award, whether a higher or a lower tier award, is cancelled before all the payments are made and the former recipient does not resume active membership of the Firefighters' Pension Scheme, the FRA will make no further payments to the pension fund. The FRA will receive a refund from the pension fund equivalent to the higher tier or lower tier ill health charges that have already been paid on behalf of that employee.

3.16 Authorities may want to consider maintaining some reserves in order to mitigate any volatility caused by the local lump sum payments in respect of ill health early retirements which is not met by the three year spread payments.

Ill-health retirements prior to April 2006

3.17 It is intended that authorities will be required to make a reduced payment of 1x average pensionable pay for ill-health retirements between 01 April 2005 and 31 March 2006 into their pension accounts on 1 April 2006. The payment will take account of the pension payments (including any commuted lump sums) which authorities have already paid. The figure of 1x average pensionable pay was arrived at by subtracting 2½ x average pensionable pay, the maximum figure for a commuted lump sum, plus ½ x average pensionable pay in respect of pension payments made during the year.

3.18 From 1 April 2006 it is intended that all ill-health retirement pensions will be paid from authorities' pensions funds. A high number of ill-health retirements prior to 1 April 2006, would have meant that a larger top-up grant would have been needed to meet any deficit in authorities' pension funds. To ensure equity all authorities were therefore notified by Fire Circular 24/2005, issued on 24 June 2005, that they must pay a charge towards all ill-health retirements taken between 01 April 2005 and 31 March 2006. Overall this means that less top-up grant will be needed for the initial split between Formula Grant and the new top-up grant, so authorities with lower levels of ill-health early retirement will not be penalised.

Ill-health retirements for retained firefighters

3.19 FRAs will not be required to pay the flat rate employer contribution for existing retained firefighters who have <u>not</u> opted to join the new firefighter pension scheme as they would not be pension scheme members. These employees will continue to remain eligible to receive a full ill-health pension if injured on duty.

3.20 FRAs should continue to pay ill-health pensions to existing pensioners who were previously retained firefighters, from their operating accounts. Pensions for existing retained firefighters who are not pension scheme members and who retire early on grounds of ill-health should also be paid from authorities' operating accounts. FRAs will not therefore be required to pay an ill-health charge, in respect of these employees, into their pension funds.

3.21 Ill-health early retirement pensions for existing RDS and new entrant RDS firefighters who join the 2006 Firefighter Pension Scheme will be paid from an authority's pension fund and authorities will be required to pay the appropriate ill-health charge in respect of these employees into their pension fund.

Other early retirements

3.22 Approved early retirements have a real cost, which must be covered by employers. These costs will be actuarially calculated for each individual, using a table of factors, following the approach taken in the PCSPS and LGPS and the FRA will be required to make a payment into their pension fund. The new Firefighter Pension Scheme will make the necessary provision for the factors which will need to be included in this calculation.

Injury benefits

3.23 Injury awards and awards payable on the death of a firefighter attributable to a qualifying injury are not part of the Firefighters' Pension Scheme because they are payable irrespective of whether a firefighter is a member of the Firefighter Pension Scheme. New tax rules from 1 April 2006 will prevent injury awards from being part of the pension scheme regulations. The opportunity is being taken to move the injury awards into a separate firefighters' compensation scheme.

3.24 From 1 April 2006 all injury awards covered by Rule B4 of the Firefighters' Pension Scheme Order 1992 are outside the Firefighters' Pension Scheme and under the new financial arrangements must be paid from an authority's operating account, not from their pensions fund.

3.25 This only includes the injury award and not the normal pension, which should be paid from the pension fund. This applies to both regular and RDS firefighters that are members of either the existing or new Firefighters' Pension Schemes. Awards for existing RDS firefighters who are not pension scheme members and who retire permanently disabled with a service related injury should however be paid from authorities' operating accounts

Previous injury awards

3.26 Continuing payments in respect of previous injury awards must be paid from an authority's operating account.

After-appearing injuries

3.27 Early payments of a deferred pension if the scheme member becomes permanently disabled should be paid from an authority's pension fund as this is an ill-health benefit of the pension scheme. However, any associated injury award must be treated in the same way as any other injury award and paid from the authority's operating account.

Survivor benefits

3.28 Payments of pension benefits to dependants as a result of the death of a pensioner in receipt of a pension should be paid from an authority's pension fund.

3.29 Survivor benefits in the case of death resulting from injury, which are not pension scheme benefits, must be treated like injury awards and paid from the authority's operating account.

Other payments which cannot be made out of pensions fund

3.30 In addition to injury awards please note that expenditure from the pensions account cannot include administration charges and audit fees.

ACTIONS FOR FRAS

From 1 April 2006 authorities are required to make a payment into their pension fund of 4x average pensionable pay in respect of all higher tier ill-health retirements and 2x average pensionable pay in respect of all lower tier ill-health retirements. These payments must be spread over three years.

Authorities are required to pay a charge of 1x average pensionable pay for ill-health retirements between 01 April 2005 and 31 March 2006 into their pension fund on 1 April 2006.

Authorities should continue to pay from their operating accounts, ill-health pensions to existing pensioners who were previously RDS firefighters.

Authorities are required to pay, from their operating accounts, awards under Rule J4 to existing RDS firefighters who do not join the 2006 Firefighter Pensions Scheme and remain eligible to receive a full ill-health pension if injured on duty. Authorities will not be required to pay an ill-health charge, in respect of these employees, into their pension funds.

Authorities are required to pay ill-health early retirement pensions for new entrant retained staff who join the 2006 Firefighter Pension Scheme from their pension funds. Authorities are required to pay the appropriate ill-health charge in respect of these employees into their pension funds.

It is intended that authorities are required to make an actuarially calculated payment for each individual who receives an approved early retirement pension into their pension fund.

Authorities are to be required to pay all injury awards covered by Rule B4 of the Firefighters' Pension Scheme Order 1992 from their operating accounts.

Authorities are required to continue paying previous injury awards from their operating accounts.

Authorities are required to make early payments of a deferred pension, if the scheme member becomes permanently disabled, from their pension funds. Any associated injury award must paid from the authority's operating account.

Authorities are required to make payments of pension benefits to dependants and survivors as a result of the death of a pensioner in receipt of a pension from their pension funds.

Authorities are required to make payments of survivor and dependant benefits, which are not pension scheme benefits, from their operating accounts.

SECTION FOUR

Transfers and secondees

Transfers

4.1 A firefighter who transfers out of the Firefighters' Pension Scheme to another pension scheme, or to the Firefighters Pension Scheme in Scotland, Wales or Northern Ireland, is entitled to ask for a Cash Equivalent Transfer Value to be paid across, equivalent to the value of their pension rights on leaving the Firefighters' Pension Scheme. This should be paid from the authority's pension fund. Similarly an inward Transfer Value should be paid into the authority's pension fund.

4.2 Where a firefighter transfers to or from another Fire and Rescue Authority within in England it is intended that there will be no need for a cash transfer. The receiving authority will simply update the firefighters' service record and start to make the employer contributions for that individual.

4.3 The responsibility for paying pension based on the firefighter's service up to the point of transfer will rest with the receiving authority, irrespective of the waiving of transfer payments between FRAs.

4.4 The value of transfers which occur prior to 1 April 2006 must be paid between FRAs operating accounts regardless of when the account is settled.

4.5 All deferred pensions will be paid from the pension fund as will requests for pensions to be transferred to another scheme made after 31 March 2006. This includes requests made by former employees which have not been received prior to that date.

Secondees

4.6 From 1 April 2006 for employees who are seconded to other organisations, the employer's pension contribution will be paid by the organisation where the secondee is working, as part of their employment costs. This means from 2006/07 Fire and Rescue Authorities will invoice for the employer pension contribution at the same time as invoicing for salary costs, NI contributions and other allowances. From 1 April 2006 onwards any organisation which employs seconded firefighters who are members of the 1992 or 2006 Firefighter Pension Schemes will need to meet the costs of the new employer contribution rates.

4.7 If a FRA seconds a member of staff to a community organisation the FRA may well excise its discretion not to charge for pension costs but in this case FRAs are required to bear these costs themselves.

4.6 The decision to retire an employee early on grounds of ill-health is taken by the sending authority since it is a matter of retirement on grounds of permanent disablement, not just for the duration of the secondment. From 1 April 2006 the pension costs (commuted lump sum and recurring element) of seconded employees who retire early on grounds of ill-health will be met from the sending authority's pension fund and the Central Government top-up grant. The sending authority will be required to pay the ill-health charge into their pension fund.

ACTIONS FOR FRAS

Transfers out of the Firefighters' Pension Scheme to another pension scheme, where an employee asks for Equivalent Transfer Value to be paid across, should be paid from the authority's pension fund and any inward Transfer Value should be paid into an authority's pension fund.

In the case of transfers to and from another FRA the receiving authority should update the firefighters' service record and start to make the employer contributions for that individual.

The value of transfers which occur prior to 1 April 2006 must be paid by the exporting FRA regardless of when the account is settled.

FRAs should invoice for the employer pension contribution at the same time as invoicing for salary costs, NI contributions and other allowances for each secondee.

SECTION FIVE

Funding under the new arrangements

Top-up grant/Formula Grant

5.1 In the first year of the new financial arrangements the pensions grant allocation will be divided between Formula Grant and the funds to be transferred to the new top-up grant.

Funds left in Formula Grant to support:	Funds taken out of Formula Grant to support:
Employer contributions	Top-up grant sufficient to meet the deficit between pension contributions plus ill-health charges, and pensions outgo.
Ill health charges	
Injury awards	

5.2 Under the new financial arrangements funding for individual authorities is as follows. The figures provided are illustrative and for the existing pension scheme.

Pensionable pay	=	**£6,000,000**

If an authority's pensionable pay bill was £6,000,000 then the amount paid in employer contributions would be:

Employer payments (Employer contribution rate and ill-health charges)	=	**26.5% of pensionable pay**
		£1,590,000

And the amount paid in employee contributions would be:

Employee contributions	=	**11% of pensionable pay**
		£660,000

If the pensions outgo was £3,000,000 then the level of central government top-up that would be required would be £750,000 (see below).

Pensions outgo	–	**Employer payments**	–	**Employee Contributions**	=	**Top Up Grant**
£3,000,000	–	**£1,590,000**	–	**£660,000**	=	**£750,000**

5.3 It is important that a fair split was made between the funding left in Formula Grant and the money that was transferred to the new top-up grant, so that neither national nor Council taxpayers are disadvantaged. The process used to make that split was as follows:

- The cost of the employer and employee contributions was estimated, based on estimates of the number of firefighters in post, their role and pay rate.
- The cost of ill-health charges was estimated.
- These costs were deducted from the projected pensions outgo, based on GAD's 2001-based projections updated in line with recent outgo, and the information collected from FRAs in 2005.
- GAD estimates and assumptions were compared with estimates and assumptions provided by FRAs to ensure no significant differences. If necessary adjustments were made to the assumptions used by GAD.
- Note – GAD estimates include an adjustment for pre April 2006 ill-health retirements (see paragraph 3.17-3.18).

5.4 The resulting sum is what was estimated to be needed to top-up authorities' pension funds, and will be transferred to the new top-up grant. This sum will be deducted from Formula Grant, with the remainder of grant being available to support the new employer contributions and ill-health charges.

5.5 The estimated cost of ill-health charges depended on the assumed rate of ill-health retirements expressed as a proportion of the numbers of firefighters in post. Using the estimates provided by FRAs in 2005 a rate of 13 ill-health retirements per 1000 firefighters is assumed.

5.6 In future spending reviews there will be two separate funding streams, one for the new top-up grant and one for general operational expenditure. These pots of money will be bid for separately and therefore there will be no need to top-slice formula grant again. The amount in Formula Grant will remain fixed for each year in the Three Year Settlement period but the amount of top-up grant will not be fixed as this pot of money is demand led. The level of top-up grant will be adjusted as necessary in the light of information supplied by FRAs at the stipulated times set out in Annex F to enable payments to be made to meet the estimated or actual pensions fund deficits in each year as appropriate.

Changes to the current arrangements for funding allocation

5.7 The new financial arrangements require changes to the way in which grant for pensions is allocated. At a national level Formula Grant is no longer distributed with reference to pensions outgo but in order to provide support towards the cost of new employer contributions and of ill-health retirement charges. The aggregate effect across the piece is cost neutral, however, this will have a distributional affect on individual FRAs grant allocations.

5.8 The distributional effects of the changes to Formula Grant have been considered by the Fire Formula Spending Share Review Group as part of the review of Formula Grant distribution for 2006/07. Various options for changes to the distribution formulae were put forward for consultation. Ministers considered the outcome of this consultation when taking decisions on the grant distribution formulae for 2006/07.

5.9 The 'pension element' has been removed from Formula Grant calculations. Funding in support of employer contributions and the cost of ill-health early retirements was distributed as part of operational funding, via Formula Grant.

The new top-up grant

5.10 From 1 April 2006 where employer and employee contributions paid into an authorities' pension fund are not sufficient to meet pension payments for that year, the deficit will be met by a new Central Government top-up grant. This grant is outside the Formula Grant system.

5.11 Any surplus in an authorities' pension fund is paid back to Central Government. The surplus can be attributed to employee contributions and as these are paid into the pension fund from an FRA's operational account, and are payments towards accruing pension liabilities, any excess cash they generate should go to Central Government as the party that brings the account into balance.

Mechanism for paying the top-up grant

5.12 The timing of the payments of the top-up grant is designed to avoid creating cash flow issues for authorities, while also meeting the Government requirement not to pay grant in advance of need. The following summarises the payment mechanism until 2008/09. Annex F shows the mechanism as a flow chart.

- September 2005 — FRAs provide estimates of the deficits/surpluses in their pension funds for 2006/07 and 2007/08. GAD takes these into account in their estimates.
- July 2006 — Based on GAD's estimates, FRAs are paid 80% of estimate for top-up grant for 2006/07.
- September 2006 — FRAs provide revised estimates of the deficits/surpluses in their pension funds for 2006/07 and 2007/08 and estimates for 2008/09, 2009/10 and 2010/11 (the years covered by the next Spending Review).
- March 2007 — FRAs which estimated a surplus for 2006/07 pay 100% of the surplus to Central Government.
- June 2007 — FRAs send ODPM un-audited accounts of deficit/surplus in their pension funds for 2007/08.
- July 2007 — FRAs are paid the remainder of the deficit from 2006/07 and 80% of the GAD estimate for the top-up grant for 2007/08.

- September 2007 — FRAs provide revised estimates of the deficits/surpluses in their pension funds for 2007/08, 2008/09, 2009/10 and 2010/11.
- March 2008 — FRAs which estimated a surplus in 2007/08 pay 100% of the surplus to Central Government.
- June 2008 — FRAs send ODPM audited accounts of the deficit/surplus for 2006/07 and un-audited account of the deficit/surplus in their pensions funds for 2007/08.
- July 2008 — FRAs are paid the remainder of the deficit from 2007/08 and 80% of the estimate for 2008/09.

  Final adjustments for 2006/07, based on audited accounts, are made. If changes in the audited accounts show significant variation from payments made payment/recovery may be made earlier.

5.13 The cycle continues as above but the years to be estimated in September depend on future Spending Review arrangements.

5.14 It is intended that payments made to FRAs in July and surpluses recouped from FRAs at the end of the financial year are based on the estimates provided by the FRA in the previous September. Adjustments to the fund are made in the following July on un-audited accounts with final adjustments based on audited accounts in July a year later.

Top-up grant requirements

5.15 In order to receive top-up grant in the way described in this guidance FRAs must meet the requirements set out in the Firefighter Pension Scheme Order.

5.16 From 1 April 2006 ODPM will make initial payments of the top-up grant on the basis of GAD's estimates adjusted by the estimates provided by the FRAs in the previous September. The form on which the estimates are submitted must be certified by the FRA's Statutory Financial Officer/Treasurer as true and accurate.

5.17 Authorities may wish to consider reviewing the training of their staff with regard to the details of the new financial arrangements and payment of the new top-up grant to help prevent any miscalculation of income and expenditure into the new pension fund.

Audit

5.18 From 1 April 2006 the pensions fund must appear as a separate statement in an authority's Statement of Accounts and be audited as part of an FRA's annual audit. This has been discussed and agreed with the Audit Commission.

5.19 FRAs will be required to set up a separate fund, in order that pension transactions are kept separate from the rest of FRA financing.

5.20 ODPM will adjust top-up grant payments and recoveries from pension funds based on the information in audited accounts as set out in Annex F (payment timetable).

ACTIONS FOR FRAS

FRAs should provide estimates of the deficits/surpluses in their pension funds in September of each year.

FRAs which estimated a surplus in 2007/08 should pay 100% of the surplus to Central Government in March of each year.

FRAs should provide copies of their un-audited and audited pensions funds to Central Government in June of each year.

The form on which the estimates are submitted must be certified by the FRAs Statutory Financial Officer/Treasurer as true and accurate

From 1 April 2006 the pensions fund must appear as a separate statement in an authority's Statement of Accounts and be audited as part of an authority's annual audit.

SECTION SIX:

Impact on Fire and Rescue Authorities

Reserves/Provisions

6.1 Many Fire and Rescue Authorities have built up reserves/provisions over recent years to address the in-year volatility caused by the uneven incidence of retirement commuted lump sums which have been a regular feature of the current system of financing pension expenditure. Under the new financial arrangements it will no longer be necessary for FRAs to maintain these reserves/provisions for this purpose. In line with Government policy Central Government will not recoup these reserves/provisions.

6.2 Depending on other budgetary pressures authorities may want to consider maintaining some reserves in order to mitigate any volatility caused by the local charges in respect of ill health early retirements which is not met by spreading the payments over three years.

Extant charging arrangements

6.3 Old 'recharging' arrangements which are still extant will cease from 1 April 2006 as there is no need for one authority to 'top-up' another authority's pension fund because of an historical liability. All 'top-up' will come from the centre.

Backdated Salary Changes

6.4 ODPM understands that many FRAs are still working through the rank to role changes, and it is likely that decisions on role allocations will need to be backdated to November 2003. Any backdated salary payments made in 2006 that relate to the period November 2003 to March 2006 will <u>not</u> be subject to the employer contribution.

Accounting procedures and FRS 17

6.5 Under the new arrangements each FRA is required to establish a separate pension fund to record all pension transactions as set out in paragraph 2.7 to ensure transparency.

6.6 Under the new financial arrangements, each authority is required to pay contributions and charges at standard rates in respect of serving firefighters into their pension funds. Central Government makes further payments into the local pension funds in respect of pension benefits payable to current pensioners. The effect of the new arrangements is that authorities will pay employer's contributions to cover the accruing liability for paying retirement benefits under the Firefighters' Pension Schemes. But authorities continue to have the legal responsibility for paying pensions.

6.7 The Statement of Recommended Practice (SORP) that governs local authority (including Fire and Rescue Authorities) accounting practice requires compliance with Financial Reporting Standard (FRS) 17 on "Retirement Benefits" for pension schemes. The current firefighters' pension scheme is classified by the SORP as a defined benefit scheme and there is no doubt that the new scheme will be too. At present the liability that FRS 17 requires to be recognised for future retirement benefits is shown in the accounts of the Fire and Rescue Authorities. In view of the continuing legal liability of authorities to pay pension it is Central Government's understanding that this will continue.

6.8 The SORP is prepared and updated by a joint committee of the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC), and is subject to a negative assurance process by the Accounting Standards Board. The current consultation CIPFA and LASAAC are conducting on the revisions to the SORP to apply from 1 April 2006 does not propose amendments to deal with the new pensions financial arrangements, but notes the need to consider whether any amendments to the SORP will be required.

Interest

6.9 Interest will not be charged on the pension fund when it is in surplus or deficit.

Administrative Changes

6.10 Each authority, or the contractor providing the service on their behalf, must adjust their payroll and finance systems so that employee pension contributions and the new employer pension contributions, comprising the flat rate for each pension scheme and the ill-health charges, will be paid into the authority's pension fund.

6.11 Pension payroll systems need to be adjusted so that pension payments, both commuted lump sums and recurring elements, are made from the authority's pension fund. This includes all ill-health retirements but not injury awards, which need to be separated out and paid from the authority's operating account. Authority financial systems should be reviewed to ensure that the appropriate accounting records can be generated.

6.12 Charges in respect of ill-health retirements will need to be paid from the authority's operating account into their pension fund.

6.13 The pension fund must appear as a separate statement in an authority's Statement of Accounts. We recommend that authorities consult their auditors at an early stage.

6.14 The company which provides the pensions IT support for the majority of Fire and Rescue Authorities (and Police Authorities) has been briefed during the development of the financial arrangements.

6.15 The data required for actuarially valuing the scheme is set out in Annex D. This information has been provided to the company which provides pensions IT support and they have agreed that they can provide this information to FRAs in standard reports when requested.

ACTIONS FOR FRAS

Authorities should adjust their payroll and finance systems so the employer and employee contributions are paid into their pension funds and that pension-in-payments are paid from their pension funds.

Authorities' pension funds will appear as a separate statement in their Statement of Accounts.

SECTION SEVEN

Legislative requirements

Legislative changes

7.1 Changes to the financial arrangements for the Firefighters Pension Scheme 1992 will be made in exercise of the power conferred by section 26 of the Fire Services Act 1947.

7.2 Financial arrangements for the Firefighter Pension Scheme 2006 will be introduced in exercise of the power conferred by section 34 of the Fire Services Act 2004.

Payment of the employers and employees contributions towards pension liabilities

7.3 From 1 April 2006 Fire and Rescue Authorities are required to make an employer contribution, as a percentage of pensionable pay, towards the future pension liability for all serving members, i.e. all firefighters but not pension credit members, of the 1992 Firefighters' Pension Scheme and the proposed 2006 Firefighters' Pension Scheme when it is introduced, into their pension fund.

7.4 From 1 April 2006 Fire and Rescue Authorities are required to pay employees' contributions, the percentage of pensionable pay paid by all serving members, i.e. all firefighters but not pension credit members of the 1992 Firefighters' Pension Scheme and the proposed 2006 Firefighters' Pension Scheme when it is introduced, towards their future pension liability into their pensions funds.

Authorities' responsibility for payment of pension awards

7.5 FRAs will continue to have formal responsibility for paying firefighter pensions.

7.6 Any award to or in respect of a scheme member will be paid by the FRA by whom he/she was last employed.

7.7 Any award payable to or in respect of a pension credit member will be paid by the relevant FRA employing the firefighter from whom the pension derives at the time of the pension sharing order, or if the firefighter had ceased serving as a firefighter when the order was made by the FRA where the firefighter was last employed.

Pension fund

7.8 Every FRA will be required to maintain a separate pension fund.

7.9 FRAs should hold one fund in respect of both the existing and new Firefighter Pension Schemes.

7.10 Payments, in addition to the employer and employee contribution rates, such as local ill-health charges will be made to and from a Fire and Rescue Authority's pension fund according to this guidance issued by the Secretary of State.

7.11 The Secretary of State will make payments into and take surpluses out of the FRAs pension fund according to calculations set out in this guidance issued by the Secretary of State.

7.12 FRAs are required to follow proper accounting practices.

Reporting

7.13 FRAs are required to provide reports and returns to the Secretary of State on payments into and out of their pension fund as required.

Payment of the top-up grant

7.14 Top-up grant in respect of the Firefighters Pension Scheme 1992 is paid in exercise of the power conferred by section 26(j) of the Fire Services Act 1947.

7.15 Top-up grant in respect of the proposed Firefighter Pension Scheme 2006 is paid in exercise of the power conferred by section 34(e) of the Fire Services Act 2004.

Transfer values

7.16 There will no longer be a requirement for transfer payments between FRAs and from 1 April 2006 the relevant provision in Rule F8 of the Firefighters' Pension Scheme Order 1992 for transfer payments between FRAs is repealed.

ACTIONS FOR FRAS

From 1 April 2006 FRAs are required to make an employers' contribution into their pension fund.

From 1 April 2006 FRAs are required to pay the employees' contribution, into their pensions fund.

Fire and Rescue Authorities are required to maintain a separate pension fund.

Fire and Rescue Authorities are required to follow proper accounting practices.

Fire and Rescue Authorities are required to provide reports and returns to the Secretary of State of their pension fund as required.

SECTION EIGHT

Next steps

Implementation Timetable

Step	Date
Legislation: **Statutory Instrument (SI) to modify the financial arrangements for the existing pension scheme**	
Consult on SI	February 2006
Lay SI	April 2006
Order to modify the financial arrangements for the existing pension scheme comes into force	April 2006
Fire Formula Spending Share	
Changes to the Fire Formula Spending Share confirmed for 2006/07	November 2005
Local Government Settlement	
Final local government settlement announced	January 2006
Accounting	
CIPFA/LASAAC issue advice on accounting treatment by joint committee	During 2006
Introduction	
New financial arrangements introduced.	April 2006
Changes to the existing scheme, including a two-tier ill-health system introduced	April 2006
New pension scheme introduced	During 2006
Scheme Revaluation	
Revaluation of scheme and adjustment of employer and employee contribution rates	2008/09
Review	
Government review of the new financial arrangements	2009 – 2011

Enquiries

If you have any enquires or require further explanation please contact:
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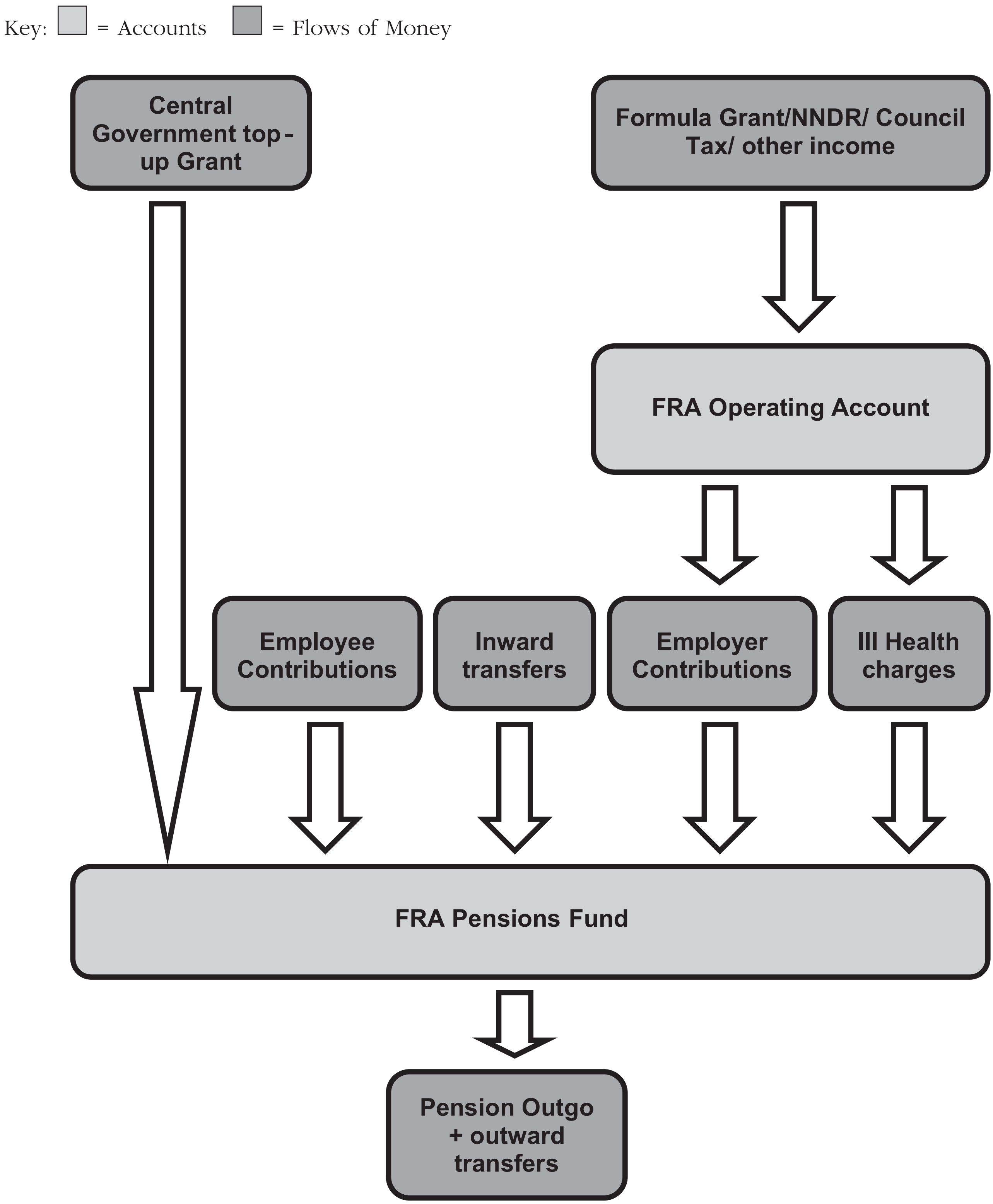
020 7944 8895

Firepensionsfinance@odpm.gsi.gov.uk

Fire Service Improvement Team
Office of the Deputy Prime Minister
Floor 4/Zone C
Allington Towers
19 Allington Street
PO Box No. 50200

ANNEX A

New financial system



ANNEX B

SCAPE

Background

1. Most major public service pension schemes are run on a pay-as-you-go basis rather than being backed by a fund (the Local Government Pension Scheme (LGPS) is the main exception). In the civil service, NHS and teachers schemes, departments and other public bodies employing members are charged an Accruing Superannuation Liability Charge (aslc) – effectively an employer contribution. This imposes financial discipline and is designed to make employers aware of the full cost of employing someone including the future cost of their pension. Employer contributions are paid from employer budgets (for central government this means Departmental Expenditure Limits). They are received by the account, which makes the pension payment. The net pensions expenditure is in departments' Annually Managed Expenditure (AME).

2. The Treasury has progressively overhauled the mechanisms for setting employer charges in the unfunded public service pension schemes. The objective was to put employer-charging mechanisms onto a consistent, rational and defensible basis to improve budgetary discipline and accountability for the costs of operating these schemes. This has meant introducing employer charging to the judicial scheme, introducing regular valuations and experience tracking in the Armed Forces Pension Scheme and reviewing the eccentric basis for setting employer contributions in schemes like those for the teachers, NHS staff, and the civil service.

How employer contributions have been set in the past

3. In the early 90s it was thought that the best way to set employer contributions was to mimic the ways in which private sector employers carried the costs of their pension schemes. A variety of notional funding arrangements were therefore set up, so that aslcs could be levied on employers participating in unfunded public sector schemes as if those schemes were funded. In some cases (such as NHS and teachers) the assumption made was that the schemes were supported by notional portfolios of gilt-edged investments. Also in the NHS and teachers schemes aslcs covered only the cost of basic pensions on retirement and not indexation. In the case of the Principle Civil Service Pension Scheme (PCSPS), the assumption was that there was a portfolio of assets matching those which would be selected by a large, mature private sector scheme: that is, predominantly, an equity portfolio.

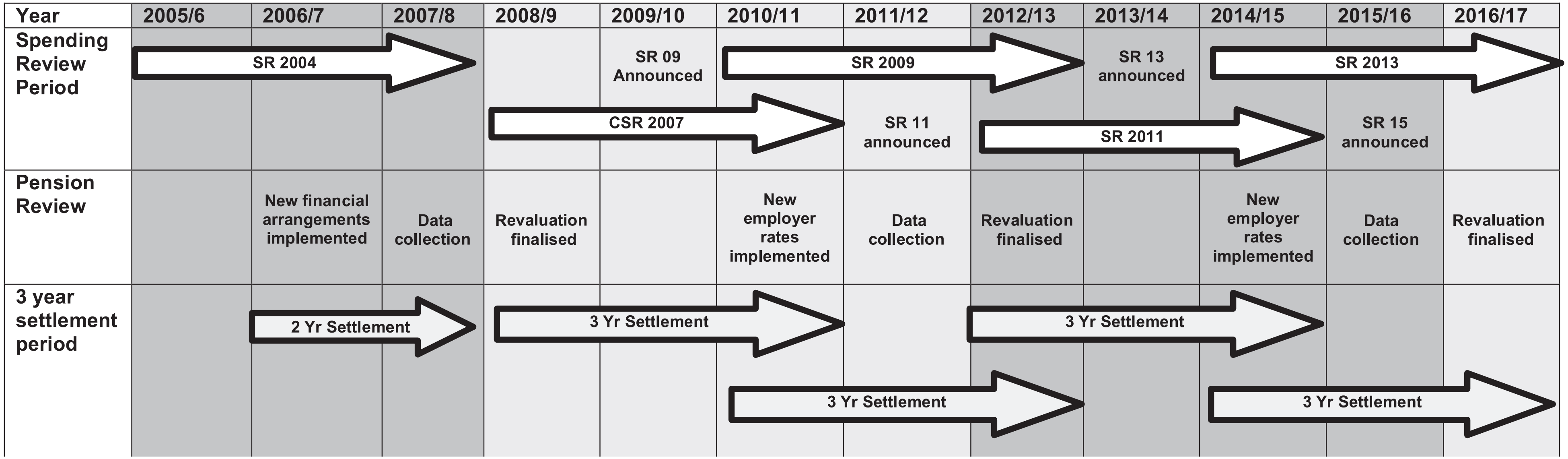
A new approach to setting employer contributions

4. Agreements have been reached with the MoD, DFES and DoH on reforms to the pension schemes for the armed forces, teachers and NHS respectively. The new methodology is now in place in those schemes. Recently the civil service reformed its system to take effect from April 2005.

5. The new methodology is called SCAPE (Superannuation Contributions Adjusted for Past Experience). It replaces complicated notional funding assumptions with a common real discount rate of 3.5 per cent. Hence the costs charged to employers reflect genuine influences on pensions: changes in mortality/longevity assumptions; trends in pay and rates of pay progression, retirement age, incidence of ill-health retirement, and so on. The system tracks actual experience (i.e. it has a memory): so that if erroneous assumptions are made at one valuation the costs of correcting those assumptions in the light of past experience are brought home to employers later. A surplus or deficit in the notional fund can arise because of changes in genuine features or experience in the pension scheme but not through investment returns differing from those assumed.

ANNEX C

Firefighter Pension Schemes Review Cycle



This review cycle assumes that the spending review cycle remains as a two-yearly cycle with a year overlap between reviews. If the spending review cycle changes, then the firefighter pension scheme review cycle will also need to change so that revaluations of the schemes are completed in time for the announcement of each, or every other, spending review. The intention is that the three year settlement cycle will follow the spending review cycle.

ANNEX D

Actuarial data required for setting Contribution Rates

Can be found and downloaded from:
www.

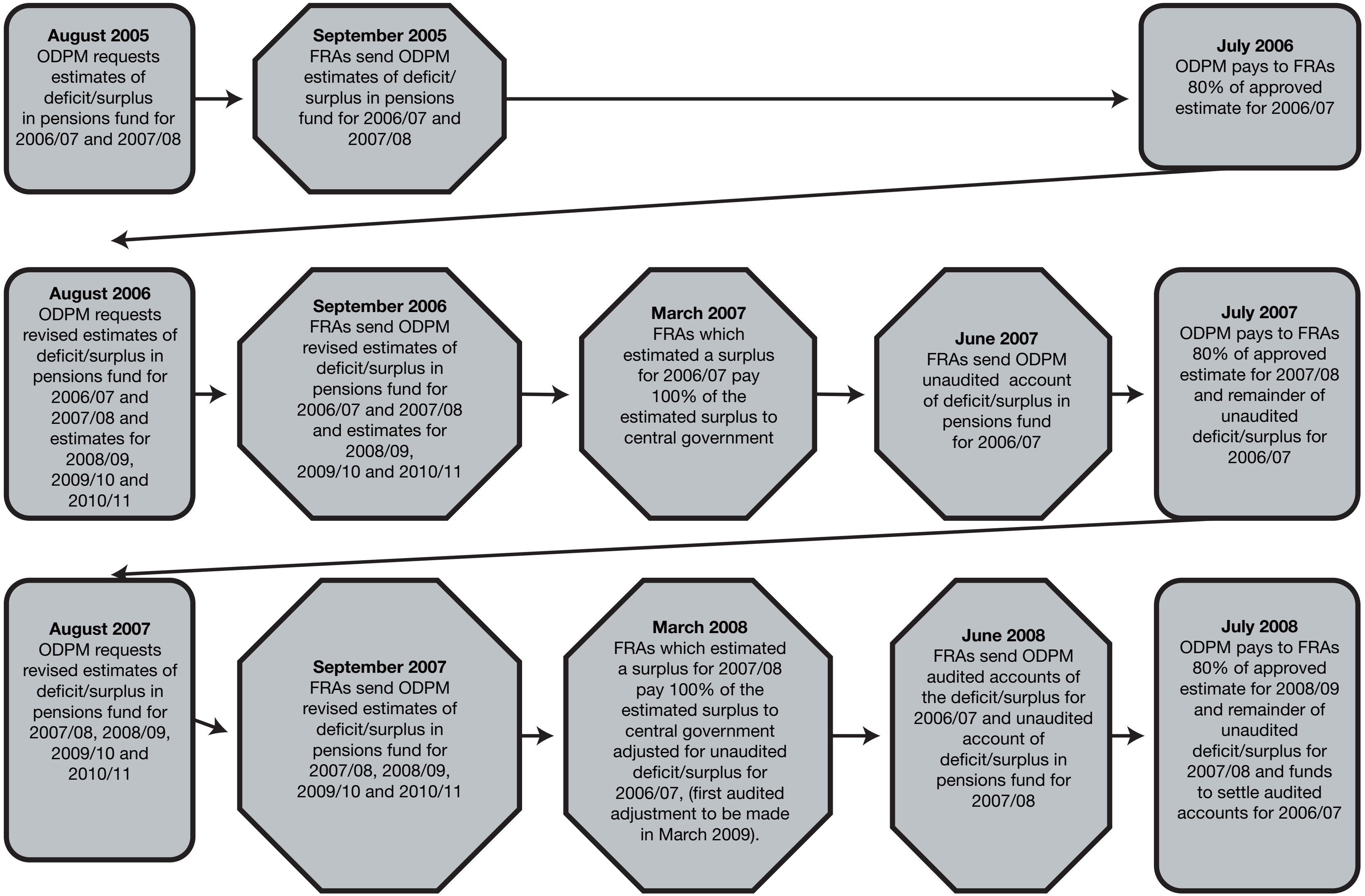
ANNEX E

Form Reference FPF1

Can be found and downloaded from:
www.

ANNEX F

Mechanism for Paying the Top Up Grant



ANNEX G

Glossary

1. **FRA** – Fire and Rescue Authority
2. **ODPM** – Office of the Deputy Prime Minister
3. **RDS** – Retained Duty System
4. **SCAPE** – Superannuation Contributions Adjusted for Past Experience
5. **LGPS** – Local Government Pension Scheme
6. **NI** – National Insurance
7. **GAD** – Government Actuaries Department
8. **SORP** – Statement of Recommended Practice
9. **FRS** – Financial Reporting Status
10. **CIPFA** – Charted Institute of Public Finance and Accountancy
11. **LASAAC** – Local Authority (Scotland) Accounts Advisory Committee
12. **SI** – Statutory Instrument
13. **ASLC** – Accruing Superannuation Liability Charge
14. **AME** – Annually Managed Expenditure
15. **CSR** – Comprehensive Spending Review