"and they all lived happily ever after"?

Public sector pensions 2015

Jerry Barnfield
Head of Market and Product Strategy
aquilaheywood

My article in February's PMI News explained the "whole new world" of public sector pensions being implemented in April 2015. It compared the challenges of implementing all the benefit changes with how Aladdin met his challenges with help from a magic lamp and a genie.

In true Disney style it all came good in the final reel as Aladdin and Jasmine flew off into the sunset on their magic carpet and "they all lived happily ever after".

So now that all the changes in public sector pension benefits are largely in place, can our 150 public sector clients that have implemented all the changes (and their 5 million+ members) "all live happily ever after"?

Let's take a look at the challenges ahead and the weather forecast for magic carpets over the coming months and years.

A 25 year deal with the TUC

As part of the November 2011 deal introducing the move from final salary benefits to career average revalued earnings (CARE) benefits, the coalition Government agreed with the TUC that it would be "a sustainable deal that will endure for at least 25 years".

This was a major commitment even allowing for the cost controls introduced from April. Now we have a government focussed on reducing the deficit and seeing pensions as an area that is ripe for generating income for the Exchequer.

Changes to State Pension Ages, increased national insurance (NI) contributions when contracting-out ceases in April 2016 and the potential tax relief changes proposed in the Summer Budget are all likely to be perceived as detrimental to members.

The Fire Brigades Union is also mounting a legal challenge to the government over what it says are unfair pension arrangements for its members.

All in all I can't see the deal with the unions enduring for 25 years.

Pension Freedoms

The 'Pension Freedoms' that came into operation in April only apply to defined contribution (DC) pots and members of the unfunded public sector pension schemes are banned from transferring to DC arrangements. Transfers to DC plans from the funded Local Government Pension Scheme (LGPS) are allowed but the regulations make such transfers very restrictive – for example excluding transfers within 12 months of normal retirement date which restricts retirement planning especially for those in ill-health who could gain from such a transfer.

I believe that, as the 'Pension Freedoms' become more popular, public sector schemes will need to offer members more flexibility in retirement without requiring them to transfer to a DC arrangement.

New governance for public sector schemes

The Public Service Pensions Act took effect from April 2015 bringing new governance structures for public sector schemes involving Scheme Managers, Scheme Advisory Boards and Pension Boards. For the locally administered schemes (LGPS and Police & Fire schemes), each of the authorities had to put in place a local Pension Board to focus on compliance with the legislative requirements and the new regulatory Code of Practice for public sector schemes introduced by The Pensions Regulator.

We believe that it will be important that local Pension Boards operate in a consistent way so that technology can streamline the operation of the boards as regards data quality, benchmarking and service delivery.

Indeed automated benchmarking should be the key driver for improving service quality and reducing costs.

Data quality is a high priority

We all know that data quality is essential to a well-run pension scheme but we now have more drivers to address this issue.

Firstly, the Department for Work and Pensions (DWP) regulations and the regulator's Code of Practice require schemes to ensure that key data is accurately recorded and maintained for all members. The DWP regulations are for 100% compliance from April this year rather than the current regulator targets to meet 90% or 95% coverage in a set time limit. The regulator will be monitoring data quality and we anticipate some initial pragmatism but there is a key emphasis on improving it.

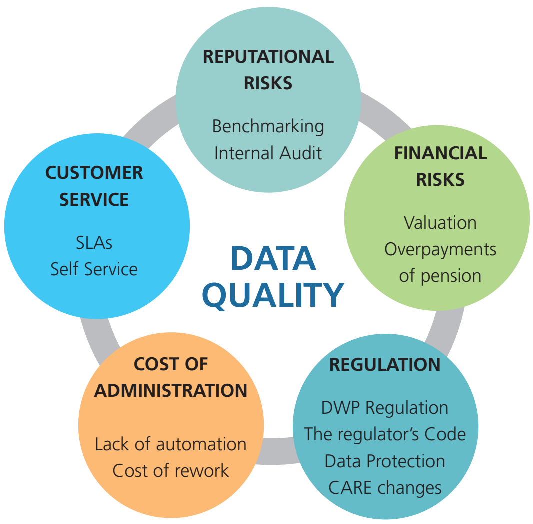
We understand that The Government Actuary's Department (GAD) has already expressed concerns about data quality impacting on the cost control measures.

Another concern is the data submission from the thousands of employers who have to submit data to administering authorities on a regular basis. With the increase in the number of employers, technology solutions are the only way to handle the data challenge.

New software developments such as our i-Connect functionality ensures that data from employers is validated and consistent before the data is submitted. The move to CARE benefits means that it is even more imperative that data is provided by employers on a timely basis (normally monthly). Where data is unreliable or incorrect, the corrective action required consumes costly effort every time that process is carried out. ▶

> So now that all the changes in public sector pension benefits are largely in place, can our 150 public sector clients that have implemented all the changes (and their 5 million+ members) "all live happily ever after"?

Data quality is paramount - touching many important areas



To reduce costs, it will be important to share system developments and automate calculations and processes. Technology can help considerably but, to be effective, it requires a level of consistency and data quality

New State Pension and the cessation of contracting-out

The new State Pension starts next April and all members who are contracted out of the additional state pension will cease to be contracted out at that time. All members of the defined benefit public sector schemes will face an increase in NI contributions as will their employers. The increase will need clear communication.

All historic Guaranteed Minimum Pensions (GMPs) will need to be reconciled with the data held by HM Revenue and Customs (HMRC). This will be a major exercise for administrators in all the public sector schemes and correcting data will be costly – the LGPS estimates that 5m records will need to be reconciled at a cost of around £100m.

HMRC has also indicated that it is intending to re-consult in this Parliament about GMP equalisation for males and females in line with EU law. This could make GMP reconciliation seem like a walk in the park!

Cost control and the cost cap

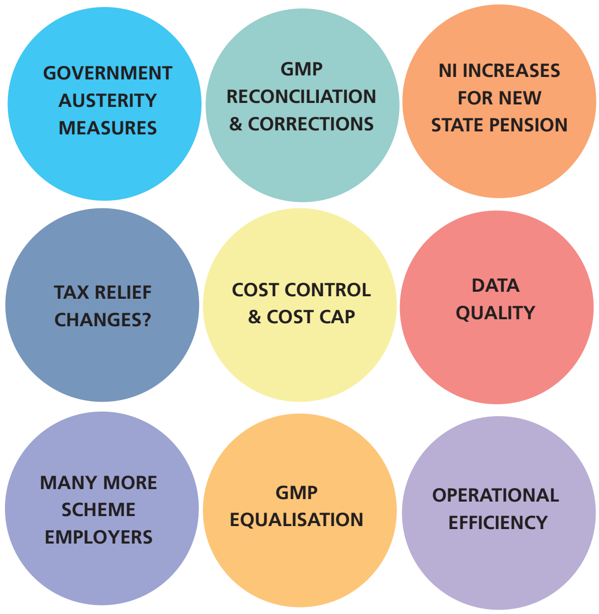
Ongoing reductions in government spending are impacting on resources to administer public sector schemes. There has been collaboration in most of the locally administered schemes facilitated by using the same administration system and we can assume that there will be more in future. Given all the additional administration and regulatory pressures from the new schemes and having to deal with a plethora of scheme employers, cost control will be an increasingly important factor.

To reduce costs, it will be important to share system developments and automate calculations and processes. Technology can help considerably but, to be effective, it requires a level of consistency and data quality. Benchmarking key performance indicators against other schemes can help identify where there are opportunities for improving service and/or reducing costs.

Many administering authorities have also adopted 'cloud' solutions for their IT delivery managed by specialist companies to reduce costs and improve efficiency. This ensures reliable 24-7-365 access using the latest technology and security including data backup and disaster recovery.

To ensure that costs are contained, the Treasury will set a cost cap for employer contributions as a percentage of pensionable pay for each of the schemes. After every actuarial valuation starting from 2016, the scheme will need to assess the future cost of providing the CARE benefits. If the cost increases by more than 2 percentage points beyond the cap then the scheme has to put in place changes to benefits and/or members' contributions to bring the costs back within the cap.

The challenges ahead for public sector pensions



Technology is key to meeting these challenges

Unfortunately we don't have a magic lamp or a genie. Instead public sector schemes can use modern technology to

- engage with members from automatic enrolment through to retirement and beyond
- provide more personalised information and online self-service access for members, reducing paper communications and costs
- ensure that benefits are calculated accurately and efficiently
- collaborate to improve operational efficiency and drive down the costs of administration
- benchmark processes to identify areas for improvements in costs and service delivery
- facilitate employers providing accurate data on a timely basis
- reconcile GMP liabilities

"and they all lived happily ever after"?

Constant government changes are making pensions more complicated and difficult for members to understand. More changes and spending cuts are highly likely.

I guess that, with my actuarial hat on, if all members of public sector pension schemes were "living happily ever after" there would be significant solvency issues!

But in reality this is just a fairy tale ending. The cost of public sector pensions and the increasing disparity with private sector pensions means that public sector pensions will remain in the spotlight rather than flying into the sunset.