Senator SC Ferguson,
Chairman,
Corporate Services Scrutiny Panel,
Scrutiny Office,
States Greffe,
Morier House,
St Helier,
Jersey JE1 1DD

14 April 2014

Dear Senator Ferguson,

Proposed Reforms to the Public Employees Contributory Retirement Scheme (PECRS)
Thank you for your letter dated 1 April 2014 inviting the Committee of Management (COM) to express its views on the proposed reforms to PECRS. I am replying on behalf of the COM.

1) Introduction
The COM has advocated the need to reform PECRS for a number of years as evidenced by its own independent actuarial review of the Scheme by Lane Clark and Peacock (LCP) completed in December 2011 and the report of the Technical Working Group (TWG) completed in November 2012 in which representatives of the COM, including myself, played a full part. I can confirm that the COM supports the proposed reforms, believing them to be in the best interests of Scheme members, and has been consulted throughout the development of the proposals. Both reports are in the public domain.

2) Significance of Public Sector Schemes in Jersey
In broad terms, PECRS has 14,000 members of which just over half are employees still employed by the States or one of the 24 other employers (so called "Admitted Bodies") which also participate in the Scheme; the rest are either in receipt of their pensions or have left service and have a benefit retained in the Scheme to be drawn at a later date, normally when they reach retirement age. The investments of PECRS total c£1.6 billion. The TWG estimated that up to one in three households in Jersey may have a direct interest in PECRS. The Scheme will provide retirement income for a significant portion of the population of the Island and is, therefore, an important aspect of the Island's economy. PECRS is not limited to the highly paid few; it is for the full range of public sector workers in Jersey, with the exception of teachers for whom there is a separate scheme. The median pension in payment from PECRS is in the region of £8,700 per annum.

3) Role of the COM
The COM is responsible for administering PECRS in accordance with the Regulations. It acts in a fiduciary capacity with a duty to look to the interests of the Scheme's membership. In considering the proposals for change, its primary concerns have been and will continue to be to ensure that the new CARE scheme benefits will be fully funded for the future and that the rights of all members earned up to the date of change are protected. To date the COM has been less concerned with the detailed design of the new benefits, on the basis that this is principally a matter for the employers and their employees.

4) The Scheme's Problems
These can be summarised as follows:

a) Underfunding: the current contributions (13.6% from employers, 5% or 6.25% from members, so in total between 18.6% and 19.85% of salary) are insufficient to pay for the

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benefits currently being promised. The contribution gap varies over time but has been over 1% for new staff joining the Scheme and up to 4% for the more expensive legacy benefits dating back to 1988. The underfunding has arisen from the significant increase in the cost of pension provision over the last 30 years due to the fact that many more people are living into old age and investments are not expected to generate the same level of returns as in the past.

b) The risk sharing arrangements with their implication of negotiations between staff and Employer on how to deal with surpluses and deficits arising from Scheme valuations appeared to have broken down following the 2007 scheme valuation. In the absence of meaningful negotiation from the States as principal employer, it was not possible to agree a method to dispose of the deficit disclosed in that valuation, with the result that the default provisions set out in the legislation came into effect. This caused the rate of annual pension increases to be cut back for the first time. The current arrangement is skewed against members as the Employer can force members to shoulder all scheme deficits through benefit reductions (by refusing to enter into meaningful negotiations) whilst it remains entitled to two thirds of any scheme surplus.

c) The current structure of PECRS cannot deal fairly with these two sets of circumstances, namely unfair and opaque risk-sharing arrangements coupled with underfunding. The current arrangements are not sustainable.

5) How do the proposals meet these problems?

The proposals improve the sustainability of the pension fund in a number of ways:

a) Benefits for future service from the date of change will be fully funded (combined contributions of 24% of salary split 2:1 employer: employee)

b) The risk sharing arrangements will be transparent with all parties able to understand at the outset how surpluses and deficits will be dealt with over time

c) The risk sharing arrangements applicable in the event of scheme deficits will be significantly more balanced between employers and scheme members than the current arrangements. Under the proposals:

   i) Benefits earned up to the date of change: all deficits will continue to be shouldered by the members but all surpluses will be retained in the Fund for the benefit of members. The rate of annual pension increase will continue to be adjusted at each valuation to reflect what the Fund can afford with the maximum being the increase in Jersey RPI.

   ii) CARE scheme benefits: the rate of annual increase of past service benefits will be adjusted at each valuation; changes to the cost of future service benefits will be shared between employer and employee in the ratio of 2:1 up to a pre-agreed cost cap.

   iii) Certain underpins will be put in place to protect benefits; these underpins will be funded by employers but only up to the pre-agreed cost cap. If costs increase above the cost cap, then future service benefits will be reduced, member contributions increased, or a combination of the two.

d) As with all defined benefit pension schemes, valuation results can be significantly affected by the state of investment markets at the particular valuation dates. The proposals will include a funding corridor mechanism which will enable the COM and Employer to manage this issue by trying to ensure that what may be an extreme and short term situation in investment markets at a valuation date does not unduly influence actions taken to meet what would be a transient funding position.

e) The use of cautious valuation assumptions for the funding methodology of the CARE scheme benefits should help to start the funding at realistic contribution rates and help to reduce the impact of any underlying cost increases (see section 8 (a) below).

6) Fairness

The COM supports the Employer's commitment to fairness and good governance for the Scheme. Aspects of the proposals which are of particular relevance to the COM are:

a) As described above, the proposed new risk sharing arrangements are more transparent and fair to Scheme members than the current position.

b) The main cross subsidy between groups of members will be eliminated with the uniformed members paying higher contributions to reflect their share of the full cost of benefits for uniformed members.

c) Although not directly interested in the design of benefits to be earned in the future, the COM agrees with the TWG's analysis of the preference for defined benefits over defined contribution schemes and also the inherent fairness of CARE designs over final salary benefits.

d) Fairness between generations is facilitated through the fact that the Scheme pension age for future service will be linked to the Jersey State Pension Age (JSPA). If JSPA is increased in the future to reflect continuing lengthening of human life expectancy, the Scheme's pension age will rise as well.

e) Fairness between generations for benefits earned up to the date of change is facilitated by several factors:

i) The protection of all benefits earned up to the date of change (accrued rights)
ii) The introduction of a funding corridor (see 5(d) above)
iii) The use of best estimate assumptions for the valuation methodology (see 8 (b) below)

7) Governance

The COM believes that it is essential to retain a managing board for PECRS which has a fiduciary duty to act in the interests of Scheme members as part of its role in administering the Scheme in accordance with the Regulations. The board should continue to be drawn from the members and employers and be representative of the main parties with a direct interest in the Scheme. All members of the board should continue to have a duty to look after the interests of the membership as a whole and not regard themselves as representing special interest groups.

8) Scheme Valuations

The outcome of Scheme valuations will affect employers differently for the CARE scheme benefits compared with the benefits earned up to the date of change:

a) CARE scheme valuations: the financial interests of scheme employers will be directly affected by the outcome of valuations of the new CARE scheme benefits. If the cost of benefits increases, the increase is shared between employers and members up to the agreed cost cap. It is, therefore, reasonable for the Employer to seek more influence upon the funding methodology of this section of the Scheme. Under the proposals the valuation assumptions to be used will have to be agreed by the COM and the Employer. It is also reasonable for the Employer to wish to adopt valuation assumptions which make it more likely that surplus will emerge at valuations than deficit in order to limit the likelihood of the funding underpins guaranteed by the Employer being called upon. Such assumptions are commonly termed "prudent" assumptions, the sort typically adopted in UK private sector balance of cost schemes where the Employer has a legal obligation to make up any scheme deficit (not an obligation being introduced into PECRS).

b) Benefits accrued up to date of change: in relation to these benefits, it is the members who shoulder the deficits and benefit from all surpluses disclosed at scheme valuations. The only employer obligation is to protect the nominal value of benefits in the extreme situation where not even a pension increase of zero could be maintained. If this underpin were to be called in, it would be funded by employers subject to the pre-agreed cost cap. The funding position in relation to these benefits will depend heavily on the income generated from the investments. The only other income will come from the pre-1987 Debt contributions. To try to ensure that one generation does not subsidise another, it makes sense to use neutral funding assumptions for valuations of these benefits. Under this methodology the actuary will set assumptions which he believes mean that it is equally likely for a deficit or a surplus to emerge over the next valuation period. The aim is to eliminate any element of caution or optimism. Such assumptions are commonly referred to as "best estimate" assumptions. Although the Employer will be consulted about these assumptions, the agreement of the Employer will not be required. It will be for the Actuary to set the "best estimate" assumptions. This is appropriate given that it is the members who will most shoulder the full consequences of valuation results.

9) Pre-1987 Debt

The proposals for the reform of PECRS have no impact per se on the Pre-1987 Debt. The original 82 year repayment period agreed with the States in 2005 was the best outcome which could be achieved at that time and represented a significant improvement to the Scheme's previous funding arrangement, and hence provided improved security for members. However, an inherent problem remained that the benefits which were being funded by the pre-1987 Debt would have been paid out long before the Debt had been paid. There remained a significant timing mismatch. The COM has welcomed the planned shortening of the repayment period brought about by the increased repayments included in the current Medium Term Financial Plan (2013 – 2015). If the repayments are maintained at 2015 levels and increased in accordance with the Ten Point Agreement documenting the Pre-1987 Debt arrangement, the repayment date would be brought forward from 2083 to around 2054, thereby reducing the timing problem referred to above. The COM would welcome further acceleration of the Debt repayment if the States were able to achieve it.

10) Conclusion

The COM has considered the proposals for the reform of PECRS from the perspective of its fiduciary role to consider the interests of the Scheme's membership as a whole. It regards the detailed design of benefits to be earned for future service to be a matter for negotiation between the Employer and the unions and staff associations through the JNG. The areas of fundamental importance for the COM are:

a) Whether the new CARE scheme benefits will be properly funded
b) The protection of benefits earned up to the date of change (accrued rights)
c) Fairness and transparency of revised risk sharing arrangements
d) The continued fiduciary role of the Scheme's managing board
e) Appropriate balances of power between the Employer and the managing board in setting the funding plans (the valuation methodologies) of the two distinct sections of the Scheme, that is the CARE Scheme benefits and benefits accrued up to the date of change.

The COM supports the direction of the TWG report and the proposals for change as it currently understands them. If the States passes the Law as currently lodged, the COM will look to continue its involvement when the detailed Regulations are drafted. Its continued support relies upon the final reforms not differing materially from the TWG report in the areas of most significance to the COM's fiduciary role as explained in this letter. Its understanding is that this is in line with the Employer's intention. The COM remains of the view that reform of PECRS is essential to restore its sustainability.

I hope that this letter is helpful to your review. I would be pleased to attend Scrutiny Panel meetings, but I should mention that my final term of office as Chairman of the PECRS Committee of Management ends on June 30, 2014. The process of appointing my successor is well advanced and with support from other members of the Committee of Management, and the Secretary, the new Chairman will be well able to assist the Scrutiny Panel after I have retired from office.

Yours sincerely,

RJ Amy OBE
Chairman of the PECRS Committee of Management