The implications of the Coalition Government's public service pension reforms

Pensions Policy Institute

Nuffield Foundation

16 May 2013

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PPI's Research on Public Service Pension Reform

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- Objective: to provide an independent assessment of the implications of the Coalition's reforms to the four largest public sector schemes;
- NHS, Teachers, Civil Service & LGPS
- Research was funded by the Nuffield Foundation – a charitable trust

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Public Service Pension Reform - Agenda

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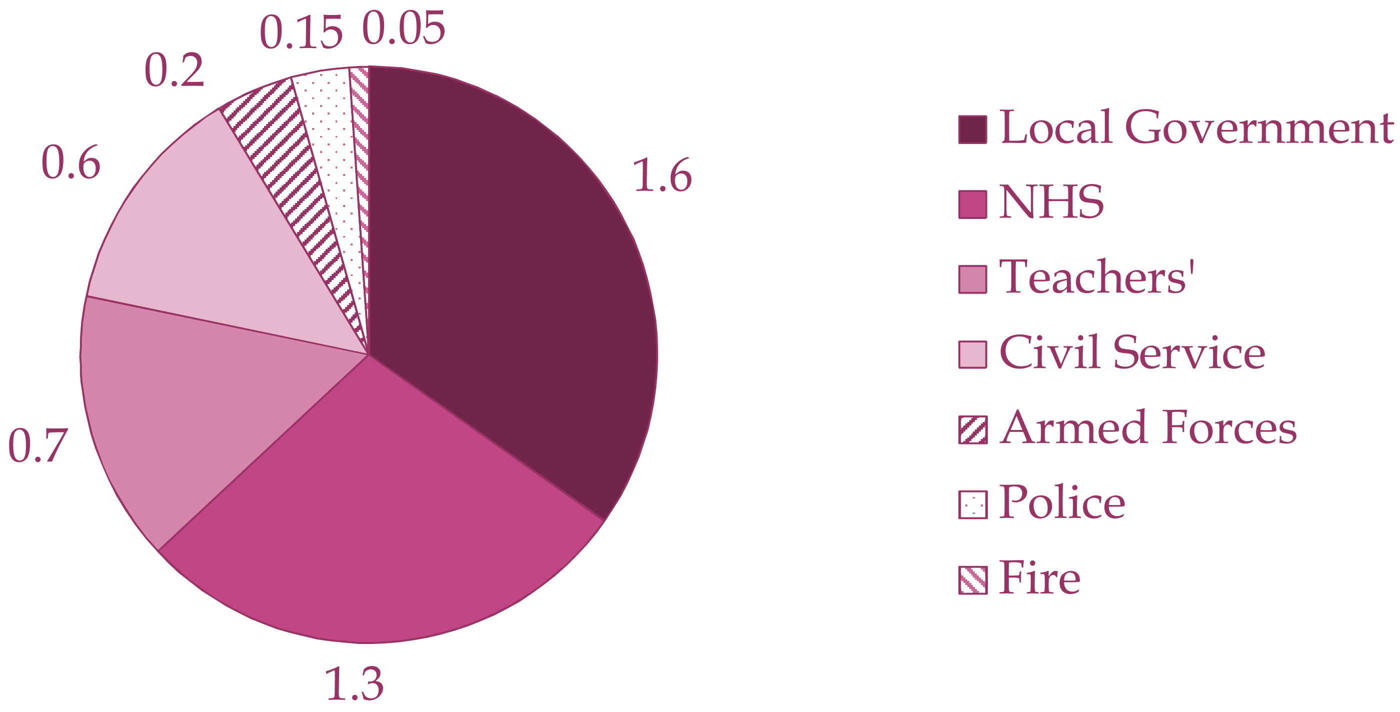
- The Coalition Government's Reforms to the public service schemes
- PPI research methodology
- Implications of the reforms for members of the four largest public sector schemes
- Implication for the sustainability of public service schemes
- Conclusions

There are seven main public service pension schemes with around 5 million active members

Number of active members of public sector pension schemes as of 31 March 2011 (millions)



The Coalition's reforms to the public service schemes

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- Switch from Final Salary to Career Average Revalued Earnings (CARE);
- Linking of Normal Pension Age to State Pension Age (except uniformed services);
- Higher rates of contributions from scheme members (+3.2% on average except LGPS) and tiered contributions;
- Reforms apply to <u>all members</u> for future accrual but protections for members within 10 years from their Normal Pension Age on 1 April 2012.

The largest four public sector pension schemes post reforms

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	NHS	Teachers'	Civil Service	Local Government
Normal Pension Age	SPA	SPA	SPA	SPA
Basic design	CARE	CARE	CARE	CARE
Revaluation	CPI + 1.5%	CPI + 1.6%	CPI	CPI
Accrual rate	1/54th	1/57th	1/43rd	1/49th
Member contributions (future service)	5% to 14.5%	6.4% to 8.8%	4.6% to 9%	5.5% to 12.5%
Indexation of pensions paid	CPI	CPI	CPI	CPI
Implementation	1 April 2015	1 April 2015	1 April 2015	1 April 2014

PPI's EEBR methodology

- Effective Employee Benefit Rate;
- Factors in CARE accrual & revaluation rate, pensions indexation to project the value of the future pension benefit payment after taking account of the member's own contributions;
- Discounts the value of the future pension benefit back to a present value; (DR = CPI + 3%)
- The EEBR is the value of the pension benefit accrued by the member in one-year expressed as a % of the member's salary.
- How much extra pay that member would need to be given by their employer to compensate for the employer closing the scheme.

The Coalition Government's proposed reforms reduce the value to pre 2008 entrants of the NHS Pension Scheme by more than a third

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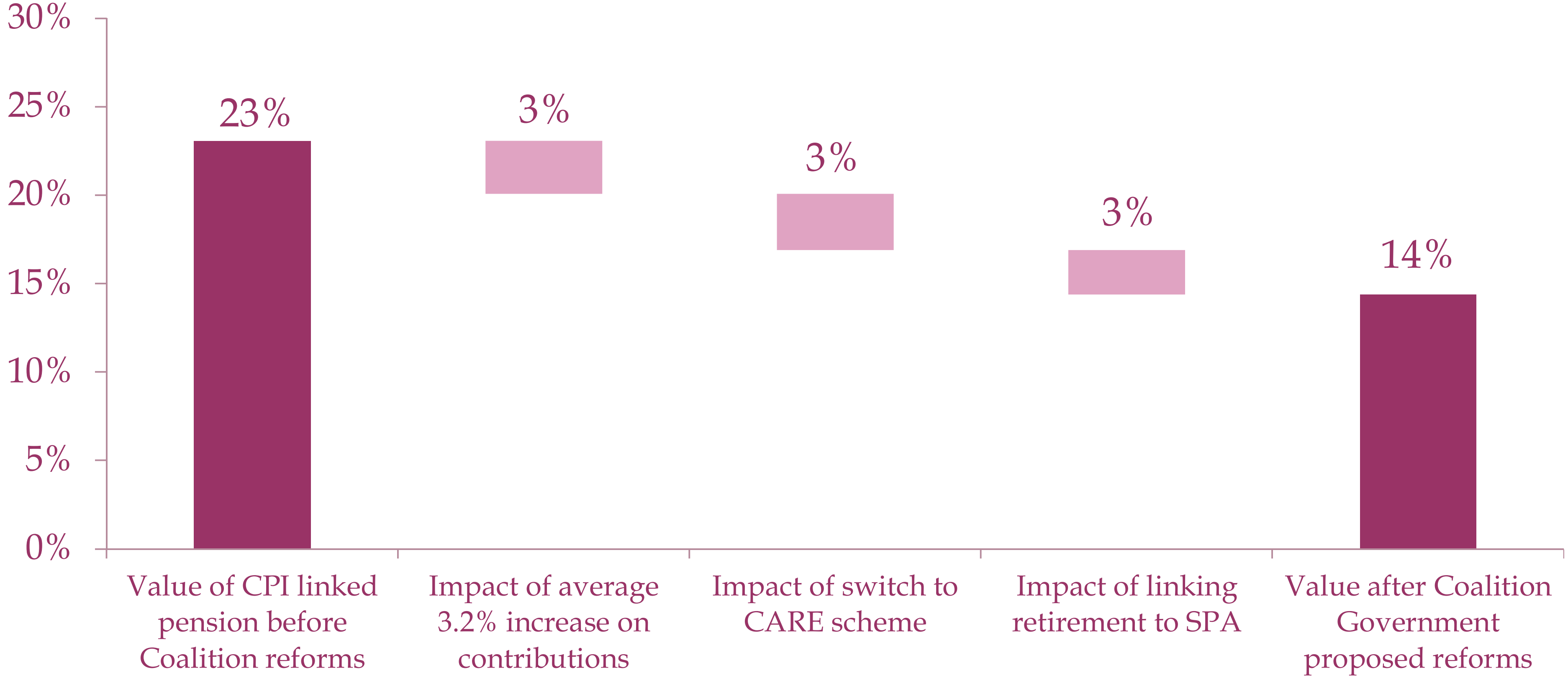
Impact of each component of the Coalition Government's proposed reforms on average value of the pension for members who joined the NHS Pension Scheme before 1 April 2008



The Coalition Government's proposed reforms reduce the value to members of the Local Government Pension Scheme by more than a third

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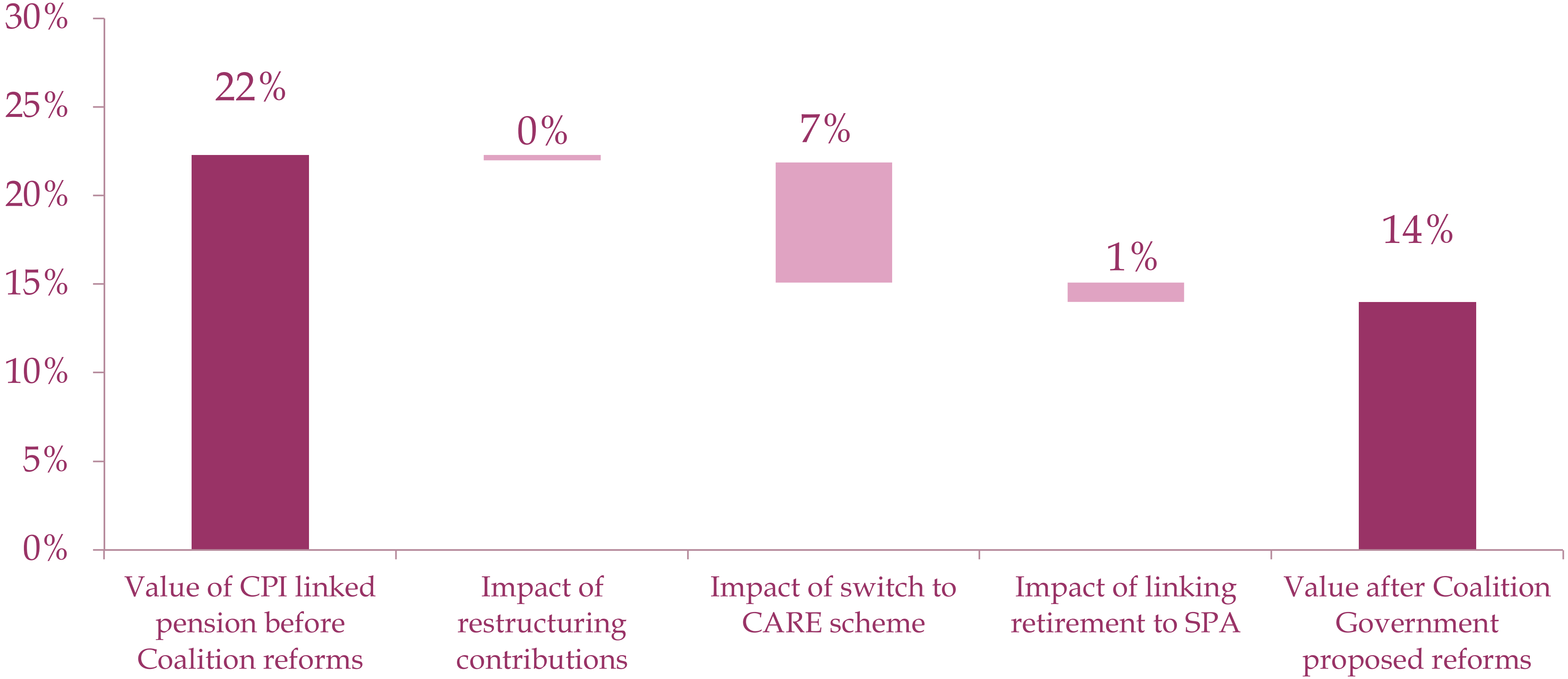
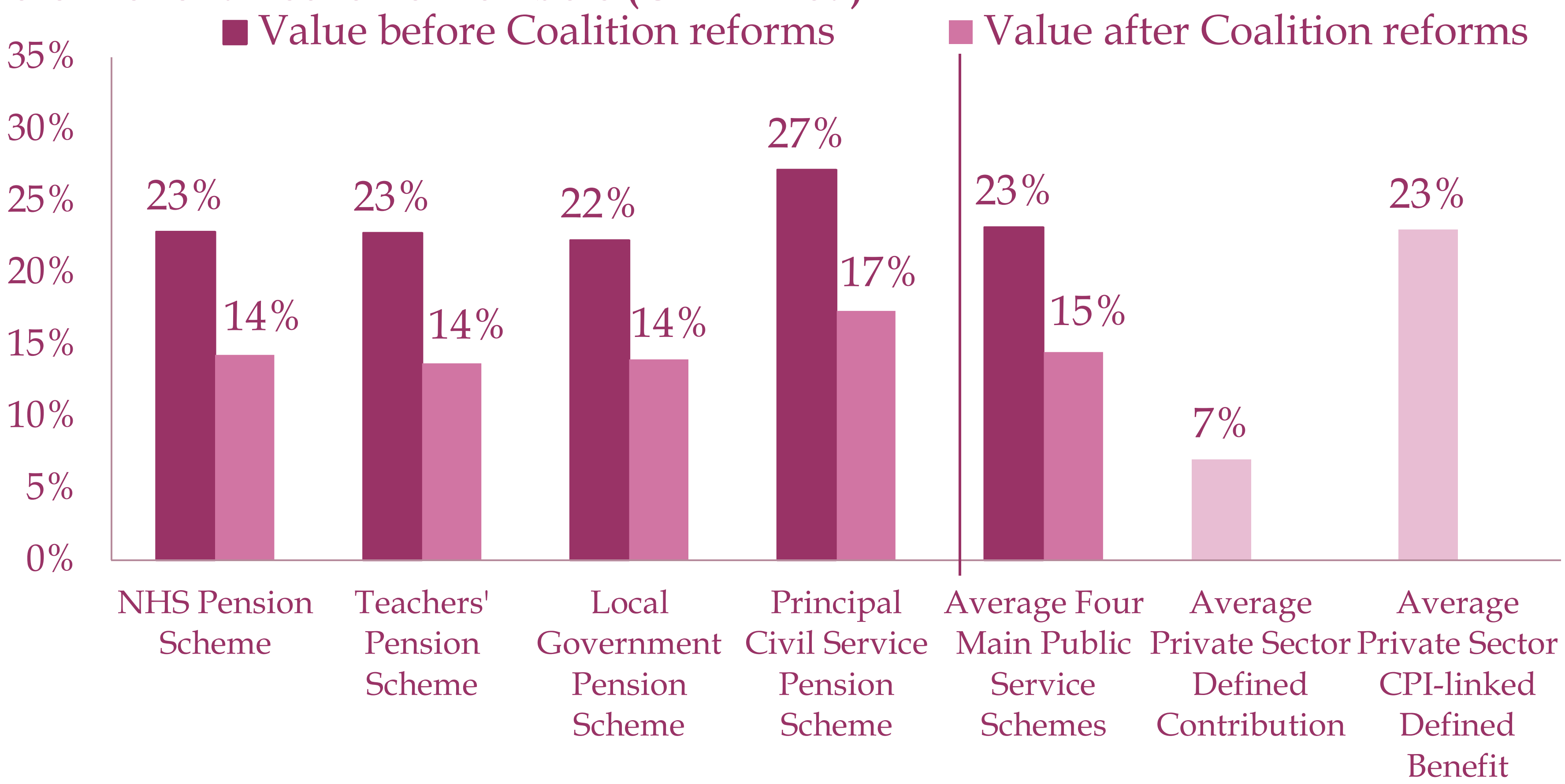
Impact of each component of the Coalition Government's proposed reforms on average value of the pension for members of the Local Government Pension Scheme



The Coalition Government's proposed reforms reduce the average value of the public service pension schemes by more than a third

Average value of the four main public service pension schemes as a percentage of the scheme member's salary before and after the Coalition Government's proposed reforms for all scheme members (CPI linked)



High-flyers and low-flyers have a pension benefit worth the same percentage of their salary under the Coalition Government's proposed reforms

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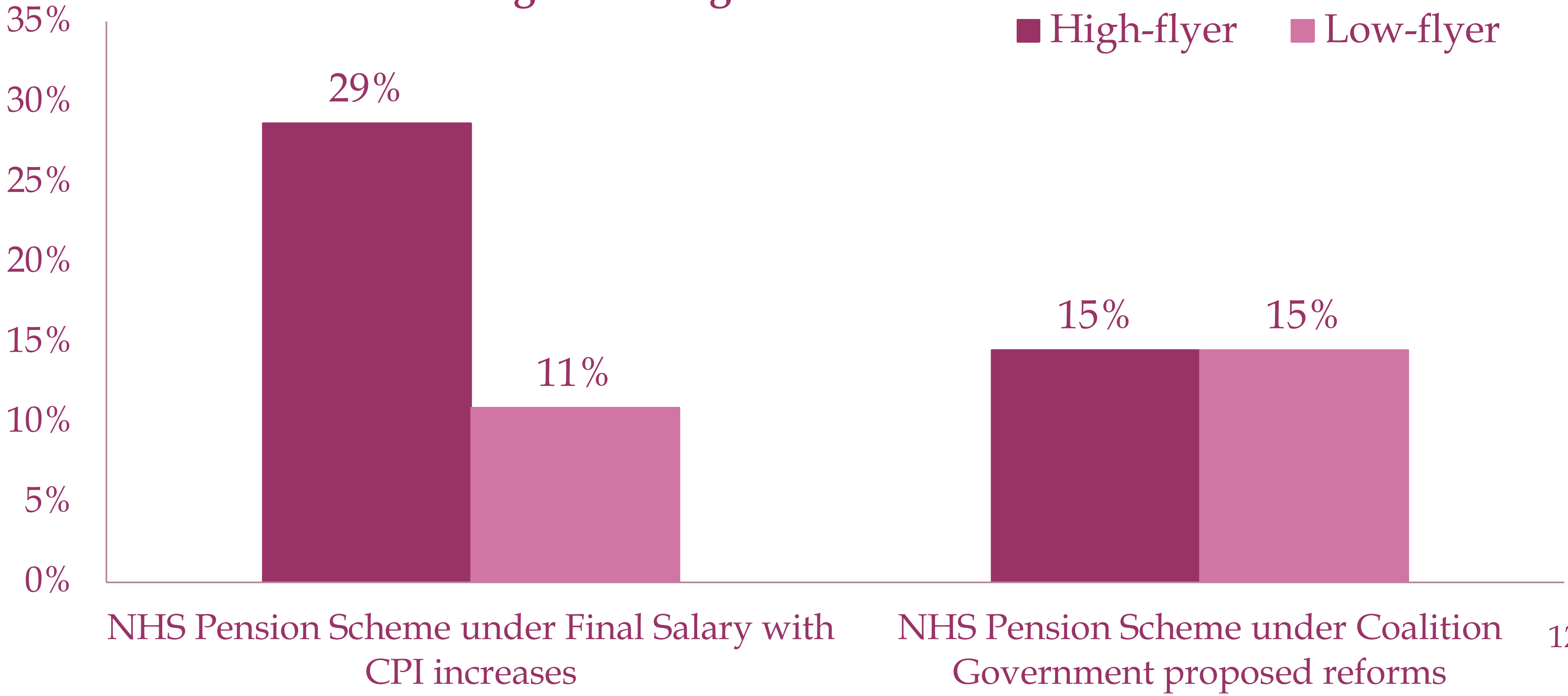
Value of the NHS Pension Scheme to members joining before 1 April 2008 who are: a high flying 40 year old man compared with low flying 40 year old man who both start at the median earning level at age 40



The impact on the affordability of public service pension schemes

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Unfunded schemes:

- **Net Government expenditure** on the NHS, Teachers, Civil Service and uniformed services schemes
- Reflects how much cash the Government spends every year to run the schemes, deducting members' contributions.

LGPS:

- **Gap between pension payments** made by the LGPS and employee contributions received.
- Illustrates the level of strain on employer contributions and investment returns to fill the gap.

Government expenditure on the unfunded public service pension schemes will increase in the short term and decrease in the long term

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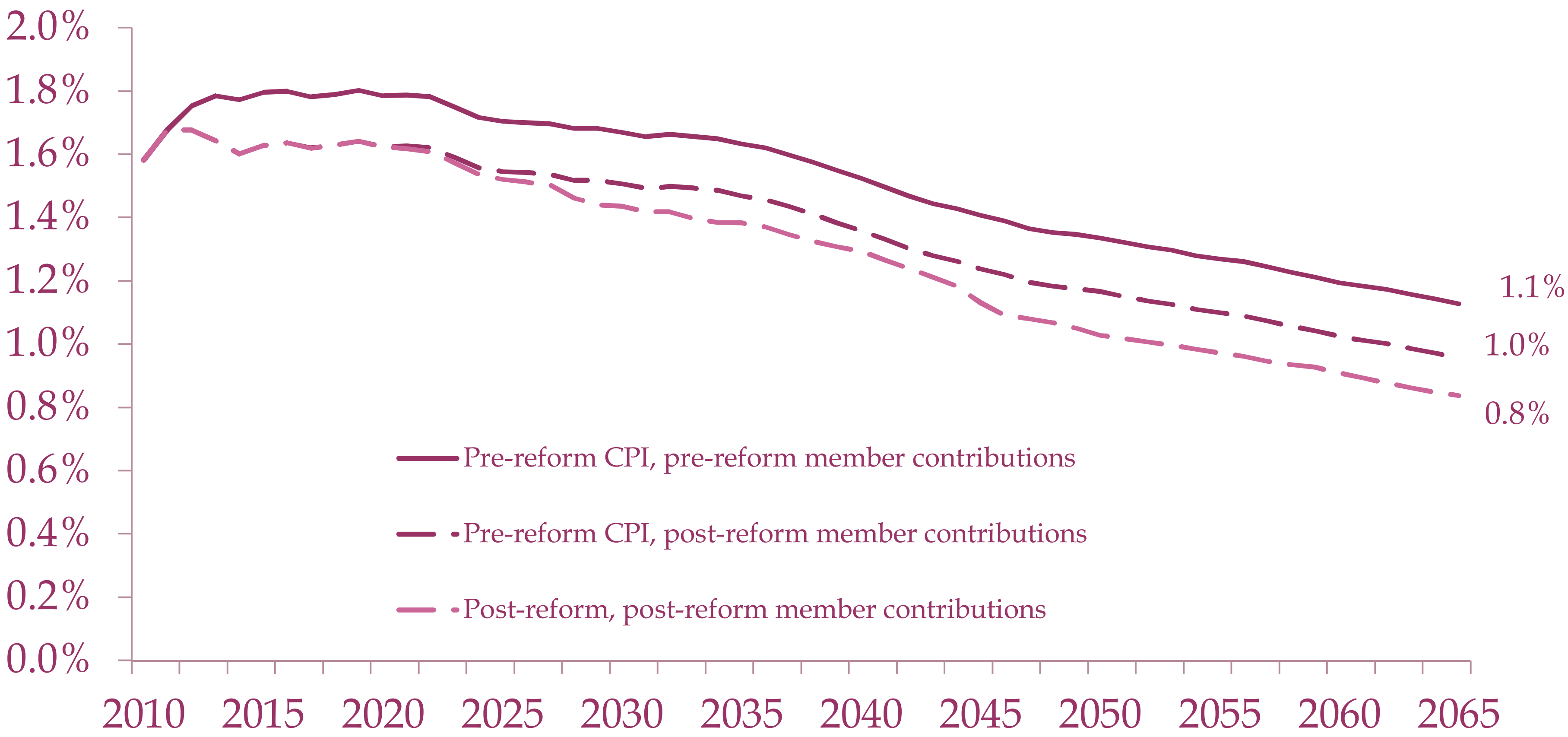
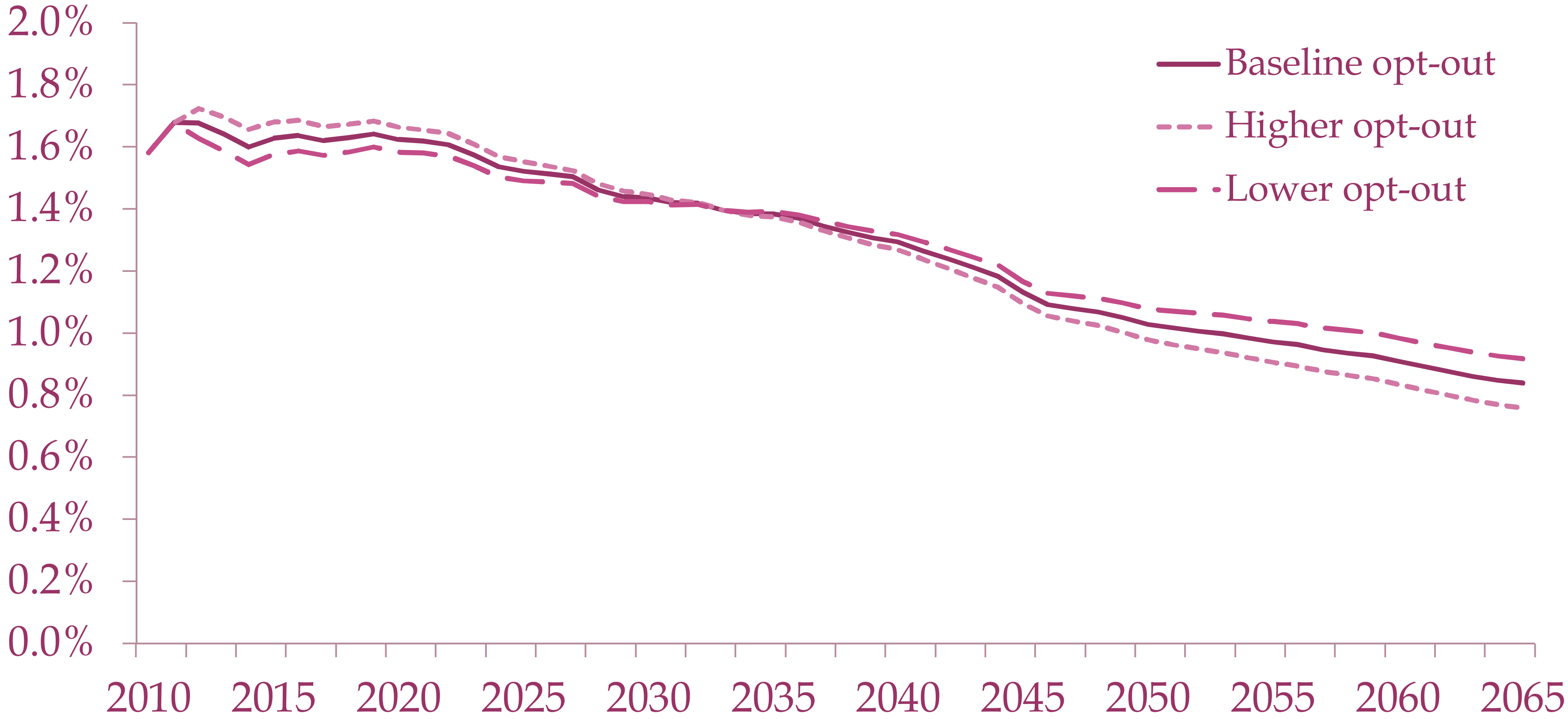
Net government expenditure on unfunded public service pension schemes, as % of GDP



Government expenditure on unfunded public service schemes could depend on employee opt-out rates

Net government expenditure on unfunded public service schemes, as a percentage of GDP



The gap between benefit payments and member contributions in the LGPS will decrease following the Coalition Government's reforms

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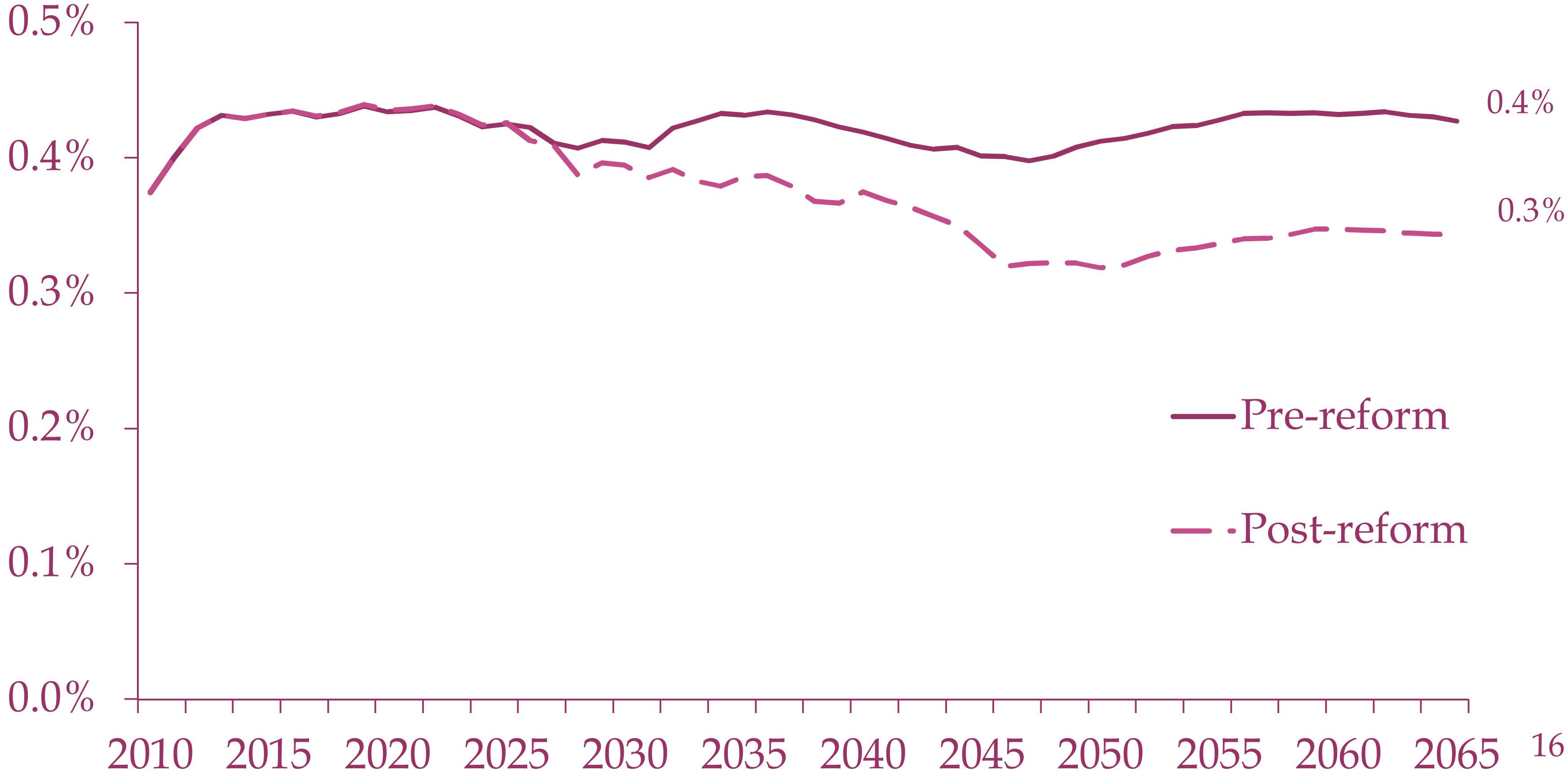
LGPS benefit payments minus employee contributions, as a percentage of GDP



A change in employee opt-out rate will affect the gap between pensions in payment and employee contributions in the LGPS

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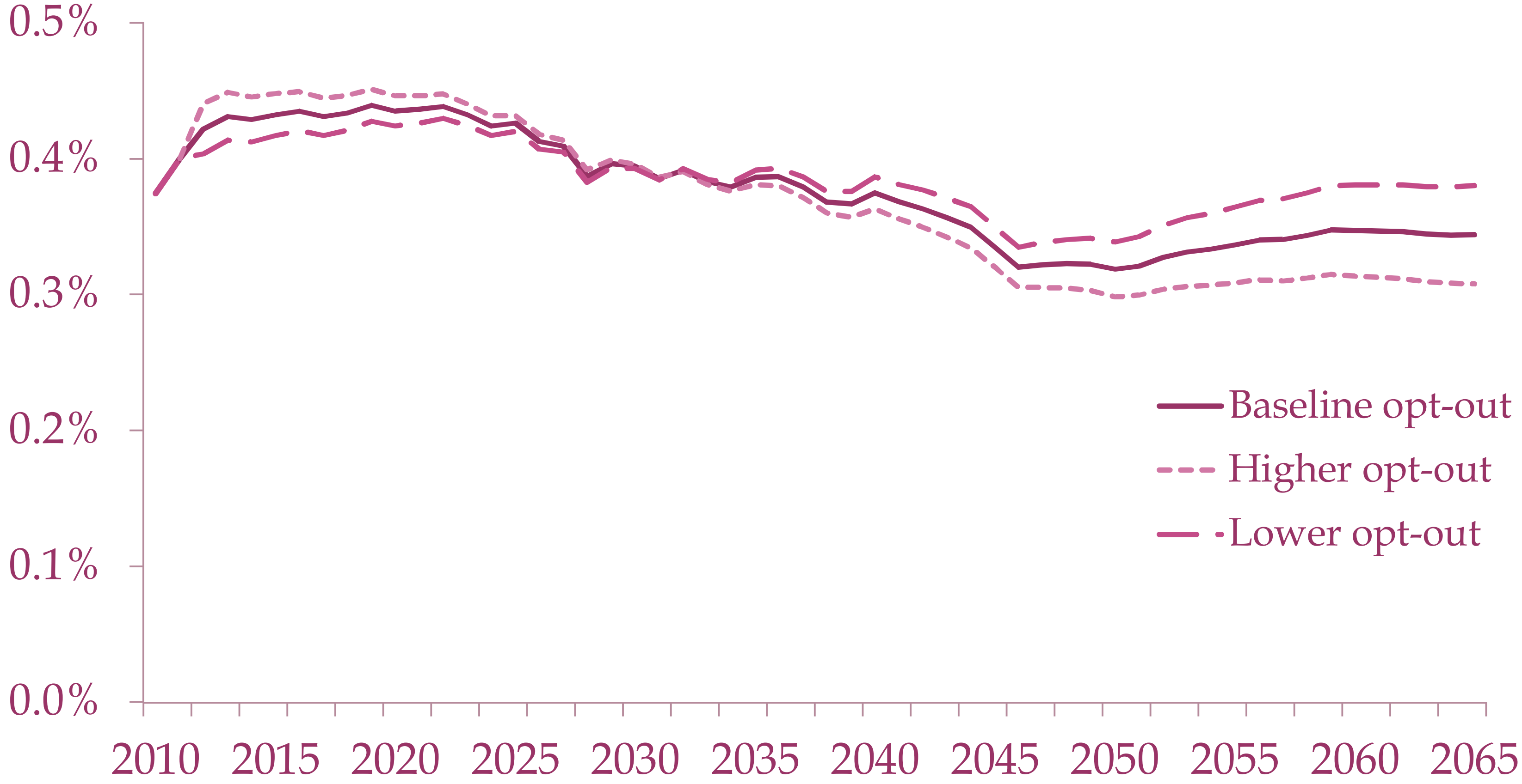
LGPS benefit payments minus employee contributions, as a percentage of GDP



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Conclusions

- The Coalition Government's reforms to the public service schemes reduce the value of the four largest schemes by <u>more than a third</u>
- Some public sector members will be affected to a greater extent, others to a lesser extent
- Public service schemes remain more valuable than most private sector DC schemes
- The reforms reduce government expenditure in the unfunded schemes and reduce the pressure on investment returns and employer contributions in the LGPS. However, this will depend on employee opt-out rates

The implications of the Coalition Government's public service pension reforms

Richard Brown, Deputy Director, Workforce, Pay and Pensions, HM Treasury

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The implications of the Coalition Government's public service pension reforms

Craig Berry, Pensions Policy Officer, Trades Union Congress

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The implications of the Coalition Government's public service pension reforms

Mike Taylor, Chief Executive, London Pensions Fund Authority

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Questions for discussion

- Do the reforms achieve a balance between fairness and long-term sustainability?
- Is a career average scheme the most proper design for public service pensions?
- What would be an adequate level for public service pensions?