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**Pensions for public service  
employees in UK:  
Long-term financial management  
and reform of benefits**

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## Background

- Improving longevity, baby boomers, dependency ratio
- Affordability and sustainability
- Comparison with private sector trends
- Impact of benefit reforms on public expenditure
- What makes this different?
  - Pay as you go, not funded in advance
  - 24 schemes valued, almost in parallel
  - Total scheme membership of almost 13 million people
  - Capture savings of £billions for UK tax payer (0.5%+ of GDP)
  - Under scrutiny from government, members and the public



## Agenda

- Background to UK pension environment
- The case for reform
- The reforms and their impact
- Financial management of unfunded pensions
- Actuarial methods and assumptions
- Practical challenges, update and wrap up



## Background to UK pension environment

- State pensions: Modest provision
- Occupational pensions

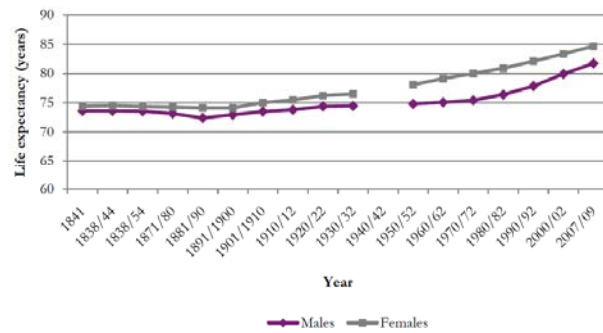
Pension schemes	Private Sector	Public sector
Set up by	Trust deed and rules	Legislation
Typical scheme designs	Historically – Defined benefit Now – Defined contribution	Defined benefit
Financing	Funded in advance	Typically unfunded (pay as you go)
Membership	14 million	13 million



## The case for reform – 1

- Demographic changes

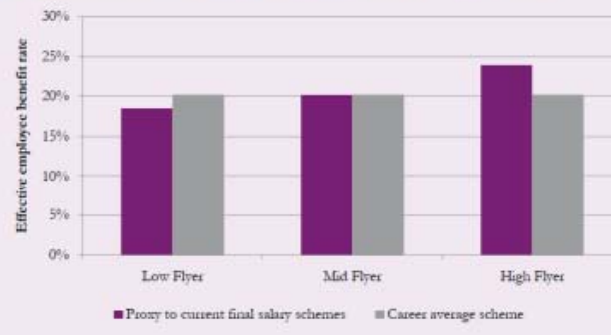
**Chart 1.A: Period life expectancies for those reaching age 60 – general population**



## The case for reform – 2

- Fairness of design

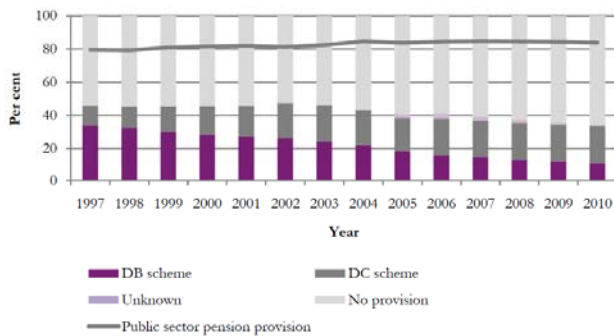
**The distributional impact of moving from final salary to CARE**



### The case for reform – 3

- Comparison with private sector

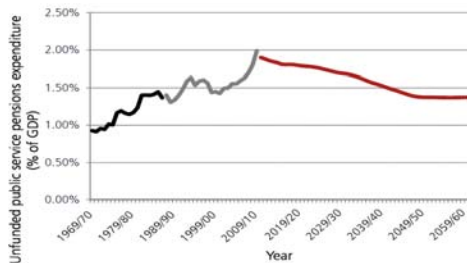
**Chart 1.D: Membership of employer-sponsored pension schemes among UK employees**



### The case for reform – 4

- Cost to taxpayer

**Chart 1.A: Historic and projected unfunded public service pensions expenditure as a proportion of GDP**



— Historic time series based on Office for National Statistics data - 1969/70 to 1986/87  
 — Historic time series based on Office for National Statistics data - 1986/87 to 2009/10  
 — Independent Public Service Pensions Commission projection - interim report

Source: HM Treasury



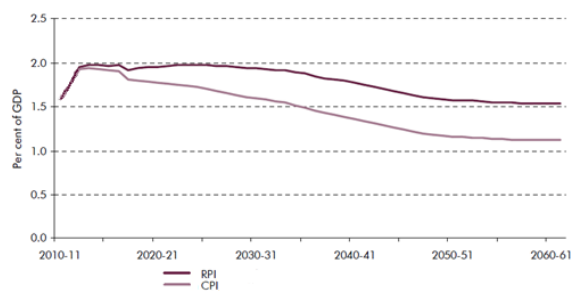
## The reforms and their impact – 1

- The inflation index changed
- Member contributions increased
- Changes to future service benefits
- Introduction of a cost cap mechanism
- Revision of governance arrangements



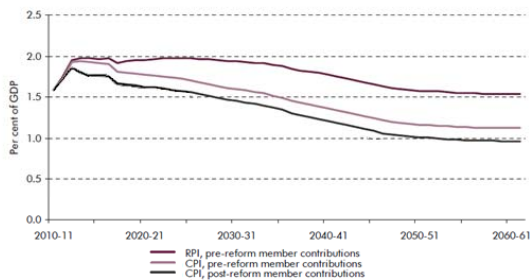
## The reforms and their impact – 2

- The inflation index changed



### The reforms and their impact – 3

- Member contributions increased



Source: OBR, GAD



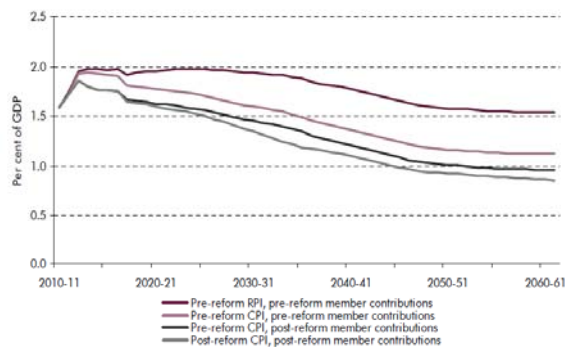
### The reforms and their impact – 4

- Changes to future service benefits

Key Hutton recommendations	Implementation
Pension promises that have been made must be honoured.	<ul style="list-style-type: none"> <li>•Final salary link maintain</li> <li>•Protection for members close to retirement to remain in existing schemes</li> </ul>
Career average defined benefit plans with earning revaluation	<ul style="list-style-type: none"> <li>•Career average defined benefit plans with revaluation varying by plan</li> <li>•Cost ceiling process to test plan design</li> </ul>
NPA linked to SPA (exceptions for uniformed services - NPA 60)	<ul style="list-style-type: none"> <li>•Future service benefits linked to SPA</li> <li>•NRA 60 for uniformed services</li> </ul>
Establish cost ceiling setting limit of amount taxpayers contribute	<ul style="list-style-type: none"> <li>•Cost cap mechanism</li> </ul>
Stronger governance	<ul style="list-style-type: none"> <li>•Single legal framework for all plans</li> <li>•Introduction of Pension Boards for each plan</li> <li>•Oversight from the Pension Regulator</li> </ul>

## The reforms and their impact – 4

- Cash flow impact of reforms



## Financial management of unfunded pensions - 1

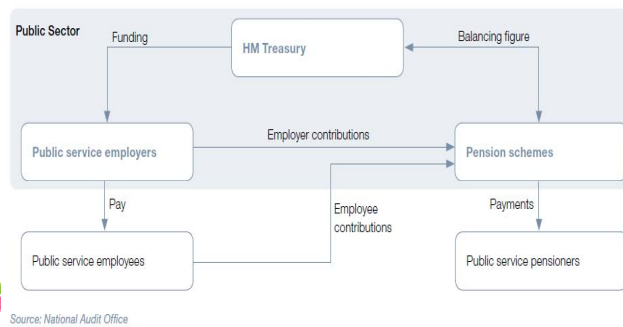
- Two forms of expenditure
  - Cash flow: Benefits paid less (employee) contributions received
  - Accrual: Cost of new benefits accruing to current workers



## Financial management of unfunded pensions - 2

- Management charge

Payments and contributions in pay-as-you-go pension schemes



## Financial management of unfunded pensions - 3

- Accrual measures of cost
  - Management charge (via actuarial valuation)
  - A supplementary table to the national accounts
  - Fund accounts reflecting IAS 19





## Actuarial methods and assumptions – 1

- Actuarial valuation
  - Management charge
  - Cost cap mechanism
- Discount rate
- Process of valuation



## Actuarial methods and assumptions – 2

- Discount rate methodology options
  - Consistent with private sector and other funded plans
  - Yield on index-linked gilts
  - Expected GDP growth
  - Social time preference rate
- Consultation process
- Government decided to select a rate based on expected long-term GDP growth



### Actuarial methods and assumptions – 3

- Valuation Directions (prescribed methods) set by HM Treasury
- Financial assumptions set by HM Treasury
- Demographics based on scheme specific experience
- Notional assets to track the impact of actual demographic experience relative to that expected



### Practical challenges, updates and wrap-up

- Observations about capturing saving
- Questions about pension design for the future
- Practical challenges
- Why we wrote the paper

