PENSIONS POLICY INSTITUTE

PPI

**PRESS RELEASE**
**For immediate release:**
**Friday 12th March 2010**

# "Any reform of public sector pension schemes needs to balance providing adequate pensions for public sector workers with affordability for taxpayers" says Pensions Policy Institute

Any proposals put forward for reforming public sector pension schemes will need to balance the needs of public sector workers, the Government as an employer and the impact on taxpayers according to a discussion paper published today by the Pensions Policy Institute.

The report *public sector pension schemes: policy objectives and options for the future*, sets out the policy objectives that any further reforms of the public sector pensions could aim to meet and identifies a set of policy options that have been proposed. The second stage of the research, due to be published later in 2010, will evaluate a range of reform options against these policy objectives.

Commenting on the report, Niki Cleal, Director of the PPI, said "While there have been many proposals made for reforming public sector pension schemes, it is not always clear what policy objectives such reform proposals are attempting to address."

"The Government's aims in providing public sector pension schemes are to provide adequate pensions for public sector workers and to help recruit and retain high quality staff. But these aims have to be balanced with affordability for the taxpayer, and other broader objectives such as fairness and transparency."

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**An executive summary of the report follows on page 4.**

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The report can be downloaded from www.pensionspolicyinstitute.org.uk

**Notes for editors**

1. The Pensions Policy Institute is an educational charity, which provides non-political, independent comment and analysis on policy on pensions and retirement income provision in the UK. Its aim is to improve the information and understanding about pensions policy and retirement income provision through research and analysis, discussion and publication.

2. The *Future of the public sector pension schemes* project is carried out by the Pensions Policy Institute and funded by the Nuffield Foundation.

3. The Nuffield Foundation is a charitable trust established by Lord Nuffield. Its widest charitable objective is 'the advancement of social well-being'. The Foundation has long had an interest in social welfare and has supported this project to stimulate public discussion and policy development. The views expressed are however those of the authors and not necessarily those of the Foundation.

4. Previous PPI research (available from the PPI website www.pensionspolicyinstitute.org.uk) examined the impact of the 2007/08 reforms to the four main public sector schemes (Civil Service, NHS, Teachers and Local Government) as well as the earlier reforms of the pension schemes of the uniformed services (Armed Forces, Police and Fire). The research found that the Government's reforms have reduced the value of the main public sector pension schemes to public sector workers. However, the value of all the main public sector schemes is still substantially higher than most of the defined contribution pension schemes that are now more commonly offered by private sector employers.

5. The current research project will:
   - Consider if there is a need for further reform of the public sector pension schemes, and identify the policy objectives that any further reforms might aim to address.
   - Identify a set of possible further reforms for the public sector pension schemes
   - Analyse the possible reforms against the identified policy objectives

6. This report addresses the first two issues above. A further report will be published later in 2010, which will set out the PPI's analysis of the set of policy options. The PPI is not calling for further reforms of the public sector pension schemes. The objective of this research is to provide an independent evidence base to help policymakers to understand the implications of alternative policies.

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## Executive Summary

Public sector pension schemes are pension schemes run and paid for by the Government for the benefit of public sector employees. They have been the subject of a number of reforms since 2002.

Previous PPI research examined the impact of the 2007/08 reforms to the four main public sector schemes (Civil Service, NHS, Teachers and Local Government) as well as the earlier reforms to the pension schemes of the uniformed services (Armed Forces, Police and Fire). The research found that the Government's reforms have reduced the value of the main public sector pension schemes to public sector workers. However, the value of all the main public sector schemes is still substantially higher than most of the defined contribution pension schemes that are now more commonly offered by private sector employers.

The PPI is undertaking further research on the future of the public sector pension schemes. The research will:

1. Consider if there is a need for further reform of the public sector pension schemes, and identify the policy objectives that any further reforms might aim to address.
2. Identify a set of possible further reforms for the public sector pension schemes
3. Analyse the possible reforms against the identified policy objectives

This report addresses the first two issues above. A further report will be published later in 2010, which will set out the PPI's analysis of the set of policy options. The PPI is not calling for further reforms of the public sector pension schemes. The objective of this research is to provide an independent evidence base to help policymakers to understand the implications of alternative policies.

**Current public sector provision**
The seven main public sector pension schemes have a combined active membership of a little under 5 million employees.

Six of the main schemes are unfunded, meaning that there is no fund of assets to back the pension promises. Current pensions are paid out using the contributions in respect of current members, with the Government making up any difference. Only the Local Government Pension Scheme has a fund of assets invested to cover the pension promises.

The main changes introduced in the 2007 and 2008 reforms were:

- The Normal Pension Age (NPA) of new entrants to the NHS, Civil Service and Teachers' schemes has increased from 60 to 65. Existing members of the schemes have retained an NPA of 60.
- A number of the schemes have changed the amount which employees have to pay in to the scheme. The NHS and Local Government scheme have introduced tiered contributions based on the level of salary.
- Accrual rates have increased for new entrants to the NHS, Teachers' and Local Government schemes for new entrants, from 80ths to 60ths of salary. The separate lump sum accrual, which used to provide a lump sum of 3/80ths of salary for each year of service, has been abolished for new entrants.
- Cost sharing and cost capping agreements are in place for each of the four main schemes. Cost sharing allocates unanticipated increases in the costs of the scheme 50:50 between the employer and the member. Cost capping limits the employer contributions at a certain level, unanticipated costs above this level may fall fully on the members.

The changes have reduced the value of the schemes to new entrants to the four main public sector schemes from around 23% to 20% of salary and for new entrants to the uniformed service schemes from around 37% to 33% of salary.

**Is there a need for further reform of the public sector pensions?**
Calls for further reforms to the public sector pension schemes have been voiced by a number of organisations. Some of the political parties, business lobby groups and trade unions have publicly discussed possible options for the future of public sector pension schemes.

It is useful to determine a set of desirable policy objectives for any reforms to the public sector pensions. The effectiveness of suggested reforms can then be measured against these objectives. Potential objectives for reform could be:

- to ensure that public sector pensions provide adequate pensions for public sector workers in their retirement,
- to address concerns that public sector pension schemes are unaffordable and not financially sustainable,
- to improve the transparency of the cost of the pensions being offered to public sector employees
- to address perceptions that public sector pension schemes offer higher levels of benefits than private sector pension schemes,
- to address unfairness between members within the same public sector pension scheme, and
- to enable the Government to recruit and retain high quality staff.

**Options for the future of the public sector pension schemes**
There have been a number of calls for reform or specific policy proposals made. These have fallen into a number of different broad categories of proposals. These are:

- *Continue current policy*, and implement the already agreed reforms for new entrants with no further change. In particular it assumes that the already agreed cost sharing and cost capping agreements are implemented.
- *Make changes to existing final salary schemes* such as increasing normal retirement ages in line with changes to the state pension age, placing a cap on the benefit accrued or increasing member contributions further.
- *Risk sharing measures* such as moving schemes to career average arrangements such as the civil service scheme or implementing hybrid scheme with a defined benefit arrangement on a base salary with a defined contribution top up.
- *Move to defined contribution arrangements* such as looking at the impact of moving to a funded defined contribution system or a notional defined contribution system such as the one used in Sweden.

The PPI will publish an assessment of these policy options against the policy objectives set out above later in 2010.