



Let's have some 'joined up' government. The doubling of public sector pension costs is only half the story...an independent review should look at improving private pensions and address elderly care...

ACA SAYS PUBLIC SECTOR PENSIONS REVIEW NOT ENOUGH... URGENT NEED TO LOOK AT THE WIDER PICTURE

17 June 2010: The Deputy Prime Minister has recently stated that public sector pension costs are to double over the next 4 years. However a more accurate statement would have been "the share of public sector pension costs met by HM Treasury is set to double over the next 4 years". Aside from the decline in private sector provision, much of the public sector pensions 'problem' lies with the impact of 'adverse' demographic changes on unfunded 'pay-as-you-go' schemes. The trade unions are right that there should be a genuine independent review, says the Association of Consulting Actuaries (ACA), but that review should usefully look at public and private sector pension reform (including NEST) in the round, take account of impending State pension changes and then move on to look at the financing of elderly care.

The public sector pensions referred to by the Deputy Prime Minister are the main unfunded pension schemes for NHS staff, teachers, police and fire, armed forces and the civil service. The NHS Scheme is almost half of the total. Local authority employees participate in funded schemes, where the issues are different and are similar to those encountered by private sector defined benefit schemes.

In the unfunded schemes, no assets are set aside from employer and employee contributions to meet future pension liabilities. These pay-as-you-go schemes are financed in such a way that this year's benefits paid to pensioners are funded from this year's employee contributions and employer contributions, which are set at a level that assumes the benefits are funded, with any balance of cost met by HM Treasury (i.e. the taxpayer).

In the early years of unfunded schemes employee and employer contributions will be more than sufficient to meet any pensions that come into payment. This is currently the case with the 2006 Police Pension Scheme and the equivalent Fire Scheme where contribution income greatly exceeds annual pension payments. Whilst this is the situation, the taxpayers of the day benefit in that pension contributions made effectively meet the cost of other government expenditure programmes.

However, the ‘problem’ comes further down the road for taxpayers. As these schemes mature and more pensioners come on stream in real terms the annual pension bills may outpace the increase in employee and employer contributions, resulting in a growing balancing sum from the Treasury. The ACA estimates that currently the amount paid to 2.5m public sector pensioners is around £20bn a year (an average so called “gold-plated” pension of around £8,000 a year) with employee contributions of around £4bn and employer contributions of around £12bn a year, leaving £4bn to be picked up by the Treasury. It is this last amount, referred to by the Deputy Prime Minister, which is likely to increase to, possibly, £9 billion within 4 years.

The danger is that, without corrective action¹, tomorrow’s taxpayers could see this annual cost escalate rapidly in the years ahead if there are continued advances in longevity – with pensions payable for longer than expected – and if there are changes in the proportion of pensioners relative to contributors (and taxpayers). These scenarios are both likely in the UK over the coming years.

So what can or should be done?

Commenting on the situation ACA Chairman, **Stuart Southall**, said:

“There is a very real danger of compounding one unfairness with another by just targeting the public sector.

“Yes, it is unfair, to some, that private sector workers see their pension prospects often deteriorating whilst also paying taxes seemingly to preserve better public sector pensions. But, equally, it could be both unwise and provocative to respond by simply increasing employee contributions and by beating down public sector pension benefits rather than looking at the pension problem – private and public sector – in the round, including the impact of further State pension reforms, as yet unannounced. We all need good pensions, otherwise there will be mounting pressures on State benefits or widespread poverty in retirement.

“An independent review body needs to look at both sectors so there is the potential for pension costs and benefits to be generally evened out between the private and public sectors. Such a body might conclude, for example, that pay-as-you-go is an unstable way of meeting pension costs in an ageing society and that, over time, there should be a change in approach. On the other hand, it might conclude that the long-term cost to the taxpayer of public sector schemes can be held down to around 2% of GDP without such a major change, as has been suggested by some. Or has the forecast lower growth rate in the years ahead changed this?

“Increasingly, we sense there is a call from both employers and employees for hybrid or middle-way pensions; pensions that can be adapted to meet the needs of both the public and private sectors. To effect such a change, there

¹ It should not be forgotten that most of the major public service schemes now have “cap and share” arrangements in place which cap employers’ contributions and include mechanisms to share costs with employees via higher employee contributions or a reduction in benefits or in increase in retirement age.

needs to be a greater freedom of design, requiring some legal changes, so employers can cap their long-term pension costs, with greater flexibility to automatically move the pension age as longevity improves and to respond to difficult economic conditions, whilst also providing employees with the stability of benefits that is essential for retirement planning.

“Whilst defined contribution schemes are sensible for those generally on higher incomes who can afford to shoulder 100% of the longevity and investment risks, and the wide variation in pension outcomes that can result, schemes that are exclusively DC based are not suitable for many of those on middle and lower incomes in either the private or public sectors. This is why the review of the exclusively defined contribution NEST scheme should take place alongside a look at what other options are available to boost private sector pensions and public sector schemes, including that of MPs.

“In looking at pensions in the round, it seems to us that it would be sensible to examine at much the same time what could be done to address the financing of elderly care through pension arrangements. Again, some joined-up thinking might help to address what is an increasingly serious dilemma for an ageing society,” concluded Stuart Southall.

For further details: Stuart Southall 0207 5331883
 Steve Leake 01483 540300
 David Robertson 020 3207 9380 (M: 07919 911380)

Note to Editors:

About the Association of Consulting Actuaries (ACA)

The **Association of Consulting Actuaries (ACA)** is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies. The ACA has 1750 members working in around 75 firms. ACA Members are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries' Code. The ACA forms the largest national grouping of consulting actuaries in the World.