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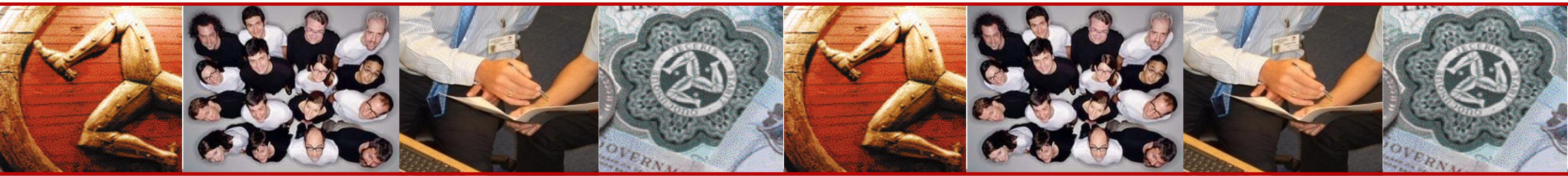

Public Sector Pensions – Fairness and Sustainability

Presentation to the Public

23 May 2016

Structure

- Introduction – Minister for Policy and Reform
- Background to Public Sector Pension Policy
- Part 1 - Legacy funding issues
    - Options for managing funding issues
    - Cabinet Office Report
- Part 2 – Sustainability options going forward
    - PSPA Report

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Background

- Ian Murray, Public Sector Pensions Authority
  - Background
  - Legacy funding issues
  - Cabinet Office Report

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Public service pensions – a history

- Original IoM civil service superannuation schemes established in the 1960's
- Modelled on UK "Pay as you go" public service schemes
- Schemes established at a time when:
  - Public service relatively small
  - Low wages compensated for by good pension
  - Limited longevity
  - Contributions exceeded payments

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Public service pensions – a history

- Schemes initially designed to be self-funding
- Contributions from Employees' (where paid) and Employers' adequately met benefit payments for many years
- The "Pay as you go" system was maintained even when there was growth in the public service and in wages
- Contributions not tied up in pensions but invested in wider Government projects (for "the greater good")

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How have we got here?

- Income was adequate to meet expenditure historically, therefore limited need in the past to set aside additional monies
- We now have to fund the benefits built up over the last 50 years, particularly the last 25 years
- In general: high level of benefit payments for older workforce who are living longer
- This has lead to current and projected Expenditure v Income issues

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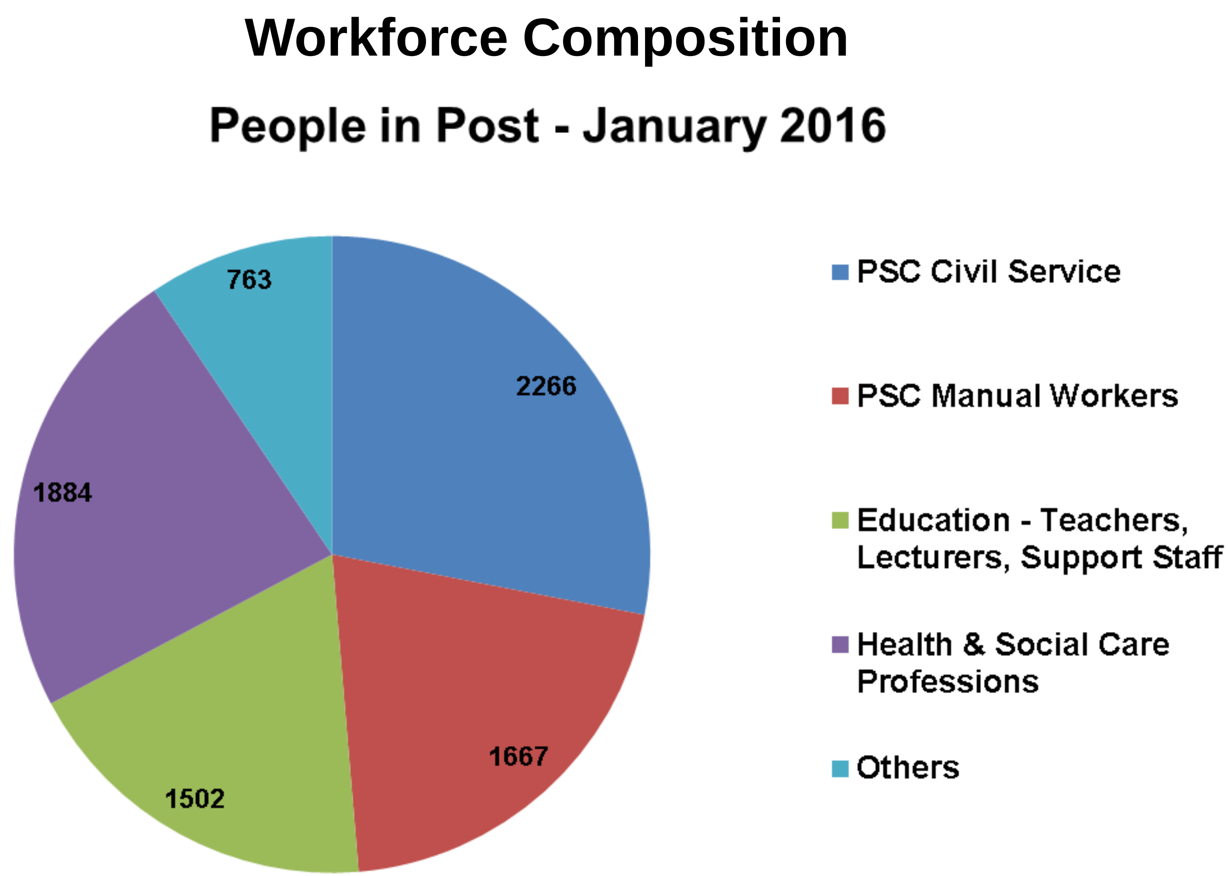
How have we got here?



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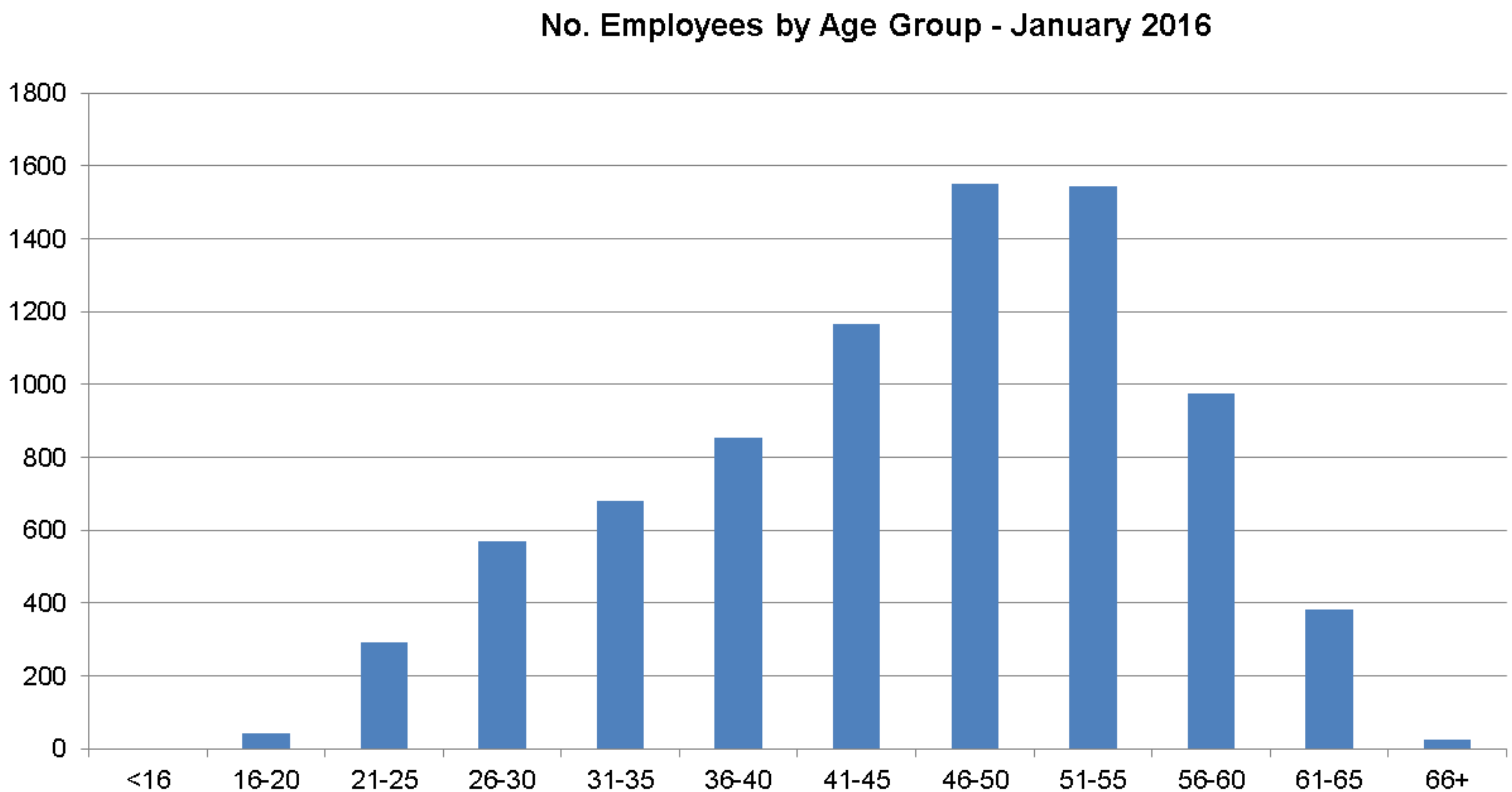
How have we got here?

Ageing Workforce



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Economic position

- Without the impact of:
  - Banking crisis
  - VAT reduction
- Strong growth would have been maintained
- Less need to draw on Pensions Reserve
- Public sector pensions may have been less of an issue

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Public Sector Pensions Liability

- Headline figures are relatively meaningless:
  - £3bn at 31/3/15 – GAD (prescribed basis)
  - £2.1bn at 31/3/13 – PSPA Actuary (funding basis)
- Will continue to grow, even with benefit changes, due to:
  - Future accrual of benefits
  - Effect of wage and price inflation on benefits
  - Longevity
  - Effect of actuarial assumptions

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Public Sector Pensions Liability

- Long term liability is an “academic” figure
- Cannot be crystallised at once
- Majority of liability relates to benefits that will only be paid when members retire
- Paid over the expected lifetime of all scheme members (i.e. to their mid 80’s)

Part 1- the Legacy Funding issue

- That means:
  - The difference between pensions income and expenditure which has built up historically
  - Many years of growth in the public service, particularly the last 25 years
  - Higher salaries leading to higher benefits for more public servants
  - An ageing workforce who are living longer in retirement

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Options for managing legacy funding issues

- Reduce accrued rights and benefits
- Close all current public sector schemes
- Cap value of public sector pensions
- Reduce lump sum commutation factor
- Reduce amount of lump sum available
- Taxation options
- Move to “Career Average” Scheme

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Reduce accrued rights – cutting benefits

- Used in Eire, but in exceptional economic circumstances via Emergency legislation
- IoM Pensions Act 2011 + overriding legislation currently prevents, without member agreement
- Could change the primary legislation to allow, but likely to lead to significant legal challenges
- What sort of message would this send out to the wider world?
- Limited effect on current expenditure unless cut backs are significant

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Close public sector schemes

Close all current public sector schemes

- Drawbacks:
  - Still have to find the money to "fund":
    - Benefits in payment (the "legacy")
    - Accrued benefits payable in the future
    - Payments for next 70 years+
- Still have to make good the "lost" employee contributions: c £18m per year

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Close public sector schemes (cont.)

- Recruitment & Retention Issues
  - – Medical and Dental Staff (160.9 fte)
  - – Nursing & Midwifery (904.3 fte)
  - – Allied Health Professionals (142.5 fte)
  - – Teachers & Lecturers (884.2 fte)
  - – CS Departmental* (829.6 fte)

*Social Workers, Advocates, Engineers, Air Traffic Controllers, Prison Officers, Surveyors, IT Analysts etc

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Cap public sector pensions

For example: £30k pension per annum cap

- What about legal position for those with accrued benefits already above £30k?
- Expenditure impact:
  - Limited
  - Makes little impact on current expenditure position
  - But shouldn't perhaps be discounted at this stage

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Reduce amount of lump sum available

Currently 30% of the pension value for GUS

- Could reduce to current UK (and former IoM) position of 25%
- Expenditure impact:
  - Some immediate savings
  - But long term pension costs increase
  - May encourage exodus of current members, therefore expenditure position worsens

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Taxation options

- Tax lump sums over a given amount - £200k?
- Higher taxes on:
  - Public service pensions in payment
  - Scheme Members (Eire did this)
- Restrict tax relief on pension contributions to public sector schemes
- UK Chancellor not progressing

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Taxation Options

- Issues:
  - Considerations for taxing lump sums already unfavourably received
  - Discriminates against public servants
  - Possible legal challenge
  - 2-tier tax structure – public and private sector
  - Issue with pensioners living off Island where we couldn't impose a higher tax
  - Need to assess financial effect

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Move to Career Average (CARE)

- Positives
  - Averages-out salary increases over a person's career
  - Seen as fairer to lower/moderate earners
  - Benefits are linked to current pay, then increased in line with future inflation
  - Cost savings achieved when salary increases are generally above inflation

Move to Career Average (CARE)

- Negatives
  - – Does not in itself guarantee cost savings
  - – Needs to be coupled with benefit reductions
  - – When salary increases are low and inflation high, CARE can lead to higher benefits and therefore higher costs
  - – Limited effect for those closest to retirement
  - – No impact on current cashflow position or legacy funding issues

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Consideration of options

- Change options all have drawbacks:
  - Limited cost savings
  - Little immediate impact on current deficit
  - Legal implications – Government liable to be challenged on some options
  - Recruitment and retention of specialists
  - Mass exodus of current members
  - **But,** shouldn't all be discounted at this stage
- One further option: managing costs via future allocation of income growth

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Managed allocation of income growth

- Long term income growth anticipated 2-3% pa
- Equates in current terms to £20-£30m pa
- Growth in pensions expenditure can be covered by projected growth in Government Income
- About a quarter of future income growth required to cover the future annual increase in pensions expenditure
- Also recommended that transition of the Reserve drawdown is lengthened to 2022/23

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Managed allocation of income growth

- Manages a challenging situation in a sustainable way
- At the same time Government will continue to drive through efficiency and reduce costs
- Income received through growing economy and increased contributions should be more than sufficient to cover increasing pension costs
- Further options will still be explored
- We are <u>not</u> going bust

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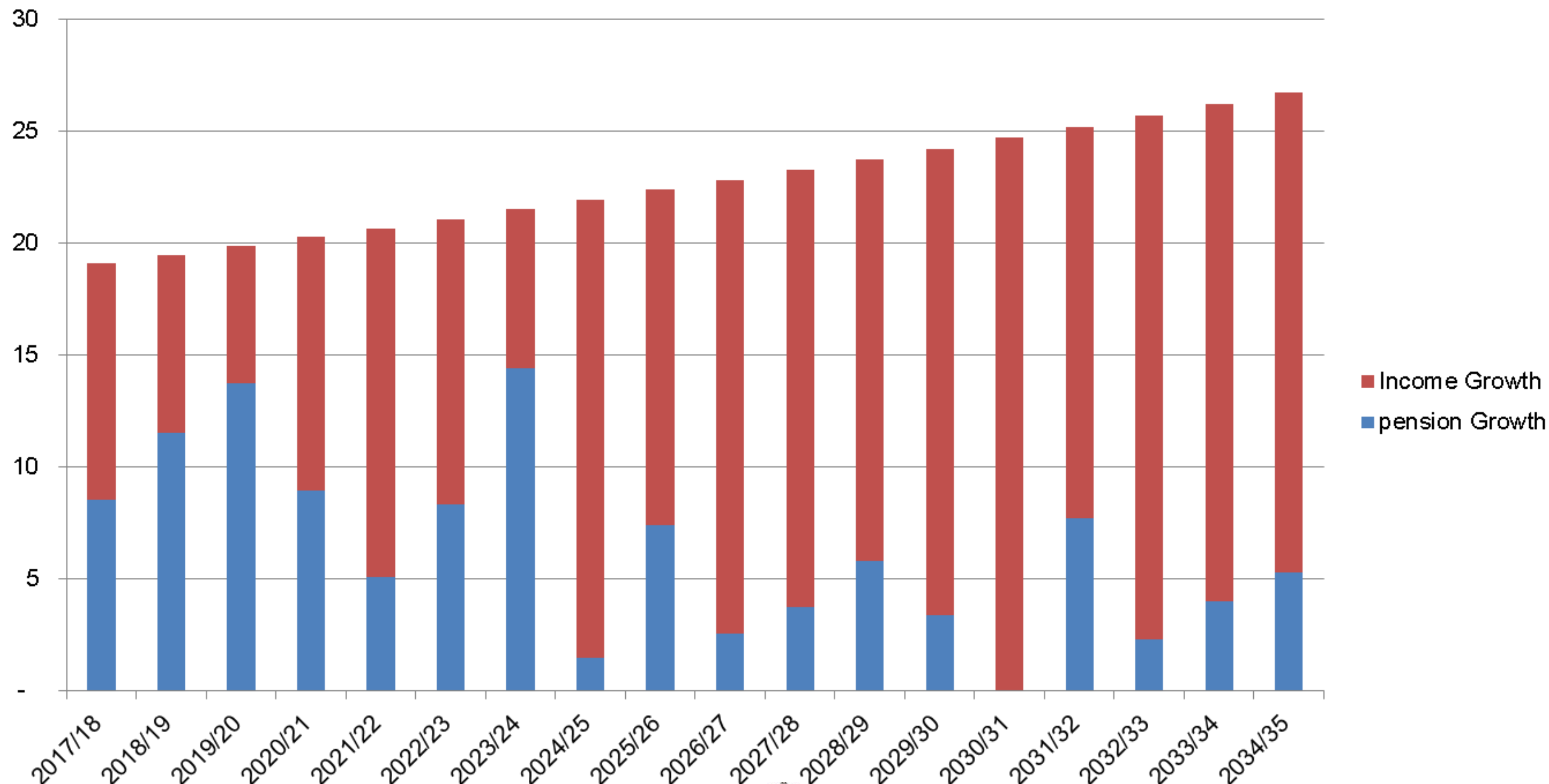
Managed allocation of income growth



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Summary and Conclusions

- Difficulty in changing anything so significantly as to impact immediately on current expenditure
- Recommendations from Cabinet Office Report:
  - PSPA/Treasury to further explore scheme design options for managing the legacy funding gap
  - e.g. taxation options, reducing lump sums and commutation factor, capping maximum value of pensions

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Summary and Conclusions (contd.)

- Recommendations continued:
  - Primary means for addressing the legacy funding gap is via managed allocation of future income growth
  - Additionally, implementation of proposals in PSPA Report expected to lead to future sustainability and removal of the legacy funding gap around 2055

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Part 2 – PSPA Report

- Jon Callister – Cabinet Office
- The PSPA Report considers:
  - Future pensions sustainability – how can we change things now to make our current public sector schemes more sustainable into the future?

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Structure of PSPA Report

- Executive Summary
- Background
- Tynwald Resolutions
- Government Unified Scheme Reforms
- Reform of Other Schemes
- Summary & Conclusions

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Unified Scheme Reforms

- PSPA Pensions Committee
  - PSPA, OHR, Treasury, Management
  - Included Unite, Prospect, BMA, RCN, FBU
- Actuarial Reviews
  - Government Actuary's Department
  - First Actuarial
- Technical Advisory Group (TAG)

Unified Scheme Reforms

- TAG Considerations
  - Value of benefits
  - Cost of future benefits
  - Share of the cost of providing benefits
  - Cost Envelope
- The “cost envelope” is the value of benefits accrued by scheme members each year expressed as a percentage of their pensionable pay.

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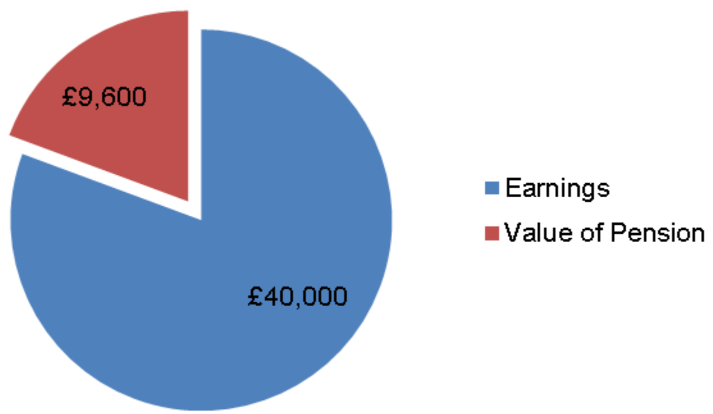
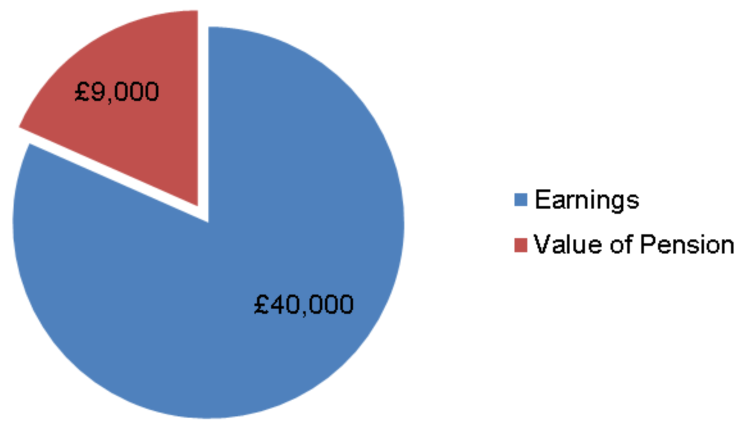
GUS Reforms - Proposed

GUS Section 1 (24%)



Proposed Revised GUS Section 1 (22.5%)



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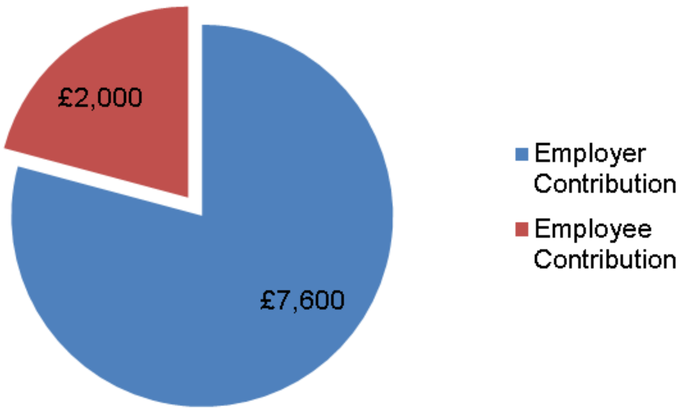
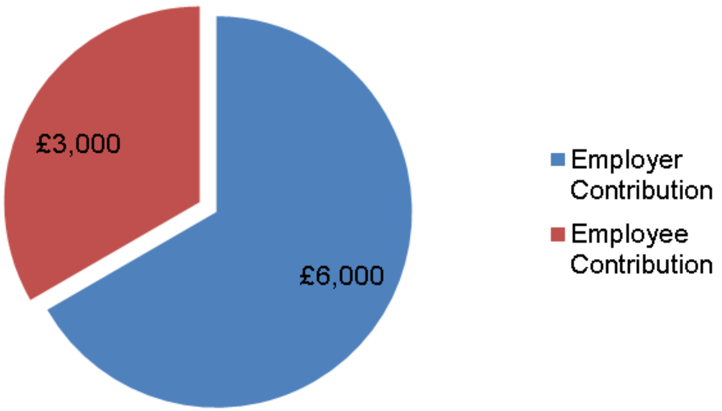
GUS Reforms – Proposed Contribution Ratios

Current Contributions Section 1 (5%, 19%)



Proposed Contributions Section 1 (7.5%, 15%)



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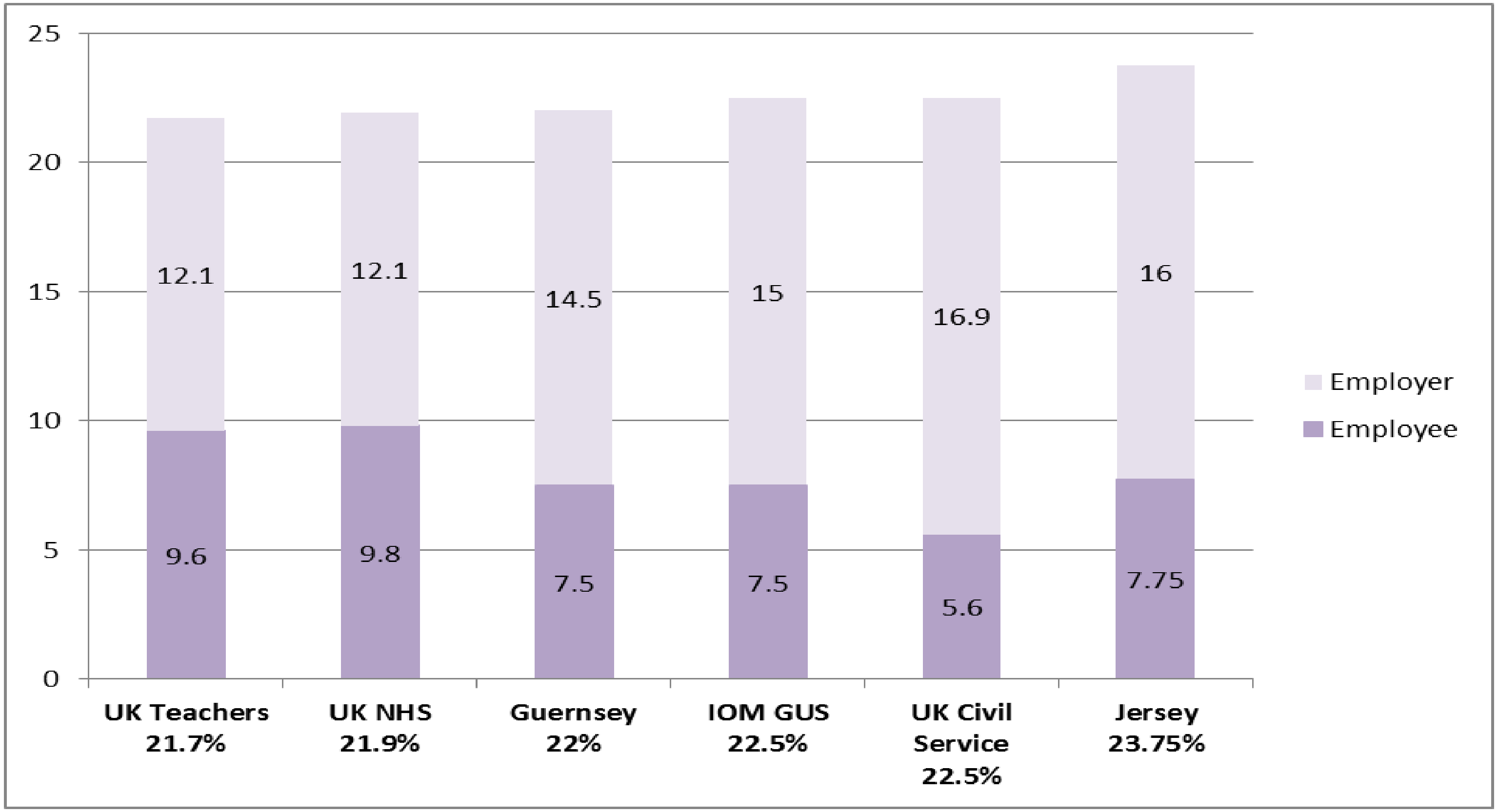
GUS Reforms

Cost Envelope/Contribution Ratios – Comparisons



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GUS Reforms

Cost Envelope – Scheme Design Options

- Linking Normal Pension Age to State Pension Age;
- Linking early retirement age to State Pension Age less 10 years;
- Changing the rate at which future benefits are built up;
- Changing the Final Pensionable Pay (FPP) definition;
- Capping Pensionable Pay and also pay rises close to retirement for pension calculation purposes;
- Capping future pension increases;
- Changing the lump sum commutation factor;
- Tiered pension contributions.

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Recommended GUS Reforms

Cost Envelope/Contribution Ratios – Key Points

- Revised split of costs from 1:3 to 1:2
- A future service cost of 22.5% for members in the standard section (Section 1)
- Continuation of protected sections (sections 2-7) at existing cost to employee
- Employee Contribution Increases of up to 50%
- Reduction in value of benefits of 6% (equivalent to 1.8% of pensionable pay)
- Cost envelope and contribution ratios comparable to UK and Channel Islands

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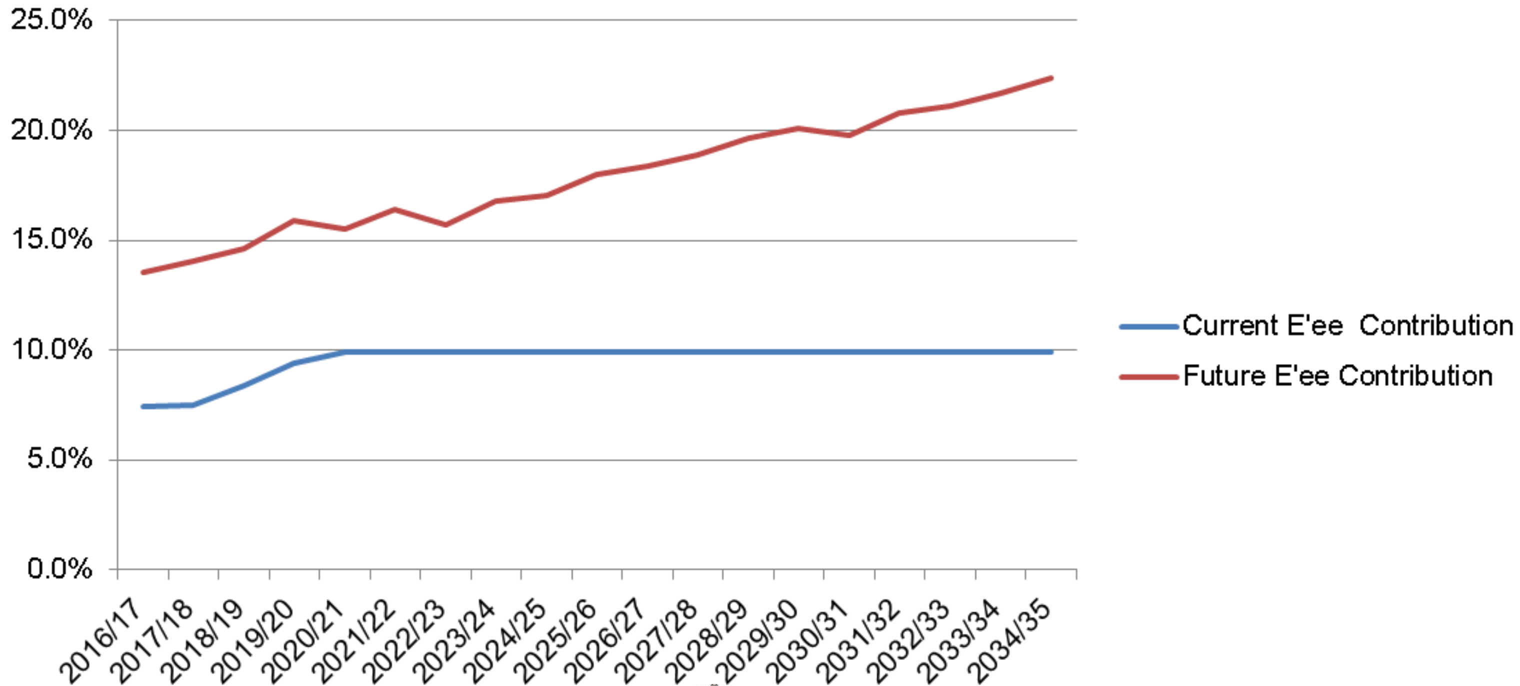
GUS Reforms

- Contribution increases if current members required to meet legacy funding gap:



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Pre-reform monetary projections

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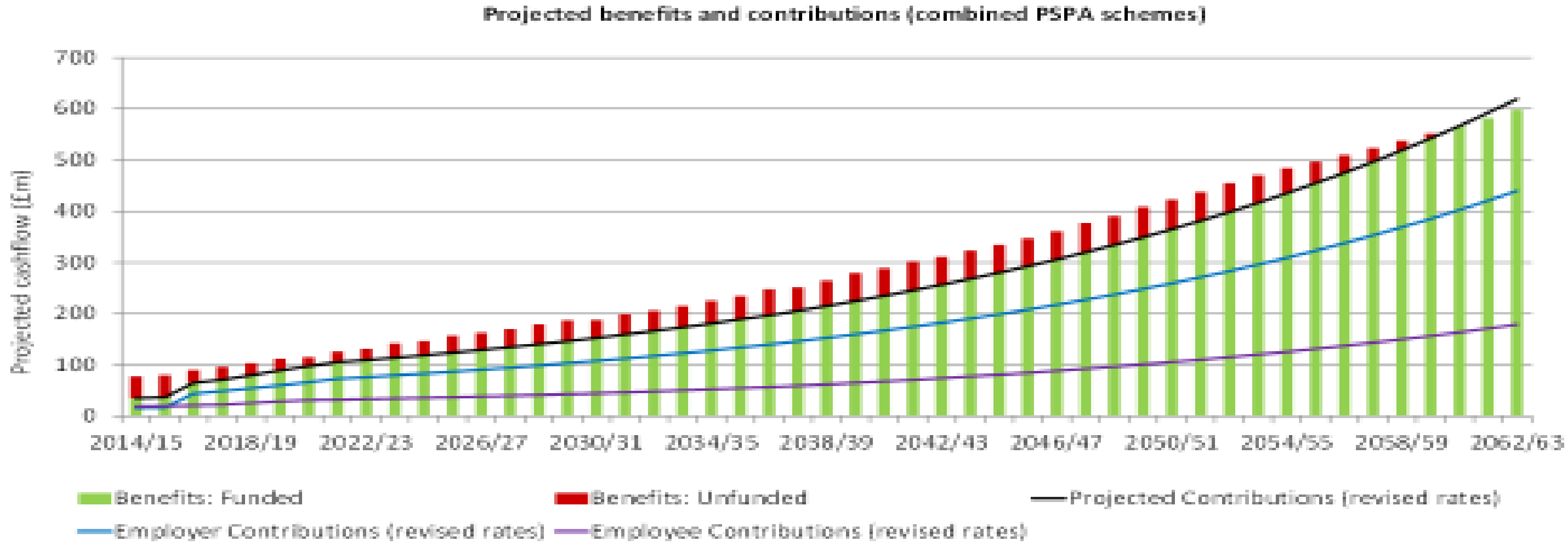
Monetary projection (50 years)
Current rates



Prior to allowing for proposed benefit and contribution reforms

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Post-reform monetary projections

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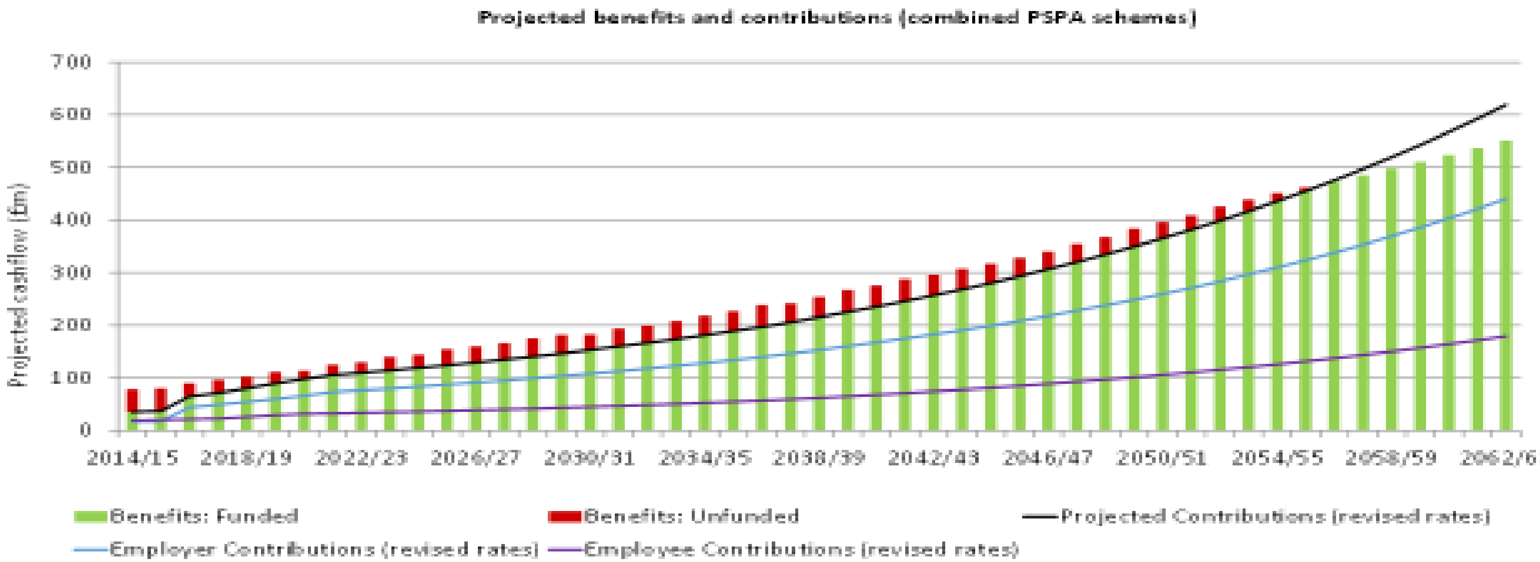
Monetary projection (50 years)
Post proposed reforms



Allowing for proposed reforms to benefits and contributions

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Reform of other Schemes

- Tynwald: in line with Working Group proposal
  - Consultation commenced 19th February
- Police: focus on new member savings
  - Productive dialogue ongoing
  - Reform via existing scheme
- Teachers: focus on similar outcomes to GUS
  - Change spread across current and new members
  - Reform via existing scheme
- Judicial: awaiting outcome of UK legal cases

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Questions?

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