

Is there a future for the public sector pension scheme?

The media spotlight has been trained on pensions in general and specifically on the decline in the number of private sector schemes still offering defined benefits.

Most comments seem to have centred on the rationale for continuing to offer such arrangements in the public sector - and how sustainable they are.

Chief Pensions Officer Mike Woodall looks at the facts behind the headlines.

1. THE LOCAL GOVERNMENT PENSION SCHEME, IN ITS CURRENT FORM, IS NO LONGER SUSTAINABLE.

The Office of the Deputy Prime Minister is currently carrying out a Stocktake of the Local Government Pension Scheme.

The main findings of the Stocktake so far have confirmed that there are no serious defects in the Scheme as a whole and the last Local Government Pension Scheme valuation exercise demonstrated that there is full compliance with the solvency requirements of the Scheme provisions.

2. EMPLOYERS' CONTRIBUTIONS TO THE SCHEME CANNOT BE SUSTAINED.

The employers' contributions to the Local Government Pension Scheme must be viewed as part of the overall remuneration package given to staff in the Local Government environment. It is incorrect to look at employer pension contribution rates without looking at the other elements of the employment package. In Local Government this list is extremely short and it involves, in the main, only a salary payment. There tend to be very few of the benefits that are common in the Private Sector, e.g performance bonus payments; private health care; company vehicles or additional salary payments in lieu etc. Independent research has confirmed that salaries in the Public Sector are lower than their counterparts in the Private Sector, but when taken together with employer pension contributions, they are fairly well balanced between both sectors.

The average pensionable pay of staff in membership of the West Midlands Pension Fund was £12,636 as confirmed at the last Actuarial Valuation.

3. THE LOCAL GOVERNMENT PENSION SCHEME PROVIDES LEVELS OF BENEFITS WHICH ARE NOT AVAILABLE IN THE PRIVATE SECTOR.

The Local Government Pension Scheme provides long-serving Scheme members (40 years plus) with a pension equal to one-half of the final salary, together with a lump-sum payment on retirement. However, very few of the current Scheme membership will achieve that in view of the reduced employment security now prevalent in Local Authorities and the more flexible workforce which moves between the Private and Public Sector with much greater frequency.

Currently the average service accrued by members of the West Midlands Pension Fund is 7.8 years and the average pension being paid to Fund pensioners is approximately £3,800 per year.

4. CLOSING THE CURRENT SCHEME WILL REDUCE EMPLOYERS' CONTRIBUTIONS.

Whilst savings can be made by offering inferior pension provision to new employees, closure of the final salary scheme to new members will have long-term financial implications.

The average age of Scheme members in a closed scheme will increase by 1 year for each calendar year that passes.

Scheme liabilities increase as individuals approach retirement and require higher levels of contributions.

The contribution rates on open schemes are less volatile since the inflow of new younger members stabilises the overall pension liabilities.

5. CONSIDERATION SHOULD BE GIVEN TO INCREASE EMPLOYEES' CONTRIBUTIONS.

The Local Government Pension Scheme requires contributions from employees in membership. The contribution rate is 6% of pensionable pay (5% for former manual employees). The Stocktake of the Local Government Pension Scheme currently being conducted by the Office of the Deputy Prime Minister has confirmed that consideration is being given to increasing employee contribution rates for new members from a future date.

6. In view of the liabilities revealed by recent FRS17 disclosures resulting from the current poor performance of the Stock Market, the Local Government Pension Scheme is not sustainable.

FRS17 requires organisations to show within their Accounts liabilities/surpluses on their pension scheme based on a current evaluation of their assets and liabilities. This is a snapshot situation which values the scheme assets on a particular day and liabilities at the same date. However, pensions are an extremely long- term issue and the value of assets on one particular date will have no relevance to their value at some future date.

Stock Markets have, since records began, always returned to their previous levels following any decline and the longest period to date for this to be achieved was marginally over 6 years. Those Pension Scheme members currently at the beginning of their careers will not retire for up to 50 years and perhaps even longer if the Government's current proposals to either increase or abolish the compulsory retirement age occur.

Stock Market values so far in the future will have no relevance to today's position.

SUMMARY

The Local Government Pension Scheme is one of very few funded Public Sector Schemes.

Whilst employer contribution rates may appear, at first sight, generous, when considered as part of the overall remuneration package this is not the case.

The average Scheme member has very little accrued service and the average pension currently being paid by the West Midlands Pension Fund is approximately £3,800 per year. Whilst many Private Sector employees enjoy non-contributory pension schemes, members of the Local Government Pension Scheme contribute 6% of their own pay towards their pensions.

There are currently significant pension liabilities in most Pension Funds as a result of recent Stock Market performance. This will, over time, recover to its former position and whilst pension liabilities are measured against a specific current date, the vast majority of liabilities will not have to be met for some considerable time as Scheme members achieve their normal retirement date.