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Mr Shane McAteer
Clerk
Committee for Finance and Personnel
Room 419
Parliament Buildings
Stormont

Our Ref MISC98/11-15

6 March 2013

Dear Shane

NORTHERN IRELAND PUBLIC SERVICE PENSIONS
(ADDITIONAL GAD INFORMATION)

I refer to my previous letter of 4 March 2013 where I had attached, for the information of the Committee, the GAD letter of 5 October 2012 (Annex A) which set out the potential cost of not applying revised pension arrangements for the Northern Ireland Health and Social Care Scheme from April 2015 and a subsequent E-mail of 18 October (Annex B) which provided more detail and assurances of the figures.

As previously indicated 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.

Corporate HR Officials have now supplied me with further GAD correspondence additional to the attachments in my original letter to you on 4 March 2013. It was the first correspondence letter issued to officials on 3 October 2012.
The letter of 5 October 2012 was an update on the letter of 3 October 2012 but as the GAD correspondence of 3 October includes an Annex on the Contribution Rates Calculation Corporate HR Officials consider the attached additional information would be helpful in understanding the methodology used.

Therefore, I now attach for your information the GAD correspondence and Annex of 3 October 2012. Although, the correspondence retains a draft watermark, this is indeed the final version of the correspondence.

This additional information has also been provided to NIC-ICTU for further discussions at the Scheme Officials/ NIC-ICTU Public Service Pensions Bill meetings.

Yours sincerely,

Judith Finlay

JUDITH FINLAY
Departmental Assembly Liaison Officer

ANNEX A

PROTECT - POLICY

GOVERNMENT ACTUARY'S DEPARTMENT

Reference:

DRAFT

Margaret Coyle
Department of Finance and Personnel NI

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

3 October 2012

Dear Margaret

Potential costs of reformed pension schemes

You have asked me to provide advice on the potential costs to 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 responsibility. 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 Irish 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 the financial impacts of the Bill provisions and also discusses other changes that may lead to changes in employer costs on a qualitative basis.

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:

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. This is reflected in LGPS employer contributions but not for any of the other schemes.

At the 2011 budget, the Chancellor announced that the discount rate used to value public sector pension schemes would change to 3% in excess of price increases. This does not affect benefits but does affect the actuarial calculation of their cost and will increase that cost and therefore

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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 enabled by the Public Service Pensions Bill

The Public Service Pensions Bill would change normal retirement age to equal 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. This will reduce the costs of these schemes as pensions will be paid for a shorter period of time. This will reduce the value of pension rights accrued in the future (all other things being equal) but may also 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 consider the savings in respect of pension rights earned after 2015, but not the possible savings in respect of pre-2015 rights.

The Bill also changes 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 have 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. The costs are described in terms of the total cost of the scheme (borne by employees and employers combined) expressed as a percentage of pay. The figures have been calculated using the new "SCAPE" discount rate set in 2011 and 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. Details of the design of the schemes valued and the approximations made are set out in the Annex to this letter. The costs of other schemes will be different and we would be happy to provide estimates of the costs of 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 cost of the current scheme (7% of pay compared with 28% of pay).

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

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 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 calculation 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.

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.

[1] http://www.hm-treasury.gov.uk/d/pensions_publicservice_021111.pdf

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 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: Contribution rate calculations

We have calculated the required contribution rate for the existing HSCSS and for the proposed design for the NHSPS(E&W) from April 2015. We have used financial assumptions consistent with the cost ceilings produced by the UK Government and demographic assumptions appropriate to HSCSS.

We have adopted a simplified methodology to calculate these contribution rates. We have assumed that all members are aged 42, and that 11% of members leave the scheme aged 48 and the remainder retire at or after the scheme's Normal Pension Age. The following table sets out the element of the scheme design which have been allowed for, and assumptions used.

Scheme	**HSCSS NPA 60**	**HSCSS NPA 65**	**Proposed NHSPS(E&W)**
Scheme design			
Basic design	Final Salary	Final Salary	CARE
Normal Pension Age	60	65	SPA
Accrual rate (for member's pension)	80ths	60ths	54ths
Accrual rate (for spouse's pension)	160ths	160ths	160ths
Automatic Lump Sum	3 x pension	None	None
Commutation factor	12:1	12:1	12:1
Revaluation of benefits in service	Final Salary	Final Salary	CPI + 1.5%
Revaluation of benefits in deferment	CPI	CPI	CPI
Financial assumptions			
Discount rate		5%	
Earnings increases		4¼%	
CPI		2%	
Discount rate net of earnings		¾%	
Discount rate net of CPI		3%	
Demographic assumptions			
Age of member		42	
Male to Female ratio (weighted by pay)		Males: 30%; Females 70%	
Proportion leaving before retirement		11%	
Age on leaving before retirement		48	
Promotional salary increases to leaving before retirement	10%	10%	N/A
Age at retirement	63	65	67
Promotional salary increases to retirement	20%	20%	N/A
Proportion of pension commuted at retirement	10%	27%	27%
Proportion married or with an eligible partner at retirement		100%	
Required contribution rate (employer and employee combined)	**28%**	**28%**	**21%**

The contribution rates emerging from the next valuations of the HSCSS will differ from the figures above for the following reasons:

- The future design of the HSCSS may differ from the designs above.
- In particular, the future design of the HSCSS may include transitional arrangements with some members in the existing schemes and others in the reformed schemes.

- The figures above represent only the costs of accruing benefits, contribution rates emerging from the future valuations may include an adjustment for any (notional) surplus or deficit.

- The figures above are based on a standard actuarial methodology know at the Projected Unit Method consistent with UK Government cost ceilings, future valuations may use a different methodology.

- The above calculations assume that all members are aged 42, and that they either leave at age 48 or contribute to work until retirement; future valuations will consider a full range of member ages and possible future exits.

- In particular, the above calculations ignore ill health retirement and death in service; future valuations will allow for these.

- The above calculations are based on assumptions used for cost ceilings or those adopted for the largest group of members in the most recent HSCSS valuation (as at 31 March 2004). Future valuations may adopt different assumptions.

The above list may not be exhaustive.