PSPA Pensions Committee – Fairness and Sustainability
Isle of Man Government Unified Scheme (GUS)
Frequently Asked Questions

Background Summary

The Public Sector Pensions Joint Working Group made its report to Tynwald into the future sustainability of public sector pensions, as required by previous Tynwald motions on pensions issues. The report came to a number of conclusions and made a series of recommendations and was debated at the December 2014 sitting of Tynwald. At the end of the debate a motion was carried that the PSPA should undertake a wide and in-depth consultation with staff and staff sides and commission, in agreement with staff sides, a validation of the actuarial figures contained in the report, and if there are any changes to be made to public sector schemes these must be done with full consultation and negotiation.

To progress the Tynwald motion, the PSPA established the PSPA Pensions Committee (the Committee) with representatives from both employers' and employees' sides. To date the Committee has met six times.

In order to consider the technical pensions aspects of the Working Group proposals, a technical sub-committee (now referred to as "TAG") was also formed comprising of the employees' side pensions and HR specialists along with representatives of the PSPA, jointly chaired by Gerry O'Dwyer from the RCN and Jon Callister, Executive Director, HR, Cabinet Office. TAG meet regularly and report back to the PSPA Pensions Committee.

The Committee realises that content of the report has unsettled many members, who now feel uncertain about their retirement plans. The Committee understands your concerns and has drawn up a list of the most frequently asked questions on the report and pensions issues in general, which it hopes goes some way to answering your questions and reassuring you that your trade unions, employer and the PSPA are committed to ensuring the future sustainability of the Unified Scheme and will work in partnership together to achieve this and to agree an outcome that is fair to all parties.

What was in the Report?

An actuarial report was commissioned by the PSPA and the conclusions set out in it projected a long-term gap between income (contributions) and expenditure (benefit payments). At the moment this "funding gap" is topped up by drawings from the Public Sector Employees' Pensions Reserve Fund and from General Revenue. However, the Actuary predicts that that at the present rate of draw-down the Pensions Reserve Fund will be fully utilised (i.e. exhausted) by 2025, if not earlier. To ensure that there will be sufficient funds to pay public sector pensions beyond 2025 and into the long-term future, the Working Group's report therefore makes various recommendations for further sustainability measures across all public sector pension schemes involving a lower cost of future benefits and increased employee and employer contributions.

Is this a done deal?

No. Definitely not. Whilst it was very clear that doing nothing was not an option, Tynwald Members stressed that that the recommendations were not to be viewed as a "fait accompli" but a starting point on a journey aimed at coming to a negotiated settlement with staff. Any recommendations made by the Committee will be subject to full consultation and negotiation with recognised trade unions and staff representative bodies through established collective bargaining mechanisms.

What is the role of the 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, negotiate upon revised provisions within the Isle of Man Government Unified Scheme (GUS). These may be those included in the report or possibly suggested further to the findings of the Actuarial reviews of GAD and First Actuarial;
- feed back 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;
- conduct initial discussions relating to the recommendations made in the report, to receive and discuss the actuarial reviews of GAD and First Actuarial and consider all suggestions before recommending these to the appropriate negotiating forums for each employment group. 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 curtailed.

What progress have the Committee made so far?

The PSPA Pensions Committee has met 6 times and to date the following issues have been agreed and actioned:

Timescale - the original aim was to reach a point of agreement by July 2015. It soon became apparent that this date was unrealistic and was moved back to the end of 2015. However, since then a debate took place in Tynwald in July, which extended the timescales for the PSPA Committee to reach conclusions by the end of the year and submit its proposals to Tynwald in February 2016.

Raising of the early retirement age from 55 to 58 - this proposal has been removed for current active and preserved members.

Taxing or changing the commutation rate for lump sums above £200,000- this proposal has been removed for current active and preserved members.

Validation of the actuarial assumptions by an independent actuary - an independent actuary, First Actuarial, was appointed to review the actuarial figures utilised in the Working Group Report. First Actuarial was also asked to provide a view on alternative options for dealing with any issues identified, in order to inform consultation on the situation.

The outcome of the First Actuarial review was that:

- They found that the actuarial figures used in the Working Group report were based on data that was fit for purpose, a sound modelling methodology and reasonable actuarial assumptions which could therefore be relied upon to project future cashflows as used in the Working Group report; and
- First Actuarial were of the opinion that further changes in both contributions and benefits may be required in advance of the 2020 cost sharing review.

Further information can be found in the Technical Sub Committee's joint notice which can be viewed here.

The Committee set up a Technical Sub Committee (sometimes referred to as TAG) comprising of pension experts from the Unions, HR specialist and representatives from the PSPA to look at the detailed and technical pension aspects of the Working Group proposals and to feed back their advice and views to the Committee. More information on their progress so far can be found on page 4.

When can I expect to see any changes introduced?

It will take time to be in a position whereby consultation and, if appropriate, negotiations are completed to the satisfaction of all sides. The Committee are aiming to be in a position to report back to Tynwald by February 2016 on any changes that may be required.

If changes are proposed which then receive Tynwald approval, the PSPA will draft a scheme (or schemes) of amendment and thereafter will formally consult with scheme members, staff representatives and the Treasury as required by legislation.

It would usually take several months to draft necessary legislation and seek guidance from the Attorney General's Chambers. Consultation will not begin until the schemes have been drafted. The PSPA would normally agree a period of consultation, for a minimum period of 3 months, but given the importance of pension scheme changes, this may be longer.

At the same time approval would need to be sought for any required changes to terms and conditions of employment via the various Joint Negotiating Committees which sit within Government.

Following formal consultation, the Public Sector Pensions Authority would:

- review all comments received from consultees;
- publish a document on its website summarising the main points;
- amend the draft Regulations, as necessary before approving and giving them effect;
- lay the Regulations before Tynwald.

The PSPA considers that it would not be in a position to lay any final scheme amendments which may be agreed and consulted upon before Tynwald before the start of the 2016 legislative session of Tynwald i.e. by October 2016.

Why did the Committee decide to drop the two proposals to increase the early retirement age from 55 to 58 and taxing or changing the commutation rates for lump sums?

Based on the feedback received from members, these two proposals caused considerable concern to those who were close to retirement and who would have had little or no time to re-adjust their retirement plans. Added to this, both suggestions would not have had any material impact on the overall future sustainability of the Scheme. Given the above, the Committee, with the approval of the Council of Ministers, decided to drop these proposals.

As the proposal to increase the early retirement age from age 55 to 58 has been dropped, does this mean I can still retire from age 55?

Yes, the proposal has been dropped and will no longer be up for consideration or change for current or preserved members. This means that all current active members and members with preserved benefits can continue to be able to claim their benefits from age 55.

Now that the proposals to raise the early retirement age from age 55 to 58 and the taxing or changing of the commutation rate for lump sums have been dropped, what proposals for change are left to be discussed?

The proposals listed below are still to be considered. However, from the discussions within the TAG alternative options or proposals may be also be up for consideration

- Raising contribution rates for all existing members by 3%;
- Raising contributions for all new members from 5% to 8%;
- Increasing employer contribution rates to 15% from April 2016 and then increasing in stages up to 20%;
- Amending the rate of pension growth rates for new members such that similar benefits will in future only be available at later ages;
- Reviewing the actuarial terms on which retirement before age 60 or 65 is taken for both active members and existing deferred members of former arrangements;
- Amending calculation of final pensionable pay to remove effect of inflation increases for future service and for new members;
- Restricting future annual pension increases to a maximum of 3% for new pensioners, but with an ongoing review where inflation is consistently higher;
- Formulating a detailed cost-sharing mechanism for future scheme sustainability reviews;
- Considering changes that other countries have made to make pensions more sustainable.

The Committee would like to reassure members that at the moment, the above points are still only suggestions for change.

What progress has been made by the Technical Sub Committee (TAG)?

TAG has met regularly since August 2015. The role of TAG is to focus on the reasons why public sector pensions are facing changes and to come up with proposals that could resolve the most significant issues.

TAG's first major task was to look at the output from the two independent reviews carried out by the Government Actuary's Department (GAD) and First Actuarial. The purpose of these reviews was to validate the data and underlying actuarial methodology that drove the conclusions and subsequent suggestions for changes to GUS made in the Working Group report.

TAG completed this work in September 2015 and found that both the Government Actuary's Department and First Actuarial agreed that the data was fit for purpose. It also concluded that sound and reasonable actuarial modelling and assumptions had been used which could be relied upon to project future cashflows.

Once TAG had reported back to the Committee that it was content that the assumptions made by the Scheme Actuary were reasonable, it turned its attention to looking at the detailed pension aspects of the suggested changes.

At the time of writing, TAG has had positive discussions about issues such as cashflow, the value of future benefits and how to share costs between employers and employees.

The outcome of these discussions has led TAG to agree to a method of valuing members' benefits known as a "cost envelope" and looking at how the suggested proposals for change as recommended in the Working Group report can be accommodated within an overall "cost envelope".

What is a "cost envelope"?

A "cost envelope" is a way of defining the overall cost of scheme benefits within which various combinations of benefit and contribution changes are considered.

This method is used for negotiations around public sector pensions in the UK and TAG have agreed that it would be an appropriate method for doing the same in the IOM. You will hear more about the "cost envelope" as discussions progress.

Put simply, a "cost envelope" is the long term value of a range of benefits built up by scheme members each year expressed as a percentage of their pensionable pay.

TAG agreed that a "cost envelope" for GUS would be a good basis upon which future change could be considered. The benefit of having an agreed "cost envelope" is that it establishes from the outset what is the agreed cost of providing future benefits and therefore is a stable basis on which to monitor how future costs may change. By having an agreed "cost envelope" any changes in benefits (for example, those proposed in the Working Group report) can then be considered against the future cost of providing those benefits and various combinations of benefit changes can then be considered within the agreed "cost envelope".

In its discussions, the Technical Sub-Committee are looking at the "cost envelope" for the 7 membership sections of GUS and working up a range of options that they will propose will put GUS on a more financially sustainable footing going forward.

The range of options includes some of the suggestions made in Pensions Working Group "Fairness and Sustainability" report, which included proposals to increase member and employer contributions and changes to future benefits for both existing members and new entrants, now within an overall cost envelope.

In addition to the "cost envelope," TAG will also make suggestions on what changes in benefits would achieve both cost savings within the "cost envelope" and a fair share of the cost between employees and employer/government.

It is important to emphasise that TAG is not negotiating any changes to the Scheme, but will be presenting options for the PSPA Committee to consider.

When will TAG present its "cost envelope" options to the Committee?

TAG is conscious that Tynwald has set a deadline of February 2016 for the PSPA to report with recommendations on the future sustainability of public sector pension schemes in response to its previous resolutions.

Whilst this deadline remains challenging, TAG believes that the work it is doing on GUS is constructive and will hopefully provide the PSPA Committee with the information required to conclude its discussions in the near future when taken with the reform discussions being undertaken by the PSPA on the non-GUS Schemes.

GUS was only introduced in 2012, why are we changing it so soon?

The key reason is its continued affordability and whether it can be sustained in its current form into the future.

To best try and explain why changes are being made so soon after GUS was introduced, it is important to understand what the reasons were for introducing GUS, how GUS is funded and what has happened subsequently that has impacted on its affordability.

Background

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 a statutory authority.

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 in broad terms provided:

- Existing members with the opportunity to protect the value of their benefits and their normal pension age;
- A more generous lump sum;
- 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 on members, the Scheme was introduced in April 2012.

How is GUS funded?

To understand the need for these changes, it is best to start by explaining how GUS is financed. GUS, like most other public sector schemes, 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. The PSPA paid out £71.4m of benefits, 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, which mean that the Scheme is not as sustainable in the long term as was hoped.

What are the reasons why changes are being proposed now?

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

Yet when the Scheme 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. This review was undertaken by the Scheme Actuary, a firm called Hymans Robertson.

Tynwald raised its concerns about the rising costs and liabilities of the scheme and a Working Group was formed to address these concerns. In December 2014 the Working Group, 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 more sustainable scheme.

The reasons that benefit costs are higher than anticipated are explained below.

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 future 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:

- Generous lump sum provisions allow members to take a higher lump sum under GUS;
- The economy hasn't grown as we expected;
- Lower overall salary increases, meaning lower member contributions into GUS;
- Unexpected 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.

As a part of the negotiations, changes were made during the implementation process which were considered as 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 members either did not pay an increased contribution 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 currently being paid which is projected to continue into the future (without agreed change) and level of benefit payments being made to current and expected future pensioners.

Please be assured that all members of the Committee are committed to ensuring the future sustainability of public sector pensions and whilst they fully acknowledge the Council of Ministers' concerns of the cost of the schemes to the Manx taxpayer, they also know that the expectation of a pension from GUS forms a significant and very precious part of your overall reward package and they are working in partnership to ensure that future sustainability is achieved and agree an outcome that is equitable to all parties.

But why is the funding situation of GUS my problem?

The Committee fully acknowledge that the funding of the pension schemes is a problem for the Isle of Man Government and not just the scheme members. However, it the Committee understands that if GUS is to continue, members and their employers will need to consider paying a fairer share of the cost of the pension they are building up than they do at the moment.

In its current form, GUS gives members a very good pension at a much cheaper cost than any other UK public sector scheme and with the proposed changes to contributions and future benefit provision will still be a good scheme to be in.

How can we trust the Government to pay us the pension we expect when we retire?

Overarching pension legislation prohibits pension schemes from worsening members' accrued rights. Accrued rights are the rights related to service already completed to which a member is entitled under an occupational pension scheme. It is most unlikely that legislation could retrospectively be changed to allow pensions already in payment or benefits accrued to date to be reduced or stopped. The proposals put forward by the Working Group were intended to make our schemes more sustainable going forward many years into the future without reducing accrued rights.

What should I consider doing now?

Please don't make any rash decision to leave the Scheme.

Any changes which might result from eventual negotiations would, before they are implemented, be subject to full consultation by the PSPA and as stated above, are not likely to be introduced until well into 2016 nor will they affect the rights you have already built up.

Therefore, if you are worried about how any potential changes may impact on your retirement plans or what you may be required to contribute from your pay, there will be plenty of time for you to await the outcome of the consultation and if necessary negotiations with staff representatives and to see any documents which would then need to be drafted and fully consulted upon before deciding what the impact on you would be.

If contributions do go up before 2020, will it be in stages like it was when GUS was introduced in 2012?

It has yet to be considered and decided, but the Committee would look at ways, such as transitional increases, that would help to minimise the impact of any contribution increase to Scheme members.

Isn't it true that in a recent survey by Prospect 500 members said that they would leave the scheme if the proposals were voted through, further exacerbating future funding issues?

The PSPA has not seen the results of that survey. However, the PSPA would question what alternative provision you would make for your retirement if you were not a member of a public service scheme? With state pension age set to rise, you may need to work longer before you could claim state pension and your public sector pension would be lower because you had left a scheme at an early age. You could pay into a private pension scheme but that is likely to give you lower overall benefits unless you personally pay significantly higher contributions than you are already, and at a higher rate than those proposed in the Working Group report.

You should also note that you would lose the benefit of the life assurance cover on death whilst in service if you opted to leave the Scheme. The cost of establishing such personal cover for yourself could be considerable.

I opted to "protect" under GUS. What does that mean now?

The same as it did when GUS was introduced. Nothing has changed in respect of the Protection option. Protection was a one-off option for existing members of the schemes that transferred into GUS for members in service prior to 1st April 2012. Anyone who joined (GUS) on or after that date (apart from firefighters) joined the Standard section.

As a reminder, the Protected section of the Government Unified Scheme (GUS) was designed to provide members with broadly the same pension and any automatic lump sum that their previous scheme provided at its Normal Pension Age i.e. generally 60 or 65 for most members. Protection did not cover the option of retiring early (i.e. before 60 or 65) and taking a lower pension. Those who didn't opt to Protect joined the Standard section of GUS and paid lower contribution rates (currently 5%). However, those who chose Standard would have to work longer to get the same pension that they expected to get at their previous scheme's Normal Pension Age.

The Protected section therefore protected the growth rate of the previous scheme's pension and any automatic lump sum that would otherwise have been received at your old scheme's Normal Pension Age of 60 or 65.

Those members who choose to join a Protected section paid a higher contribution rate to secure the higher benefits of their former arrangements. This would still be the case if the proposed Working Group changes were eventually introduced.

Is my higher "Protected Section" contribution paying towards lowering the funding gap?

No, the contribution you pay toward your pension benefit does not meet the full cost of your pension. The majority of the cost is met jointly by employers and general revenue.

The true cost of providing pension benefit is currently valued at 28.6% of pensionable pay, and on average members in GUS pay 6.4%. Currently, the lowest contribution rate for protected members is 6.6% rising up to 11% - with the higher rate securing a higher pension at an earlier retirement age.

What is Cost Sharing?

Cost sharing is the mechanism for sharing any change in the future cost of providing benefits between employers (government) and employees. Rule 83 of the Unified Scheme sets out that 25% of and future change in costs will been borne by the employer with the remaining 75% being borne by the employee. Under a cost sharing arrangement, the part of any future cost variation borne by Scheme members will be applied through either an adjustment to the member contribution rate or by adjusting benefits (or if circumstances require, both).

Please note that cost sharing isn't a way of assessing the adequacy of the overall level of contributions into the Unified Scheme to remove the overall deficit. It is a mechanism to address the change in pension costs between two agreed dates - which is usually between each Actuarial valuation of the Scheme.

So what happens next?

The Committee will continue with its discussions and aim to reach a conclusion over the next few months.

Once a conclusion for any changes has been reached, the Committee are required to report back to Tynwald in February 2016 whereupon any approval will then be sought to proceed with any proposals for change, and then it is likely that your staff representatives will consult with you on the proposals.

It is important to make clear that any proposals to change the Scheme, that are made by the Committee, will still be subject to full consultation and negotiation, with recognised trade unions and staff representative bodies, through the established collective bargaining mechanisms.

Remember, the Committee consists of PSPA officers, trade union and staff representatives and representatives of employers and in some cases, Treasury, and if you have any questions or concerns you can raise them with the PSPA or with your staff representative.

Where can I find out more?

The Committee has set up a Communications Sub-Committee, who will be responsible for making sure that members are kept up-to-date with the progress of the various Committees by way of member notices.

In addition to that, there will be 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.

Also, you can email your concerns, feedback or ask a question to the Pensions Committee at Feedback.PSPA@gov.im

Issued by the Communications Sub-Committee of the PSPA Pensions Committee

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