Isle of Man
Trade Union Council

14th May 2019

Mrs J Mooney
PSPA
3rd Floor Prospect House
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Dear Mrs Mooney

Please find a collective statement in relation to your consultation of the Public Sector Pensions Cost Sharing Principle.

This information will be released to the media and our Social Media pages at noon on Friday 17th May 2019.

Public Sector Pensions – Consultation on Cost Sharing Principle

1. The trade unions representing public sector pension scheme members have agreed on this joint response to the PSPA's consultation on cost sharing principles.
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. Scheme members accept that a cost sharing mechanism is a necessary further step to ensuring that public sector pension provision is sustainable in the long-term as well as fair and affordable now.
4. The principle of a cost sharing mechanism is not controversial in general. However it is important that the approach taken to cost sharing is principled and robust and that it achieves sensible objectives.

- Principles for a cost sharing mechanism

5. We believe a cost sharing mechanism should be based on a number of key principles, these are: sustainability, stability and fairness.

6. 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.

7. 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 having a threshold or a buffer zone within which cost changes (increases or decreases) can be tolerated.

8. 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.

9. It is important to assess the different cost sharing options according to how they adhere to these principles (and any other principles that are thought to be appropriate).

- Cost sharing options

10. The first major element of a cost sharing mechanism that is currently under consultation is the overall approach to cost sharing. Three options are presented in the consultation document: a 2% pay buffer, a 75% / 25% split and a 75% / 25% split with a small buffer.

11. A 2% pay buffer: This option caps the cost of the schemes to taxpayers. This ensures the cost will be sustainable. To take the long-term employer cost of GUS as an example – on the current basis this will eventually be about 15% of pay when nearly all members are in Section 1 of the scheme – under this approach the cost to taxpayers will always be in the range of 13% to 17% of pay. For the vast majority of the time, the cost will be in the range of 14% to 16% of pay which is a very manageable level of variability. The buffer will minimise the number of times changes will have to be made following the operation of the cost sharing mechanism. The buffer is reciprocal which is inherently fair. Our analysis is that this option is sustainable, stable and fair.

12. A 75% / 25% split: 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. This option will also inevitably result in changes to contributions and / or benefits every time it is implemented which is inherently unstable. The split of costs of 75% / 25% is unbalanced and unfair and has not previously been agreed by scheme members

themselves and could undermine their confidence in cost sharing. Our analysis is that this option is unsustainable, unstable and unfair.

13. A 75% / 25% split with a small buffer: This option is obviously very close to the previous option. It will inevitably be slightly more stable than the previous option and hence is preferable to it but our analysis is that this approach is still unsustainable, unstable and unfair.

14. For the reasons outlined above, we feel that the 2% pay buffer option is clearly the best approach for cost sharing in the Isle of Man's public sector pension schemes.

- Recovery period

15. The second major element of a cost sharing mechanism that is currently under consultation is the length of the recovery period. In practice it is impossible to look at individual elements of the mechanism in isolation, they have to be considered together in an overall package.

16. It is important to acknowledge that future notional cost sharing surpluses are just as likely as future notional cost sharing deficits. It is not helpful to approach the issue of the appropriate length of recovery period from the perspective of either trying to minimise the cost of dealing with notional cost sharing deficits or maximising the benefit of dealing with notional cost sharing surpluses. The approach to the recovery period should be based on the principles underlying the overall cost sharing mechanism.

17. Generally speaking, the important principles for assessing the appropriate length of recovery period are stability and fairness (this is because sustainability should be maintained by a cap on the cost to taxpayers).

18. The longer the recovery period, 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 the PSPA wishes to implement to allow for a recovery period that represents the average future working lifetime of scheme members. This is stated to be 8 years. It is important for the PSPA to share the derivation of the estimate of the future working lifetime of scheme members with the trade unions so we can discuss this 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 adopting a recovery period of 15 years, consistent with the approach in the UK, is the most appropriate approach. However a recovery period of 12 years could be an adequate compromise.

- Other issues

22. The consultation covers two very important issues in relation to cost sharing. However there are a number of other important issues that have to be resolved in partnership with the trade unions before a final cost sharing arrangement can be agreed.

23. For example, there is no clarity on what the baseline valuation underpinning the whole cost sharing process will be yet.

24. Neither has there been discussion about the assumptions that might be in or out of scope for cost sharing. Only cost pressures arising from changes to assumptions that reflect actual changes in cost should be in scope for cost sharing. Cost pressure arising from changes to assumptions that have no impact on the real cost or can be easily manipulated so be out of scope (eg changes in the discount rate).

25. There has been no formal discussion of the timing of the first and subsequent cost sharing valuations.

26. Ultimately there will have to be quite detailed regulations specifying how the cost sharing mechanism will operate and the trade unions expect to be consulted on drafts of these so that members can have confidence that any final cost sharing mechanism will work fairly and as intended.

27. 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.

- Summary

28. Scheme members are in favour of a cost sharing mechanism that ensures that 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 important cost sharing issues not covered in this consultation that have been highlighted in our response.

Yours Faithfully

Debbie Halsall

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