Isle of Man
Trade Union Council

06 November 2020

Mrs Jane Mooney
Public Sector Pensions Authority
3rd Floor, Prospect House
27-29 Prospect Hill
Douglas, Isle of Man
IM1 1ET

Dear Mrs Mooney,

Please find enclosed a collective statement in relation to the Public Sector Pensions Authority (PSPA) consultation on the Public Sector Pensions (Cost Sharing) Scheme 2019.

Public Sector Pensions – Consultation on Cost Sharing

1. The trade unions representing public sector pension scheme members have agreed on this joint response to the PSPA's consultation on the implementation of cost sharing regulations.
2. A lot of progress has been made to date in putting public sector pension provision on a fair and affordable footing. The reforms that officials and many scheme members have agreed and implemented should be recognised as a significant contribution towards addressing concerns about the cost of public sector pensions. Many scheme members have accepted significantly higher contributions (with increases of up to 8.75% of pay), and all public sector workers have accepted lower pension benefits, in order to control these costs.
3. Members previously accepted these changes in good faith believing this would put public sector pensions on a sustainable long-term footing. These cost sharing proposals sadly indicate that the Government is backing away from this commitment.
4. Scheme members accept the principle of cost sharing if the result of this is that it makes the pension scheme sustainable, stable and fair. The principle of a cost sharing mechanism is generally accepted however it is important that the approach taken to cost sharing is principled and robust and that it achieves sensible objectives.
5. Unfortunately we do not believe that the proposed cost sharing mechanism meets these principles and this could be the first step in making the pension scheme unsustainable and taking away defined benefit pensions from public sector workers.

6. The consultation document states that the future sustainability of public sector pensions is improved by putting this cost sharing mechanism into place. We fundamentally disagree with this for the reasons given in this response.

- Principles for a cost sharing mechanism

7. In our previous consultation response we set out the principles that any cost sharing mechanism should be based on. We feel there is value in reiterating them now as these should be the guiding principles behind a cost sharing mechanism. The key principles are: sustainability, stability and fairness.

8. Sustainability: A cost sharing mechanism needs to ensure that the cost of public sector pension schemes remains affordable in the future. The only way this can be guaranteed is to have a cap on the cost of these schemes to taxpayers. Any cost sharing mechanism that does not cap the cost of the schemes to taxpayers will be inherently unsustainable.

9. Stability: A cost sharing mechanism should deal with major unexpected changes in the cost of the schemes. If the future experience is in line with the baseline assumptions, then there should be no changes resulting from the operation of a cost sharing mechanism because the cost will have been as predicted. Similarly a cost sharing mechanism should not be triggered because of changes in the cost below a de minimus threshold, a certain level of change in the cost of a pension scheme is to be expected and can be managed relatively easily. There are costs to implementing changes arising from the operation of a cost sharing mechanism so it makes sense to have a threshold or a buffer zone within which cost changes (increases or decreases) can be tolerated.

10. Fairness: A cost sharing mechanism has to be fair to gain acceptance. Primarily it needs to be fair between scheme members and all taxpayers. It also has to be fair between different generations of scheme members.

- Cost sharing proposal

11. The main features of the proposed cost sharing mechanism are a 75% / 25% split of any increased cost or saving between employees and the employer with a small 0.5% buffer. Under this option there is no cap on the cost of the schemes to taxpayers. This is potentially unsustainable if eventually costs rise to an unaffordable level.

12. A buffer of this level is too low and is likely to lead to scheme changes at each cost sharing valuation which means that the scheme is inherently unstable. This proposal is not workable in practice and will ultimately put the future of the public sector pension schemes into doubt.

13. The cost split of 75% / 25% is unbalanced and unfair. Our analysis is that this option is unsustainable, unstable and unfair. The proposal is that members bear 75% of any cost increase, with employers bearing 25%. Firstly, this does not cap the cost of the scheme as there is potentially an open-ended increase for employers. Secondly, the proposal for a 0.5% buffer does not provide sufficient protection against unnecessary change to the design of the scheme.

14. A preferable course of action is the earlier proposal for a 2% buffer. This option caps the cost of the scheme to taxpayers which ensures that the scheme is sustainable. The level of the buffer will also minimise the number of times that

changes have to be made to the scheme following a cost sharing valuation. The buffer is reciprocal which is inherently fair. We therefore believe that the 2% buffer option meets the principles outlined above and is therefore sustainable, stable and fair.

- Recovery period

15. The second major element of the cost sharing mechanism that is currently under consultation is the recovery period. It has been proposed that a length of 8 years is used for the recovery period.

16. We believe that a period of 8 years is too short and will lead to unnecessary volatility. This could easily lead to a situation where contributions are increased to unaffordable levels for members. The consultation references a situation where there could be "significant deficits" to recover. It is wholly unacceptable and unfair that scheme members should be required to absorb the vast majority of this cost.

17. One part of the rationale given for a period of 8 years being used is that this fits in with UK private sector schemes. This is an irrelevant consideration as they will be funded schemes which are largely closed to new members and so their time horizon is much shorter than that of the Isle of Man public sector schemes which can take a far longer term approach.

18. The longer the recovery period is, the more stable the cost sharing mechanism will tend to be. The main UK pension schemes adopted a recovery period of 15 years as the best approach for cost sharing in its pension schemes. It is difficult to see why a different approach would be more appropriate for the Isle of Man's pension scheme or why it would result in better outcomes.

19. The consultation document states that the principle underpinning the approach is that the recovery period represents the average future working lifetime of scheme members. This is stated to be 8 years. Despite several requests, the PSPA have not shared the derivation of the estimate of the future working lifetime of scheme members with the trade unions so we can analyse this and discuss it further.

20. The ability to recoup deficits (or share surpluses) with scheme members over their remaining working lifetime is an important element of ensuring intergenerational fairness. However this is only one factor to consider and it needs to be balanced with the need to ensure stability.

21. For these reasons, the trade unions believe that the recovery period should be a minimum of 12 years, and preferably 15 years in line with the UK public sector schemes.

- Technical issues.

22. The draft regulations include a list of what assumptions will be included in the cost sharing mechanism but as yet the details of these assumptions have not been shared. This is a key part of the cost sharing mechanism and we will want to have sight of and discuss these as soon as possible.

23. Within the draft regulations there is continued reference to 'cost cap'. This is misleading because, as we have already identified, this proposal does not cap the cost to the employee or the taxpayer. A more suitable term would be 'cost control mechanism'.

24. The consultation says that upon a cost sharing valuation, the cost of past service benefits will be taken into account. This has not been agreed with members and should not form part of the employee contribution rate that is decided upon after concluding a costs sharing valuation.

25. Whilst analysing the draft regulations and consultation document we have identified a number of issues that either require clarity or amendment. These are as follows:

a. Regulation 6(3)(a) currently reads "all past service accrued on or before the cost sharing valuation date is to be taken into account in the calculation". As previously stated, we do not believe that past service should be included, however, if it is this regulation is inconsistent with other parts of the consultation document which state that only the past service of active members will be part of the cost sharing mechanism. We therefore believe that the words "for active members" need inserting. If this is a deliberate omission then we would strongly object to this part of the regulations as active members should not be repaying a deficit in respect of other members who are no longer paying into the scheme.

b. Regulation 9(2) & (3). This sets out the default position if an agreement is not reached on how the scheme must be amended following a breach of the cost sharing buffer of 0.5%. If the cost of the scheme increases, the default is to adjust the accrual rate, this is acceptable and in line with the UK public sector schemes. However, within clause (3) there is a large amount of ambiguity as to what will happen if the cost of the scheme decreases. The default appears to be a contribution reduction but only if the scheme actuary, Treasury and the PSPA agree. Even after the required consultation, the wording currently states that there "may" be a contribution reduction. If there is not a reduction in the contribution rate, the regulations do not state what the default adjustment would be. This is in stark contrast to the regulation where there has been an increase to the cost of the scheme. The purpose of this section is to provide certainty if there is no collective agreement on scheme changes. The current wording does not achieve this and gives the Treasury far too much discretion. There needs to be certainty as to what the default position is should the cost of the scheme goes down and where agreement is not reached.

c. Regulation 10(2)(b). This gives power to Tynwald to reject the agreed adjustment to the scheme following a breach of the 0.5% cost buffer. Although it is accepted that Tynwald would ultimately have to pass legislation to amend the scheme, if agreement has been reached on scheme changes then this should be a formality rather a power to reject the changes. This is a concern to us as the regulation reads as though this is an additional check rather than simply passing the agreed changes.

d. Schedule 1, 1(1)(e)(vi) - new entrant profiles. Clarity is required as to what this entails. We believe that it relates to the age and salary of new entrants but clarification would be appreciated.

e. Schedule 1, 1(1)(e)(vii) – mortality rates (both baselines and future improvements). This should read as "both baseline and future changes" to take into account a situation where mortality rates worsen.

f. Schedule 1, 3(3). It is not clear to us what this clause is trying to achieve. An explanation and amendment to the wording is required.

26. In the interest of transparency there should also be a governance structure overseeing the valuation arrangements that provides a mechanism for members' representatives to comment on the assumptions used. There is a proposal within the consultation document to form a committee that considers the cost sharing mechanism and report on how it believes any cost change amount should be reflected in scheme changes. We welcome this proposal as it provides the required forum for scheme members to be represented however the scope of the committee should be widened to include a greater overview of the cost sharing mechanism and how this is working, rather than meeting to only discuss scheme changes.

- Summary

27. Scheme members are in favour of a cost sharing mechanism that ensures the public sector pension schemes are sustainable. We hope this response to the consultation is helpful; we are available to discuss any of the underlying issues with the PSPA and others. It is particularly important for the PSPA to continue a dialogue with the trade unions about the assumptions used in the cost sharing mechanism.