

Independent Public Service Pensions Commission (IPSPC)

Lord Hutton's interim report

7th October 2010

This morning Lord Hutton of Furness published his interim report of the Independent Public Service Pensions Commission (IPSPC). We have produced this summary of some of the key points which we think may be of interest to you.

The first headline is that "the current structure of public service pensions is in need of reform". We have split the other key points into three broad headings: short term reform, long term reform and miscellaneous.

Short term reform

- "There is a case to make short-term changes" but "There must be proper protection for accrued rights", and so "changing the benefit structure is not a viable option for making short-term savings."
- "There is a rationale for increasing member contributions to ensure a fairer distribution of costs between taxpayers and members" and "it is a matter for the Government to decide the manner and level of any increases in contributions necessary."
- The Government "should have regard to protecting the low paid and to the possibility of significant increases in the number of employees opting out of schemes and should consider staging increases in contributions where appropriate, to minimise this risk."

Long term reform

- "The current public service pension system has been unable to respond flexibly to changes in demographics over the past few decades and the need for greater mobility between the public and other sectors". It "has also led to disproportionate benefits for high flyers" relative to low flyers "and an unfair division of costs between the employer and the employee".
- "Long-term structural reform is needed as these issues cannot be dealt with through provision of traditional final salary defined benefit schemes."
- Moving to "a funded, individual account, defined contribution model for all employees" is not a viable option because, for example, "this would place a major financing burden on taxpayers."
- "An alternative scheme model that provides a fair sharing of risk between the employer and employee; and adequate pensions for members is needed."
- So that the Commission can make a recommendation on a range of options to the Government in its final report "a range of alternative structures will be considered. This will include a career average alternative to the current final salary defined benefit schemes", "alternatives such as Sweden's use of notional defined contribution

schemes and the Netherlands' collective defined contribution schemes" and "risk sharing models, such as hybrid schemes that combine elements of defined benefit and defined contribution models. The Commission will also consider elements of scheme design, such as, ensuring normal pension ages are in line with the latest developments in longevity."

Miscellaneous

- Cap and share arrangements "cannot of themselves address the underlying issue of structural reforms, nor significantly reduce current costs to taxpayers."
- The recent change in the indexation of public service pensions from RPI to CPI "may have reduced the value of benefits to scheme members by around 15 per cent on average. When this change is combined with other reforms to date across the major schemes the value to current members of reformed schemes with CPI indexation is, on average, around 25 per cent less than the pre-reform schemes with RPI indexation."
- Having considered various arguments "the Commission believes that it is reasonable, on balance, for Government to structure their public service pension provision on a mainly unfunded basis" and "the Commission has concluded that the current LGPS should continue on a funded basis".
- The Commission "recommend that the Government review the use of the current rate of 3.5 per cent above RPI inflation, in the context of actuarial valuations used to set employer contribution rates, preferably concluding in time to inform the Commission's final report."
- "The current pension structures, combined with the requirement to provide comparable pensions ('Fair Deal'), are a barrier to non-public service providers, potentially making it more difficult to achieve efficiencies and innovation in public service delivery."
- "The Commission does not believe it would be an appropriate short-term measure to introduce member contributions for the armed forces at this time."
- "The downward drift in pension provision in the private sector does not provide sufficient support or justification in my view for the argument that pensions in the public sector must therefore automatically follow the same course".
- Relative to those in the private sector, "There is no evidence that pay is lower for public service workers to reflect higher levels of pension provision."
- "Assessment of reform needs to consider ... implementation and transitional issues, including the means for protecting accrued rights and possibilities for more cost-effective administration."
- It is important that schemes "have a clear legal framework and have effective and accountable governance structures."

The schemes covered by the terms of reference for the IPSPC are listed on the next page. If you have any questions on this summary please get in touch with your usual GAD contact.

The full report can be found at the following link:

http://www.hm-treasury.gov.uk/d/hutton_pensionsinterim_071010.pdf

The schemes covered by the terms of reference for the IPSPC are:

- Principal Civil Service Pension Scheme
- Principal Civil Service Pension Scheme (Northern Ireland)
- Armed Forces Pension Scheme
- NHS Pension Scheme
- NHS Superannuation Scheme (Scotland)
- Health and Personal Social Services Northern Ireland Superannuation Scheme
- Teachers' Pension Scheme (England and Wales)
- Scottish Teachers' Superannuation Scheme
- Northern Ireland Teachers' Superannuation Scheme
- Local Government Pension Scheme (England and Wales)
- Local Government Pension Scheme (Scotland)
- Northern Ireland Local Government Pension Scheme
- Police Pension Scheme (administered locally)
- Firefighters' Pension Scheme (administered locally)
- United Kingdom Atomic Energy Authority Pension Schemes
- Judicial Pensions Scheme
- Department for international Development – Overseas Superannuation Scheme
- Research Councils' Pension Schemes

In addition to the schemes mentioned above, there are a number of smaller schemes and many established to cover only one senior appointment which do not specifically need to form part of the review but which will be required to act on the recommendations.