



# **CIPFA FINANCING PENSIONS**

**8th March 2006**

**Bob Summers**

**Director of Finance, Norfolk County Council,  
Chair of the CIPFA Pensions Panel  
Administrator of the Norfolk Pension Fund**

# **‘Public Sector Pensions Provision’**



- **Scale of the problems facing various public sector service providers UK wide**
- **Update on the latest position**
- **What can we do about it?**





“80% of public sector employees participate in occupational pension schemes compared to less than 40% in private sector”

***(Pension Commission 2004)***

Total active Public Sector Pensions Membership in UK- 4.5m people

***(Private Sector 5.7m)***



# Momentum for change



Government's agreement with unions on changes to Public Sector Schemes (except LGPS)

Spiralling Employer Costs

Commitment by Government to introduce the new LGPS (in 2008)

Adair Turner report 'Pensions Challenges & Choices'

Efficiency agenda - Gershon and potential for increased targets after 'Public Spending Review' in July 2006

Media storm - Channel 4 TV - 'Whose Pensions are you paying for?'

Private Sector woes / pensions envy growing daily

# Examples of Pensions Envy / Private Sector Woes



## **Sir Digby Jones, director general of the CBI:**

“The world of pensions has changed. The days of paternalism are over. This isn’t a sign of bad employers, but ones who are facing up to today’s challenges. It’s a pity the Government, in charge of an ever-burgeoning public sector, is not being responsible with taxpayers’ money”

## **Stewart Ritchie of Aegon, the insurance group:**

“But the value of their pensions is so excessive compared with the rest of industry that the scales have completely tilted in favour of working for the Government”

## **David Frost, director general of the British Chamber of Commerce:**

“This deal is unacceptable from the standpoint of British business” . “The government needed to grasp the nettle and increase the public sector retirement age for existing employees on a sliding scale. They have failed to do this” , he added.



**David Willets, the Shadow Trade & Industry Secretary, says:**

“There is growing divide between public and private sector pensions which cannot be sustained”, he added

“At this rate it could take forty years for the public sector retirement age to rise. The Arctic ice cap is melting more rapidly than the Government is reforming public sector pensions”

**And....Top business leaders letter to Tony Blair:**

“How fair is it to expect corporate and individual taxpayers in the private sector to pay twice for the emerging pensions crisis, by making sacrifices to their own retirement provision, while paying for public sector employees’ pensions”?

# Today's public service provision



- Provides substantial health, education, armed forces and infrastructure services
- Employs around 17% of workforce & provides 17% of all earnings
- Public Services consume 41% of GDP
- Accounts for 36% of accrued occupational and personal pension rights. This percentage is predicted to grow
- Different Pension schemes

# Seven Main Public Sector Schemes



## Centrally Run

## Locally Run

### Unfunded

NHS  
Teachers  
Armed Forces  
Civil Servants

Police  
Fire-fighters

### Funded

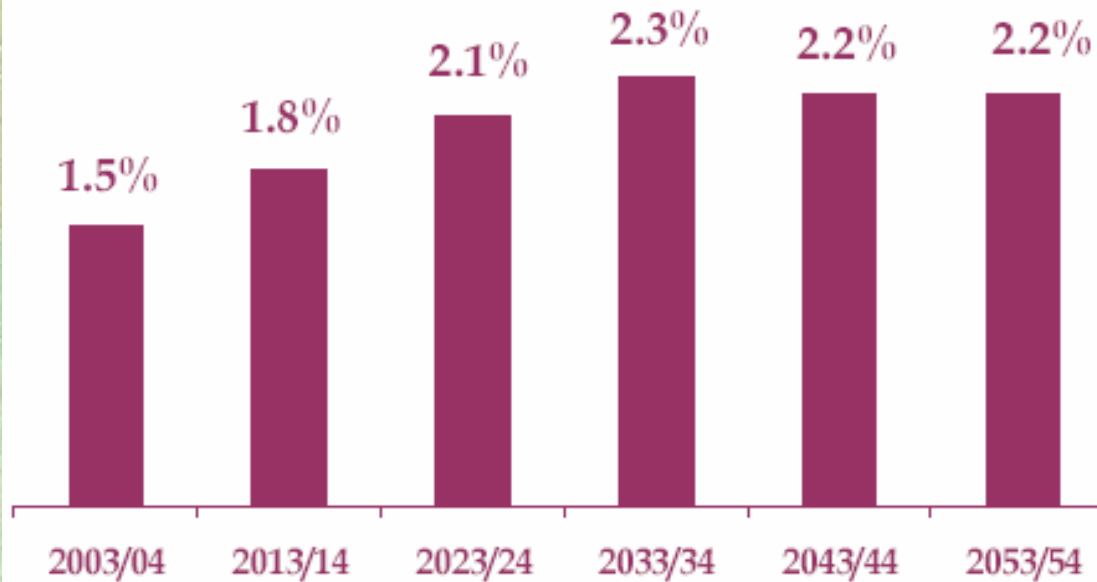
Local Government



**Currently pays out £16.5bn a year  
in pay-as-you-go pensions, 1.6% of  
GDP & rising**



**Expenditure on benefits from the unfunded public  
sector pension schemes, % GDP**



# How do we pay for Public Sector Pensions?



- **Employees paying a pensions contribution:**

Teachers - 6%

*(Employer contribution paid at rate set by central government into a notional fund)*

Police - 11%

Fire-fighters - 11%

- ***Employer Cost - Not per Channel 4!!***

Using 2004/5 & (2005/6) data indications:

5-8% FSS (Formula Spending Share)



# How do we pay for the LGPS?



## The only 'funded' scheme - Local Government Pension Scheme (LGPS) pays benefits from:

- Employers contributions  
(variable percentage of payroll according to liabilities and actuarial assumptions) currently approx.. between 14% and 22%
- Employee contributions 6%, set by statute
- Returns on investment

# Why are costs rising?

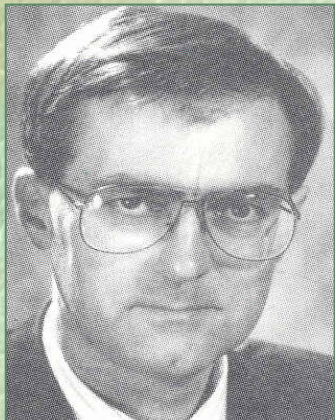
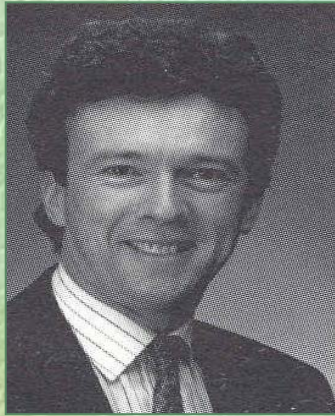


- Non funded public sector schemes paying benefits on a 'pay as you go' basis are paying more! There are significant annual variations based on outflow of members retiring, drawing pensions and taking lump sums
- Like all funded pension schemes in the private sector, the LGPS has seen a gap open between its assets and liabilities
- Investment markets have been flat since the late 1990's. Effect of poor returns on equities (until recently) has been exacerbated by the fall in long term interest rates and bond yield that has, unusually accompanied it
- People are living longer - when LGPS set up (70 years ago) average male life expectancy on retirement was another 11 years - it is now 20

# We're all living longer!

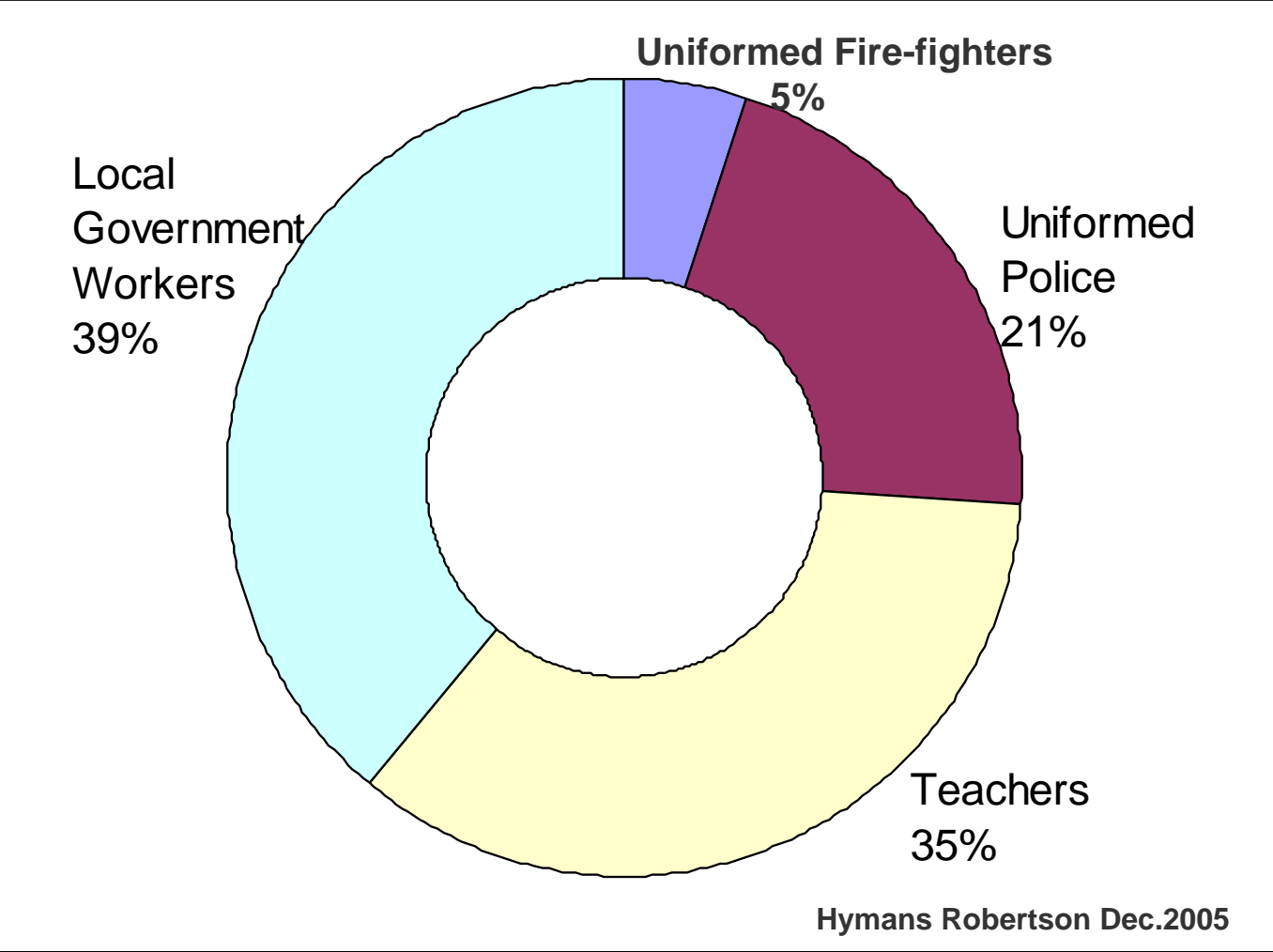


Norfolk Pension Fund

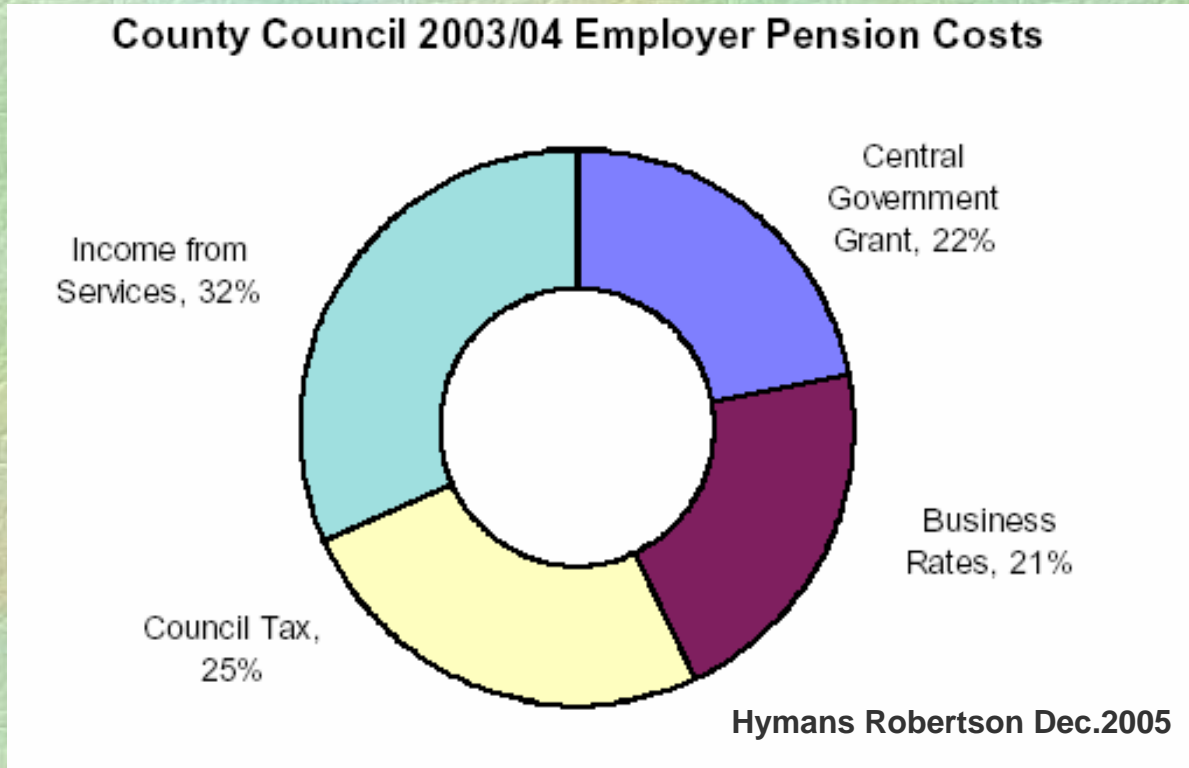


**For every 2 girls born in 2006 one will live to be 100!**

# County Council 2003/2004 Employer Pension Costs



# Income Sources



The second graph shows the split of County Council income between its four principal sources. Local Government has limited control over the level of its income. The levels of business rates are set by Central Government. Central government grant is attributed under a complex system that considers various criteria.

# Pressure on Contribution Rates - Impact on a typical Employer



## 2001 Employer Funding Position

Surplus	£3.4m
Employers Contribution Rate	12.5%
Active Membership	1,006

(Active membership at 1998 Valuation was 1,884 but Direct Service Organisation (DSO ) was outsourced in 2000)

# Pressure on Contribution Rates - Impact on a typical Employer (cont..)



## 2004 Employer Funding Position

* Deficit		£27m
(Using more prudent assumptions than in 2001)		
Employers Contribution Rate		
<i>(almost double that in 2001)</i>		23.2%
Comprising:	Future Service	13.2%
	Deficit Recovery	10%
<i>(Increase in rate to be phased in over 6 year period)</i>		
Active Membership		908
Deficit Recovery Period		20 years
invi		
* <b>Contributing factors, lower return on investment (capital loses), prior ill-health retirement experience, salary increases greater than inflation</b>		

# Potential to get worse!



## Reducing Pensionable Payroll

- In response to budget difficulties the employer makes further redundancies in staff, thus reducing it's pensionable payroll *by 31 January 2006 - payroll has already reduced by another 92 active members)*
- Cash Deficit recovered against a smaller payroll therefore the required contribution rises - "Gearing on Deficit Recovery"
- Potentially 1.3% per annum onto contribution rate if we were to take a snap shot at current time

# Further Pressure on Contribution Rate Post 2004 Valuation for this Employer



**Remember, responsibility for impact of service deficit on outsourced services remains:-**

- Employer retains liability for pre-contract liabilities of outsourced staff of DSO
- Contract let when the Fund was in surplus
- Current Liability relating to the employer is £4 million
- Will need to be addressed at the 2007 valuation
- Estimate would be additional 1.5% for the next 20 years (above addition of 1.3% already identified)

# Impact of decline in bond yields



## Significant decline since 2004 Valuation but accelerated in January 2006

- Because of the way actuaries value future liabilities, the fall significantly increases the value of liabilities in the future
- The problem is common to all employers whichever actuarial firm is used
- If the extremely low bond yields continue, contributions could rise by another 3 - 4% per annum

# Pressure on Contribution Rates



## What can be done for this Employer?

The issue must be recognised by the senior management team and elected members so that it can be addressed -

*(this is not just a matter for the Finance Director)*

- Need for meaningful dialogue between Pension Fund and Employer
- Ultimately it is the Employer that has responsibility for the Deficit

***But we don't know the impact of.....***

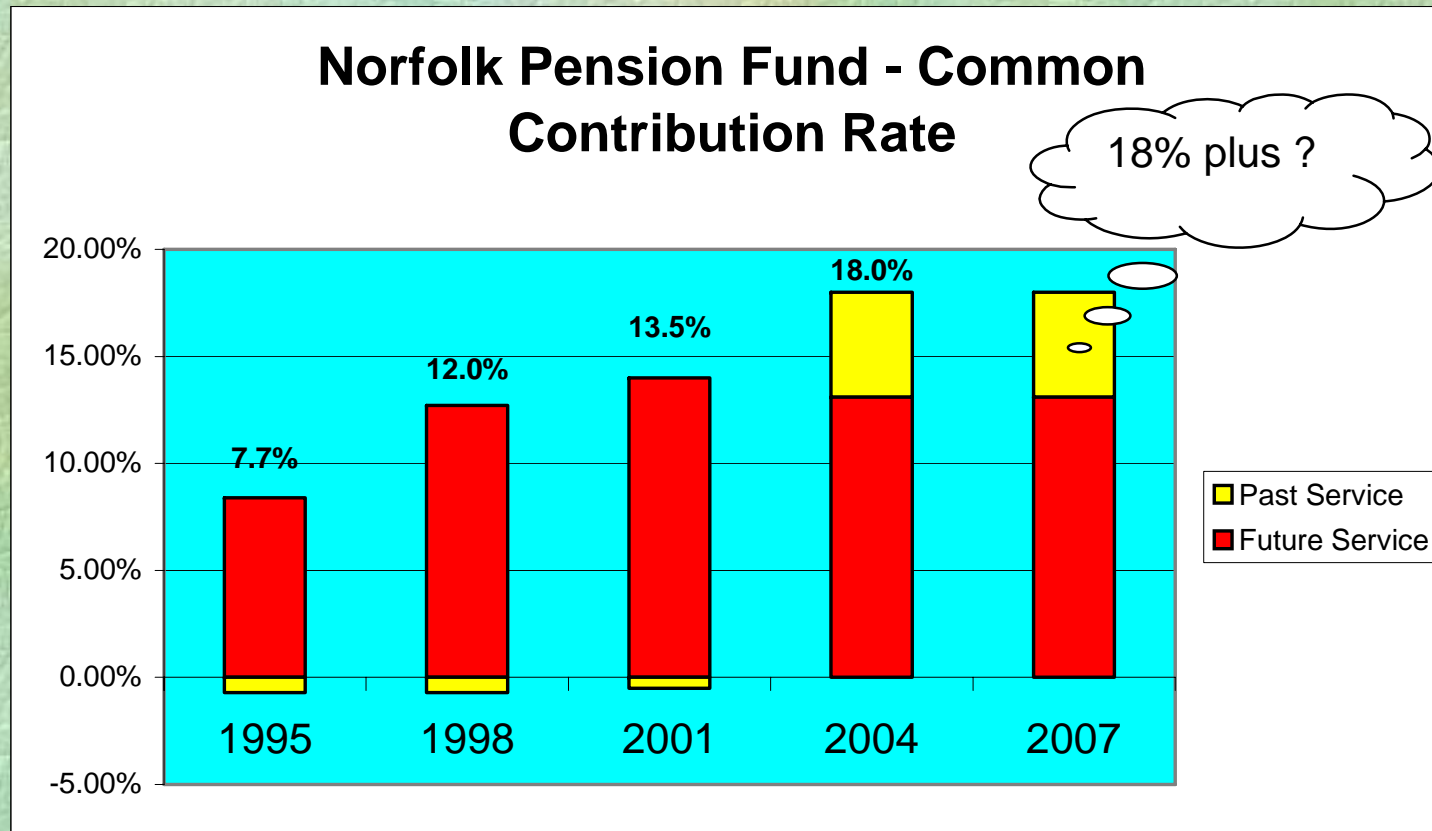
- Savings from the Abolition of the "Rule of 85"?
- Is bond yield a market blip or will it continue?
- What assumptions will be used at the 2007 valuation?
- Will longevity continue to be an issue!
- A new scheme in 2008?

**.....But we do know the deficit won't go away!**

## Next LGPS Valuation - March 2007 ???



# Illustration of affordability & sustainability issue - your funds are unlikely to be any different



- **Past Service Adjustment** is made in respect of deficit or surplus on Fund at date of valuation. The rate is reduced if the Fund is in surplus and increased if there is a deficit
- **Future Service element** is the cost of benefits accruing in the current year

# All this means it's not surprising that administration & investment costs are coming into the spotlight



- Requirement to minimise impact on Council Tax whilst still providing an appropriate pension scheme for employees
- Media circus around pensions
- Union action
- Public pensions envy
- Government under pressure to do something
- Freedom of Information Act



- Affordability for Employers - remember in the average Shire County - 1% of payroll equates to approx. 0.5% increase in Council Tax
- More complex investment arrangements and products
- Customer expectation
- Administration - demand for “smart” services from both employer and employee members
- A new LGPS from 2008 - attractive, affordable & appropriate
- Increasing requirement to prove that our Pensions Service (investment & administration) is efficient and effective

**All this underpinned by the Governments’ Gershon initiative - “releasing resources to the front line” through efficiency savings - means we must take a serious look at the way we run the LGPS**

# Savings/Efficiencies/Gershon



## Sir Peter Gershon

Independent review of public sector efficiency identifies significant potential savings from more efficient corporate service or back office activities

For essentially transactional services, he proposes that major savings are achievable by combining LA delivery across many authorities in a shared service centre

(2.5% year on year for 3 years made up of cashable and non-cashable efficiencies)



**Target for Local Government - £6.45b over 3 years**

***Gershon - report published July 04  
followed by IDeA & LGA guidance  
August 2004***



**“Releasing resources to the front line through efficiency savings”**

- Reduced number of inputs (people/assets) whilst maintaining the same level of service provision -

***Same for less***

- Improving quality for the same level of input -

***More quality for same***

- Improved ratios of output per unit cost of input -

***More quantity for same***

# London pension costs already under scrutiny



Although there may be valid reasons, the Office of the Deputy Prime Minister (ODPM) data demonstrates unit costs for pensions administration (including fund management & investment fees) in London are generally higher than elsewhere in the country.

This has raised question of whether there are opportunities for savings





The LGPS in London is administered by each individual London Borough

In addition London Pension Fund Authority deals with ex-Greater London Council and Inner London Education Authority pensions, parts of the Greater London Authority family and a number of smaller bodies

**LONDON**



## England and Wales SF3 Data - 2000/01 - Per Capita Administration Costs



SF3 DATA 20010/01	Admin Costs (£ psm)	Fund Management (£ psm)	TOTAL (£ psm)
Inner London	£43.59	£102.79	£146.38
Outer London	£43.62	£67.77	£111.39
English Shires	£21.75	£48.64	£70.39
Metropolitan Authorities	£17.90	£21.37	£39.27
Other English Authorities	£31.12	£37.19	£68.30
All English Authorities	£24.29	45.57	£69.86
Welsh Authorities	£23.51	63.34	£86.86
All Authorities	£24.24	£46.63	£70.87

Cost per scheme member has been calculated as the total cost divided by the total number of scheme members in each category. </=

Last publicly available data from the ODPM web site



The Audit Commission is undertaking an initial study with the objective to:

- identify savings for local authorities; and
- identify best practice supported by objective evidence

**The Audit Commission is well placed to do this work as they are the auditor for the London Pension Fund Authority (LPFA) & London Boroughs**



# Audit Commission Project Timetable



Date of Project Stage	Project Stage
Sept - Nov 2005	Initial planning and consultation (with all London Boroughs)
Dec 2005 - March 2006	Main research, including fieldwork and data collection
April 2006 - onwards	Product development.
Summer 2006	Publication of open letter

**Depending on the findings from this work a more in depth study may be carried out which would be consulted on at a later date**

# But don't panic, its only the beginning....



Many discussion papers are being produced by leading academics and individuals as contribution to the public pensions debate, there is already recognition of the more long-term view of the public sector rather than the immediate focus on the balance sheet (primarily prompted by FRS17) in the private sector

**The debate will continue.....**



Don't  
Panic!

Mr  
Mainwaring



**And after all.....**

**Public Sector Pensions -**

**“Currently the most stable  
part of the UK System”**

**Adair Turner 2005**



**And you can be sure that whatever route we take -  
the Local Government finance community is committed to  
managing and balancing pension costs to ensure that public sector  
pensions are affordable and sustainable into the future.....**

