WRITTEN QUESTIONS TO THE MINISTER FOR TREASURY AND RESOURCES BY SENATOR B.E. SHENTON

ANSWER TO BE TABLED ON TUESDAY 4th JULY 2006

Questions

1. Would the Minister inform members why he reported to members that the Public Employees Contributory Retirement Scheme (PECRS) deficit as at 31st December 2004, had fallen to £17,400,000, whereas in his reply to my written question on 6th June, 2006, he acknowledged that the deficit calculated under recognised reporting standards was in fact £158,441,000 - a difference of £141,041,000.

2. The notes to the Financial Report and Accounts 2005 state that *'The Scheme is not a conventional final salary scheme in that the employers are not responsible for meeting any deficiency in the Scheme'*. Would the Minister inform members –

   (a) whether the scheme is now 'stand-alone' and, if so, that the States will not meet the cost of any future deficits?

   (b) whether PECRS members have been made aware of the possibility of any future dramatic cut in benefits resulting from large deficits to the scheme caused through inflation and poor investment returns?

   (c) of the past service liability, under FRS17, at the time the States agreed the Public Employees (Retirement) (Additional Contributions – Amendments) (Jersey) Regulations 200- (P.190/2005) on 27th September 2005, which confirmed responsibility for that liability arising from the restructuring of the PECRS arrangements with effect from 1st January 1988?

Answers

1. The actuarial valuation as at 31st December 2004, published in March 2006, values the deficit at £17,400,000.

   The total deficit as at 31st December 2005, and calculated in accordance with FRS17, is £158,441,000. The equivalent value as at 31st December 2004, is £213,095,000. Neither of these figures includes pre-1987 debt.

   There are two main reasons for the difference between the actuarial calculation and the total deficit calculation. Of these, the more significant is the fact that the two sets of figures are evaluated using different actuarial assumptions. In particular, the valuation position is evaluated using an assumed future rate of return on assets which is set having regard to the asset classes in which the PECRS is invested. In contrast, the total deficit figure is derived from figures produced in accordance with accounting standard FRS17. This accounting standard requires the assumed rate of return to be derived from the corporate bond market, despite the fact that the PECRS invests predominantly in other asset classes such as equities. Because the returns available on corporate bonds are generally lower than might be assumed on equities, future investment returns are assumed to be lower for the total deficit calculation. The conclusion, therefore, is that a higher level of assets is required to meet the liabilities, and hence the deficiency is shown to be higher than under the valuation calculation.

   The second key reason for the difference is that the two calculations are actually comparing different things. The valuation calculation looks at the expected cost of all of the benefit promises made by the Fund, for both service prior to the measurement date and also for service after the measurement date, including the future service for new entrants to the Scheme. This is compared with all assets, including the pre 1987 debt, as well as the expected level of future contributions. The difference between the two

amounts gives the valuation surplus or deficiency.

In contrast, the total deficit calculation is a more simple comparison of the expected cost of all promises made in respect of service before the measurement date against the value of all assets, including the pre 1987 debt. This calculation, therefore, excludes the expected costs of promises in respect of service after the measurement date, and expected future contributions.

It should be noted that the total deficit calculation is slightly inconsistent in that the value of the pre 1987 debt taken into account is as certified by the Actuary, rather than calculated using the same assumptions required for accounting purposes. As referred to in the answer to part 2(c) below, the assumptions used to evaluate the debt for certification purposes do not necessarily match those used for accounting purposes. The value of the debt based on the assumptions used for accounting purposes is not readily available. This inconsistency does not alter the central issues discussed above.

2(a) The Scheme is "stand alone" and not a conventional final salary scheme. The employers are not responsible for meeting any deficiency in the Scheme other than the pre-1987 debt. Accordingly, the States has no obligation to meet the cost of any deficits in PECRS, which is why it has not recognised a liability in accounts in accordance with FRS17.

(b) An extensive consultation exercise, including a thorough explanation of the revised benefits and associated transference of risk of moving to the new scheme, was undertaken when existing members were given the choice as to whether they wished to remain under the 1967 Regulations or transfer into the new scheme.

Information provided to both new and existing members of the current scheme includes the following statement on Pension Increases:

"Pensions in payment and deferred pension are reviewed each January with the aim of providing increases in line with the rise in the Jersey Cost of Living Index. Proportionate increases are awarded for pensions which came into payment and for deferred pensions which came into existence part way through the previous year.

Increases in line with rises in the Jersey Cost of Living Index cannot, however, be guaranteed and are subject to the financial condition of the Scheme remaining satisfactory."

The following information is provided regarding the financial condition of the scheme:

"If, at a future valuation of the Scheme, the Actuary advises that its financial condition is no longer satisfactory, proposals agreed by the Committee of Management may be submitted to the States for members contributions and/or employer's contributions to be increased and/or member's benefits to be reduced which may affect pension increases."

(c) Calculations in accordance with accounting standard FRS17 bear no relation to the pre-1987 debt calculation .The methodology for calculating the pre-1987 liability was explained by the Minister in answer to a question by Senator B.E. Shenton on 6th June 2006, (part (d)). As it is calculated on a future revenue stream based on 2% of payroll increased by the value of future pay awards, the capital value will fluctuate.

As also stated in answer to the same question (part (a)) on the 6th June 2006, the calculation of the value of the pre-1987 debt at 31st December 2005, was £123,152,000. No equivalent valuation has been calculated as at 27th September 2005, but it is assumed that the figure would have been broadly similar.

It would appear from the questions tabled today, and on 6th June 2006, that because of the undoubted complexity of this issue there may be some misunderstandings that are, perhaps, the source of unnecessary anxiety. It might have been simpler for the Senator to contact me or Treasury officers and to express his concerns, which could

then have been dealt with. I remain happy to offer the Senator, or other interested members, the chance to meet and to discuss these complex PECRS issues, in order to assist their understanding and address their queries.