

Pensions Alert

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Lord Hutton's Public Sector Pension Reforms

To say that pension issues have been in the news in recent months is something of an understatement.

The recent switch from RPI to CPI as a basis for pensions revaluation has been at the forefront of the Government's so-called austerity measures.

The Pensions Act 2008, due to take effect in October 2012, will place a new duty on all employers operating in the UK to automatically enrol their qualifying employees into a pension scheme (watch this space for our upcoming Alert on this).

Then, on 30th June thousands of public sector workers walked out on strike over proposed public sector pension reforms. This Alert discusses these proposed reforms and comments on how they may impact on the pensions landscape as a whole.

The reforms were recommended by an Independent Public Service Pensions Commission, headed by Lord Hutton, which was tasked with examining the reform of public sector pension schemes. The principal rationale behind the recommendations is, as Lord Hutton himself put it, to address the fact that *"longevity [is] the main risk to the sustainability of public sector pensions."* Life expectancy continues to rise and, therefore, so too does the cost to the taxpayer of providing public sector pensions for ever-longer periods of time.

The reforms were accepted as a whole by Government; David Cameron insisted that there should be *"no cherry picking on either side."* The key reforms are as follows:

- By 2015 the public sector's existing final salary schemes are to be replaced with a new career average scheme (CARE) for future service. (A CARE scheme is a type of defined benefit pension scheme in which the member's pension at retirement is calculated using their average salary over the entire period of their service with the employer, rather than using their final salary.) However, the Government has promised that accrued final salary benefits will be protected and current members will retain their final salary link for past service.

Treasury Chief Secretary, Danny Alexander, justified this change on the basis that CARE schemes are fairer than final salary schemes as they *"would guard against the risks and costs that come from individuals jumping to higher salaries in the last few years of their careers."*

- Normal Pension Age is to be linked to State Pension Age for future service in most public sector schemes. The only exception to this will be for members of the "uniformed services" (i.e. the armed forces, police and fire service) for whom Normal Pension Age will be raised from 55 to 60.

This means that, as the legislation currently stands, Normal Pension Age for most public sector workers would increase incrementally to 68 by 2046 in line with increases to State Pension Age.

- Increased member contributions will be phased in over three years from April 2012. The Government anticipates an average 3.2% increase in member contributions (with no increase for those earning less than £15,000 p/a and a 1.5% increase cap for those earning up to £18,000 p/a).

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A “fixed cost ceiling” is also proposed whereby a cap of employer (i.e. taxpayer) contributions will be applied which, if breached, would automatically trigger an increased contribution rate from members.

As a side (but related) issue, the Treasury consultation on ‘Fair Deal’ closed on 15th June. ‘Fair Deal’ provides that non-public sector employers must provide “broadly comparable” pensions when public sector staff are transferred to them e.g. in an outsourcing scenario. The outcome of this consultation is due to be announced later in 2011, but it is anticipated that the ‘Fair Deal’ obligations will be watered down, if not abolished entirely. Lord Hutton’s report itself commented that the concept is “*in principle undesirable for future non-public sector workers to have access to public sector pension schemes.*”

True to form there has been much scaremongering and sensationalism amongst the British press about the above reforms. This has not helped to encourage helpful debate on the issues, particularly when set against an already prevalent public misunderstanding on how the changes will affect public sector workers. Research undertaken by Hymans Robertson in May 2011 revealed that, for example, only 3% of people surveyed understood that CARE schemes are a form of defined benefit pensions and one in ten believed they would lose benefits already accrued, despite the Government’s reassurance on this point.

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