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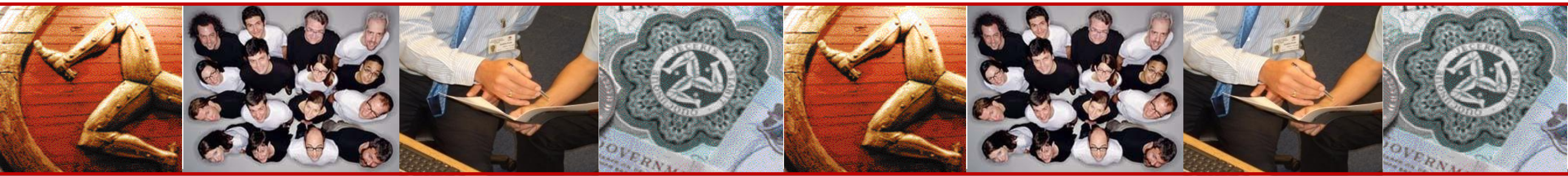

Public Sector Pensions – Fairness and Sustainability

Presentation to the media

18 March 2016

Introduction

Introduction by Minister for Policy and Reform

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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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The “pay as you go” system

- Contributions from members and employers used to pay the benefits of current and future retired scheme members
- No investment in a separate “fund” (as there would be in the private sector) to meet benefits
- Therefore, viability of the schemes means maintaining an adequate inflow of contributions whilst controlling future benefit payments
- Limited options for closure without incurring significantly higher costs

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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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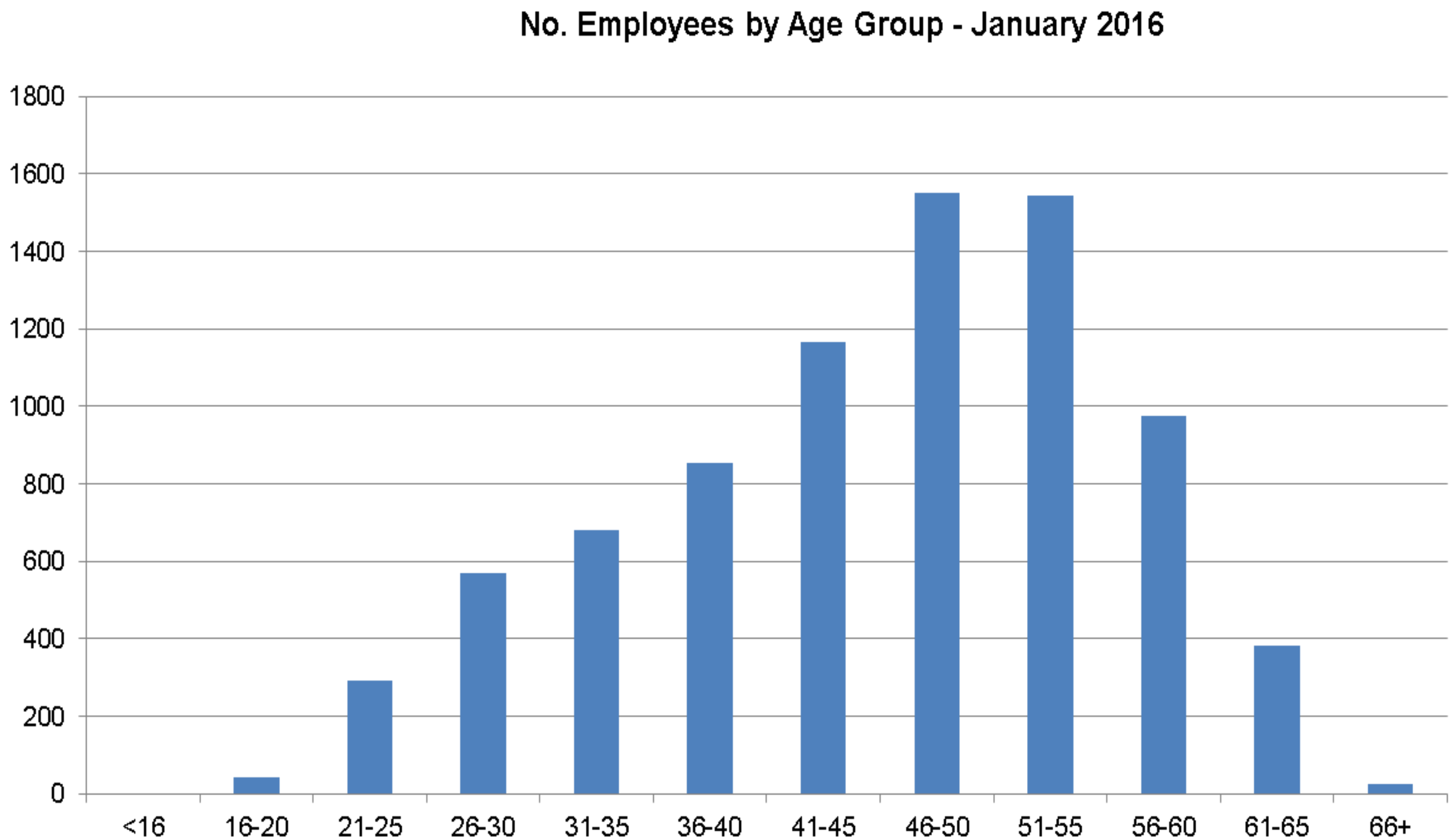
How have we got here?



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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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We are not alone……

- UK National Audit Office report 2010:
  - Cost of all UK public sector schemes £25.4bn in 2009/10
  - Costs expected to rise to £79.1bn by 2059/60 (expressed in 2008/09 prices)
  - No reduction in costs until after 2059/60
  - Reasons for increase: rising number of retirements directly linked to number of staff in post

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

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Conclusions on Options

- Reducing accrued rights/benefits: legal challenges and sends signals to the wider world
- Closing current schemes: significant additional monies required to be found, current expenditure increases sharply
- Capping pensions: limited effect on current expenditure, effect is long term
- Reduce lump sum commutation factor: same effect as capping pension

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Conclusions on Options (contd.)

- Reduce/cap amount of lump sum:
  - Achieves expenditure savings, but
  - Consider accrued rights, and
  - HR issues, recruitment/retention
  - Increases long term pension costs
- Taxation options are a possibility, but may discriminate against public servants
- Career Average: may not lead to cost savings, no immediate reduction in expenditure

Conclusions on Options (contd.)

- Difficulty in changing anything so significantly as to impact immediately on current expenditure
- Recommendations:
  - 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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Conclusions on Options (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

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 we will continue to drive efficiency and reduce costs
- Income received through growing economy and increased contributions will be more than sufficient to cover increasing pension costs
- Further options will still be explored
- We are not going bust

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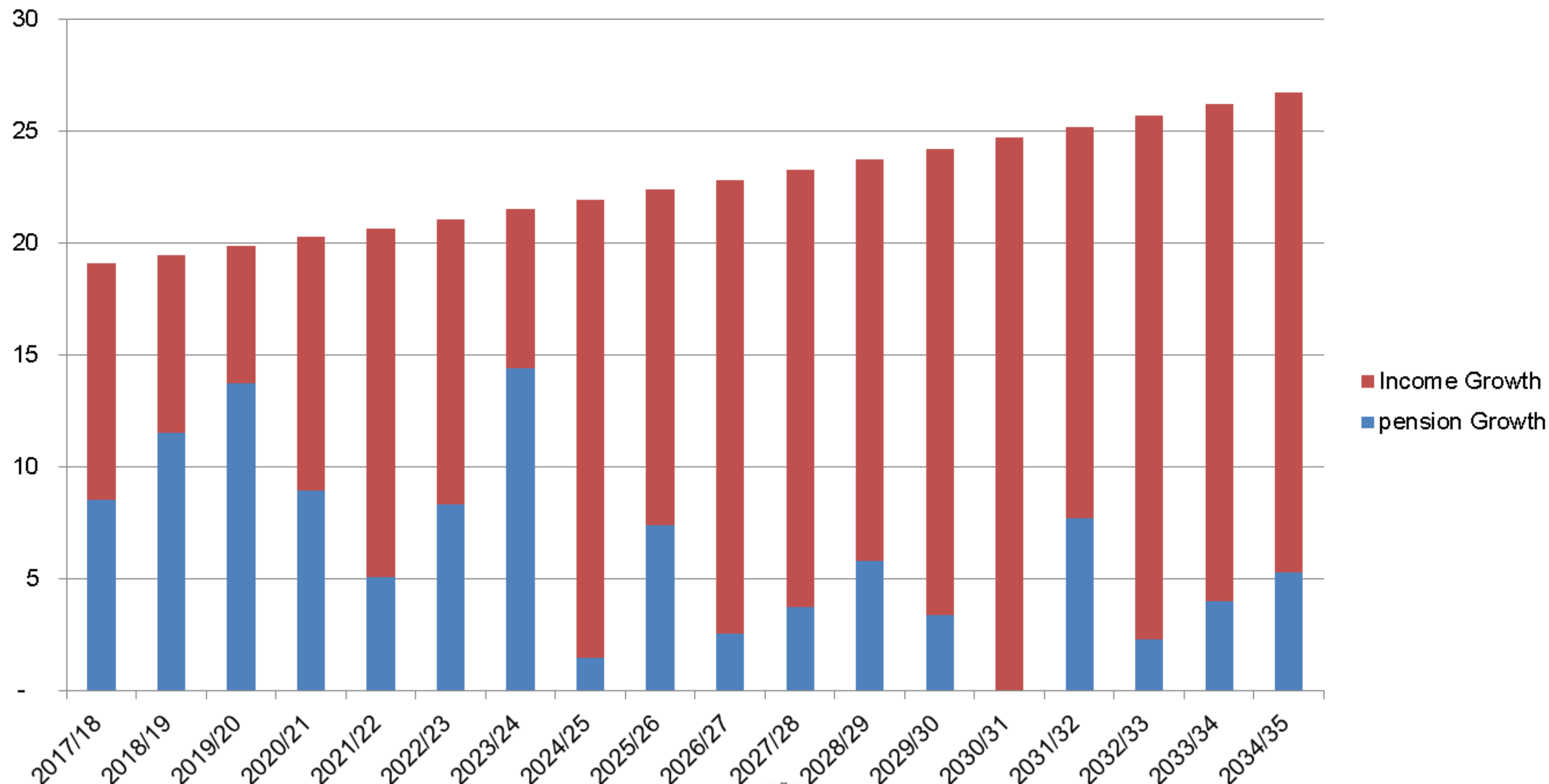
Managed allocation of income growth



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GUS - Why further reform is needed

- The economy hasn't grown as we expected;
- Lower levels of contribution;
- Reduction in government workforce;
- Pension increases have been higher than we assumed;
- Later working not achieved.

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GUS - Why further reform is needed

- Changes were made during the consultation process which have impacted on the Scheme's affordability
- More members than anticipated (85%) protected their benefits;
- Income from increased contributions was lower than anticipated, due to phasing in and concessions for those within 7 years of retirement.

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Tynwald Resolution

- December 2014 Resolution
  a) *to undertake a wide and in-depth consultation with all affected staff and staff sides;*
  b) *to commission, in agreement with the staff sides, a suitable person or persons to validate the Hymans Robertson figures contained in the report; and*
  c) *if there are any changes to be made to public sector pension schemes these must be done with consultation and negotiation*

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GUS 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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Current Pension Values

Costs of all Schemes (2013 Valuation)

	GUS	Police	Teachers	Judicial	MW No.1	Tynwald
Employer	22.5%	30.3%	17.1%	39.5%	23.5%	42.1%
Employee	6.1%	13.3%	9.0%	3.0%	1.5%	4.0%
Total	**28.6%**	**43.6%**	**26.1%**	**42.5%**	**25.0%**	**46.1%**

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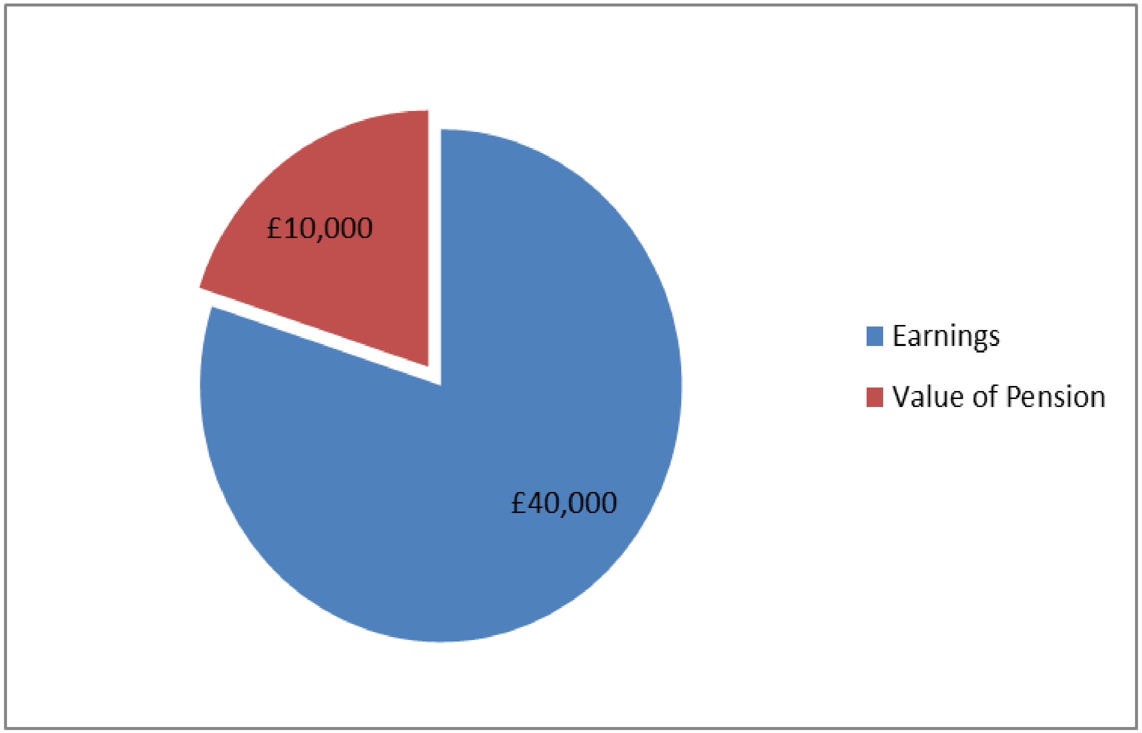
Current Pension Values

Example



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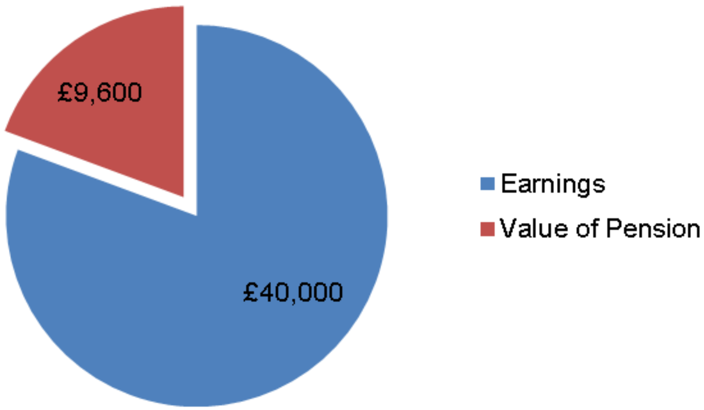
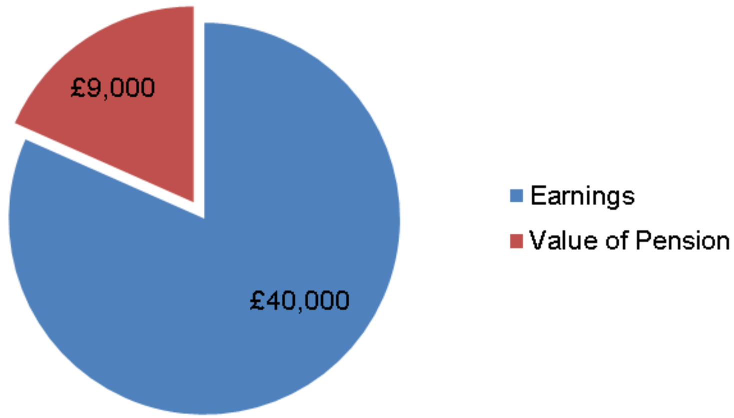
GUS Reforms - Proposed

GUS Section 1 (24%)



Proposed Revised GUS Section 1 (22.5%)



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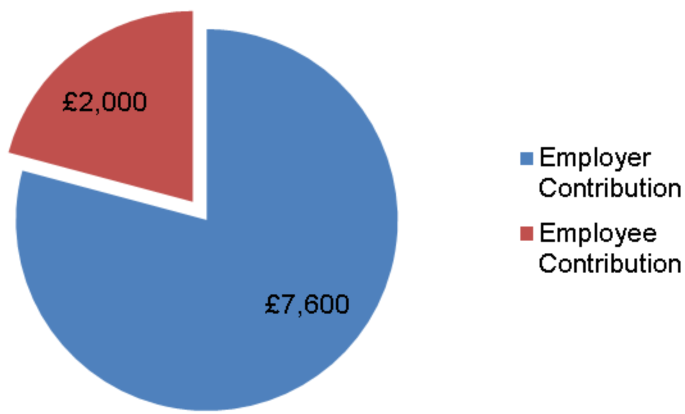
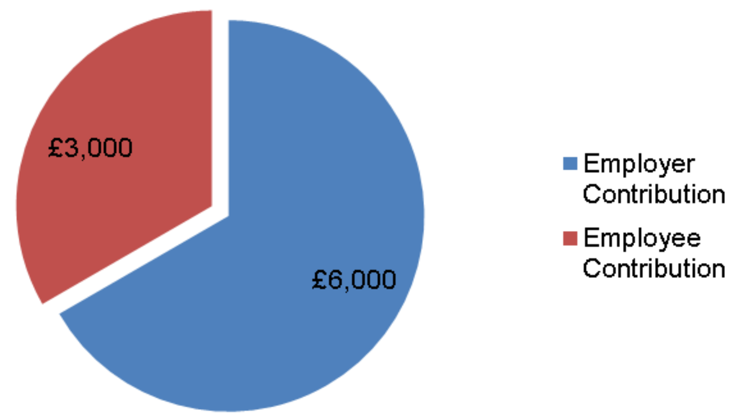
GUS Reforms – Proposed Contribution Ratios

Current Contributions Section 1 (5%, 19%)



Proposed Contributions Section 1 (7.5%, 15%)



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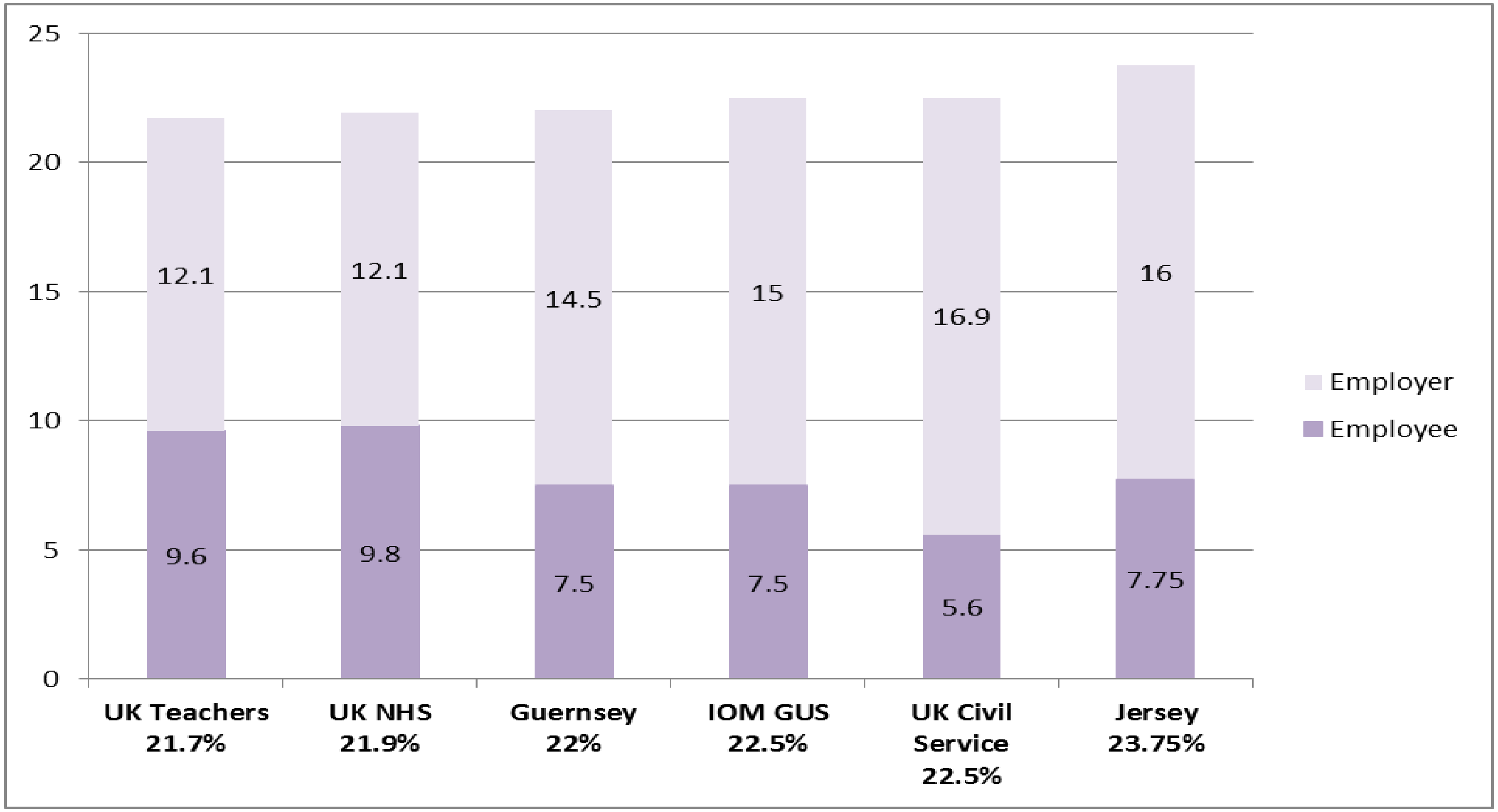
GUS Reforms

Cost Envelope/Contribution Ratios – Comparisons



GUS Reforms

Cost Envelope/Contribution Ratios – Key Points

- Revised split of costs from 1:3 to 1:2
- 25% - 75% to 33% - 67%
- 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 Public Sectors

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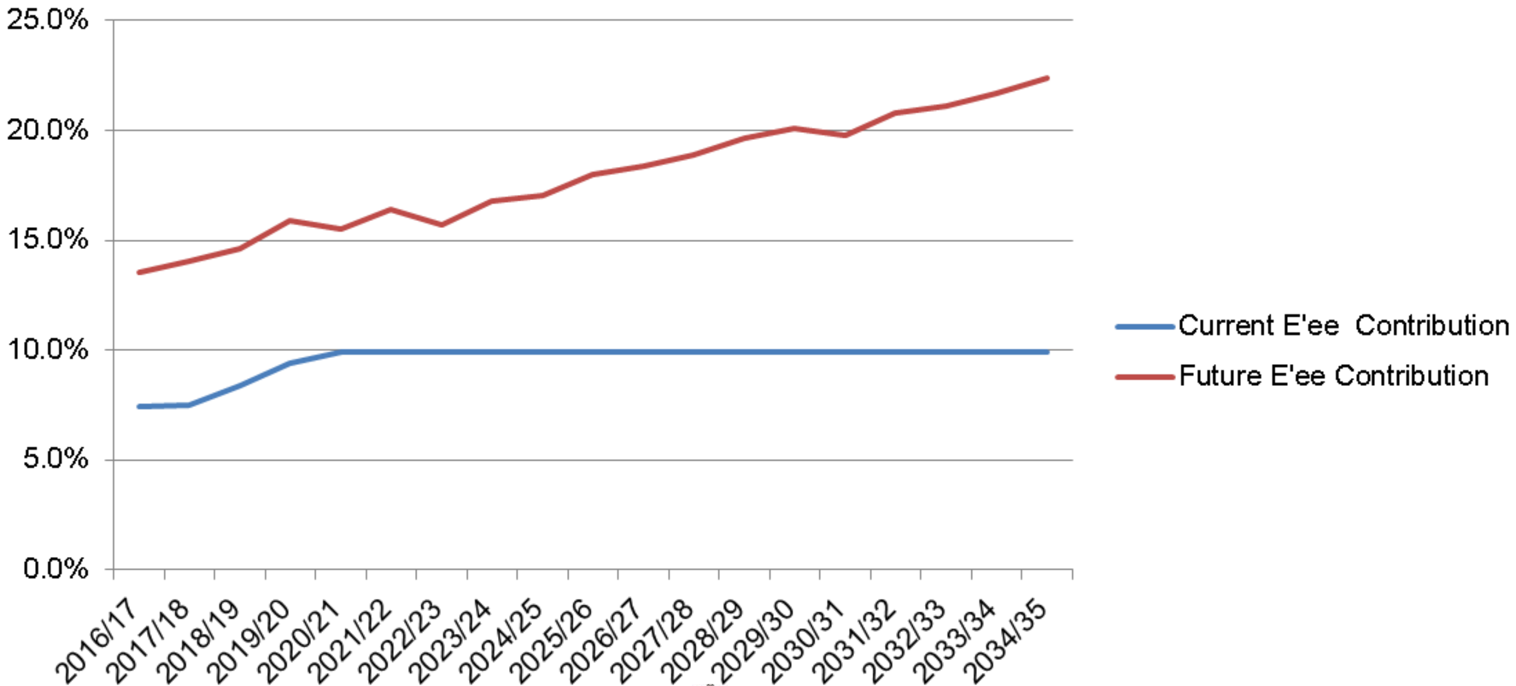
GUS Reforms

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



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GUS Reforms

Summary of TAG Proposals

- An increase in employee pension contributions of 2.5%
- Immediate benefit reductions equivalent to 6% (1.8% of pensionable pay) for future service
- A future service cost (the “cost envelope”) of 22.5% for members in the standard section (Section 1)
- Continuation of protected sections (sections 2-7) at existing cost to employee
- The Employer’s share of the cost of providing benefits reduces to 15% in the long term

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Summary of TAG Proposals

- Any future changes should be subject to the agreed cost sharing mechanism
- However, if any changes affecting contributions or benefits are proposed in future, outside of cost sharing, this will require an affirmative parliamentary process

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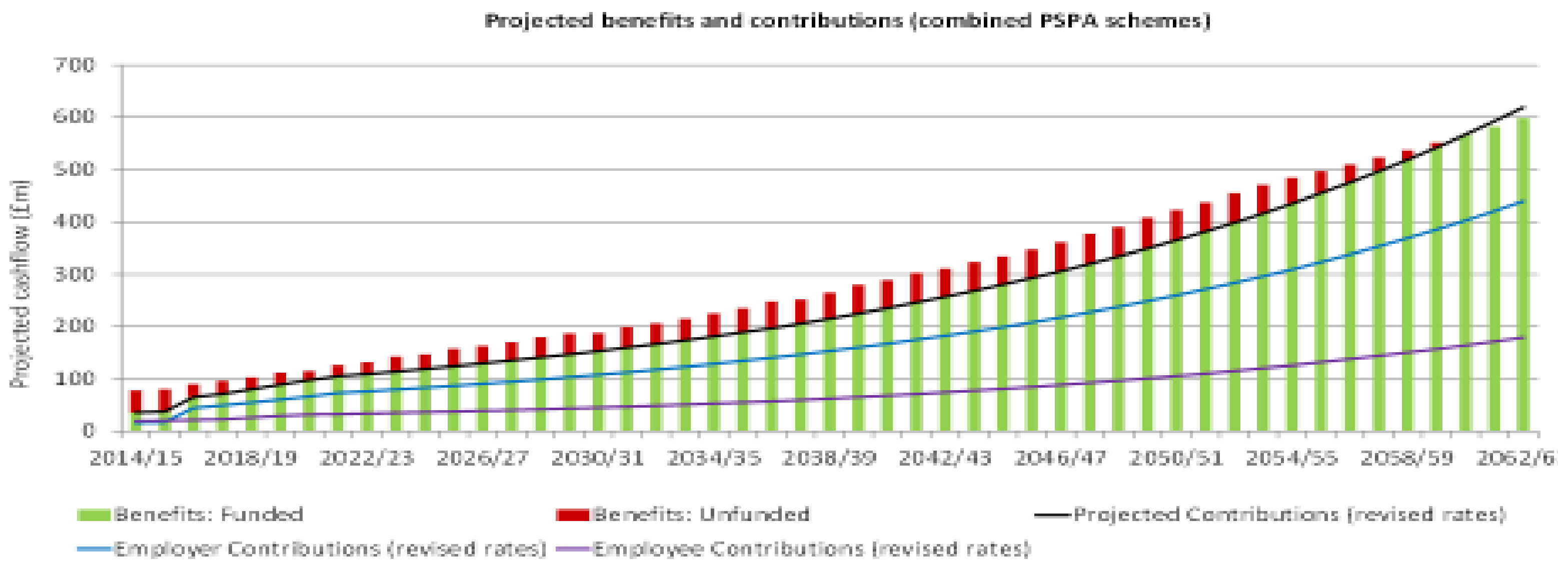
Pre-reform monetary projections

HYMANS ROBERTSON

Monetary projection (50 years)
Current rates



Prior to allowing for proposed benefit and contribution reforms

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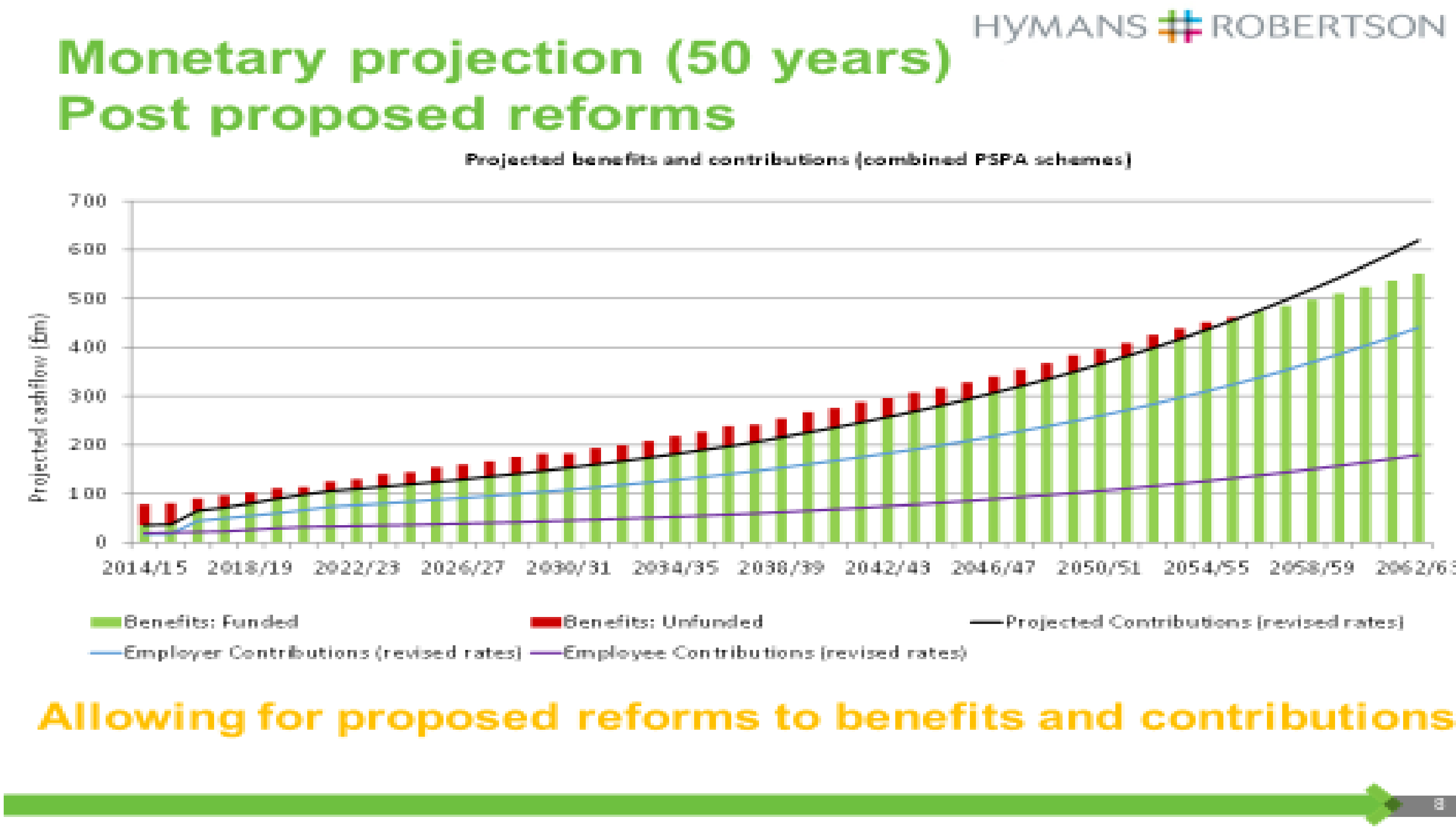
Post-reform monetary projections



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Consideration of Scheme Design

Proposed Timetable

Subject to Tynwald approval of Cost Envelope:

- TAG to discuss Scheme Design – March to May 2016
- Scheme Design to PSPA Board – June 2016
- Formal consultation – July to September 2016
- Ratification through JNC's – September/October 2016
- Scheme changes to Tynwald in November 2016
- Commencement date – April 2017

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Reform of other Schemes

- Tynwald: in line with Working Group proposal
  - Consultation commenced 19^{th} 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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Conclusions & Recommendations

Tynwald is therefore requested to:

a) Receive the report of the Public Sector Pensions Authority entitled “Fairness and Sustainability of Public Sector Pension Schemes – Revised Proposals;”

b) Endorse the proposals for reform of the Government Unified Scheme (**parts 4.1 and 4.2 of the report**);

c) Endorse the continued process for negotiating reforms of the Teachers and Police Schemes with a view to introducing changes by 30 November 2016 (**parts 5.2 and 5.3 of the report**);

d) Endorse the proposals for reform of the Tynwald Members Scheme (**part 5.1 of the report**);

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Conclusions & Recommendations

Tynwald is therefore requested to:

e) Request the Public Sector Pensions Authority to consult on detailed scheme changes with a view to formal amendments to all schemes being laid before Tynwald for approval by no later than November 2016, and

f) Receive the report of the Cabinet office entitled “Public sector Pensions – Legacy Funding;

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Conclusions & Recommendations

Tynwald is therefore requested to:

g. Note that the Medium Term Financial Strategy has identified that the Public Sector Pension Reserve will soon be depleted and by controlling expenditure on public services, Treasury has accommodated the legacy funding requirements within the revenue account, and

h. Note that as part of future budget setting processes, the PSPA and Treasury has identified options for managing the issue in the long term, through managed allocation of income growth together with exploration of other options for reform.

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