Isle of Man Government

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# Pensions Update

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**Foreword by the Minister for Policy and Reform**

In December 2014 Tynwald tasked the Public Sector Pensions Authority (PSPA) to review public sector pension schemes, including the Isle of Man Government Unified Scheme (GUS)

Since that time, a number of Employing Authorities, as well as individual employees, have been seeking further information and clarification with regard to the Pensions review which is being progressed through a Pensions Committee, established by the PSPA and made up of Unions, Employers, Treasury and the PSPA, this review has taken place.

Given the discussions have now been ongoing for twelve months, I felt it was important that employees are provided with a summary of the current position, and given that the vast majority of employees spread across the many Employing Authorities will be affected by this review, I felt it was most appropriate that this update should be provided by the Employers Side of the Committee.

This update therefore details the reasons why it is proposed that GUS is changed now, along with an outline of the key communication activities that are planned to be undertaken, so you know what to look out for and when.

**It tells you:**

- How we got to where we are now
- Why the changes are being proposed now
- Who proposed the changes
- The proposals that are under discussion
- A timetable for the changes to be introduced
- How to find out further details.

Please read this pensions update carefully to make sure you understand the reasons why changes to your scheme are being proposed.

The intention of this document is to give you a broad summary of a complex subject and it isn't possible to cover everything in this document. Information, including a copy of the Working Group's Report and updates from the PSPA Committee, can be found on the Unified Scheme Reform 2015 page of the PSPA website www.pspa.im.

John Shimmin MHK

Minister for Policy and Reform
Cabinet Office

## How we got to where we are now

In 2008, the Isle of Man Government set out on its journey to rationalise and reform the Island's public service pension arrangements.

The Government's plans involved the creation of a new Isle of Man Government Unified Scheme (GUS) that was designed to incorporate 15 former schemes into one and to ensure that Isle of Man public sector employees received a good level of pension when they retired. The principles for the development of the new Scheme were:

**Simplicity** – pension arrangements should be both simple to understand and administer.

**Affordability** – pension arrangements should be affordable to both the members and the Island's taxpayers.

**Governance** – public service pensions should be administered according to best practice by an independent government body.

The decisions that were taken and the changes that were originally proposed were not popular with everyone The Government responded to this feedback by proposing considerable changes to the original design of the Scheme, which provided:

- Existing members with the opportunity to protect the value of their already accrued benefits and their normal pension age;
- The phasing in of contribution increases;
- Protection for those closest to retirement age;
- A different level of benefits for new employees, but better than the original proposals.

After four years of consultation and negotiation, resulting in significant revisions to the scheme design to make it fair, the Scheme was introduced in April 2012.

## Why are changes being proposed now?

When it introduced GUS, the Government did not intend to introduce any further changes or anticipate that it may need to review the affordability so soon after its implementation.

Yet when GUS had its first detailed review of its finances – its first "Actuarial Valuation" – in 2013, the review indicated that the Scheme was not meeting the expected requirements and had a significant long term funding shortfall. In short, expected future benefits were too high and likely contributions too low.

Tynwald raised its concerns about the rising costs and liabilities of the scheme and a working party was formed to address these concerns. In December 2014 the working party, made up of three Members of Tynwald along with representatives of Treasury, the Cabinet Office and the PSPA, reported its recommendations, that it considered would reduce the long-term liabilities, increase contributions plus provide a fairer and sustainable scheme.

## Why are these changes needed so soon after the Scheme was brought in?

To understand the need for these changes, it is best to start by explaining how GUS is financed. GUS is an "unfunded" scheme. There is no pot of money that delivers a pension to each member. Instead, the benefits in payment now to pensioners are paid out of the contributions that you and your employer pay in and "topped" up where necessary from the Pension Reserve Fund and tax payers money.

In 2014-15 for example, the contributions paid into GUS were £ 26m. In total £71.4m of benefits were paid out, so the shortfall (known as the "Funding Gap") of £45m came from the Tax Revenue and the Pensions Reserve Fund.

When the Scheme was introduced, the intention was that it wouldn't need any changes until at least 2020. However, there have been developments both in the run up to 2012 and since then, that resulted in higher than anticipated costs. These developments have meant that the Scheme is not as sustainable in the long term as was hoped.

The reason that costs are higher than we thought is two-fold.

**Firstly**, it is acknowledged that the original basis used for the future affordability forecasting was in hindsight optimistic and at the time of implementation, concerns over affordability were raised by the Unions. However, at that time rather than delay the implementation of GUS any longer, it was considered that the introduction of cost sharing measures in 2020 would rebalance any affordability issues.

No-one could have accurately foreseen the speed at which the original affordability assumptions (made over 7 years ago) would become outdated and how what was considered affordable then, would now appear unaffordable. In the last 7 years since GUS was designed, the following events have impacted on the original affordability bases:

- The economy hasn't grown as we expected;
- Lower levels of contribution;
- Reduction in government workforce;
- Pension increases have been higher than we assumed, meaning the future cost of pensions will be more expensive to pay;
- Later working not achieved – average retirement age is still close to 60, even though the contractual retirement age is 65 for most members.

**Secondly**, as a part of the negotiations, changes were made during the consultation process which were considered necessary to get the Scheme implemented, but have impacted on the Scheme's affordability, such as:

- More members than anticipated (85%) protected their benefits resulting in higher than anticipated future pension benefits;
- Income from increased contributions was lower than anticipated, due to the level of phasing in (by 1% per year) and;
- Concessions for those within 7 years of retirement (30% of the membership either did not pay any increased contributions or were capped at 5%).

The high cost of future benefits is compounded by the fact that there is an increasing gap between revenue from contributions being currently paid which is projected to continue into the future (if not changed) and the level of benefit payments being made to current and expected future pensioners. The Government recognises this, and as such the PSPA and Employers are being asked to negotiate with members on measures that will put the Scheme on a more affordable and sustainable basis.

The funding gap is growing as many members in the Scheme are in their 40s and 50s – and so are approaching their retirement. This means the difference between the money going into the Scheme and the money paid out (the value of the future benefits) is set to grow even further. The taxpayer is already supplementing the Scheme to the tune of £45.3 million a year, and this is also set to grow.

The PSPA has therefore been asked to report to Tynwald on a way to tackle the funding issue in February 2016.

## How can we trust the Government to make changes that will ensure the Scheme is affordable in the future?

The Government understand that members want to be able to have faith that the decisions made now will ensure the schemes remain viable for the generations to come.

Quite simply, there is only so much that can be done to make a scheme affordable and that is to pay more money in and to pay less pensions out.

The proposed recommendations suggest that employers pay more (15% going up to 20%) and for members to pay 3% more.

In addition, it is also proposed that the Scheme pays out lower future benefits. It is important to note that only future benefits can be reduced, therefore benefits already in payment to pensioners and those already built up by current members cannot be reduced under current legislation, so the only option would be to reduce or change the benefits going forward.

The recommendations for change are being considered by the PSPA Committee and are centred on increasing contribution income and reducing the future benefits that can be built up. The basis on which the proposed changes have been made have been validated by two independent actuaries, as a fair solution for achieving future affordability. Much of the proposed changes will fall on new members but unfortunately, for current members to retain their good level of benefits going forward, they too will need to share in further changes.

Consideration of the proposed changes has been undertaken by a small group of the unions' pensions experts and the PSPA on behalf of the PSPA Pensions Committee. Therefore any recommendations made will be as a result of partnership working between the unions, employers and the PSPA.

It is acknowledged that to continue with the Scheme in its current form, we all need to make tough decisions. To save the Scheme in its current form, but also to limit the future subsidy from the taxpayer, it is now increasingly likely that members of the Scheme will be asked to pay more in.

We, as employers, recognise your roles as public servants, and therefore wish to retain a defined benefit pension if we can, which will continue to offer quality benefits. But it is recognised that the taxpayer will continue to pay a subsidy to the Scheme, and we need to make sure this is affordable in the medium to long term.

Alongside any changes that are made, the PSPA will continue to assess the future affordability of the scheme via an established process known as Cost Sharing which is already required by GUS. This will mean that every three years the scheme will undergo a formal review and assessment. Depending on the outcome of those assessments, adjustments to contributions and or benefits for the future may be recommended. This is the same process that will happen to UK public sector pension schemes.

## Can the Government guarantee that it won't be making more changes in the future?

**No**, whilst members can be assured that these recommendations will go some way to make the Scheme more affordable going forward, there can be no guarantee that adjustments to contributions and benefits won't be made in the future.

The reality is that from now on, public sector schemes will be under continual scrutiny and adjustments may be needed to ensure the schemes remain affordable and fair, not only to scheme members, but to the Government and thereby the taxpayer.

## What is being done to progress these potential changes?

In order to consider the recommendations made by the working party, the PSPA formed its Pensions Committee (see "who is proposing the changes on page 6") to look at the recommendations made in order to make the future funding of the Scheme more sustainable.

The Committee has looked at all aspects of the Scheme's funding. They arranged for the actuarial valuation results to be independently assessed by two actuaries, the UK Government Actuary's Department (GAD) and pension specialists First Actuarial (who were nominated by the unions), to make sure that the findings were accurate. Both sets of actuaries have since and independently validated the valuation results.

## Who has proposed these changes?

These changes have been proposed by the PSPA Pensions Committee.

The role of the Committee is to:

- Achieve effective and constructive partnership working between employers, trade unions and other staff representative organisations;
- Act as an effective vehicle to consider and, if considered necessary, agree upon revised provisions within the Unified Scheme. (These may be those included in the report or possibly suggested further to the findings of the Actuarial reviews of GAD and First Actuarial);
- Feedback and make recommendations to the PSPA on the aforementioned provisions in order that the PSPA can report back to the Council of Ministers and Tynwald.

It is hoped, that by developing proposals in this way, the mechanism for approving any changes to GUS in the appropriate collective bargaining arenas will be greatly assisted and ideally the need for further lengthy negotiation will be reduced.

## What is being proposed?

The PSPA Pensions Committee is working on a range of proposals and these are still to be agreed. A final report outlining any proposals to change benefits and/or contribution rates, is due to be presented to Tywnald in February 2016. It is anticipated that members will be informed of proposals prior to the report going to Tynwald.

It is important to say that any changes will only impact on any future benefits that you earn in the Scheme. The benefits that you have built up so far will not be reduced. Furthermore, any changes that are made will be subject to full consultation.

## What other changes were considered?

The Committee did look at proposals for increasing the early retirement age from 55 to 58 and taxing, or changing, the rates for calculating the amount members can take as a lump sum (known as the commutation rate).

However, feedback received from members was that these two proposals would cause considerable concern to those who were close to retirement with little or no time to re-adjust their retirement plans. Added to this, both suggestions would not have any material impact on the overall sustainability of the Scheme.

For these reasons, the Committee, with the approval of Council of Ministers, decided to drop these proposals for current members.

One of the changes made to UK public sector schemes is to link future retirement age with State Pension Age. This was raised as an option by First Actuarial in its assessment of the Scheme and is therefore also under consideration by the Committee.

## How are the other pension schemes being changed?

Options for reforming the Police, Teachers, Judicial and Tynwald Members Schemes are currently being discussed with employers and staff representatives and in the case of the Tynwald Scheme, the members themselves. The PSPA will report back to Tynwald in February 2016 on the progress of these discussions.

## Is this a done deal?

No. Definitely not. Any recommendations made by the Committee will be subject to consultation in accordance with the Public Sector Pensions Act 2011 and where necessary negotiation with recognised trade unions and staff representative bodies through established collective bargaining mechanisms. Any changes will then be subject to Tynwald approval.

## Is there a timetable for introducing the changes?

It will take time to be in a position whereby consultation and, if appropriate, negotiations are completed to the satisfaction of all sides. Trade unions will also wish to ballot their members at some point in the process. The timetable for making the changes could however look as follows:

| Task | Date |
|---|---|
| The Committee to report back to Tynwald with detailed proposals on any changes that may be required | February 2016 |
| The Committee will then report to members on the detailed proposals | February 2016 |
| If the suggested changes receive Tynwald approval, the PSPA will draft a scheme (or schemes) of amendment ready for consultation | Early to Mid-2016 |
| The PSPA will begin formal consultation with scheme members staff representatives and the Treasury | Early to Mid-2016 |
| Consultation on the changes takes place | Mid to Late 2016 |
| Review all comments received during the consultation; publish a document on its website summarising the main points | Mid to Late 2016 |
| Amend the draft Regulations as necessary, before approving them | Mid to Late 2016 |
| Lay the Regulations before Tynwald to be adopted. | October 2016 at the earliest |

**Further details**

**Where can I find out more?**

There will be a number of ways that we will keep you up to date on the proposals, as follows:

**1.** As matters progress the PSPA will send you regular member notices to keep you up to date on progress.

**2.** There is a dedicated Unified Scheme Review webpage on the Unified Scheme Pages of the PSPA website at www.pspa.im where you can refer to for the latest information about the progress of the various Committees and discussions.

## What you need to do

You don't have to do anything at the moment, but we would remind you that if any of your personal details change, especially your address, you must advise the PSPA, as well as your employer.

If we don't have your address, we can't keep in touch. Contact us by email at pensions@pspa.im or write to us at PSPA, Goldie House, 1-4 Goldie Terrace, Douglas, Isle of Man, IM1 1EB.

## Glossary

What is meant by...

**Actuarial Valuation:** an in depth examination of GUS's liabilities and how these are financed.

**Liabilities:** the estimated cost of providing benefits earned by members, together with the benefits already being paid such as pensions and lump sums.

**Scheme Actuary:** the professional adviser appointed by the PSPA to advise on the pension scheme's liabilities, life expectancy and probabilities (the likelihood of things happening) and their financial impact.

**Pensions Reserve Fund:** operates alongside public sector schemes and is controlled by Treasury. The intention of this fund is that it meets any part of the funding gap which cannot be met from Treasury's general reserves or taxation.

**Cost Sharing:** is a method for sharing any changes in the future costs of providing benefits between the employers (government) and scheme members, by increasing contributions or reducing future pension benefits.