GD No. 2014/0079

Public Sector Pensions Joint Working Group

"Public Sector Pensions – fairness and sustainability."

Report to Tynwald – December 2014

REPORT OF THE PUBLIC SECTOR PENSIONS JOINT WORKING GROUP

DECEMBER 2014

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To the Hon Clare Christian MLC, President of Tynwald, and the Hon Council and Keys in Tynwald assembled

Introduction

At the January 2014 sitting of Tynwald, an amendment to the motion under item 39 on the Order Paper by the Hon Member for Middle, Mr Quayle MHK, read:

> *"That Tynwald views with concern the continued rising cost and liabilities associated with public sector pensions including Tynwald Members' pensions, and calls upon the Public Sector Pensions Authority:*
>
> *(a) to undertake a full and comprehensive valuation of the Government Unified Scheme, Tynwald Members' pension schemes and relevant pension schemes as applicable; and*
>
> *(b) with the Pensions Working Group to report to Tynwald by December 2014 on the feasibility of implementing further cost sharing and other measures to reduce the long term liability in order to provide for a sustainable and fair pension scheme."*

At the May 2014 sitting of Tynwald, an amendment to the motion under item 24 on the Order Paper, by the Minister for Policy and Reform, read:

> *"That Tynwald is of the opinion that in preparing its report for the December 2014 sitting of Tynwald the Pensions Working Group should give full consideration to the report laid before October 2013 Tynwald by the Public Sector Pensions Authority and recommends that the Council of Ministers should only draw up appropriate legislation to enable certain actions to be enforced that will assist in providing a stable financial platform for the future once options arising from the Pensions Working Group Report have been fully considered and the implications of those options have been fully evaluated."*

The Public Sector Pensions Joint Working Group ("the Pensions Working Group") was established with the remit of responding to the above motions via a report for December 2014 Tynwald. The Group comprises:

Members: Hon C R Robertshaw MHK (Chair); Hon R A Ronan, MHK; Mr R P Braidwood MLC;

Officers: Jon Callister (Executive Director) and Carl Hawker (Director of Policy/Economic Adviser), Cabinet Office; Ian Murray, Chief Executive, Public Sector Pensions Authority (PSPA).

The purpose of this report, submitted via the Public Sector Pensions Authority, is for the Public Sector Pensions Joint Working Group ("the Working Group") to update Members with regard to work on the above two motions and to make recommendations for further fairness and sustainability changes. These issues will be covered as follows:

Section 1: Feedback on the actuarial valuations undertaken by the PSPA in respect of the major Isle of Man public sector pension schemes for which it has management responsibility, and will also include the Tynwald Members Pensions Scheme, which is not managed by the PSPA but is administered by it;

Section 2: The feasibility of introducing further cost sharing measures to schemes;

Section 3: The feasibility of introducing other measures to schemes to reduce the long term liabilities and to provide for sustainable and fair public service pension schemes, split as follows:

- Government Unified Scheme (GUS);
- Police, Teachers and Judicial Schemes;
- Tynwald Members Scheme.

Section 4: consideration of the report laid before October 2013 Tynwald by the Public Sector Pensions Authority and impact on the Pensions Working Group's deliberations;

Section 5: Conclusions

Executive Summary

Actuarial Valuation Feedback (Section 1)

- The liabilities of all schemes managed and administered by the PSPA as at 31 March 2013 are around £2.063bn;
- The future service costs of providing benefits for all schemes is 28.8% of pensionable pay (excluding the accrued liability for benefits earned to date);
- Currently, employees pay an average of 6.4% of pensionable pay and employers pay an average of 6% of pensionable pay across all schemes. Current total annual contributions across all schemes are circa £32 million;
- The Public Sector Employees Pensions Reserve Fund is currently expected to be fully utilised by 2025 based on current benefit and contribution estimates;
- Given the actuarial work undertaken, there is a projected long term gap between income (contributions) and expenditure (benefit payments) levelling out at around 23% of pay. This long term gap indicates that further sustainability changes are required to all public sector pension schemes.

The feasibility of introducing further cost sharing measures to schemes (Section 2)

- A detailed mechanism for measuring future increases in costs and apportioning these between employees and employers is recommended and this basis is outlined in section 2 of the report.

The feasibility of introducing other measures to schemes to reduce the long term liabilities and to provide for sustainable and fair public service pension schemes (Section 3)

a) Government Unified Scheme (GUS)

Future new members of GUS

- Move the current accrual rates upwards by five years such that the present level of benefits achieved at current ages would not be achieved in the future until 5 years later;
- Increase the rate of employee pension contributions from 5% of pay to 8% of pay. This should raise an estimated £400,000 in the first year, rising to an estimated £4 million per annum in year ten given an average turnover of public servants.

Current members of GUS

- A recommended increase in contributions of 3% of pensionable pay across all sections and members to improve the cash flow position. This does not arise as a result of a cost sharing valuation having been undertaken, but arises in order to improve the cash flow position of the Scheme given the funding shortfall of 23% shown by the actuarial work. If the increase is phased-in over three years, this should raise an estimated additional £8.4 million once phased in, based on the current GUS membership;
- Amend the definition of Final Pensionable Pay to exclude inflationary increases from the calculation before averaging, such that the definition going forward will now be: the average of the best three consecutive years pensionable pay figures in the last thirteen years before retirement or leaving. This should also be applied to future new

members of GUS. On average, this should reduce the final pensionable pay figure by between 4-6% over time and should end the position whereby the Final Pensionable Pay calculated is often higher than a member's current Pensionable Pay;

- Raise the minimum age of retirement from 55 to 58 with immediate effect, with progressive future increases as longevity improvements continue. This should also be applied to future new members of GUS;
- Review the actuarial terms on which retirement before 60 or 65 (depending upon the former schemes' normal pension age) is taken to ensure that the pension growth rates (for current members) and actuarial reductions (for deferred members) on earlier retirement are truly reflective of both members options (e.g. taking the lump sum in most cases) and anticipated longevity;
- Changes to the contributions or benefits for current members of GUS should only be introduced via due process, which is via consultation by the PSPA with affected members and their representatives (along with Employers and Treasury) in line with the Public Sector Pensions Act 2011 and for a three month period and, where required, negotiation of the changes;
- The Working Group does not recommend capping of the lump sum on retirement but instead, recommends consideration of two options in respect of the payment of large lump sums:

  Firstly: that Treasury considers whether any member who is able under Scheme rules (and so chooses) to take a lump sum in excess of £200,000 should pay tax at their highest marginal rate on the excess above £200,000. It is expected that this will in practice affect only a limited number of retirees (less than 3% of overall pension scheme memberships);

  Secondly: that the commutation rate i.e. the amount of pension given up in return for taking a lump sum, is amended from the current 18:1 to 12:1 in respect of that part of any lump sum over and above £200,000. The current commutation rate for most UK public sector schemes is 12:1 and therefore for those members choosing to take a large lump sum, members will need to give up pension in return for taking the lump sum on the excess over £200,000 at the same rate as in the UK.

Previous leavers from GUS ("Deferred members")

- Raise the minimum retirement age from 55 to 58 with progressive future increases and review the actuarial terms on which early retirement benefits are taken;
- Consider changes to large lump sums payable on retirement in the same manner as for current members of GUS.

Future Pensioners under GUS

- Restrict annual pension increases to the level of UK CPI inflation subject to a maximum 3% per annum, for future service for existing members and also for any new members once members retire, but not for existing deferred members;
- In times of inflation above 3%, measured over three consecutive years, it is recommended that Treasury is required to review the level of pension increases with a view to making additional increases over and above the 3% level depending upon what is affordable at the time.

Employer pension contributions

- In the short term, all employers should pay a 15% of pensionable pay contribution into GUS for both current and future employees. Based on current Scheme memberships, this should improve visible cash flow into all schemes by around £27 million per annum;
- The longer term aim should be to fund benefits at a level of 20% of contributions. Based on current Scheme memberships, this should improve cash flow into schemes by a further £13 million per annum;
- The 15% contribution (followed by an increase to the 20% employer contribution) is introduced across the non-GUS schemes for Police, Teachers, the Judiciary and Tynwald Members;
- A system of monitoring the future utilisation of the Pensions Reserve on an annual basis is set up between Treasury and the PSPA.

Transfers from all Schemes

- Progress with the legislation to restrict the future payment of transfer values from all schemes to "inappropriate" personal pension or defined contribution arrangements via an amendment of the regulations to allow PSPA suitable payment discretion;
- Payments in respect of pension sharing on divorce and to UK based public sector and to most occupational pension schemes for individuals moving employment will still be allowed.

Effect on future contributions of a continued reduction in the size of Government

- This will lead to the bigger short term funding gap of the order of 2% of pay if Government staffing levels reduce further. This is based on an assumption by the actuary that Government staffing and therefore pension scheme membership will diminish by a further 10% over a 5 year period, which may or may not be the actual position;
- The ongoing position in relation to this assumption should be monitored and if it does appear that pension scheme membership is diminishing as projected, then provision to introduce the additional 2% of pensionable pay contribution, shared between employees and employers, should be made.

b) Police, Teachers and Judicial Schemes

- The reforms recommended for GUS around higher contributions, raising the minimum age of retirement, reviewing early retirement provisions, consideration of changes to large lump sums payable on retirement, restricting transfers and capping pension increases for future service and for new members should be replicated for police, teachers and the judiciary;
- This could be achieved by allowing police, teachers and the judiciary to remain in their current schemes but only if the direct link to the equivalent UK scheme reforms are not replicated in the future and therefore simplified versions of the UK reforms or alternative sustainability changes are agreed;
- These simplified versions of reform should achieve future cost savings but would not necessarily reflect a move to a CARE basis nor ultimately an absolute requirement for later working;
- Discussions should commence with these groups shortly in order to have in place suitably agreed reforms by April 2016.

c) Tynwald Members Scheme

- A lower benefit is recommended for first time Members from October 2016 of 2% (1/50th) benefit for each year of service;
- A reduction in the dependant's pension on death from 75% to 50% of the member's pension;
- Benefits should be taken from a later minimum age of 55 (rising to 58 in line with the suggested changes to GUS) rather than the current age 50;
- With regard to protecting existing Members who are re-elected in October 2016, a reduction in benefits should be introduced for future service post October 2016 in line with new Members whilst pre-October 2016 benefits are retained on the current basis;
- As an alternative, Members should be given the option of retaining their current benefits for future service on the basis that they pay a higher level of "Protected" contributions for the greater benefits;
- Pension contributions should be increased to 10% of pay for newly elected Members after 2016 and for those existing Members who are re-elected in 2016 and who opt for the reduced basis of benefits going forward. Contributions should be increased to 15% of pay for existing Members who are re-elected and who opt for "Protection" of future service benefits on the same current basis;
- The principle of cost sharing should be extended to the Scheme;
- The Scheme should be established on a statutory basis and should come under the management of the PSPA for future governance purposes via a switch of Members to a new section of GUS. This will mean, amongst other factors, that Members should benefit from the tax reliefs available to other statutory schemes in respect of tax relief on contributions and lump sums on retirement;
- Members will also have the option (in line with other GUS members) of joining the GUS Standard basis for future service where they will pay a lower contribution in return for the Standard level of GUS benefits.

Consideration of the report laid before October 2013 Tynwald by the PSPA (Section 4)

Proposals for implementing a detailed cost sharing mechanism for GUS

- The cost sharing recommendation in the report is endorsed by the Working Group and should be introduced across all schemes, including that for Tynwald Members.

Other areas, including Members pensions, where cost sharing could be applied

- Recommendations in the report around capping future pensions increases, lower future accrual rates or higher actuarial reductions for early retirement have already been considered and accepted by the Working Group;
- Introducing a link between the amount of future pension and longevity is discounted at this point in time by the Working Group but could be considered at a future date.

Measures brought in by other countries to rebalance pension liabilities

- The Working Group considers that changes made by some jurisdictions around applying a longevity or sustainability measure and moving to some sort of defined contribution basis (actual or notional) are in most circumstances too expensive and

complex to implement and administer in relation to the potential cost savings to be achieved;

- However, an element of future adjustment to pensions at the point of retirement in line with a pre-determined longevity measure could be introduced at some point in the future and the Working Group recommends that this is investigated further by the PSPA to establish if and how this could work.

Measures brought in Eire

- The Working Group does not endorse a reduction in pensions in payment, which potentially would be challenged through the Courts if introduced in the Isle of Man;
- Some of the other changes made in Eire around later working, raising the minimum age of retirement and changes to the level of future pension increases are supported elsewhere in this report;
- The future integration of state and public service pensions could be considered further at a later date as part of an additional piece of work connecting the review of state pension and benefit provisions currently being undertaken separately to this report.

Conclusions

The recommended changes should:

- Reduce the long term "funding gap" between income and expenditure from around 23% of pay to around 6% of pay across all schemes;
- Act to further reduce liabilities in respect of new members and for non-GUS schemes where changes have still to be introduced;
- Prolong the life of the Pensions Reserve Fund for at least the next 20 years (based on current estimates, depending upon when and how the Fund is utilised) and potentially beyond 20 years if a smaller proportion of the Fund is used to meet future shortfalls;
- Improve the short term cash flow position of schemes;
- Introduce risk control measures to limit the effects of future inflation on final pensionable pay and on pension increases;
- Raise the minimum age of early retirement to account for improvements in longevity;
- Introduce a cost sharing mechanism across all schemes to monitor and act upon future cost increases;
- Introduce more transparent pension accounting via a visible employer pension contribution for current and new employees so that pension costs are fully accounted for.

1. Actuarial valuation feedback.

1. The results of the actuarial valuations undertaken for the major public sector pension schemes managed by the Public Sector Pensions Authority (PSPA), and for the Tynwald Members Pension Scheme ("the Tynwald Scheme") as at 31 March 2013 are shown in the report prepared by the PSPA's appointed actuaries, Hymans Robertson LLP, entitled "Isle of Man Public Sector Pensions Authority 2013 Actuarial Valuation Report" and attached at **Appendix 1**.
2. The report is structured as follows:
   - Section 3: (page 3) assumptions and funding method;
   - Section 4: (page 8) results. The results are split into two parts:
     - The past service liabilities (i.e. the value of the benefits earned up to 31 March 2013 for active, deferred and pensioner members projected for future salary growth) split between each of the major schemes using the actuarial assumptions and funding method described in Section 3. The overall past service liability position for all schemes administered by the PSPA as at 31 March 2013 was as follows:

	31 March 2013 (£000)
Past Service liabilities	
Employees	1,131,859
Deferred Pensioners	141,530
Pensioners	789,951
Total liabilities	**2,063,340**

     - The future service cost of accruing benefits (i.e. the percentage of pensionable pay costs of providing future benefits) again split between each of the major schemes using the actuarial assumptions and funding method described in section 3. These costs ignore the fact that the past service benefits remain unfunded and are therefore the costs reflect only those of providing future benefits. The total future service contribution rate for all schemes administered by the PSPA as at 31 March 2013 was as follows:

Valuation date	**31 March 2013**
Employer Future Service Contribution Rate	22.4%
Employee Future Service Contribution Rate	6.4%
Total Future Service Contribution Rate	**28.8%**

- The Employee Future Service Contribution Rate is an average across all schemes as at 31 March 2013 (contribution rates are different in each scheme and for GUS, within each section, as can be seen in the scheme break down on page 10 of the report). The Employer Future Service Contribution Rate is the overall employer contribution which would be required to fund the average future benefits from all schemes, this being the difference between the Total Future Service Rate and the Employee Contribution Rate. The actual rates of employer contribution vary between employers from zero to 22.1%, with the average across all employers and schemes being around 6%. The Total Future Service Contribution Rate is lower when compared with the results produced in 2012 for the purposes of preparing actuarial statements for the pension scheme accounts due primarily to the change in financial assumptions (which are on page 11 of the report) as outlined in Section 3 of the report.
- The split of the Future Service Contribution Rate as at 31 March 2013 between each of the individual schemes (page 10 of the report) is as follows:

	GUS	**Police**	**Teachers**	**Judicial**	**Man. Workers No. 1**	**Tynwald Members**
Future service contribution rate:						
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%**

- Section 5: (page 12) risk assessment, which shows the effect on the results if some of the key assumptions are varied e.g. inflation and longevity risks.

- The breakdown of liabilities and future service contribution rates for the Tynwald Members Scheme can be seen in the detailed breakdowns in section 4. of the report.

3. The PSPA and the Working Group also asked Hymans Robertson to establish whether the reforms introduced by GUS in April 2012 had worked as expected and what the effect on future cash flows and in particular, the Pensions Reserve might be. Broadly, GUS successfully introduced:
    - Lower future benefits for new members post April 2012;
    - Higher member contributions e.g. civil servants transitioned from 1.5% to 7.75% over 7 years;
    - A "protection option" whereby members could choose to protect the rate of accrual and pension age under their previous scheme for a higher rate of contribution when compared with the Standard section of GUS;
    - A higher lump sum option with a corresponding lower ongoing pension;
    - Averaging of final pensionable pay over the last 13 years rather than having benefits based upon pay in the last 3 years;
    - Revised ill-health pension with a more stringent test;
    - New proposed cost sharing mechanism from 2020;
    - Concessions for the lower paid and those within 7 years of their current scheme's normal pension age.
4. Undoubtedly, the major success of GUS was to combine effectively fifteen previous and diverse schemes into one new scheme, to rationalise and simplify the administration, to break the pensions link with the UK and to therefore establish local control of the majority of public sector pensions now and for the future. This was achieved in a cooperative manner with the trade unions and without the industrial unrest seen in the UK around pensions change. This success should not be underestimated and to date, is far more than the UK has achieved in rationalising its public sector pensions.
5. From discussions undertaken with Hymans Robertson, whilst GUS undoubtedly provides lower benefits for new members and has improved pensions sustainability, some of the other anticipated savings from GUS have not been realised in certain areas as expected when it was designed six years ago, for the following reasons:
    - Lower than anticipated growth in the economy and therefore in expected pension contributions;
    - The new member contribution rate of 5%, in the light of subsequent evidence for typical final salary schemes, was pitched too low;
    - More members with secondary pensionable employments than anticipated thus giving rise to higher than expected overall pension liabilities;
    - More members taking up the protection option than anticipated. 85% of members opted to protect whereas it was assumed at the outset based on feedback from trade unions and members that only 50% would protect. This has led to payment of much higher benefits in the long term and contribution rates should probably have been set at a higher level to acknowledge this, had this been known at the time;

- GUS was designed to encourage later working but the majority of members have in fact chosen to retire at earlier ages. This is predominantly due to the shrinkage in the public service and the success of voluntary retirement and redundancy schemes which have encouraged employees to retire early, rather than any deficiency in GUS. Furthermore, it is expected that younger members will work to and retire at a later age, as this becomes the expectation. However, for those who have retired since 2012, one might have expected that historic financial plans were already in place to enable them to retire at their previous normal pension age, which for most was age 60. Overall, this has led to significant increased expenditure in the last two years which is anticipated to continue into the near future and therefore has an immediately adverse effect on cash flows, which was not known when GUS was designed;
- GUS could be regarded as being too generous to those within 7 years of current normal pension age, requiring them to pay contributions of no more than 5%, or their current contribution rate if no higher than the Protected rate of contribution. These concessions led to around 30% of the scheme members enjoying this additional protection and therefore lower ongoing rates of contribution than originally anticipated.

6. It should however be born in mind that GUS could not have been introduced unilaterally for existing employees as membership of their then pension schemes were written into the terms and conditions of many employment groups. Therefore, the introduction of GUS was via a process of consultation and where necessary, negotiation through various Joint Negotiating Committees during which concessions had to be granted in order to win agreement. The Working Group would reiterate that the big success that GUS achieved was to break the link with UK public service schemes in terms and conditions to and to bring future control of such schemes into the Island. It also introduced other significant changes such as higher contribution rates for the majority of public servants and lower benefits for new members all of which have helped towards sustainability.
7. However, when considering all of the issues raised above, along with the fact that schemes for Police, Teachers, the Judiciary and Tynwald Members have not had sustainable benefit changes applied yet in the same way as GUS, the cash flow graph prepared by Hymans Robertson in **Appendix 2**, across all public sector pension schemes administered by the PSPA broadly indicates that the level of contributions does not rise sufficiently fast enough to support the expected future benefit outgo in the long term (even on the basis that GUS will provide lower future benefits). The "green" portion of the bars show the benefits which are expected to be covered by the ongoing rate of current contributions, whilst the "red" portion is the "unfunded" benefit in excess of contributions.
8. This position will lead to an ongoing "funding gap", that is the additional pension contributions required to fund the gap between expected contributions and expenditure, which will widen considerably over time. In order to measure of the shortfall, it can be expressed as a long term percentage of pay, which is expected to flatten out at around 23% of pay in the long term. This is shown in Appendix 3. It should be noted that contribution income under GUS was never expected to rise to such a level that it exactly matched benefit outgo, hence the existence of the Public Sector Employees Pension Reserve Fund ("the Pensions Reserve") which was expected to be used on an ongoing basis to meet any shortfall between pensions income and expenditure, albeit that

   contribution increases and future lower benefits were designed to prolong the life of the Pensions Reserve.

9. The effect of the revised cash flow projections on the Pensions Reserve can be seen in the graph in **Appendix 4** prepared by Hymns Robertson. Various scenarios are shown in the graph of 100%, 30% and 15% of any shortfall between income (contributions) and expenditure (benefit payments) being taken from the Pensions Reserve. If 100% of any shortfall is taken from the Pensions Reserve, then based on current projections, the fund would be fully utilised by around 2020. The dotted green line entitled "Projected Affordability" is the original affordability measure adjusted for current cash flows and contributions, assuming 50% of any shortfall between income and expenditure is taken from the fund, which is broadly the current position. On this projection, the fund is expected to be fully utilised by around 2025.
10. The position is likely to worsen in the short term if the numbers of public servants continues to diminish as Government reduces in size and contribution income reduces, although the exact impact will to some extent be dependent upon the interaction between all of the possible variables (salary, inflation, interest rates, gilt yields, benefit build up etc.) and the rate of change in staffing numbers in comparison. Although future benefits will be correspondingly lower in the long term due to both the GUS changes and fewer scheme members, because current benefit expenditure is predominantly based on the historical position i.e. benefits accrued to date, which cannot be retrospectively reduced unless by agreement of each member [Public Sector Pensions Act 2011, Clause 7. (4) (b) and (c)], then reducing future benefits further when tied in with lower levels of ongoing contributions will have a limited impact upon current cash flow and the utilisation of the Pensions Reserve.
11. The above scenarios therefore indicate that further sustainability changes in a number of areas across both benefits and contributions are required at an early stage to all public sector schemes and the Working Group's recommendations for change therefore follow.

2. The feasibility of introducing further cost sharing measures to schemes.

1. Cost sharing would normally only apply to active members as changes in costs, which are assessed at regular intervals via actuarial reviews, are reflected in changes to the contributions rate of current and future members.
2. It is difficult to involve other categories of member (e.g. previous leavers with deferred members and pensioners) in cost sharing arrangements as they are no longer contributing to the scheme and therefore the normal mechanism by which costs are shared (increased contributions) does not apply to them.
3. Other alternatives for these groups are therefore considered in section 3. of this report.

Background

4. The Government Unified Scheme 2011 (GUS) introduced the broad principles of a cost sharing mechanism in Rule 83. Broadly, cost sharing is the mechanism for sharing any **change** in the **future** cost of providing benefits between employers (government) and scheme members. Cost sharing is not therefore an assessment of future cash flow requirements. Historically, any increases in pension costs tend to have been borne by the employer/government in the Isle of Man. Under a cost sharing arrangement, part of any future cost variation is shared with the Scheme members by adjusting the member contribution rate. This is the means by which the sustainability of GUS is addressed going forward.
5. It is important to note that cost sharing does not mean assessing the present adequacy of the overall level of contributions into GUS nor does it necessarily mean reviewing the benefits to be provided with a view to removing any actuarially calculated deficit. What the cost sharing mechanism will however indicate on an ongoing basis is whether the cost of providing benefits when measured between two points in time continues to rise, which might then trigger, and to a certain extent inform, a wider review of GUS, its benefits and contributions.
6. Cost sharing therefore only measures how costs are changing from the present starting point and not from where we might think that starting point should be, which is considered in the following sections of this report. By way of a broad example, if the current cost of funding future service benefits for all schemes is 28.8% of pay (as shown in Section 1 of this report) and under a cost sharing review, the cost increases to 32.8%, then the cost increase is 4% which is the amount which would then be shared amongst scheme members and employers.
7. Negotiations around the implementation of GUS brought about a concession from the Council of Ministers that the formal cost sharing mechanism as defined in the Rules would not impact upon GUS members until 2020.
8. The GUS rules approved by Tynwald in June 2011 set out the broad principles under which cost sharing will operate. In simple terms, the rules:
    - State that the Scheme Actuary must produce a regular actuarial report on the liabilities and potential income of the Scheme (Rule 84);
    - State that whenever a cost sharing review is triggered the Scheme Actuary must (if applicable) set out a "Cost Change Amount" (rule 83.2 (iii));

- State that the PSPA (after actuarial and Treasury input) determines which part of this Cost Change Amount is to be shared between members and employers (rule 83.3);
- Notes that the PSPA can only change the level of contributions and not benefits as a result of a cost sharing review;
- States that any shared costs will be split in the proportion 75% to the employee (i.e. the scheme member) and 25% to the employer (rule 83.5).

Current position

9. The PSPA has been reviewing the detailed basis for cost sharing which will be required to be incorporated into the GUS rules. The PSPA has taken actuarial advice on how a detailed cost sharing mechanism should work and, bearing in mind the decisions already agreed as part of the implementation of GUS, had determined the following basis (described below) of a cost sharing proposal.
10. As part of the detailed design of GUS prior to its implementation, the Council of Ministers approved certain elements of the cost sharing mechanism as part of its overall agreement to implement the GUS scheme design plan. These elements were as follows:
    - Changes in costs would be reflected primarily in changed contribution rates for members (rather than in benefit changes) and therefore only current employees would be affected by the cost sharing mechanism;
    - Measurement would be against the underlying cost of benefits (not cash contributions);
    - Broadly, it was considered that the measurement of factors impacting on cost sharing should be as objective as possible and, with the exception of the mortality assumption, should be capable of being influenced in the future by government. The following factors were therefore included in the cost sharing mechanism: mortality assumption changes (due to observed experience rather than assumed), pay increases, benefit changes and other demographic experience and member options;
    - How quickly to deal with measured variations – "early action" was preferred such that matters did not get out of hand and therefore sustainability was maintained.
11. It was also agreed that the need for judgement and subjectivity in the cost sharing mechanism should be minimised as far as possible and that the mechanism should be objective and evidence based. Additionally, the same principles and methodology should be applied to all employees and sub-groups of employees with the same benefits to ensure equality of treatment.

Detailed cost sharing proposal put forward by the PSPA.

12. Since the implementation of the Unified Scheme and the establishment of the PSPA, work on the detail of cost sharing has been progressed by the Authority, which now holds responsibility for the administration and management of the majority public sector schemes in the Island. The conclusions of this work are set out below.
13. The previous decisions made by Council of Ministers and noted in paragraph 10. above were ratified by the PSPA.
14. Measurement of service: that the costs associated with benefits relating to both future service (after the inception of GUS on 1 April 2012) and past service from previous schemes converted and transferred into GUS will be tracked going forward. There was some discussion within the PSPA as to whether only pensionable service since the

inception of GUS should be costed. However, it was agreed that the mechanism would be a more effective "pressure release valve" for GUS if all service was measured, which will help with future sustainability.

15. Mortality issues: in simple terms, the PSPA will need to assess (with the help of its Actuary) how long people are living and the impact of this on the future cost of the Scheme. It was agreed by the PSPA that future improvements in mortality since the inception of GUS would be measured which will also act to make the cost sharing mechanism more effective.
16. Sharing of costs: the split of any shared future cost increases will be 75% to members and 25% to employers/government. This is a fundamental decision previously agreed by Council of Ministers and the unions of affected members and is already contained within the GUS rules approved by Tynwald.
17. Valuation period: a cost sharing valuation will be carried out every three years (subject to suitable funding being agreed with Treasury) in order to track the progress of GUS against the cost sharing mechanism. Although the Council of Ministers agreed a concession that the cost sharing mechanism would have no impact on active members until 2020, monitoring of the position every three years will lead to early understanding of the cost sharing position.
18. Rate of change of contributions: any future member contribution changes will be restricted to +1%/-1% per annum where possible, in line with current transitional provisions, unless there is a significant increase in contributions required as a result of future cost sharing valuations whereby a greater annual increase may be required.
19. Early action: in line with a wish to see "early action" in order to maintain sustainability and to ensure that any potential phased change in contributions does not overlap with each subsequent cost sharing valuation, it was noted by the PSPA that a period of three years should be adopted to recover any future required increase in contributions. If a degree of flexibility is required to cope with large impacts, the preferred option might be extended to "a period to be agreed not exceeding five years".
20. Tracking mortality improvements: it was noted that the effect of changing future mortality will be a significant part of the cost sharing mechanism. The amount of work involved in tracking observed mortality rates and setting assumptions for future improvements should not be underestimated. External consultants can assist in this process but there will be a fee associated with this. The Chief Executive of the PSPA has been tasked to take this up with suitable qualified consultants and thereafter Treasury, to establish both the cost and benefits which would result from such monitoring and these discussions are underway.
21. Documentation of the cost sharing mechanism: the detail of the cost sharing mechanism should be documented in the GUS Rules or via alternative legislation. This will mean that the PSPA will consult with affected members and stakeholders on the detail in the legislation once the provisions are drafted and the cost sharing mechanism is therefore in the public domain. Being contained within legislation also means that Tynwald will ultimately decide on the cost sharing mechanism to be adopted.

Other considerations

22. The PSPA noted as part of its deliberations that:
    - There is a fundamental tension between fairness and impact in the design of a cost sharing mechanism.

- Some aspects of the cost sharing mechanism once in place can be considered as part of a possible review of the future Scheme design rather than simply as a contribution increase. For example, if the cost sharing mechanism continues to show ever increasing longevity, then rather than just increasing contributions every three years, other action could be considered instead e.g. reducing future benefits or pegging GUS retirement age to State Pension Age. However, such changes would require changes to the Scheme rules as well as to cost sharing legislation.

Summary

23. Cost sharing is an important part of the future sustainability of GUS. Therefore, the PSPA believes that it is important to get the detail of the mechanism agreed and in place as early as possible, so that Scheme members are made aware of how the mechanism works and the PSPA can begin monitoring the position over time. Similar arrangements are already in place for cost sharing provisions in UK public sector schemes, although with the changes scheduled to many UK schemes from 2015, the detail of the new cost sharing provisions post 2015 are still under review.

Recommendations

24. Having considered the above basis of cost sharing as established by the PSPA and subsequently approved by Treasury and the Council of Ministers, the Working Group accepts the basis outlined as a prudent way of measuring future changes in pension costs and therefore recommends that this basis is adopted and that the PSPA drafts and thereafter consults upon the appropriate legislation to introduce this as the detailed cost sharing mechanism for GUS.
25. Such a basis should thereafter be introduced for other non-GUS schemes for Police, Teachers, the Judiciary and Tynwald Members.

3. The feasibility of introducing other measures to schemes to reduce the long term liabilities and to provide for sustainable and fair public service pension schemes.

Government Unified Scheme (GUS)

1. The Working Group has considered the results of the actuarial valuation of schemes and separate cash flow projections. It is apparent that there are two key issues:
   - The need to contain long term pension liabilities;
   - Cash flow considerations.
2. There are often conflicts when dealing with these issues: what might be regarded as a positive change in one area can have a negative impact on another. For example, restricting the amount of tax free lump sum that members can take on retirement will improve current cash flows but in the long term, will increase pension liabilities: a lower lump sum means a higher pension, potentially payable for a much longer period of time as members continue to live longer.
3. The Working Group has noted the concerns with regard to the growth in public sector pension liabilities. However, it is clear that whatever sustainability changes are made to future benefits, the liability will continue to grow for the following reasons:
   - members continue to accrue/earn more benefits each year as their service in the schemes continues;
   - the effect of wage and price inflation acts to increase benefits each year for both current members, former members who have not yet retired and pensioners;
   - members are now living considerably longer and therefore their pensions in payment are continuing for many more years than could have been expected;
   - the effect of actuarial assumptions on the calculation of the liability: the calculations are sensitive to the assumptions around salary and price inflation, mortality, and in particular, interest rates. Whilst interest rates are low, pension liabilities generally appear higher due to the way that future cash flows are discounted as part of actuarial valuations.

   It was therefore noted that significant falls in pension liabilities should not be expected in the future, even with the introduction of further sustainability measures.
4. Therefore, bearing in mind the various tensions and conflicts within public service pension schemes, the Working Group has determined the following key principles which it has used in order to determine future pension sustainability:
   - That it should consider changes which, as far as possible, act to contain long term liabilities whilst also trying to improve current cash flows;
   - That future benefit reductions or changes alone will not make schemes more sustainable, as these will take many years to work through the system such that members retire on the lower benefits ;
   - That changes should, as far as possible, impact across all groups of pension members in order to achieve a degree of fairness: i.e. current members, previous leavers (deferred members) and pensioners as well as on employers;

- However, once benefits have been determined, as in the case of previous leavers and pensioners, it is very difficult to introduce retrospective changes, which inevitably means that the burden of future change tends to fall on current or expected future new members. However, this should not stop previous leavers and pensioners contributing towards sustainability changes where legally permissible;
- That a smaller future Government workforce should be taken into account in terms of future projections;
- However, as future projections of benefits and contributions are only estimates, whatever changes are determined now, regular actuarial and cost sharing reviews should be undertaken every three years in order to monitor the success or otherwise of changes made and to determine any further refinements that may be required.

Future new members of GUS

5. The Working Group considered a number of possible changes to GUS in respect of future members, including the following:
    - Ceasing to offer membership of GUS to new employees. This was discounted on the basis that as GUS is an unfunded scheme, a flow of new members is required to maintain income into the scheme and therefore any alternative e.g. a switch to a defined contribution basis, would result in an unacceptable cost increase;
    - Similarly, a switch from a "final salary" to a "Career Average Revalued Earnings" (CARE) basis for new members was discounted on the basis that CARE in itself does not lead to sustainability or lower costs, but rather the accrual rate that is applied is what determines the cost effectiveness of a scheme. CARE is likely to lead to cost and benefit increases whilst inflation is higher than wage growth and for employments where there are not significant pay increases and many individuals remain on the same grade. Thus it is believed that a switch to CARE alone would not lead to any cost savings for Isle of Man public service schemes. In any event, GUS is no longer a "final salary" scheme as final pensionable pay is determined by taking a consecutive three year average of pay over a 13 year period rather than just taking pay in the last year of employment. Thus any large increases in pay that may occur are already "averaged out";
    - Encouraging longer working for new members. With the possible introduction of a new Equality Act which will not in the future compel employees to retire at 65 (or at any other age), coupled with significant improvements in longevity, new employees should expect to have to work longer in order to achieve a good level of public service pension. Therefore, the structure of the pension scheme should reflect this to a greater extent than it currently does;
    - An employee pension contribution of 5% is generally regarded as too low in order to achieve a good level of defined benefit, particularly in comparison with private sector pension schemes, many of which are no longer of the defined benefit type;
6. Bearing the above in mind, the Working Group recommend that the following changes should be made to GUS in respect of new members:
    - Move the current accrual rates upwards by five years such that the current level of benefits achieved at age 65 would not in future be achieved until age 70. Thus the current benefit at age 65 of 1.5% of final pensionable pay for each year of service would in future not be available until age 70. If members did wish to

retire at age 65, the benefit would be 1.16% of final pensionable pay (currently the benefit due at age 60) and at age 60, 0.81% of final pensionable pay (currently the benefit due at age 55). Thus new members would be encouraged to work longer in order to achieve a good level of pension. The effects of this will not be seen for many years until this new group of members retires. However, this will act to improve future sustainability by requiring later working in return for higher benefits;

- Increase the rate of employee pension contributions from 5% of pay to 8% of pay. This is likely to raise in the region of £400,000 in year one, compounding each year thereafter as new members replace leavers to an extra £4 million per annum in year ten.

Current members of GUS (also encompassing future new members)

7. As the majority of the cost of GUS is in respect of benefits already earned, which cannot be retrospectively reduced, it was considered by the Working Group that the key factors for more sustainable pensions for current employees was to increase their contributions, control the payment of future benefits linked to inflation and encourage later working.
8. Although members were given a concession that cost sharing measures would not be introduced for them until 2020, given the generous concessions granted when GUS commenced and the experience since, as highlighted earlier in this report, and in particular, the cash flow issues arising on a long term basis, the Working Group consider that current members should be asked to contribute at an increased rate as soon as this can be agreed, outside of the cost sharing basis which will still not come into force until 2020. This should reflect the fact that most members chose to protect their previous pension age and accrual rate and therefore in relation to the new GUS Standard basis of contribution, the rates of protected contributions are too low in return for a very generous continuing benefit. It should however be noted that a higher rate of contribution may not be able to be applied to current members without some degree of negotiation via the various Joint Negotiating Committees around Government whether this is a legal requirement or not.
9. The Working Group believe that retaining a defined benefit basis of pension provision is appropriate for current members and that a switch to a CARE basis is not required in order to improve future sustainability. However, although GUS is now an average salary rather than a final salary scheme, in times of high price inflation compared with low salary growth, the effect of inflationary increases in the calculation of final pensionable pay is having a distorting effect on the calculation, thus in some circumstances leading to final pensionable pay (as used to calculate benefits) which is in fact 4-6% higher than the member’s current pay, which then translates into higher benefits. To counter this, the Working Group believes that the inflationary increases applied to the current final pensionable pay calculation should be reconsidered.
10. Age of retirement: in an era when individuals are living longer and therefore later working is to be encouraged, it is inequitable for current members to be able to take their public service pension at a relatively young age in comparison to private sector employees, who cannot generally retire on the same level of pension and therefore must work longer. For a member choosing to retire at age 55, that member could easily live for another 25 to 30 years and thus their length of retirement becomes comparable with their length of time in work. Therefore, both the minimum age at which retirement is allowed from a public service scheme and the potential reduction in benefits taken early should be reviewed both now and on an ongoing basis in line with future longevity improvements.

11. Lump sums: it is noted that an increasing number of members are taking large lump sums on retirement which are payable free of tax and therefore this position should also be reviewed.
12. Taking the above into consideration, the Working Group therefore recommend that the following changes should be made to GUS in respect of current members:
    - Negotiation where required of an increase in contributions of 3% of pensionable pay, to be phased in via tranches of 1% per annum, over a three year period. This would be applied to all members i.e. both members who opted for Protection, those in the Standard section of GUS and any specially protected members (e.g. those within 7 years of normal pension age, those already at the Protected level of GUS contributions). This is expected to raise an additional £8.4 million per annum after transition (if transitional increases of 1% per annum are utilised) based on the current GUS membership of around 8000 and an average pensionable pay per person of £35,000;
    - Remove the annual inflationary increase within the calculation of final pensionable pay in the future to ensure that the final pensionable pay figure, when applied to a Scheme member's benefit calculations, cannot be higher than a member's current pensionable pay. This change should also be applied in respect of future new members to GUS;
    - Raise the minimum age of retirement from 55 to 58 with immediate effect, with progressive future increases as longevity improvements continue. This should, where possible, be applied across all public service workers, including those with prior special arrangements for early retirement at or before age 50, 55 or 60 (but possibly only for future service) and to both new and current members;
    - Review the actuarial terms on which retirement before age 55, 60 or 65 (depending upon the former scheme's normal pension age) is taken to ensure that the pension growth rates for active members and actuarial reduction factors for deferred members retiring earlier are truly reflective of both members options (e.g. taking the lump sum in most cases) and anticipated longevity;
    - The Working Group does not recommend capping of the lump sum but instead, recommends consideration of two alternative options in respect of large lump sum payments:

      Firstly: that Treasury considers whether any member who is able under Scheme rules (and so chooses) to take a lump sum in excess of £200,000 should pay tax at their highest marginal rate on the excess above £200,000. It is expected that this will in practice affect only a limited number of retirees (less that 3% of overall pension scheme memberships);

      Secondly: that the commutation rate i.e. the amount of pension given up in return for taking a lump sum, is amended from the current 18:1 to 12:1 in respect of that part of any lump sum over and above £200,000. The current commutation rate for most UK public sector schemes is 12:1 and therefore for those members choosing to take a large lump sum, members will need to give up pension in return for taking the lump sum on the excess over £200,000 at the same rate as in the UK.

      Either of these options should be considered for new members of GUS and in respect of all other public sector pension schemes;
    - Changes to the contributions and benefits for current members of GUS should only be introduced via due process, which is via consultation by the PSPA with

affected members and their representatives (along with Employers and Treasury) in line with the Public Sector Pensions Act 2011 and for a three month period and, where required, separate negotiation of any changes.

Previous leavers (“deferred members”)

13. The benefits of those who have already left GUS cannot be recalculated using some of the changes outlined above. However, the following changes can and should also be applied to previous leavers who will retire in the future:
    - Raise the minimum retirement age from 55 to 58 with progressive future increases;
    - Review the actuarial terms on which early retirement benefits are taken;
    - Consideration of changes to large lump sums permitted under the Scheme rules in excess of £200,000 as outlined above.

Pensioners

14. The benefits in payment for current pensioners and their prospective spouse/dependents and also for existing deferred members cannot be retrospectively recalculated or reduced as this would be deemed a worsening of accrued rights.
15. The Working Group does however believe that the rate of increase to pensions in payment, being linked to full UK CPI changes each September, are overly generous in comparison with both public sector pay increases and with private sector scheme pension increases. Pensioners have received significant inflationary increases for a number of years in comparison with low public sector pay rises. It is common in private sector defined benefit schemes for pension increases to be restricted to inflation subject to a maximum 2.5% per annum. As pension increases are based upon the rate of increase in the UK rate of CPI each September, applied in the following April, and as the UK Government’s long term inflationary target for CPI is 2% per annum (which is currently being met), the Working Group believes that an inflationary increase in line with UK CPI subject to a maximum of 3% per annum is not unreasonable for existing members in respect of their future service, and for new members going forward, once they retire.
16. Whilst this change will not achieve an immediate saving when CPI inflation is below 3% per annum and until existing or new members retire, this is a future risk control mechanism which will ensure that, in times of high inflation, pension increase are set at a sustainable level for all future retirements.
17. It is however recommended that, in times of higher inflation over and above 3% measured over a consecutive three year period, Treasury is required to review the level of pension increases with a view to granting additional increases over and above the 3% level in line with what it considers to be affordable at the time.
18. By way of example, based on the current level of public service pensions in payment of around £50 million, a 1% inflationary reduction if applied to current pensions would save around £500,000 per annum.

Employer pension contributions

19. Currently, there is a wide variety of employer contributions into GUS ranging from zero to 22.1%. The average employer contribution across all schemes is around 6% and within GUS, around 4.7%. The Working Group acknowledged that some employing authorities do not contribute towards the cost of providing pension provision for their staff. Pension costs are often met by Central Government and do not come out of the

Departmental budget. The Working Group considered that this represented poor cost accounting.

20. A proposal for applying full cost pension accounting was discussed by the Working Group, whereby all employers would have a separate ring fenced budget for staff costs from which they would pay contributions towards the cost of providing a pension for their employees. This would facilitate wider discussion around the removal of the headcount mechanism and enable resourcing to be based purely on a financial control rather than headcount. Departments would therefore be able to increase staffing resources without the restriction of the headcount, but only if they had the budgetary resources to do so, inclusive of the cost of providing pensions.

21. Based on its deliberations and the costs of funding future service benefits as revealed by the actuarial valuations of schemes, the Working Group recommends that, in the short term, there should be a 15% of pensionable pay contribution into GUS for both current and future employees as a priority. This would significantly improve the cash flow into the scheme by around £27 million per annum and would enable pension costs to be better managed via a combination of cash flow/income with any top up required in years of higher expenditure being met from the Pensions Reserve. The longer term aim should be to fund benefits at a level of 20% of contributions, taking into account the proposed increases to employee contributions highlighted above. The Working Group therefore recommends that Treasury consider moving to a 20% employer contribution phased in via 1% per annum increases over the next five years, or via some other mechanism as agreed with Treasury. This would improve the cash flow into the scheme by around £40 million per annum.

22. Contributions of this order from employers, along with increased contributions from current and new members, would considerably improve the sustainability of GUS and longevity of the Pensions Reserve. The Working Group also recommends that the 15% contribution followed by the increase to 20% employer contribution is introduced across the non-GUS schemes for Police, Teachers, Tynwald Members and the Judiciary.

23. Based on a long term scenario of a 20% level of employer contributions into schemes, it is estimated that this could extend the life of the Pensions Reserve to beyond 20 years and depending upon how much of any future shortfall is funded by the Reserve, that period could be longer. This is one area that Treasury with the help of the PSPA should continue to monitor closely.

Transfers from GUS

24. There is an emerging trend for individuals who retire, in particular, to transfer the value of their public sector pension to a personal pension in their own name rather than taking benefits from a public sector scheme. This is generally seen as a "risky" option as the member would need to invest the transfer value and then live off the emerging income, which is not guaranteed to be at the same level as under the public sector scheme and is determined in the future purely by investment returns and the level of future income drawn down. Few individuals have traditionally chosen this option, preferring instead to have the certainty of future income from a public sector scheme. This option is rarely utilised for leavers from UK public sector schemes, particularly because UK financial advisers regard such transfer advice as not being in the member's best interests, as being unduly risky and therefore generally they will not transact such business.

25. The trend for personal pension transfers in the Isle of Man covers public servants in varied occupations (civil servants, nurses, teachers, bus drivers, manual workers) who are foregoing the certainty of a public sector pension for the risks associated with a transfer to a self-invested personal pension. The Executive of the PSPA has questioned

whether such individuals are financially aware enough to understand the implications of their decisions, but those financial advisers who have advised them assure the PSPA that all relevant advice has been provided and that members have confirmed in writing that they understand the advice before they proceed.

26. Over £4m in transfer values were paid in the last financial year compared with £2m in the previous year. In the first six months of this financial year, £2.8 million of transfer payments are already in the pipeline and in addition, over £600,000 in transfers have already been paid.
27. As the transfer value is based on the value of the individual's pension rather than the amount they have contributed to their scheme, most public sector transfer values are significantly in excess of the contributions paid by the member. Therefore, this has the potential to cause a significant additional strain on Government's pensions expenditure in the future, particularly if more transfers continue to be paid.
28. The PSPA has therefore recommended that payment of transfer values from all public sector schemes to inappropriate defined contribution arrangements should be at its discretion and, with the support of Treasury and the Council of Ministers, proposes that amending legislation to this effect is introduced shortly. This follows changes proposed in the UK from April 2015 to similarly restrict transfers from unfunded public sector schemes to defined contribution arrangements. Transfers to a new employer's pension scheme (either in the UK or elsewhere within the world) or to an overseas scheme where the individual is resident in that country will in principle still be allowed.
29. The Working Group has considered this issue and supports the stance already being taken by the PSPA, Treasury and the Council of Ministers on this matter to restrict the future payment of transfer values from all schemes where the transfer will be to a defined contribution arrangement.

Effect on future contributions of a continued reduction in the size of Government

30. Whilst reforms in the structure of future pension provision as outlined previously will act to contain future costs and the build-up of benefits, one of the key considerations is how Government will continue to downsize going forward in terms of headcount and therefore in relation to pension scheme membership. Significantly lower numbers of future members will mean lower overall contributions to all schemes and lower future benefit outgo. The interaction between headcount, pension scheme membership and future benefit outgo alongside other actuarial variables such as salary growth, inflation, interest rates, gilt yields, longevity etc. will determine the future impact of a reduced Government headcount.
31. Hymans Robertson has estimated that, on the broad assumption that many leavers in the next 5 years will not be replaced, leading to a 10% reduction in overall headcount and therefore pension scheme membership, this will lead to an additional cost of funding benefits of around 2% of pensionable pay. Although the longer term, projected benefit outgo will be lower (as a result of less members), the lower contribution income in the short term (from fewer members) will not be matched by a corresponding short term reduction in benefits (due to the fact that the bulk of the current pension costs are in respect of accrued benefits). This will therefore lead to a bigger short term funding gap of the order of 2% of pay. The ongoing position in relation to this assumption should be monitored and if it does appear that pension scheme membership is diminishing as projected, then provision to introduce the additional 2% of pensionable pay contribution, shared between scheme members and employers, should be made.

Police, Teachers and Judicial Schemes

32. The Island's pension schemes for Police, Teachers and the Judiciary are still linked to the UK in terms of retirement ages, benefits and contributions as historically, employers have chosen to copy the equivalent UK schemes via legislation drafted and applied in the Isle of Man. Local teachers and teaching unions were approached in autumn 2013 by the PSPA about the possibility of them joining GUS but at that time, they expressed a firm preference to remain in a scheme linked to the UK. Although the views of the police have not been sought in a similar manner, it is believed by the PSPA (as part of the PSPA's participation in the Police Joint Consultative Committee) that the police also have a preference to remain in a UK linked scheme. The Judiciary have not been approached yet about possible future changes.

33. The UK is introducing some significant changes to all of its UK public service pension schemes, including those for police, teachers and the judiciary. These involve significant contribution increases phased in over three years between 2012 and 2014 (and already replicated in the Isle of Man schemes for police and teachers) and also, from April 2015, a move from a Final Salary to a Career Average (CARE) basis of future pension provision with full benefits only being available after a period of later working tied into state pension age (or from age 60 for the police). It is known that both the police and teachers are unhappy about these reforms, particularly the police who will now have to work until age 60 as opposed to age 50 or earlier, before they can collect full benefits for future service.

34. From discussions with the PSPA, the Working Group understands that the move from a final salary to a career average basis of pension provision (for future service only) will be:
    - complex to administer, as there will effectively be two separate periods of service which will have to be calculated and then amalgamated on a completely different basis, with further separate protections for members within 13 years of their current normal pension age;
    - costly, with benefit re-programming and testing for the two separate sections of each of the police and teachers schemes (therefore four different schemes will require amendment) likely to cost in excess of £300,000 in administration costs, which is disproportionately high given the small size of each scheme (around 210 active police members and around 1200 teachers);
    - unlikely to achieve the expected level of future cost savings compared with the UK due to the small size of each scheme and the fact that the accrual rates under the CARE basis are higher than the current rates;
    - introducing further complexities due to the extra choices to be given to members around enhancing service or early retirement options which would usually be replicated from the UK schemes.

35. After discussions with the PSPA and bearing in mind the above issues, the Working Group therefore recommend the following for the Police, Teachers and Judicial Schemes:
    - Broadly, the reforms seen for GUS around higher contributions, raising the minimum age of retirement, reviewing the basis of early retirements, consideration of changes to large lump sums on retirement, restricting future transfers and capping pension increases for existing and new members are replicated for police, teachers and the judiciary;

- However, this could be achieved by allowing police, teachers and the judiciary to remain in their current schemes but only if the direct link to the equivalent UK scheme reforms are not replicated in the future and therefore either further simplified versions of the UK reforms, or alternative sustainable reforms, are agreed;
- These simplified versions of reform should achieve future cost savings but would not necessarily reflect a move to a CARE basis, nor ultimately an absolute requirement for the same degree of later working. Therefore, it is believed that this allows a fair deal to be struck in respect of future service which removes some of the issues around the UK reforms for police, teachers and the judiciary, allows them to remain in their current schemes but seeks to achieve demonstrable future savings.
- It is recommended by the Working Group that the PSPA commence discussions with these groups to have in place suitably agreed reforms by April 2016.

Tynwald Members Scheme

36. The Tynwald Members Scheme is established by resolution of Tynwald as a pension arrangement for Members of Tynwald. As it is not a statutory scheme, some provisions of other public sector pension schemes are not available under the scheme e.g. tax relief on contributions, payment of the lump sum on retirement free of tax. However, the actuarial valuation of the scheme undertaken by Hymans Robertson indicates that the scheme is costly in comparison with the future service cost of other public sector schemes because of the significantly higher overall benefits provided by the Scheme in comparison with, for example, GUS.
37. The features of the Tynwald Scheme which make the benefits more costly are as follows:
    - the young age at which members can retire – a minimum age of 50 in comparison with GUS which is 55;
    - the high accrual rate: 2.5% of Pensionable Pay (or 1/40th) for each year of service. Most GUS sections provide a 1/80th, 1/60th or (for new members after April 2012), a 1/67th benefit (at age 65) for each year of service;
    - the high amount of pension for a spouse on death: 75% of the member's pension in comparison with GUS, which is roughly 50%;
    - the relatively low level of member contributions: 5% in comparison with the GUS protected sections, which range from 6.6% to 11% depending upon the section of the scheme.

Options for change for the Tynwald Scheme

38. Broadly, the options for change fall into four main categories:
    - Lower future benefits;
    - Higher contributions;
    - Cost sharing;
    - Future Governance.

Lower future benefits

39. Newly elected members: a lower benefit should be offered to first time Members from October 2016. The current 1/40th (or 2.5%) benefit per year of service is considered generous in comparison with other public sector schemes. In order to attract new members, a final salary benefit should be retained but, recognising that the current benefits are generous in comparison with other public sector schemes, the ongoing benefit should be reduced to a 2% (or 1/50th) benefit with a corresponding reduction in the dependant's pension on death from 75% to 50% of the member's pension. Benefits could then be taken from a later minimum age of 55 (rising to 58 in line with the suggested changes to GUS) rather than the current age of 50. Such changes would still place the Scheme benefits above the majority of the sectionalised benefits provided within GUS.

40. Existing Members: with regard to protecting existing Members who are re-elected in October 2016, it may be considered that existing Members should take the lead in acknowledging the generosity of their benefits when compared with other public sector pension schemes. Therefore, benefit changes along the lines of the above i.e. a reduction in the level of future benefits to a 1/50th along with the reduction in the dependant's pension could be introduced for future service post October 2016, whilst pre-October 2016 benefits are retained on the current basis.

Higher contributions

41. Newly elected Members: a higher contribution should be in place for first time Members from October 2016 to reflect the fact that the level of benefits, in comparison with other schemes, still provide higher overall benefits than most existing public sector schemes. For comparison, the most generous section of GUS is section 7, which is the fire fighters section. Fire fighters can currently retire from age 50 on a benefit of 2.22% (or 1/45th) for each year of service for a contribution of 11% of pensionable pay. However, this rate of contribution is likely to increase by 3% if the Working Group's recommendations are approved. Therefore, for a 2% (1/50th) benefit for first time Members, an appropriate contribution rate should be 10% of pensionable pay.

42. Under GUS, new members post April 2012 who are in the Standard section currently pay a 5% contribution for benefits which are broadly three times less generous that the comparable Tynwald Scheme benefits at age 55 (the current minimum retirement age under GUS). However, this rate of contribution is also recommended to increase as previously outlined to 8%.

43. Existing Members who are re-elected: where benefits are reduced for future service as described above, Members would pay the 10% contribution post October 2016. However, a "Protection" option should be offered to existing Members of the Tynwald Scheme who are re-elected in October 2016. For comparison purposes under GUS, those GUS members who chose the Protected section option at outset, such that their benefits were broadly maintained at the same level as under their previous scheme, paid a "premium" for the protection in terms of higher contributions. The premium depended upon the level of benefits provided by the previous scheme and ranged from an additional 1.6% contribution over and above the 5% to an additional 6% contribution. Therefore, if existing Tynwald Members wish to protect their basis of benefits after the next election (rather than taking a benefit reduction for future service), payment of a "premium" contribution over and above the recommended normal level of contributions should be made. The Working Group therefore recommends a Protected rate of contributions of 15% is paid by existing members in return for retaining their current basis of benefits going forward.

Cost sharing

44. At present, there are no cost sharing provisions within the Tynwald Scheme. However, it is considered that cost sharing on a similar basis to that determined for GUS should be applied to the Tynwald Scheme. Cost sharing can be applied to any pension scheme on any agreed basis, and therefore the basis agreed for GUS could be applied equally to the Tynwald Scheme. The rules/basis of the Tynwald Scheme would need to be amended to allow cost sharing to apply and the basis of measuring changes in costs and appropriate underlying assumptions would need to be considered and agreed. An actuary would also need to be appointed to provide relevant advice and to undertake the regular actuarial and cost sharing reviews (generally every three years). The Members would need to agree to accept any increase in future contributions indicated by the review.

Future Governance

45. The present Tynwald Scheme is not a statutory scheme and therefore as previously outlined, it does not enjoy some of the benefits that other public sector schemes enjoy e.g. tax relief on pension contributions and a tax free lump sum on retirement. Nor does it meet some of the legislative requirements for comparable statutory schemes. The Scheme should therefore be put on a statutory footing. However, to achieve this, a detailed new Scheme would need to be drafted, incorporating updating changes in pension legislation over many years.

46. This is a significant piece of work. An alternative is for the Tynwald Scheme to be incorporated as a new section of GUS and for the existing Tynwald Scheme to be revoked, which would require an amendment to the Public Sector Pensions Act 2011 and possibly other legislative changes. This has the following advantages:

    - considerably less work is required to incorporate the Tynwald Scheme into an already existing and approved public sector scheme such as GUS;
    - there are some areas where the Tynwald Scheme is inferior in comparison with GUS e.g. GUS provides a more generous lump sum on retirement and on death in service. Thus Members would benefit from those areas of GUS which are better than the Tynwald Scheme;
    - Tynwald Members would automatically fall under the cost sharing provisions to be introduced under GUS. Thus the Tynwald Scheme would not need to introduce its own cost sharing arrangements, put them into the scheme and appoint an actuary to advise on them;
    - As a feature of joining GUS, a further option for Tynwald Members (which is also available to current GUS Protected members) would be to opt for the Standard basis of GUS at the recommended 8% level of contributions for future service;

- the PSPA would become the independent Scheme Manager as it is with other public sector schemes. Although this might be a concern for Members, the PSPA already has arrangements with Police and Teachers that no changes to their schemes are made without prior consultation (and generally therefore by agreement in most cases). The PSPA could have a similar arrangement with Tynwald Members such that no changes were made to benefits or contributions without prior discussion and consultation with Members and ultimately, with Tynwald approval. This would obviously be a significant change to the current position whereby in effect, Members manage their own Scheme. However, in terms of ongoing governance, it would generally be regarded as better governance to have Tynwald Members pensions independently managed in a similar manner to other public servants' pensions. The Working Group therefore recommends

that the Tynwald Scheme is incorporated as a new section of GUS and that the existing Tynwald Scheme is revoked.

Other issues

47. The above are recommendations from the Working Group as to how the Tynwald Scheme should be amended for the future. If changes are approved, other factors will need to be considered in detail subsequently, such as:
    - The impact upon the Members of the former 1985 Scheme and their benefits;
    - The detail of which benefits would be amended and which would remain as they currently are. For example, differing provisions on ill-health early retirement;
    - The process of having changes agreed by Members;
    - How ongoing Governance will work in practice, particularly if the responsibility for Tynwald Members pensions falls upon the PSPA in the future.

Recommendation

48. Having considered the requirement for further sustainability changes across all schemes and, as far as possible, categories of members, the Working Group recommends that the changes outlined in this section of the report are approved.

4. Consideration of the report laid before October 2013 Tynwald by the PSPA.

1. This report ("the October 2013 report") considered three main areas of public service pensions:
   - Proposals for implementing a detailed cost sharing mechanism under GUS;
   - Other areas, including Members pensions, where cost sharing could be applied to public service pension schemes;
   - Measures brought in by other countries to rebalance pension liabilities, including Eire.
2. The Working Group has now considered the October 2013 report to inform the recommendations made in this report and would comment on each of the three main areas as follows.

Proposals for implementing a detailed cost sharing mechanism for GUS

3. The underlying cost sharing basis detailed in the October 2013 report reflects the basis recommended by the Working Group to be implemented under Section 2 of this report, which should also be applied to the Tynwald Members Scheme and in due course, a similar version to the Police, Teachers and Judicial Schemes. Therefore, there is no further comment the Working Group wishes to add on this section of the October 2013 report as this recommendation has been noted and agreed by the Working Group.

Other areas, including Members pensions, where cost sharing could be applied

4. The October 2013 report notes that cost sharing can only apply to current members of schemes as any change in costs is reflected in the rate of contributions paid by active members.
5. However, the October 2013 report also comments on other possible sustainability changes by which increasing pension costs are shared, including:
   - Reducing or capping future pension increases, which this report covers in Section 3;
   - Introducing a link between the amount of future pension and a measure of longevity and/or economic performance. This is complex to administer and difficult to introduce, and could only be applied to the future accrual of pension. Those countries which have such a link and are now using it to reduce pensions in payment (or the expectation of future pension amounts) are finding considerable opposition to the measure and are revisiting it. Therefore, although the Working Group has discounted introducing this measure at this current time, it could be something that is considered again at a future date.
   - A lower accrual rate or higher actuarial reduction for earlier retirement and higher contributions for new and existing members. Again, these are areas which have already been covered in Section 3 of this report.

Measures brought in by other countries to rebalance pension liabilities

6. This is the most comprehensive section of the October 2013 report and considers what measures other countries have taken to manage their emerging public sector pension costs. Many of the changes introduced by other countries have already been implemented in the Island or are considered as part of this report, including higher

contributions, later working, higher minimum retirement ages, reduced levels of benefits and creating an element of pre-funding of benefits similar to the Pensions Reserve. The majority of countries which operate public service pensions have taken or are taking this route to change their schemes.

7. However, other more innovative changes have been made by some countries, including:
    - Deduction of other sources of income from retirement pension if total pension income exceeds a given ceiling i.e. some form of integration of state and public sector benefits (Germany);
    - Applying an economic, longevity or sustainability measure which adjusts benefits in the ratio of pensioners to contributors (Germany, Holland and Sweden);
    - A switch to a defined contribution basis of pension provision with collective investments and also with an adjustment of benefits at retirement based on longevity measures (Holland and Sweden);
    - A move to "notional" defined contribution schemes where existing contributions are used to fund current pensions but members are credited with a notional amount of contributions into their defined contribution pot which then attracts an agreed annual rate of return and is converted to pension at retirement (Sweden).
8. Such changes have often taken many years to introduce (Sweden took 15 years of discussion to move from away from traditional defined benefit schemes), are very costly to administer and tend to be sustainable only when applied to large groups of employees where costs can be spread across a large population.
9. In particular, the concept of a "notional" defined contribution scheme would appear to merit some attention and might work for an existing pensions system where incoming contributions are still required to meet current pensions in payment (e.g. the revised Swedish system). However, the Working Group considers that this degree of change is too far removed from the Island's existing pension system, too expensive to implement (particularly with no relevant experience in either the Island or in the UK), too complex for most members to understand and to administer (who would determine the rate of investment return, the conversion to pension at retirement and the longevity adjustment?) and would still result in an unfunded pension at retirement. It is also doubtful whether public servants would accept the concept of a notional pot of money and investment returns with the added "risk" that "accrued rights" are reduced at a future point, which goes against the basic legal backdrop of all current schemes.
10. However, an element of future adjustment to pensions at the point of retirement in line with a pre-determined longevity measure could be considered at some point in the future for future service benefits only. The Working Group therefore recommends that this is investigated further by the PSPA to establish if and how this could work if introduced.

Measures brought in Eire

11. With regard to the changes made to public sector schemes in Eire, which is also considered in the October 2013 report, historically, Eire operated a system of public service pensions for civil servants, health workers and teachers which were broadly similar to that of the UK (and the Isle of Man prior to the introduction of the Unified Scheme). However, in 2010, in response to the significant economic problems being experienced and demands made upon the country by the IMF, legislation was passed to introduce changes to public service pensions as follows:

- Existing public service pensions in payment were retrospectively reduced on a progressive basis by an average 4% alongside a reduction in the pay of public sector workers averaging 7%;
- Public service pensions were moved from a final salary basis to a Career Average basis for new public servants only and a single scheme was introduced in January 2013 for all new public servants;
- The retirement age of new members to the scheme was increased in line with state pension age, currently 66 rising to age 68 by 2028 (although early retirement is still allowed on reduced benefits);
- Tax free lump sums on retirement were capped at 200,000 Euro;
- Post retirement pension increases are now linked to CPI rather than to increases in average earnings;
- The general level of contributions for public servants have been increased to between 10-15% of salary;
- Integration with state benefits – public servants appointed after 1995 have their occupational pension reduced by the amount of state pension received and also pay a lower pension contribution as a result.

12. However, fundamentally, it is understood that all existing public servants are exempt from many aspects of the new rules and therefore some of the changes do not quite have the radical impact that may at first be assumed. Additionally, it is expected that the effect on government expenditure will not be felt until new members retire well into the future, which does not necessarily resolve current sustainability issues.
13. The Working Group has considered these measures and would comment initially that the Isle of Man is not and has not been in the same financial and economic difficulties as Eire and therefore it would not favour some of the changes introduced in Eire, such as reducing pensions in payment. It would require a major change to primary legislation in the Island to retrospectively reduce any benefits in payment or accrued to date, and this would be very likely challenged through the Courts and may ultimately therefore fail.
14. Some of the other changes made in Eire, such as the move to Career Average have been discounted by the Working Group, but other changes such as encouraging later working, raising the minimum age of retirement, changes to pension increases for future service and for new members, requiring higher pension contributions and the possibility of taxing or amending the basis for higher lump sums have been recommended.
15. Some level of future integration of state and public service pensions could also be considered further at a later date as part of the review of state pension and benefit provisions currently being undertaken separately to this report. However, the Working Group would not wish to comment further on the possibility of introducing integration until further detailed consideration had been given to this as part of a wider piece of work.

Recommendations

16. Having reconsidered the October 2013 report to Tynwald, the Working Group recommends that:
    - The basis of cost sharing previously outlined in this report and also contained within the October 2013 report is now implemented;

- Introducing a link between the amount of future pension and a measure of longevity and/or economic performance should not be introduced at this time but should be the subject of further consideration by the PSPA;
- Some level of future integration of state and public service pensions could also be considered further at a later date as part of the review of state pension and benefit provisions currently being undertaken separately to this report but not until further detailed consideration had been given to this as part of a wider piece of work.

5. Conclusions

1. The Unified Scheme (GUS) was introduced on 1 April 2012 and brought together fifteen existing public service schemes into one new scheme. The Unified Scheme successfully introduced a number of significant changes to public service pensions, with the aim of broadly:
    - Requiring members to pay more;
    - Providing lower overall benefits going forward for new members on a new "Standard" basis;
    - Influencing the age to which members work and therefore take their benefits (which is linked with wider Government policies);
    - Changing the underlying benefits to exert a greater degree of influence over benefit costs;
    - Introducing a workable cost sharing solution going forward;
    - Introducing local control rather than automatically following UK pension changes.
2. At the point that GUS was being developed (over six years ago), no-one could have accurately foreseen the speed at which the original assumptions would become outdated and how what was considered affordable only a relatively short time ago would now appear unaffordable. It should also be born in mind that the implementation of GUS was via a long process of negotiation with staff representatives and therefore at the time, appropriate concessions were considered necessary to gain agreement to the scheme. Existing schemes had remained relatively unchanged since the 1970's for most public servants and therefore a radical move to a single scheme for the majority of Isle of Man public servants (a move which has not been proposed in the UK) was a major change.
3. The actuarial valuation of all of the Island's public service schemes, the future cash flow projections and the impact on the Pensions Reserve indicate that further reforms are required to all schemes, including those still linked to the UK for police, teachers and the judiciary.
4. The Pensions Working Group have therefore recommended a proposed package of reforms which impact across a wide group of new, current and former members of schemes and upon employers, in order that the burden of future change is shared.

The likely view of public servants to the reforms

5. It is anticipated that the proposals outlined in this report for further pensions reform will be viewed by current and former employees as being of real significance and therefore consultation and negotiation, where required, around the reforms in line with the requirements of the Public Sector Pensions Act 2011 will be both necessary and challenging. The changes would be introduced in the main by the PSPA supported by the Office of Human Resources. When GUS was introduced there was a long period of discussion and negotiation with public servants and their representatives. Regular contact was maintained with scheme members via group presentations, one-to-one meetings, presentations at JNCs and tailored member communication material. This resulted in major pension change being introduced with the support of the trade unions and without the resulting industrial action that has been seen in the UK around its 2015 pension changes. Coming so soon after the start of GUS, the further changes proposed in this report to GUS will be much harder to implement and even a similar period of full consultation and communication with

affected members may still mean that they are less likely to be supported by staff and unions during what are already perceived as difficult times for public servants.

6. Other groups as yet unaffected by major reforms to their schemes (police, teachers, the judiciary and Members of Tynwald) are to some extent already anticipating reforms, particularly on the back of UK led changes. Therefore, discussions with these groups at an early stage should lead to agreement on future sustainability changes.

The UK perspective

7. Proposed reforms to all UK public sector pension schemes from April 2015 will see them moving from a final salary basis to a Career Average Revalued Earnings (CARE) basis for future service for all current and future members, with full benefits only being available from a later retirement age linked to the increasing state pension age. For the uniformed services such as police and fire fighters, scheme pension age will generally be raised from 50 (or lower in some cases) to 60 for service after April 2015. However, members within 13 years of their current normal pension age from April 2012 will not fall within the above changes.
8. The accrual rates under most schemes will be improved from April 2015 to mitigate the move to a CARE basis and later working in order to achieve full benefits.
9. Significant contribution increases have been introduced across all UK public sector schemes over the last 3 years, with average contributions now towards the 10% of pay level with significantly higher contributions for higher earners. This places UK contributions at similar levels to the Island's schemes after the recommended 3% increase, but for high earners, UK contribution rates are still predominantly higher.
10. The proposed further changes to Isle of Man schemes made by the Working Group will not see schemes move to a CARE basis nor will they require later working for existing members in order to achieve full benefits. Existing members will also not see their current accrual rates change.
11. Therefore, the Working Group believes that the proposed reforms for existing members still leave the Unified Scheme (and others) still comparable with UK public sector schemes after their April 2015 reforms.
12. For new members, the Unified Scheme remains on a final salary basis with a contribution rate comparable with that of UK schemes, although the accrual rate under the Standard basis of GUS for new members would be lower than most of the comparable UK schemes for civil servants and NHS workers.

Do the reforms achieve sustainability?

13. The Working Group believes that the changes recommended in this report will considerably improve the future sustainability of public service pensions and address some of the fundamental issues surrounding future affordability.
14. Changes in future benefits for new employees to accommodate anticipated later working and the raising of the minimum age at which public sector pension benefits can be taken recognise that current and former public servants should expect to work longer in the future before claiming benefits, particularly as state pension age rises. Raising contributions for both new and existing members acknowledges that these benefits are valuable and now have to be adequately paid for in order to improve the long term cash flow position of schemes, which is crucial to the future viability of unfunded schemes. Many Civil Servants will now pay a contribution in excess of 10% of pay (after transition) compared with just 1.5% of pay two years

ago, with future contribution reviews in line with new cost sharing measures. Consideration of taxing lump sums or amending the commutation rates to align with the UK for lump sums in excess of £200,000 will also be given. Capping future pension increases and removing the effect of inflation on the calculation of final pensionable pay are both risk control measures for the future. Proposals to limit the ability of pension scheme members to transfer their benefits to inappropriate defined contribution arrangements will control the payment of large transfer values in relation to relatively low levels of member contributions.

15. Introducing a minimum 15% contribution requirement for all employers, increasing over time to a 20% contribution with provision for a further (shared) 2% increase dependent upon the future profile of the workforce recognises that pension costs should be more accountable in the future. Future contributions in relation to the ongoing "funding gap" (i.e. the gap between contribution income and benefit expenditure) and the use of the Pensions Reserve going forward will be monitored on a more regular basis.

16. It is also recommended that the recommended changes should be introduced across all schemes, including after negotiation, further sustainability changes to those schemes still linked to the UK for Police, Teachers and the Judiciary. It is also recommended that there are significant changes in benefits, contributions and future governance arrangements for the Tynwald Members Scheme.

17. The Working Group notes that in comparison with state benefits, public service pensions have an accrued entitlement to benefits building up every year for every scheme member, with the eventual benefits not being fixed in nature, but dependent upon the variables of pay, service and point of retirement. Pay can and does change in terms of annual increases, spine point increases and promotions. Service can go from full time to part-time and vice versa. Members also have a choice of when to retire and a right that their accrued benefits will not be reduced.

18. Both the accrued and future cost of benefits also depends upon other variables, such as future salary, inflation, interest rates, gilt yields, mortality, longevity, date of retirement, options at retirement, ill-health provisions etc. Under an unfunded public sector pension scheme, sustainability is achieved by anticipating future benefits (given the varied assumptions), reducing or controlling these better in the future and then matching these with long term contribution income. This is what the Working Group has endeavoured to do with the reform proposals. The Pensions Reserve then exists to manage any shortfall in a particular year. The ongoing use of the Reserve and how it diminishes in the future should also be monitored and reviewed on an annual basis going forward.

19. Contribution increases of the order of 3% for current and new members of schemes and over time, 20% from employers will produce net additional contributions of around 17% of pay. Future benefit changes for both new and existing members of all schemes should act to further reduce ongoing benefit payments over the long term. Based on the current income and expenditure graphs prepared by the PSPA's actuaries and shown in **Appendix 2**, there is a long term shortfall of income over expenditure of the order of 23% of pay (shown in the "Funding Gap" graph in **Appendix 3**). The overall additional contributions of 17% of pay will reduce the long term gap from around 23% of pay to around 6% of pay as can be seen in **Appendix 5**. The larger "green" portion of the bars now show the benefits which are covered by the higher contribution income whilst the "red" portion is the benefit in excess of contributions which is not funded. It is now apparent that the "funded" green portion

is significantly greater than previously expected due to the recommended contribution increases.

20. The ongoing shortfall between contributions and benefits expressed as a percentage of pay of 6% is shown in the graph at **Appendix 6**. It is anticipated that the benefit changes outlined in this report and those to be agreed for the non-GUS schemes should act to have a further positive effect on this gap. Therefore, if the future actuarial assumptions are borne out, the changes outlined should result in a significant move towards sustainable public service pension schemes.

21. In the **short term**, the cash flow position of schemes is also improved in line with the Table below:

	Current position	Post transition, including 15% employer contributions	Post transition, including 20% employer contributions
Employee contributions	£17m	£25m	£25m
Employer contributions	£15m	£43m	£57m
Total	£32m	£68m	£82m
Expenditure	£77m	£77m	£77m
Net position	(£45m)	(£9m)	£5m

22. The table is **indicative** only of the short term position and assumes:
    - The position after full transition to the highest rates of employee contributions under GUS, plus the additional 3% recommended increases;
    - Inclusion of the higher 15% or 20% rate of employer contributions;
    - A similar level of scheme memberships as at present;
    - Contributions exclude income from transfers into schemes;
    - Expenditure excludes transfer payments from schemes and also that the current expenditure on benefits continues at the same levels at present in the short term.

23. The long term impact of the proposed contribution increases on the Pensions Reserve is shown in **Appendices 7 and 8**. In the long term, more of the Pensions Reserve will be drawn down (albeit at a slower rate because of the contribution increases) and therefore any short term surplus will be exhausted.

24. If 100% of any shortfall between contributions and benefits is taken from the Reserve Fund going forward (with no further benefit changes factored-in), the life of the Reserve Fund should be extended to around 2036 based on current estimates. If however only 50% of any shortfall is taken (**Appendix 8**), then the Reserve Fund is extended well beyond 2039 to a period whereby it is too far into the future to be accurately predicted.

25. The reality is that an assessment of future sustainability can only be made via a process of ongoing review of benefits and contributions and adjustment in line with future cost sharing reviews. These recommended reforms are therefore the second stage in the process of change which started with GUS. The third stage will be changes to non-GUS schemes. The fourth stage will then be establishing a process for ongoing formal review, assessment and adjustment via recommendations made by the PSPA and Treasury.
26. However, given that accurate predictions beyond 25 years are difficult and also given the long term nature of pension provision and the numerous variables that impact on pension costs, many of which cannot be actively controlled, the position must continue to be monitored, reviewed and amended where necessary at regular intervals into the future.