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Mr Shane McAteer
Clerk
Committee for Finance and Personnel
Room 419
Parliament Buildings
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Our Re: MISC98/11-15

4 March 2013

Dear Shane

NORTHERN IRELAND PUBLIC SERVICE PENSIONS

At the Committee meeting on 9 January 2013, Corporate HR officials provided information on proposals for the introduction of a Public Service Pensions Bill in the Assembly. The Minister announced his intention to introduce this Bill in his speech to the Assembly on 26 November 2012. In this speech, the Minister also provided details to the Assembly of potential costs associated with failing to meet the HM Treasury deadline of April 2015 for the introduction of pension reform. Subsequently, the Department provided the Assembly Research and Information Service information in relation to the calculation of the estimated figures on 12 December 2012.

The Government Actuary's Department (GAD) provided data indicating, in broad terms, the financial impacts of the Public Service Pensions Bill provisions and in particular the quantitative analysis considering the savings in respect of pension rights earned after 2015. GAD adopted a simplified methodology to calculate the contribution rates for the Northern Ireland Health Service Pension Scheme based on percentage assumptions of membership retiring at normal pension age and leaving the scheme prior to normal pension age. DFP officials used this methodology to estimate costs for the other main Northern Ireland Public Service Pensions and the estimated costs were estimated to be in excess of £260m.

The Department has established a working group in conjunction with the Northern Ireland Committee of Irish Congress of Trade Unions (NIC-ICTU) to

facilitate discussions with Trade Unions on the Public Service Pensions Bill. At a meeting of this group on 14 February NIC-ICTU requested sight of a letter, received by the Department from the Government Actuary's Department (GAD), which sets out the potential cost of not applying revised pension arrangements for the Northern Ireland Health and Social Care Scheme from April 2015. This correspondence has now been provided to NIC-ICTU for discussion at the next meeting scheduled for 5 March 2013.

I now attach, for the information of the Committee, the GAD letter of 5 October 2012 (Annex A) and a subsequent E-mail of 18 October (Annex B) which provides more detail and assurances of the figures provided.

Yours sincerely,

JUDITH FINLAY
Departmental Assembly Liaison Officer

ANNEX A

PROTECT - POLICY

GOVERNMENT **ACTUARY'S** DEPARTMENT

Reference:

Margaret Coyle
Department of Finance and Personnel NI

by email to margaret.coyle@dfpni.gov.uk

5 October 2012

Dear Margaret

Potential costs of reformed pension schemes

You have asked me to provide advice on the potential costs in Northern Ireland if public service pension schemes in Northern Ireland are not reformed in line with the proposals that the UK government currently has in relation to the schemes for which it has policy and legislative responsibility. I understand that this is in connection with the possibility of the Northern Ireland Assembly passing a legislative consent motion that would enable the Public Service Pensions Bill currently passing through the Westminster parliament to extend to Northern Ireland.

The Northern Ireland schemes covered by this letter are:

- Health and Social Care Superannuation Scheme (HSCSS)
- Teachers' Superannuation Scheme
- Principal Civil Service Pension Scheme
- Local Government Pension Scheme (LGPS)
- Firefighters' Pension Scheme
- Police Pension Scheme

This letter provides some figures indicating, in broad terms, the financial impacts of the Bill provisions and also discusses, on a qualitative basis, other changes that may lead to changes in employer costs.

Changes already in train

The Westminster government has made three significant changes which will affect the cost of the schemes that are not necessarily reflected in employer contribution rates paid currently in Northern Ireland. These are separate from the provisions in the Public Service Pensions Bill.

- Since April 2011, pension increases have been linked to the CPI instead of the RPI. This has reduced pension scheme costs since CPI is expected to increase more slowly than RPI on average. I understand that this change is reflected in LGPS employer contributions but not, at this stage, for any of the other schemes.

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> At the 2011 budget, the Chancellor announced that the discount rate used to value unfunded public service pension schemes would change to 3% in excess of CPI price increases (from 3.5% in excess of RPI increases). This does not affect benefits but does affect the actuarial calculation of their cost and will, all other things being equal, increase that cost and therefore employer contribution rates. Taken together, the pension increase and discount rate changes lead to an increase in employer costs. This discount rate is not relevant to LGPS which is funded.

> Employee contribution rates increased in April 2012 for all schemes other than LGPS. The intention is that further increases will be applied in 2013 and 2014 so that the overall increase for the schemes that the UK government has responsibility for (other than LGPS) is worth 3.2% of pay. Northern Ireland schemes have implemented the same increases. The overall value may not be the same in Northern Ireland in terms of percentage of pay since the increases depend on employees' salaries which may be distributed differently. An increase in employee contribution rates means that employer contribution rates could fall, all other things being equal.

Changes to scheme designs in consequence of the Public Service Pensions Bill

The Public Service Pensions Bill would align normal retirement age with state pension age for all the pension schemes discussed in this letter other than the Firefighters' and Police schemes which would have a normal retirement age of 60 for retirements from active service. This will reduce the costs of these schemes as pensions will be paid for a shorter period of time. It will reduce the value of pension rights accrued in the future (all other things being equal), but may also be expected to reduce the value of pension rights already earned if members with rights earned before and after 2015 choose to claim their pre-2015 rights later than they would have if the scheme remained unreformed.

The quantitative analysis below considers the savings in respect of pension rights earned after 2015, but not the possible savings in respect of pre-2015 rights.

The Bill also requires schemes to be "career average revalued earnings" ("CARE") instead of "final salary" but leaves the details of the scheme to be specified in secondary legislation. The Nuvos section of PCSPS that new entrants have joined since 2007 is this type of scheme. The cost of a career average scheme depends on the accrual rate and the rate of revaluation of the pension rights while a member is in service. Each of the schemes for which the UK government has policy responsibility has proposed a different revaluation rate and a different accrual rate.

Quantitative analysis

This section of the letter discusses the potential impact on employer contributions of the changes to the Health and Social Care Superannuation Scheme that the Bill will enable. Future employer contributions will depend on the approach taken at future valuations, and we do not know what that approach will be (for example, under the Bill valuations must be carried out in accordance with Treasury directions, and we do not know what Treasury will direct). The costs in this letter are described in terms of the total cost of benefits being accrued by current employees expressed as a percentage of pay ,and we can reasonably expect HMT directions to require costs in future valuations to be expressed in this format. These costs are borne by employees and employers combined in the form of the contributions that each pays.

Details of the design of the schemes valued and the approximations made are set out in the Annex to this letter. The costs in respect of the other Northern Ireland schemes will be different and we would be happy to provide estimates of the costs for those schemes.

The cost of the current HSCSS benefit design is about **28%** of pay. This figure is higher than the current combined employer and employee contributions, for the reasons set out above.

The details of the "proposed final" NHS Pension Scheme in England and Wales are published here:
http://www.parliament.uk/deposits/depositedpapers/2012/DEP2012-0454.pdf

If the scheme were changed to fully reflect this design, then the cost would be about **21%** of pay. Based on a HSCSS pensionable payroll of about £1.5 billion per annum, the savings forgone would be about £100 million per year. The savings forgone represent about one quarter of the total cost of the current scheme (7% of pay compared with 28% of pay), but a larger proportion of employer costs.

The figures above have been calculated using the new "SCAPE" discount rate set in 2011; have been calculated on an approximate basis and are not directly comparable with the employer costs currently being paid. If this scheme design is adopted in Northern Ireland, the costs calculated at that time are likely to be different to those calculated here due to the approximations made. It is not possible to say with certainty what that difference would be without carrying out more detailed calculations, but the difference could be of the order of up to 10% (ie the annual savings forgone in respect of HSCSS might be £10 million higher or lower than £100 million due to the approximations made).

The OBR's Fiscal Sustainability Report of 12 July 2012 noted that the reform of (all) schemes in line with the recommendations of "Good Pensions that Last"[1] would be expected to cause a 0.1 per cent of GDP fall in net spending, to around 0.9 per cent of GDP, i.e. a saving of about 10%.

The OBR projection is expressed in terms of the cash expenditure in benefits rather than the cost of benefits accruing so is not strictly comparable with the figures that we calculated. The savings in terms of employer contributions are greater than the savings noted in the OBR report for the following reasons:

- The 50 year projection period in the OBR report is not long enough for all the potential savings to be recognised; note that the report recognises that further savings may continue to emerge beyond the projection period.
- It is expected that the long term cash flow savings will be less than the impact on contributions, because the change in retirement age increases the period during which (notional) investment returns are earned and this effect further reduces the required contribution rate.
- The HSCSS has lower withdrawal rates and faster promotional pay progression than NHSPS (E&W), which means that the existing scheme is more expensive in Northern Ireland than England and Wales, but these features have less impact on the relative cost of the CARE scheme.

Note that these calculations consider only the savings in respect of pension rights earned after 2015, but not the possible savings in respect of pre-2015 rights discussed above. If these possible savings in respect of pre-2015 rights were allowed when employer contribution rates were set, then the savings to NI of implementing reforms (or the costs of not implementing them) would be greater.

Transitional arrangements

The Bill allows for transitional arrangements and the UK government's proposal is that members of existing schemes on 1 April 2012 who have ten years or less to normal retirement age will be able to remain in their current scheme. A taper covering those with up to fourteen years to normal retirement age has also been proposed. This means that although the new schemes start in 2015, reduced contribution rates will not be fully realised until around 2022 when the last fully protected members reach normal retirement age and tapered members reach the end of their taper.

Savings in cashflow terms will take many years more to be realised since rights accrued before 2015 are to be protected.

Cost of delaying reforms

If the proposed reforms were implemented with a delay, there would be a cost relative to implementation in 2015. For the HSCSS, this would be, broadly, £100m for each year that the implementation of a new scheme was postponed. This does not allow for the further cost of any reduction in savings if members with rights accrued prior to 2015 retire earlier as a result of a delay or any costs/ savings due to transitional protection being amended.

In practice, actual employer costs will only change when a valuation is completed and contribution rates are changed. It is not clear how HM Treasury would seek to measure or reclaim any costs of postponing reforms, but HM Treasury may seek to have the extra costs reflected through the usual valuation process to set employer contributions. Treasury's usual policy is that employers should bear the cost of pensions as they accrue and therefore the natural extension of this would be that it would wish to reclaim the cost of higher pension accrual in Northern Ireland as the benefits accrue rather than gradually as this is reflected in higher benefits expenditure.

Other changes in the Bill

The Bill will replace the "Cap and Share" arrangements that some of the schemes currently have in force with an "employer cap". The purpose of both of these arrangements is to cap the maximum employer contribution rate that would be paid. Contributions or benefits might be adjusted to keep employer costs within the desired range. For most schemes covered by the "cap and share" policy, the cap was set at the most recent valuation and the valuations that were halted by HMT were the first at which "cap and share" may have led to a change in benefits or contributions. HMT has not yet set out the details of how the "employer cap" will work in practice so it is not possible to quantify the financial effect of this provision. The sort of effect that might lead to the employer cap impacting on contributions or benefits is future mortality improvements or a change in the demographic characteristics of a scheme's membership.

Another change that the Bill would make is that the assumptions to be adopted in valuations and the details of the "employer cost cap" would be set by HM Treasury. This could have a very large impact on employer costs (as the change to the discount rate has done) but it is not possible to say in advance what this would be. For the LGPS, this provision does not cover valuations carried out to calculate employer contribution rates but it does include valuations carried out for the "employer cost cap" process. This provision explicitly gives a power to HM Treasury. It may, however, be the case that HM Treasury currently has the ability to influence valuations of NI schemes in a similar way through less direct means. In practice, I understand that most of the unfunded Northern Ireland schemes followed the "SCAPE" methodology previously set out by HMT so the impact may not be significant.

Other future changes that may impact on employer costs

It is worth noting that one of the aspects of the "single tier pension" proposals that DWP have consulted on in Great Britain involves the abolition of salary-related contracting-out. The timetable for this could involve implementation from 2015. If this were to happen, employers and employees would no longer benefit from the NI rebate. The rebate is currently 1.4% of pay in the relevant bands for employees and 3.4% for employers.

State pensions do not accrue in the same way as occupational pension schemes, and the implications for "accrued" S2P and SERPS pensions are not yet clear.

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Please let me know if you have any comments of if you would like us to consider the costs of the proposed designs for other schemes.

Yours sincerely

James Pepler
Deputy Chief Actuary

Annex B

From: James Pepler [mailto:James.Pepler@gad.gov.uk]
Sent: 18 October 2012 10:54
To: Nesbitt, Grace; Coyle, Margaret
Cc: Miskelly, Margaret; Michael Scanlon; George Russell; Ian Boonin; PCSPS(NI)
Subject: PROTECT - SCHEME MANAGEMENT: RE: Revised Scheme Costings

Grace

We are aware that at a recent MOCOP teleconference the advice in our letter of 5 October and, in particular the figure of £100m, was discussed and you also mentioned this figure had been used to answer an Assembly Question last week. I understand it was suggested in the MOCOP meeting that the figures were higher than expected. This email provides some further assurance.

Our letter discusses some of the reasons for higher cost in NI relative to E&W, including the differences in demographic assumptions in Northern Ireland and England and Wales.

The £100 million figure is the annual cost of not implementing reforms in the long term. It is then important to understand the sensitivity of this figure in the short term to the policy stance taken towards transitional protection. Broadly speaking, the proposal in E&W is that members of existing schemes on 1 April 2012 who have ten years or less to normal retirement age will be able to remain in their current scheme (with a taper arrangement for those up to 13-14 years from normal retirement age).

If all aspects of reform are delayed by 1 year, including both the date of implementation of new scheme and transitional arrangements then, as stated in our letter of 5 Oct 2012, the cost relative to implementation in 2015 for the HSCSS would be, broadly, £100m for each year that the implementation of a new scheme was postponed. That is, if the new scheme was implemented from April 2016 (rather than April 2015) and members within 10 years of pension age in April 2013 were protected (rather April 2012) plus a 3-4 year taper then the cost for HSCSS would be, broadly, £100m. This figure is a capitalised cost but includes the cost of additional accrual in 2015/16 and for the following seven years for the additional members who would be protected compared with England and Wales. It is not clear whether HMT would seek to obtain this money entirely in 2015/16 or over the period 2015/16 to 2022/23.

Alternatively, if the new scheme was implemented from April 2016 (rather than April 2015) but protection was as for England and Wales (i.e. members within 10 years of pension age in April 2012 were protected plus a 3-4 year taper in addition) then the cost for HSCSS would be less than £100m. Please let us know if you would like us to calculate any figures for this latter scenario.

I note that the answer to the AQ, which we did not see beforehand, did not go into this level of detail, perhaps deliberately so. Nevertheless, I think it is important to have the background set out in this e-mail to help respond to possible follow-up questions.

(This e-mail should be read in conjunction with our 5 October letter.)

Regards

James

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