Alternatives to full funding of public sector pension plans in the UK

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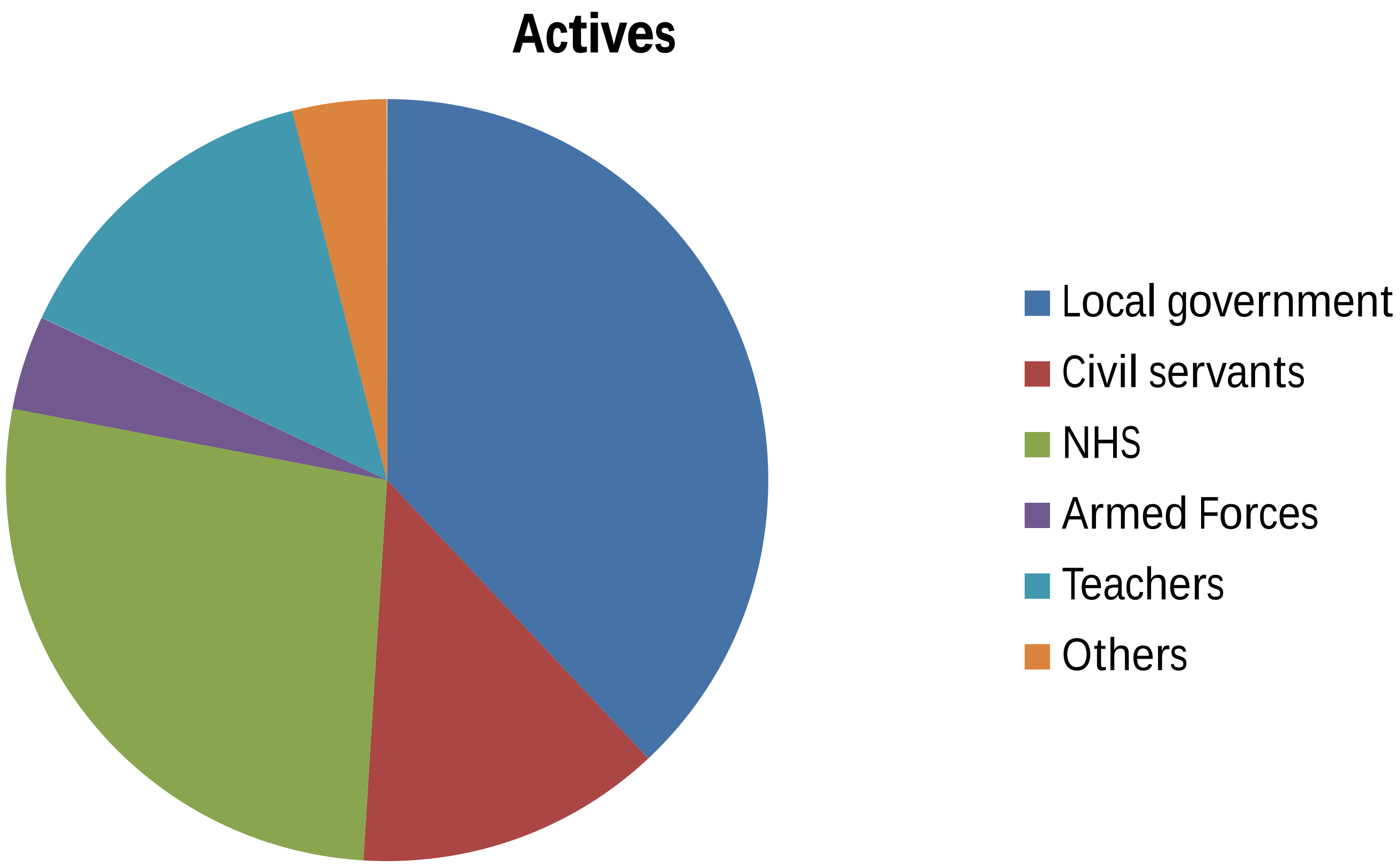
UK Public sector pensions

- Civil Service
- Teachers
- National Health Service
- Armed Forces
- Police
- Fire service
- Members of Parliament
- Local authorities

Public sector plan members

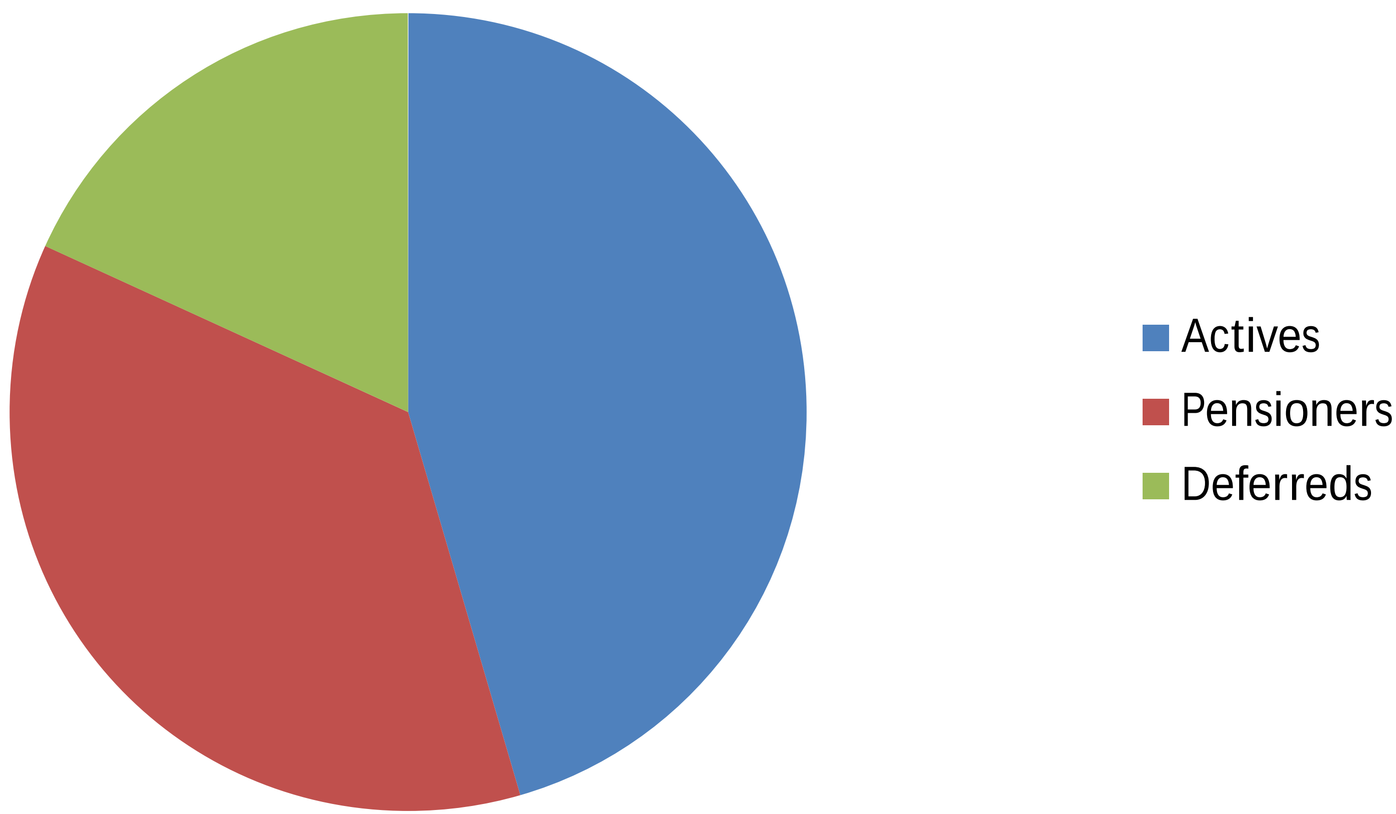
- Civil Service – 670,000
- Teachers – 700,000
- National Health Service – 1,500,000
- Armed Forces – 200,000
- Police – 140,000
- Fire service – 100,000
- Members of Parliament - 650
- Local authorities – 1,900,000 (86 schemes)

Public sector plan members



Public sector plan members

Category of member



Public sector v private sector

- 85% of public sector employees are members
- 5 million public sector pension plan members
- about 4 million pensioners
- open defined benefit schemes
- some have DC option
- most are unfunded – except local authorities

Typical benefits – 1

- as a multiple of final year's salary
- pension of 1/80 per year of service
- lump sum of 3/80 per year of service
- widow(er)'s pension at half the pension rate
- death lump sum of 2 years' salary
- pensions in payment increased in line with RPI
- Public Sector Transfer Club

Typical benefits – 2

- some schemes have more generous accrual
    - in particular armed forces, police and MPs
- most have normal retirement age of 60
- contracted out of State Second Pension
- also qualify for Basic State Pension at 60f/65m

Financing methods – 1A

- notional funds (teachers and NHS)
- employer/employee contributions credited
- interest credited to fund
- benefits paid from fund
- fund represented by notional assets
- actuarial valuation every 3 or 5 years
- ...to set future employer contributions
- interest rate reflects cost of government finance

Financing methods – 1B

- reality is that contributions go to Treasury
- ...benefits are paid by Treasury
- so in effect pay-as-you-go
- but with some discipline to pass on increased costs to employers (or employees)
- but no surplus/deficit from market

Financing methods – 2

- explicitly pay-as-you-go
- armed forces, police, fire service
- actuary recommends employer contributions
- contributions paid to Treasury
- benefits paid by Treasury
- no fund maintained – either real or notional

Financing methods – 3

- fully funded
- MPs, wider public sector
- normal funded schemes as in private sector
- subject to normal actuarial disciplines
- most are subject to full regulatory requirements
- ...and pay levy to Pension Protection Fund
- trustees responsible for investment for funds

Financing methods – 4

- partially funded
- local authorities
- funded pension schemes as in private sector
- subject to actuarial valuation
- not subject to full regulatory requirements
- ...do not pay levy to Pension Protection Fund
- managers free to invest funds
- local authorities have own tax-raising capacity

Disclosure

- future projected cashflows published
- income/expenditure disclosed
- unfunded liabilities reported annually
  - but controversy over discount rate assumptions
  - aggregate disclosure often delayed
  - some critics have published much larger figures

Issues

- most private sector schemes are now closed
- DB schemes replaced by DC
- public sector schemes are now out of line
- generous DB benefits with RPI linkage
- costs are met by taxpayer
- are they well enough controlled?
- disclosures may not be good enough for scrutiny

Government response

- costs are subject to actuarial disciplines
- ...costs are known and affordable
- changes already made for new entrants
  - employee contributions increased
  - final salary replaced by career average revalued
  - cost-sharing following actuarial deficits
- majority of public sector workers on low salaries
- no need for fund as no insolvency risk

Government expenditure

% of GDP	2007-08	2027-28	2047-48
Education	5.0	5.8	5.5
State pensions	4.9	5.6	6.3
Health	7.4	8.6	9.6
Long-term care	1.2	1.4	1.8
Public sector pensions	1.5	2.0	1.8
Other spending	20.4	18.9	18.1
Total spending	40.5	42.3	43.1

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