PENSIONS POLICY INSTITUTE

PPI

# PPI policy seminar: The implications of the Coalition Government's public service pension reforms

The Pensions Policy Institute (PPI) held a policy seminar on 16 May 2013 to launch its latest report *The implications of the Coalition Government's public service pension reforms.* The research was funded by a grant from the Nuffield Foundation and its main goal was to analyse the impact of the Coalition Government's proposed public service pension reforms:

- On the value of the pension benefit offered to public service scheme members.
- On long-term affordability and sustainability of public service pension schemes.

The seminar was attended by around 40 people representing a broad range of interests within Government, the pensions industry and the third sector.

**Sharon Witherspoon, Nuffield Director,** chaired the seminar.

**Niki Cleal, PPI Director,** presented the findings of the report related to the impact of the Coalition Government proposed reforms on the pension benefit offered to public service scheme members. The main findings are:

- The reforms will reduce the average value of the pension benefit for all members of the NHS, Teachers, Local Government and Civil Service pension schemes from 23% of a member's salary before the Coalition Government's reforms, to 15% of a member's salary after the Coalition Government's reforms, a reduction in the average value of the pension benefit for members of these four schemes of more than a third.
- Even after the Coalition's proposed reforms the benefit offered by all four of the largest public service pension schemes remains more valuable, on average, than the pension benefit offered by Defined Contribution (DC) schemes that are now most commonly offered to employees in the private sector, into which employers typically contribute around 7% of a DC scheme member's salary.
- The specific impact of the proposed reforms on the value of the pension benefit offered to public service pension scheme members will depend on when the member joined the scheme and on a range of factors, including: the member's age and salary when the reforms are introduced, their salary progression and whether they leave public service early or stay in the scheme until they retire.

**Chris Curry, PPI Research Director,** presented the findings related to the long-term affordability and sustainability of public service pension schemes. The main findings are:

- The reforms will reduce net government expenditure on unfunded public service schemes from around 1.1% of GDP by 2065 under the current system to around 0.8% of GDP in the reformed system – a reduction of around a quarter.
- However, future levels of scheme member opt-out rates will affect long-term net government expenditure on public service pension schemes.
- If the opt-out rate increased from 15% (the baseline used in this analysis) to 25%, net government expenditure on the unfunded public service pension schemes could decrease to around 0.7% of GDP by 2065.
- Conversely, if the opt-out rate decreased to 5%, net government expenditure could increase to around 0.9% of GDP by 2065.
- In the LGPS, after the implementation of the reforms, the excess of pension payments over employee contributions is projected to fall to around 0.35% of GDP by 2065, compared to 0.4% before the reforms.
- However, if the opt-out rate increased to 25%, the gap between pensions in payment and member contributions could decrease to around 0.3% of GDP by 2065, compared to 0.35% under the central opt-out rate scenario of 15%.
- By contrast, if the opt-out rate decreased to 5%, the gap between pensions in payment and member contributions could increase to around 0.4% of GDP.

The PPI presentation can be accessed here.

**Richard Brown, Deputy Director of Workforce, Pay and Pensions at HM Treasury**, provided the Government's perspective on the proposed reforms to public service pension schemes. He highlighted that the Coalition Government undertook a strategic approach to public service pension reform by setting up the Independent Public Service Pensions Commission to build consensus around the need for reform and to develop proposals on the reforms themselves. In terms of costs, he noted that the change in the measure to index public service pensions from the Retail Price Index (RPI) to the Consumer Prices Index (CPI) had a significant impact on the long-term cost of public service pensions. He also highlighted that the increase in contributions has shifted some of the cost of paying for pensions from the employer, and ultimately the taxpayer, to the beneficiaries, although employers' contributions still remain significant.

Moving to fairness, Richard highlighted that a CARE scheme will be fairer to most middle and low earners. He also highlighted that provisions in the Public Service Pensions Act set a high hurdle to any future changes to core elements of public service pension schemes in the next 25 years.

In terms of cost risk management, Richard highlighted that the reforms will align the Normal Pension Age to the State Pension Age to track longevity changes and introduce an employer cost cap mechanism, which will see unforeseen changes in scheme costs shared by members and employers. The reforms will also see stronger scheme governance requirements.

**Craig Berry, Pensions Officer at the Trades Union Congress,** provided a public service scheme member perspective. He acknowledged that higher longevity has increased the cost of providing public service pensions, but noted that reforms must be addressed in a way that does not undermine public services or overlook that the best solution to population ageing is higher employment among the existing working-age population. Growth of the public sector workforce is also a cost driver that is too often overlooked.

Craig also observed that public service pensions are not as costly and generous as people think. In this sense, he highlighted that the reforms will reduce employee benefits and that the switch to CPI for the indexation of pensions has had a significant impact on the costs of public service pension schemes. He argued that decisions about the provision and cost of public service pensions cannot be distinguished from decisions about the shape, extent and quality of public services, and about the workforce needed to deliver public services. He also noted that it is important that people in the uniformed services have a lower Normal Pension Age but that other public service workers performing demanding jobs should also have a lower NPA.

Finally, Craig remarked that although scheme members are advised against opting-out of public service pension schemes, some public service scheme members may opt-out because they may not afford higher contribution rates.

**Mike Taylor, Chief Executive, London Pensions Fund Authority,** provided a public service employer view of the reforms. He highlighted that the PPI research shows that the proposed reforms make a difference but over the long-term. On the Local Government Pension Scheme, he observed that the PPI research suggest that the reforms will reduce the value of the benefit offered to scheme members by around a third. He also noted that the significantly higher contribution rates for higher earners could lead to less support for the schemes and higher opt-out rates in the future. In turn, higher opt-out rates could put pressure on the funding of the schemes, making necessary further cost saving measures in the future.

Finally, Mike noted that while a CARE system will produce fairer outcomes it will also introduce more complexity in the administration of the schemes.

**Questions and Discussion:**
The following points were raised during the questions and discussion section. They do not necessarily reflect the views of the PPI or the PPI seminar speakers.

- It is difficult to make comparisons between the value of the pension benefit being offered to members of public service schemes and the value of the pension benefit being offered to members of private sector Defined Benefit schemes, and that it would be much more expensive to provide a scheme equivalent to the reformed public service schemes in the private sector. However such comparisons can be made as long as consistent assumptions are used as in the report, which estimated the value to members of the public service schemes of providing private sector level benefits.
- Higher levels of opt-out could affect the sustainability of public service pension schemes.
- It was felt that there is a reason for public service pensions to be different from the ones offered in the private sector. However, it was highlighted that public service pensions should be affordable and sustainable.
- The reforms will have a significant impact on the governance of public service schemes. It was felt that much can be learned from changes in governance in private sector pension schemes.
- The combination of higher contributions for higher earners and a CARE benefit structure that will reduce the value of the pension benefit offered to high-flyers may have an impact on future opt-out rate levels from some scheme members. In turn, this may affect the future sustainability of public service schemes.
- There was some discussion around the issue of protection. It was argued that older workers are protected by the reforms. However, it was felt that the concept of protection is relative, as the government may change rules that could have a significant impact on the cost of public service schemes at any time, such as the change in the measure to index public service pension from the RPI to the CPI.

- Members of the uniformed services may not see a similar impact of the proposed reforms on the value of the pension benefit being offered as those of the four largest schemes because of the lower Normal Pension Age of 60 years.
- There was some discussion around whether a Notional Defined Contribution benefit structure had been considered as an option for the reform public service pension schemes. It was noted that the Independent Public Service Pension Commission had analysed such an option.
- There is a question as to whether Defined Benefit public service pension schemes will be sustainable in the future given the increasing role of Defined Contribution schemes in private sector pension provision.