

Hutton report on Public Service Pension Provisions in the UK

Lord Hutton of Furness has recently published his final report on public service pension provision in the UK in which he set out his recommendations to the Government on pension arrangements “that are sustainable and affordable in the long-term, fair to both the public service workforce and the taxpayer and consistent with the fiscal challenges ahead, while protecting accrued rights”. The report expands upon the interim report published in October last year, and puts forward some interesting arguments for reform, some of which are set out below in italics.

The Government is expected to respond in the summer.

Final salary schemes

Final salary schemes unfairly benefit high flyers who can receive up to twice as much in pension payments per £100 of contributions. It exposes taxpayers to salary risk (the risk that higher than expected salary rises increase the cost of providing pensions), which should be borne by the scheme member who benefits from the salary rise. And final salary creates a barrier to employees moving from the public to private sector. These inherent problems of final salary schemes impact on fairness and sustainability and have led the Commission to conclude that an alternative model should be chosen for the future. Career average schemes allow pension to be accrued on the basis of earnings in each year of service.

- Comment – There does not appear to be any consideration as to whether this would disproportionately affect women who have taken maternity leave; although this would no doubt be addresses in any impact assessment as part of the consultation process.

The justification for the proposed changes seems to be the need to simplify the existing system and that we are living longer. The reports gives the example of a female pensioner in the NHS scheme who retired at the age of 60 in 2010 could expect to spend around 45 per cent of their adult life in retirement, compared to around 30 per cent for pensioners in the 1950s. Fair income Ensuring that public service pensions continue to provide at least an adequate level of income in retirement is, in the view of this Commission, a crucial result of any structural reforms of the schemes. [my highlighting].

Who Bears the Risk?

Within pension schemes the three main parties that may bear risk are the employer, the scheme members and in the event of insuring pension incomes, the insurer. Across the public services, almost all pension schemes are run on a defined benefit basis, and most of those provide benefits based on final salary. This places the majority of the risks in the hands of the employers – or in this case, mainly the Government and ultimately the taxpayer. The report suggests that it should be possible to introduce these new schemes before the end of this Parliament, in 2015, while allowing a longer transition, where needed, for groups such as the armed forces and police.

Other key recommendations in the report include:

- Linking Normal Pension Age (NPA) in most public service pension schemes to the State Pension Age;
 - Introducing a Normal Pension Age of 60 for those members of the uniformed services – armed forces, police and firefighters – who currently have a NPA of less than 60;
 - Setting a clear cost ceiling for public service pension schemes – the proportion of pensionable pay that taxpayers will contribute to employees’ pensions – with automatic stabilisers to keep future costs under more effective control;
 - Honouring, in full, the pension promises that have been earned by scheme members (their “accrued rights”) and maintaining the final salary link for past service for current members;
 - Introducing more independent oversight and much stronger governance of all public service pension schemes;
 - Encouraging greater member involvement in consultations about the setting up of new schemes, and in the running of schemes; and
 - Overhauling the current legal framework for public service pensions to make it simpler.
- Additional facts from Government press release:
- About one in five UK citizens has some entitlement to a public service pension.
 - Public service schemes paid out £32 billion in 2008-09, about two thirds of the cost of the basic State Pension.
 - The average pension paid to pensioner members is around £7,800 per year.
 - Around half of pensioners receive less than £5,600 per year.
 - The highest-earning fifth of Local Government Pension Scheme pensioners get almost a third more in pensions per £100 of contributions than the lowest-earning fifth.
 - Current pensioners can expect to spend about 40 to 45 per cent of their adult lives in retirement if they retire at 60, compared with about 30 per cent for pensioners in the 1950s. If scheme Normal Pension Ages are linked to the State Pension Age as the Commission recommends, the proportion of life in retirement is projected to remain at about a third over the next five decades.
 - Around 85 per cent of public service employees have some form of employer-sponsored pension provision, compared to around 35 per cent in the private sector.

The full report can be viewed on ISSU –
http://issuu.com/hmtreasury/docs/hutton_final_100311?mode=embed&layout=http%3A%2F%2Fskin.issuu.com%2Fv%2Fflight%2Flayout.xml&showFlipBtn=true

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