

States of Jersey
States Assembly



États de Jersey
Assemblée des États

Corporate Services Scrutiny Panel

Public Sector Pension Reform



Presented to the States on 12th May 2014

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1. KEY FINDINGS AND RECOMMENDATIONS

Key Findings

1. Adoption of the draft Law would effectively provide in-principle approval for the move from a final salary scheme to a Career Average Revalued Earnings (CARE) scheme. The rationale for such a move is compelling and the debate on the draft Law should therefore proceed, albeit with the caveat that the details of how the scheme will operate will not be agreed until the draft Regulations have been finalised.
2. Further evidence is required in respect of the affordability of the proposed employer's contribution cap in the long term.
3. Further clarity is required regarding the manner in which Article 8(1) of the draft Law would be applied.
4. It would be beneficial for Regulations under the draft Law to include, in respect of the CARE scheme, provisions in relation to investment strategies; prudent and best estimate funding assumptions; and the declaration of conflicts of interest.
5. The aim to implement the proposed CARE scheme on 1st January 2015 means that the development and consideration of the draft Regulations will be undertaken within a very tight timescale. Sufficient time must be allowed for those Regulations to be considered.
6. Further information and analysis is required in respect of the cost comparison between PECRS and the proposed CARE scheme; the sensitivity of the results to the assumptions underlying the calculation of the anticipated contribution rates; and the quantification of risks of underfunding within the CARE scheme.
7. The concept of prudence within the funding assumptions to be used under the proposed CARE scheme should be clearly established.
8. Some of the protections which would be afforded to current members of PECRS in the move to a CARE scheme are essentially unfair. They appear to have been included for pragmatic reasons to ensure the proposed reforms would be acceptable to employees.
9. Appropriate provision needs to be made within the draft Regulations for the circumstances in which Admitted Bodies to the CARE scheme wished to leave the scheme.
10. It is not ideal for both the PECRS and CARE scheme Committee of Management and the States Employment Board (as employer) to receive actuarial advice on the choice and prudence of assumptions from the same actuarial firm, since there is a risk that the advice may not be, or seen to be, completely independent.

11. There needs to be clarity regarding the administration costs arising from implementation of the CARE scheme and confidence that the staff resources would be sufficient and adequately trained. These are matters which will be pursued during Phase 2 of the Scrutiny Review.
12. Notwithstanding the large amount of communication which has taken place, care should be taken to ensure that communication with members of PECRS is not inadvertently misleading about the status of the proposed reforms.

Recommendations

1. Prior to the debate on the draft Law (and the accompanying amendments), the States Employment Board should ensure the States Assembly is provided with sufficient evidence on the affordability of the proposed employer's contribution cap.
2. The States Employment Board should clarify the policy that would be followed in the application of Article 8(1) of the draft Law.
3. The States Employment Board should clarify whether and how provision will be made in Regulations for the matters identified by Scrutiny's expert advisor.
4. The States Employment Board should take appropriate steps to ensure that additional information and analysis identified by Scrutiny's expert advisor is made available before the draft Regulations are debated.
5. The States Employment Board should ensure that the Regulations underpinning the proposed CARE scheme incorporate the concept of prudence being used within the funding assumptions.
6. The States Employment Board should ensure that the draft Regulations make appropriate provision for the mechanism which would apply if one of the Admitted Bodies to the CARE scheme wished to leave the scheme.
7. The States Employment Board should take appropriate steps to ensure that, from 1st January 2015, actuarial advice to the Board and to the PECRS Committee of Management on the choice and prudence of assumptions is provided by separate actuarial firms.

2. THE PANEL'S REVIEW

Introduction

- 2.1 *Draft Public Employees (Pensions) (Jersey) Law 201- (P.28/2014)* was lodged by the States Employment Board (SEB) on 11th March 2014 and, at the time of this report's presentation, was due to be debated at the sitting of 13th May 2014. Its adoption would see the first legislative step towards reform of public sector pension provision in the Island; draft Regulations would subsequently be lodged for debate by the States Assembly. The proposed reforms would see the effective closure of the current scheme, the Public Employees Contributory Retirement Scheme (PECRS), to new members and the establishment of the Public Employees Pension Scheme (PEPS). PEPS would begin on 1st January 2015 and would be a Career Average Revalued Earnings (CARE) scheme, rather than a final salary scheme. We shall refer to it as the 'CARE scheme'.
- 2.2 Following the lodging of the draft Law, we agreed to undertake a Scrutiny Review of the proposed reforms. Given the demands of our work programme and the technical nature of this topic, we commissioned an expert advisor to review the proposals. BWCi Consulting Limited was appointed on 4th April 2014 and we are grateful for the work it has undertaken in reporting within a particularly tight timescale.
- 2.3 BWCi Consulting Limited has prepared a report, which we have appended. The report sets out the background to the types of pension scheme that might be introduced and to PECRS as it currently stands. Our advisor then proceeds to explore the proposals for the CARE scheme in relation to a number of areas, including the principles which are intended to underpin the proposed reforms: affordability, sustainability and fairness.
- 2.4 Our advisor has made 15 recommendations for us to consider, which we do below and we have drawn our own Key Findings and Recommendations. The information underlying our Key Findings and Recommendations is contained within our advisor's report, however, and we would urge people to read that report in order to gain a full understanding of the proposed reforms and the issues involved.
- 2.5 For this review the Corporate Services Scrutiny Panel comprised Senator S C Ferguson (Chairman); Deputy J G Reed (Vice-Chairman); and Deputy R J Rondel. Connétable D W Mezbourian, as a Member of the SEB, declared an interest and took no part in the proceedings. A copy of our Terms of Reference has been included in our advisor's report.

- 2.6 The written material provided to us and our advisor during our review is also listed within the advisor's report. In addition, we held three public hearings and received two written submissions, as follows:

Public Hearings

22nd April 2014	Chief Minister (as Chairman of the SEB), accompanied by the Chief Executive, the Treasurer of the States, the Project Director of Pensions and the Human Resources Senior Advisor
23rd April 2014	Chairman of the Joint Negotiating Board, accompanied by two other members of the Board (including its Secretary)
23rd April 2014	Chairman of the PECRS Committee of Management

Written Submissions

14th April 2014	Chairman of the PECRS Committee of Management
17th April 2014	Joint Negotiating Board

The written submissions and the transcripts of the public hearings are available to read on the Scrutiny website (www.scrutiny.gov.je).

- 2.7 We agreed to undertake our review in two phases. Phase 1 (of which this report represents the culmination) was to last until the debate on the draft Law. Phase 2 would begin once (and if) the draft Law were adopted and would last until the debate on the draft Regulations. It is apparent that 5 of our advisor's recommendations are most relevant to Phase 1 of our review and therefore to the debate on the draft Law. We shall therefore consider those recommendations first before moving on to the 10 recommendations which relate more directly to Phase 2 (and which we will therefore follow up during that Phase). In each instance, we have provided the reference in our advisor's report where our advisor has considered the issues in question.

Recommendations relating to the Draft Law

Scheme Design

- 2.8 Our advisor has recommended that we consider whether the arguments put forward for a CARE scheme are compelling. The rationale underlying that recommendation is covered in Section 4.4 of the advisor's report.
- 2.9 In considering this recommendation, we have noted that the draft Law itself does not explicitly establish a CARE scheme. In any event, very little detail is contained within the

draft Law and the proposed reforms would not be implemented unless and until draft Regulations were debated and approved. Nevertheless, it is clear from the report accompanying the draft Law that it is intended as a step towards the introduction of a CARE scheme. Approval of the draft Law could therefore be seen as an in-principle approval of the introduction of a CARE scheme.

- 2.10 We have taken into account the fact that work on the proposed reforms has been underway for some time and that there has been recognition from all parties that PECRS needs to be reformed. We have also taken into account that the proposals have already been subject to negotiation between the employer (i.e. the SEB) and employee representatives and that the agreement to maintain a defined benefit scheme and to introduce a CARE scheme have formed part of those negotiations. We have also considered the argument that aligning Jersey's public sector provision with the provision that exists in the United Kingdom (UK) (where CARE schemes have already been introduced) is in the Island's best interests in terms of recruitment. Thus, whilst it is difficult to disagree with the assertion that the move to a CARE scheme will mean that public sector provision is still more generous than what one might find in the private sector, the rationale underlying such a move is indeed compelling and rejection of the draft Law would risk derailing the proposed reform process. As ever, the devil will be in the detail and it is when the draft Regulations are finalised that the detail will become truly apparent.

KEY FINDING

- 2.11 Adoption of the draft Law would effectively provide in-principle approval for the move from a final salary scheme to a CARE scheme. The rationale for such a move is compelling and the debate on the draft Law should therefore proceed, albeit with the caveat that the details of how the scheme will operate will not be agreed until the draft Regulations have been finalised.**

Affordability

- 2.12 Our advisor has recommended that we seek further evidence to satisfy ourselves on whether the 16% / 16.5% cost cap (for the employer) would be affordable for the tax-payer in the long-term. This is covered in Section 6.4 of the advisor's report.
- 2.13 The need for the Assembly to consider this question has been raised by the decision of the SEB to lodge an amendment to the draft Law which would place the employer's contribution cap of 16.5% within the draft Law (and the decision of Deputy E.J. Noel to lodge an amendment to that amendment which would see the cap limited to 16%). We understand

that it had initially been foreseen that the employer's contribution cap would be incorporated within the draft Regulations. If the Assembly is to be asked to debate whether the employer's contribution cap should be incorporated within primary legislation, it should be provided with sufficient information on the implications of that cap.

KEY FINDING

2.14 Further evidence is required in respect of the affordability of the proposed employer's contribution cap in the long term.

RECOMMENDATION

2.15 Prior to the debate on the draft Law (and the accompanying amendments), the States Employment Board should ensure the States Assembly is provided with sufficient evidence on the affordability of the proposed employer's contribution cap.

Draft Legislation

2.16 Our advisor has recommended that we consider the text of the draft Law and, in particular, the risk of ambiguity in interpreting "significant" in Article 8(1). Our advisor has also recommended that the Chief Minister seek appropriate legal and/or actuarial advice in relation to that Article. The Article covers instances in which Regulations made under the draft Law make retrospective provision which appear to have either 'significant adverse effects' or which may be 'otherwise unfavourable'. In Section 10.4 of the report, our advisor has highlighted that these are subjective terms and that the manner of their interpretation is important. Clarity is required to be able to understand how Article 8 would be applied.

2.17 Such clarity might come from the provision of legal advice, as our advisor has highlighted. However, we are also reminded of the advice provided by HM Solicitor General to the Assembly during the recent debate on the Interim Population Policy: that it is preferable to have policies in place to ensure consistency of decision-making by Ministers. This might well be such an instance where a policy would be beneficial to ensure consistency of decision-making under Article 8 of the draft Law.

KEY FINDING

2.18 Further clarity is required regarding the manner in which Article 8(1) of the draft Law would be applied.

RECOMMENDATION

2.19 The States Employment Board should clarify the policy that would be followed in the application of Article 8(1) of the draft Law.

2.20 In Section 10.5 of the report, our advisor has also highlighted other areas which it would be beneficial to include within the scope of Regulations and has therefore recommended that we consider whether it would be helpful to expand the list of areas for potential regulation. The areas identified by our advisor are investments, investment strategy and returns; prudent and best estimate funding assumptions; and the declaration of conflicts of interest within the Committee of Management.

KEY FINDING

2.21 It would be beneficial for Regulations under the draft Law to include, in respect of the CARE scheme, provisions in relation to investment strategies; prudent and best estimate funding assumptions; and the declaration of conflicts of interest.

RECOMMENDATION

2.22 The States Employment Board should clarify whether and how provision will be made in Regulations for the matters identified by Scrutiny's expert advisor.

Legislative Process

2.23 In Section 10.7 of the advisor's report, it is recommended that we satisfy ourselves that the legislative timetable is sufficient to review what are expected to be complex Regulations.

2.24 The proposed CARE scheme is due to be implemented on 1st January 2015. Before that time, the draft Law needs to be debated by the States Assembly; the unions (should they choose to do so) need to ballot their members; and the draft Regulations need to be developed, consulted upon and debated by the States Assembly. In that latter regard, both the PECRS Committee of Management and the Joint Negotiating Group will need to consider the draft Regulations to ensure that from their perspectives they say what they should. The draft Regulations will also be subjected to Scrutiny. There is seemingly a desire from all parties to get through these processes to allow for implementation to occur in January 2015 but these are not insignificant stages through which the proposed reforms will need to pass.

2.25 This is happening in an election year when there is an even greater drive for States business to be completed before the summer recess. The current plan is therefore for the draft Regulations to be debated at a sitting of the Assembly in July 2014, ahead of which the process we have described above need to be completed. There is, we understand, the

procedural possibility that the draft Regulations could be debated at the first sitting in September 2014 (should such a move become necessary) but the desirability of doing so, given the proximity of the elections, is questionable. The development and implementation of the proposed CARE scheme is being undertaken within a tight timescale.

KEY FINDING

2.26 The aim to implement the proposed CARE scheme on 1st January 2015 means that the development and consideration of the draft Regulations will be undertaken within a very tight timescale. Sufficient time must be allowed for those Regulations to be considered.

Recommendations relating to the Draft RegulationsFurther Analysis and Information

2.27 Our advisor has made three recommendations that further analysis or information in relation to the CARE scheme is required. First, our advisor has suggested that additional information is required to enable the costs of PECRS and the new CARE Scheme to be compared on a consistent basis. The nature of the information required is described in Section 5.7 of our advisor's report. Secondly, our advisor has recommended that additional sensitivity testing is carried out to determine the funding contribution rates on a range of assumptions. This is also covered in Section 5.7. Finally, in Section 7.2.2 of the report our advisor has highlighted the need for additional modelling to be carried out to quantify the risk of underfunding even after benefit increases have been reduced to the minimum levels over the sustainability time horizon of 25 years.

2.28 In all three instances, our advisor has indicated the type of information or analysis which is required (analysis which we anticipate would be undertaken for the SEB by its actuarial advisors). We recognise that such information would assist the States Assembly when it comes to debate the draft Regulations and therefore support our advisor's recommendations.

KEY FINDING

2.29 Further information and analysis is required in respect of the cost comparison between PECRS and the proposed CARE scheme; the sensitivity of the results to the assumptions underlying the calculation of the anticipated contribution rates; and the quantification of risks of underfunding within the CARE scheme.

RECOMMENDATION

2.30 The States Employment Board should take appropriate steps to ensure that additional information and analysis identified by Scrutiny's expert advisor is made available before the draft Regulations are debated.

Funding of New Arrangements

2.31 Our advisor has recommended that the intended level of prudence in the funding assumptions be agreed at the outset and written into the regulations. This is a matter covered in Section 7.2.1 of our advisor's report. The fact that, within the proposed CARE scheme, funding assumptions would be based upon prudence (rather than best estimates, as is the case for PECRS) was often stated during the review. It is a matter we raised with the Chief Minister and there was an undertaking on his part to consider how the concept of prudence could best be dealt with in the Regulations.¹

KEY FINDING

2.32 The concept of prudence within the funding assumptions to be used under the proposed CARE scheme should be clearly established.

RECOMMENDATION

2.33 The States Employment Board should ensure that the Regulations underpinning the proposed CARE scheme incorporate the concept of prudence being used within the funding assumptions.

Fairness

2.34 Our advisor has recommended that we consider whether the fairness of the protections for certain members should be challenged. This is covered Section 8.3.1 of our advisors report. The protections in question are that those within 7 years of normal retirement age would be able to elect to retain their current provision (i.e. the final salary scheme) rather than move to the CARE scheme. Similar protection would be afforded to those members of PECRS on a 1/45th accrual rate. As our advisor has highlighted, the protection for those within 7 years of normal retirement age means that those least affected by the move to a CARE scheme would receive the most protection.

¹ Chief Minister, Transcript of Public Hearing, 22nd April 2014, Page 39

2.35 We have noted from the evidence we have received, and from our advisor's recommendation, that such protections are essentially unfair in that they mean certain members of PECRS would stand to benefit where others would not. Indeed, it was not a recommendation of the Technical Working Group that such protections be included. However, they were evidently a negotiating requirement of the Joint Negotiating Group and we recognise that the protections have been introduced following a negotiation process between that Group and the employer. They might therefore represent a pragmatic decision to compromise and thereby to make the proposed reforms acceptable. However, that does not alter the position that, in themselves, those protections are unfair.

KEY FINDING

2.36 Some of the protections which would be afforded to current members of PECRS in the move to a CARE scheme are essentially unfair. They appear to have been included for pragmatic reasons to ensure the proposed reforms would be acceptable to employees.

Risk-Sharing

2.37 From the information we have received to date, our advisor has highlighted that it is not clear what the mechanism would be if one of the Admitted Bodies to the CARE scheme wished to leave the scheme. Our advisor has therefore recommended that we pursue this in Phase 2 of our review to ensure that it is reflected in the draft Regulations. It is a matter we would expect to be covered in the Regulations and we would therefore hope that the SEB would make provision for such arrangements.

KEY FINDING

2.38 Appropriate provision needs to be made within the draft Regulations for the circumstances in which Admitted Bodies to the CARE scheme wished to leave the scheme.

RECOMMENDATION

2.39 The States Employment Board should ensure that the draft Regulations make appropriate provision for the mechanism which would apply if one of the Admitted Bodies to the CARE scheme wished to leave the scheme.

Governance

2.40 In Section 11.5 of our advisor's report, consideration is given to the fact that both the PECRS Committee of Management and the SEB (as employer) receive actuarial advice from the same firm. Our advisor has highlighted the issues raised by this arrangement and has recommended that we consider whether we are content with that arrangement. We understand that this position is not ideal and although our advisor has also suggested a compromise arrangement that could potentially be implemented, we believe it would be preferable for the situation to be addressed outright. The intended reforms and the introduction of the proposed CARE scheme would appear to present an ideal situation for that to happen.

KEY FINDING

2.41 It is not ideal for both the PECRS and CARE scheme Committee of Management and the States Employment Board (as employer) to receive actuarial advice on the choice and prudence of assumptions from the same actuarial firm, since there is a risk that the advice may not be, or seen to be, completely independent.

RECOMMENDATION

2.42 The States Employment Board should take appropriate steps to ensure that, from 1st January 2015, actuarial advice to the Board and to the PECRS Committee of Management on the choice and prudence of assumptions is provided by separate actuarial firms.

Administration

2.43 Our advisor has made two recommendations in relation to the resource requirements of the proposed reforms. They are addressed in Sections 12.4 to 12.7 of our advisor's report. First, our advisor has recommended that we consider whether the additional internal pensions administration costs arising from the CARE scheme should be identified and managed explicitly. Secondly, we have been advised to seek confirmation that the anticipated additional pensions administration staffing resources will be sufficient and adequately trained prior to 1st January 2015.

2.44 The report accompanying the draft Law states that the resource implications of implementing the CARE scheme (i.e. the manpower and systems) will be met from the scheme itself. It is also stated that the draft Law does not in itself have any additional financial implications for the States. Even if the anticipated resources are to be funded from the scheme (and not from States revenue expenditure), we believe it important that there is full understanding of

what those resource requirements are and that there is confidence that appropriate systems and arrangements have been put in place for when the reforms are due to be implemented. We would expect such matters to have been subject to consideration already and for there to be an appropriate project plan. Nevertheless, these are matters we will pursue and seek to address in Phase 2 of our review.

KEY FINDING

2.45 There needs to be clarity regarding the administration costs arising from implementation of the CARE scheme and confidence that the staff resources would be sufficient and adequately trained. These are matters which will be pursued during Phase 2 of the Scrutiny Review.

Member Communications

2.46 We have noted the findings of our advisor that some of the communication with members of PECRS about the proposed reforms could be reviewed as misleading in that it has presented the reforms as a certainty rather than as proposals (which await approval by the Assembly). Not all of the communication falls into that category and we recognise that a good deal of communication with the members of PECRS has been undertaken. Nevertheless, it is important that the correct message is provided at all times.

KEY FINDING

2.47 Notwithstanding the large amount of communication which has taken place, care should be taken to ensure that communication with members of PECRS is not inadvertently misleading about the status of the proposed reforms.

2.48 In considering this particular recommendation, we have recognised that communication about the proposed reforms has been undertaken by the various parties involved: the PECRS Committee of Management; the employer (i.e. the SEB); and employee representatives. This places a further emphasis on the need for care in undertaking communication to ensure that mixed messages are not provided. It also raises the question of which party should be primarily responsible for communication with the members of PECRS. In our view, it is the Committee of Management which should be clearly seen as primarily responsible.

3. REPORT OF BWCI CONSULTING LIMITED

**Independent Review
of the Proposed Reforms to the
Public Employees Contributory
Retirement Scheme (PECRS)**

Prepared for

The States of Jersey Corporate Services Scrutiny Panel

Prepared by

Mrs M Galpin, FIA

12 May 2014

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Executive Summary

We have reviewed the proposed new CARE scheme arrangements and our principal conclusions are:

- Our analysis of Jersey average earnings increases suggests that the CARE benefits indexation is quite generous.
- Indexing the CARE benefits to uncapped RPI introduces a risk that benefits could increase rapidly and substantially in a high inflation environment before corrective action can be taken.
- If the costing assumptions are not sufficiently prudent then the 24% cost envelope will not be adequate to meet the funding costs.
- We have not seen any evidence that the 16.5% [or possibly 16%] cost cap would be affordable for the tax-payer in the long-term.
- The proposed risk-sharing arrangements are complex
- Our principal recommendations are that:
 - the Panel consider whether the arguments put forward by the TWG and the JNG for a CARE scheme are compelling (section 4.4)
 - the Panel consider whether to seek evidence that the 16.5% [or possibly 16%] cost cap would be affordable for the tax-payer in the long-term (section 6.4)
 - the intended level of prudence in the funding assumptions is agreed at the outset and written into the regulations (section 7.2.1)
 - the Panel consider whether to seek additional information to enable the costs of PECRS and the new CARE scheme to be considered on a consistent basis (section 5.7)
 - additional sensitivity testing is carried out to determine the funding contribution rates on a range of assumptions (section 5.7)
 - additional modelling is carried out to quantify the risk of underfunding over the sustainability time horizon of 25 years, even after benefit increases have been reduced to the minimum levels (section 7.2.2)
 - the Panel consider whether the fairness of the protections for certain members should be challenged (section 8.3.1)
 - the Panel pursue what the mechanism would be if one of the Admitted Bodies wished to leave the CARE scheme (section 9.2)
 - the Panel consider whether the text of the draft law be reviewed, in particular in relation to Article 8(1) (section 10.4)
 - the Panel consider whether it would be helpful to expand the list of areas for potential regulation (section 10.5)
 - the Panel satisfy themselves that the legislative timetable is sufficient to review what are expected to be complex regulations adequately (section 10.7)

Executive Summary (continued)

- the Panel is content with the current arrangements, whereby actuarial advice to both the COM and SEB is provided by separate offices of the same company (section 11.7)
- the Panel consider whether the additional internal pensions administration costs arising from the CARE scheme should be identified and managed explicitly (section 12.7)
- the Panel verify that the anticipated additional pensions administration staffing resources will be sufficient and adequately trained prior to 1 January 2015 (section 12.7)
- that the Panel consider whether some of the online communication with members could be viewed as misleading and whether any action should be taken as a result (section 13.4.2)

1. Introduction

1.1 Role of BWCI

BWCI Consulting Limited ("BWCI") has been engaged as an independent expert advisor by the Corporate Services Scrutiny Panel of the States of Jersey ("the Panel") to assist them with their review of the proposed reforms to the Public Employees Contributory Retirement Scheme ("PECRS") and the related draft legislation. Details of the Panel's Terms of Reference for the review are set out in Appendix A of this report.

1.2 Structure of Review

The Panel's review will be broken down into two discrete phases. Phase 1 will run until the States' debate on the draft primary legislation on 13 May 2014. Phase 2 will then run from 14 May until the subsequent debate on the regulations, which is expected to be in July 2014.

1.3 Background

In *Strategic Plan 2012*, the Council of Ministers stated that it would review the affordability, sustainability and fairness of public pension schemes and the proposed changes to PECRS follow from this review.

The review of PECRS sought to address a number of issues that had been identified:

- to determine the most appropriate structure for the public sector pension arrangements going forward
- to ensure that the future risk-sharing arrangements are as fair as possible
- to ensure that the solution put in place is both affordable for members, their employers and the taxpayers, as well as sustainable in the long-term
- to avoid any unnecessary cross-subsidy between the members
- the payment of the Pre-87 Debt (see section 3.3)

The proposals have had regard to the principles set out by Lord Hutton for the reform of UK public sector pensions, following his detailed consideration of a range of approaches to pension provision both in the UK and other jurisdictions. Lord Hutton concluded that a Career Average Revalued Earnings ("CARE") scheme would be the most appropriate structure for the public sector in the UK.

In November 2012, a report on the possible options for reform of PECRS was published by the Technical Working Group ("TWG"). Following the endorsement by the States Employment Board ("SEB") of the option to move to a CARE scheme, detailed proposals have been discussed with the Joint Negotiating Group (JNG). The States is now being asked to approve the reforms, for subsequent implementation on 1 January 2015. It is anticipated that will be done through a draft enabling law, followed by approval of draft regulations in which the details of the proposed reforms will be laid out.

1. Introduction (continued)

1.4 Key Issues for the Panel

The Panel has identified the following key issues that it wishes to consider as part of its review of the proposed reforms:

1. How will the proposed structure for PECRS compare with the current structure in terms of sustainability, affordability and fairness?
2. What will be the financial impact of the proposed reforms for employers, employees and taxpayers?
3. What impact will the reforms have on benefits, risks and contribution rates, both from the employers' perspective and that of the employees?
4. Are the proposed reforms sustainable in the long term?
5. Are the proposed reforms fair for the various classes of members of PECRS?
6. What will be the future liability of the States within a reformed scheme?
7. What impact will adoption of the proposed reforms have on the repayment of the Pre 1987 Debt?

1.5 Scope of the Review

While the key issues outlined above form the central part of their review, the Panel has also asked that the scope of BWCI's report should be extended as necessary to cover other potential areas of risk that may be identified whilst considering the evidence presented. As a result, we have also commented upon the following:

- Governance arrangements
- Administration arrangements
- Member communications

We have not considered whether any changes might be required to contracts of employment, as a result of the proposed pension changes, since this is a legal issue and therefore is outside the scope of our report.

1.6 Evidence considered

In order to assist the Panel we have been provided with evidence from a number of sources. In addition, we have also drawn on additional information that is available online. The documents that have been considered are listed in Appendix B.

1.7 Abbreviations

There are a number of abbreviations and technical pension terms that are used throughout the evidence considered and for ease of reference, we have included the most frequently used terms in the box below.

1. Introduction (continued)

Key Abbreviations	
CARE	Career Average Revalued Earnings
COM	Committee of Management
DC	Defined Contribution
DB	Defined Benefit
DPU	Dedicated Pensions Unit
JNG	Joint Negotiating Group
PECRS	Public Employees Contributory Retirement Scheme
SEB	States Employment Board
SPA	State Pension Age

2. Types of Pension Scheme

2.1. Overview

Before reviewing the pension reform proposals, it may be helpful to summarise briefly the different types of pension scheme, how they operate and the relative advantages and disadvantages of each.

2.2. Types of Scheme

Essentially there are two types of pension arrangement:

- Defined contribution (DC or Money Purchase)
- Defined benefit (DB)

2.3. Defined Contribution Schemes

In a defined contribution scheme the employer and the members pay a specified contribution rate into a "pot" for each individual member. The retirement benefits available to a member will depend on the value of the funds in that individual member's pot and the cost of purchasing an annuity at retirement. This in turn depends on the contributions paid into the scheme and the investment return achieved. At retirement the member has the option to choose the type of pension that best suits their individual circumstances.

Defined contribution schemes are by far the most common type of open pension arrangement found in the private sector, both in Jersey and the UK. From an employer's perspective, the contribution rate is known and because the benefit is always equal to the value of a member's pot, there are no funding surpluses or deficits to be addressed.

From the member's perspective, defined contribution provides the flexibility to select the form of pension that best suits their personal circumstances, as well as usually providing some choice around how the contributions are invested. However, the members bear all of the risks associated with poor investment returns and improving life expectancy.

2.4. Defined Benefit Schemes

The benefits payable from a defined benefit scheme are calculated by applying a set of rules. Normally the benefit is calculated as a proportion of salary for each year of service, according to the particular formula for an individual scheme. The benefits would normally be independent of both the investment performance of the scheme's assets and the contributions paid. Both PECSRS and the proposed new arrangements have most of the characteristics of a defined benefit schemes from the members' perspective. However, the risk-sharing arrangements described in section 9 mean that they are not fully defined benefit.

2.4.1 CARE Scheme

A Career Average Revalued Earnings ("CARE") scheme is a form of defined benefit scheme and in many ways is similar to a traditional defined benefit final salary scheme. The one key difference is that the pension "earned" during each year of employment increases in the same way for all members, rather than in line with an individual's salary increases during their working life.

2. Types of Pension Scheme (continued)

At an individual level, a final salary pension arrangement will tend to favour "high flyers". The exact relationship between the benefits provided under a CARE and final salary scheme cannot be compared easily on a scheme wide basis, other than by considering the cost of providing each type of benefit using consistent actuarial assumptions. We have requested such a cost comparison from the Treasurer, and while we have received some additional summarised information, we have some further points that we would like to be clarified before considering this further. We would recommend that the Panel pursue this in Phase 2 of their review (see section 5.7).

2.5. Actuarial valuations

The financial position of a defined benefit scheme needs to be reviewed on a regular basis by the scheme's actuary. Typically a formal actuarial valuation is carried out once every three years and involves the comparison of the market value of the scheme's assets with its liabilities at the date of the valuations. The value placed on the liabilities is calculated using a financial model that projects the expected amounts and timing of the benefit cashflows from the scheme, using a set of assumptions.

2.6. Valuation Assumptions

While the value of the assets is an objective value, based on the market value of the investments, the present value placed on the scheme's liabilities is much more subjective, since it is necessary to make assumptions about when and for how long the benefits are expected to be paid, as well as how they will increase.

As the cost of providing the benefits is to be partially met by the investment return on the scheme's investments, the assumed rate of return on the investments is a key valuation assumption. This assumed rate of return is generally referred to as the discount rate. The discount rate, together with the assumption made for future Jersey inflation, are the key financial assumptions. In general, it is the difference between these two assumptions that is more important than their absolute values.

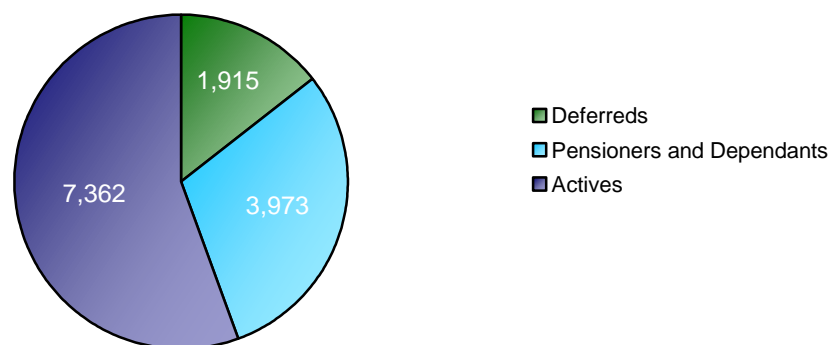
3. Background to PECRS

3.1 Overview of PECRS

PECRS is a statutory scheme and, on the face of it, is a final salary defined benefit pension scheme. However, as Aon Hewitt point out in their report of 15 July 2011, it is hybrid between a defined benefit and a defined contribution scheme due to the unusual way in which the funding surplus and deficits are managed. The Committee of Management ("COM") has oversight of the operation of PECRS and operates in a broadly similar way to a trustee board for a pension arrangement established under trust.

The membership of PECRS comprises the employees of the States of Jersey, together with the employees of 24 other employers, known as the "Admitted Bodies". In total there were 13,250 members as at 31 December 2012. The majority of the membership are current public sector employees who are still accruing benefits. Around a quarter of the members are in receipt of pensions and the remainder are deferred pensioners who have left employment but who have not yet started to draw their pensions. The chart below illustrates the distribution of the membership.

PECRS Membership at 31 December 2012



Source: PECRS 2012 Annual Report

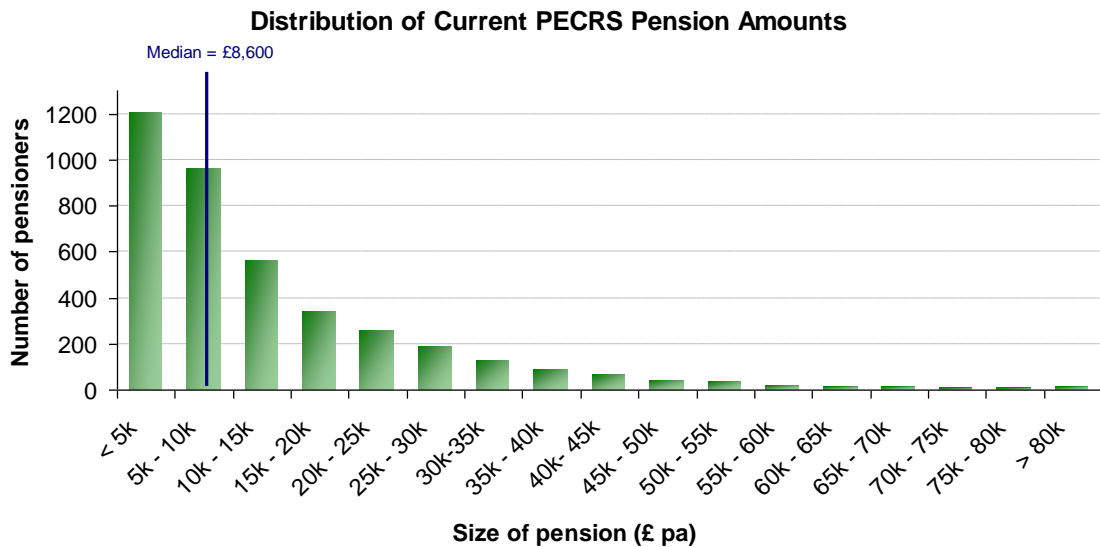
3.2 Benefits provided

3.2.1 Overview

Not all of the members have the same benefit structure. In particular, there are differences between the "uniformed" and "non-uniformed" staff, as well as some members with legacy benefit structures dating back to before the changes made to PECRS which gave rise to the Pre 1987 Debt (see section 3.3). The headline differences in benefit structure are around the accrual rates and normal retirement age.

The median pension provided by PECRS is understood to be £8,600 pa. However, there is a wide distribution of the size of pension which is illustrated in the chart below.

3. Background to PECRS (continued)



3.2.3 Pension at retirement

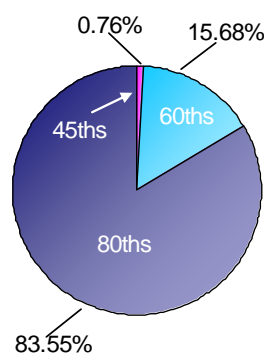
The pension provided under PECRS at normal retirement age is calculated using the following formula:

$$\text{Pension} = \frac{\text{Pensionable Service} \times \text{Final Pensionable Earnings}}{\text{Accrual rate}}$$

3.2.4 Accrual rates

The lower the accrual rate the faster the rate, at which the pension builds up. For example, an 80ths accrual rate is equivalent to a pension of 1.25% of final pensionable earnings for each year of service. However, a 60ths accrual rate would provide a greater pension, as it is equivalent to the pension building up at a rate of 1.67% for each year of service. As illustrated in the pie chart below, the vast majority of the members have an accrual rate of 80ths.

Number of active members with each accrual rate



Based on a total number of active members of 7,417.

Source: Treasury and Resources Presentation

3. Background to PECRS (continued)

NB: The pie chart illustrates the most recent information provided to the Panel on the numbers of members of PECRS with a particular accrual rate. This is why the figures for the total number of active members is different from the number in section 3.1 above. In addition, we understand that a very small number of new prison officers have an accrual rate of 1/70th which is not reflected in the pie chart.

3.2.5 Pension increases

PECRS does not currently provide **guaranteed** increases to pensions in payment for the majority of members. However, it is required to provide increases in line with the Jersey All Items Cost of Living Index provided that PECRS's financial position remains satisfactory.

Following the 2007 valuation the financial position of PECRS was found to be unsatisfactory and consequently pension increases were awarded at 0.3%pa below the rate of inflation. This is understood to be the first time that the COM had to take this action. The 2010 valuation indicated that subsequently the position had improved slightly and pension were re-adjusted to be 0.15% pa less than inflation.

3.3 Pre 1987 Debt

3.3.1 What is the Pre 1987 Debt?

Following changes made to Jersey's public sector pension arrangements in 1987, PECRS took on the liability for paying increases to pensions accrued in respect of service prior to the changes. Previously these increases were funded by the States on a "pay as you go" basis. While PECRS took on these additional liabilities, no additional contributions were paid into PECRS to cover this. This shortfall in the funding of the pension increases is how the "Pre 1987 Debt" arose.

It was not until 2003 that an agreement was reached between the COM and the Policy and Resources Committee on the framework for dealing with this debt and the detailed process was set out in a "10 point plan" and eventually enshrined in regulations in 2005.

3.3.2 How large is the Debt?

Under the 10 point plan the actuary to PECRS is required to certify the debt each year and a note of the amount is included in the States Accounts. The latest accounts available relate to 2012 and at 31 December 2012 the actuary certified that the debt was £250.45M, having reduced from £252.02M the previous year. However the note to the accounts also highlights the sensitivity of the value of the debt to small changes in the discount rate used to value it. In particular, a reduction of 0.1%pa in the assumed discount rate would increase the value of the debt by around £8M.

3.3.3 How is the debt to be eliminated?

It was agreed that from 1 January 2002 the employer's contribution rate of 15.6% of pensionable earnings would essentially be split into 13.6% to cover the cost of future benefits accruing and 2% would be allocated to paying off the Pre 1987 Debt. This approach was expected to eliminate the debt over an 82 year period.

3. Background to PECRS (continued)

According to the 2012 States Accounts, the payment towards the debt in 2012 was £4.1M and the expected payment in 2013 was £4.3M.

3.3.4 Eliminating the debt more quickly

It is recognised that the period over which the debt was initially planned to be eliminated is very long. The key problem with this is that the benefits to which the debt is linked would have had to have been paid out of PECRS before the debt is fully repaid. This would result in a weakening of the security of the benefits for younger members of PECRS until the full debt had been repaid. Consequently steps are being taken to accelerate the funding of the debt, in order to eliminate it over a shorter period. Section 9 of the written submission to the Panel dated 14 April 2014 from the Chairman of COM indicates that if the increased payments included in the States current Medium Term Plan (2013-2015) can be maintained, the repayment date of the debt is expected to be reduced by around 29 years to 2054. This is still a long period and the Treasurer has indicated that the debt will be repaid over a shorter period if it is possible to do so.

4. Proposed benefit structure

4.1 Introduction

Before commenting on the proposed fairness of the benefit structure, it is important to realise that the current proposals are slightly different from the initial proposition put forward by the TWG. Various adjustments have been made as a result of discussions with the JNG.

A summary of the changes that have been brought about by the negotiations are provided in Slide 11 of Part A of the Treasury team's presentation to the Panel.

4.2 Type of benefit structure

A key decision to be made is the type of benefit structure. The benefit design then follows from this. Essentially the choice is between a defined contribution arrangement and a form of defined benefit. Section 2 of this report provides a description of each type of scheme.

To help put this decision in context, virtually all private sector employers, both in Jersey and the UK have closed their defined benefit pension schemes in the last 20 years or so, replacing them with a defined contribution scheme. Defined contribution schemes are seen as particularly attractive to private sector employers, as they provide complete certainty over the cost of providing pension benefits and eliminate balance sheet volatility. Defined contribution schemes are not necessarily inferior to defined benefit schemes; it will depend on the level of contributions paid.

4.3 Reasons for proposed CARE Structure

In contrast to the position in the private sector, Lord Hutton's review of the UK public sector pension arrangements recommended a CARE benefit structure, which is a form of defined benefit scheme (see section 2.4.1).

The TWG considered a range of types of arrangements in their November 2012 report before proposing a CARE arrangement, citing various disadvantages of defined contribution schemes including:

the potential difficulty of recruiting specialist staff from the UK,

the lack of certainty of outcome of a defined contribution scheme,

the administration costs and

the risk of poor decision making affecting members' benefit outcomes

However, the evidence that we have reviewed does not seem to entirely support these arguments and therefore the Panel may wish to question the robustness of the arguments put forward to support this central part of the proposed reforms.

4.3.1 Recruitment from the UK

In section 12.2 of the 2011 LCP Scheme Review for the COM it says "the current New Member Regulations benefit scales under PECS are now much less valuable than typical public sector arrangements from which members might be transferring."

We understand that these New Member Regulations apply to employees joining after 1 September 1989.

4. Proposed benefit structure (continued)

Section 12.4 of the report goes on to say that the volume of transfers was not thought to be insignificant, with more transfers in from the UK than back to the UK. We do not have any information about the current situation, but if it is still the case then the Panel might wish to consider whether this would appear to weaken the argument that a less generous pension arrangement would act as an obstacle to recruitment.

While some staff with specialist skills will undoubtedly be required, does it necessarily follow that all public sector employees should be provided with a pension arrangement that is broadly in line with the UK public sector? If recruitment of key staff from the UK is an issue, a more targeted solution might be to provide cash-based compensation. A counter argument to this would be that it is treating certain categories of employees differently and goes against the fairness principle. Any potential difficulty of recruiting staff from the UK falls outside the scope of this report.

4.3.2 Uncertainty of benefit outcome and poor decision making

While there is inevitably some variation in the size of a defined contribution pot at retirement, these issues can be addressed by ensuring the scheme has a default investment strategy which automatically moves to lower risk investments as a member approaches their selected retirement age.

The limited number of annuity providers in the Channel Islands at the current time could also be a reason for not going down the defined contribution route. However, Jersey's tax legislation does already provide for an alternative form of retirement income known as "income drawdown", provided that an individual can demonstrate that they have a guaranteed income at least equal the Jersey single person's old age pension.

4.3.3 Administration costs

While the UK Government accepted the CARE benefit structure for the UK public sector, they have taken a different approach to the recently introduced auto enrolment legislation[†], which has led to downward pressure in the UK on investment management costs associated with a defined contribution scheme.

4.3.4 Fairness to Taxpayers

Looking at the fairness criteria, most of the private sector employees in Jersey will either have no pension provided by their employer or will be in some form of defined contribution arrangement. Therefore it would appear reasonable to question if it is fair to taxpayers that they are funding a public sector defined benefit pension scheme, notwithstanding the effect on the pension amounts of the risk-sharing arrangements (see section 9).

4.4 Conclusions on benefit design

We have highlighted some of the main arguments for and against whether the public sector pension provision in Jersey should be on a CARE basis. Ultimately the solution needs to strike a balance between the theoretical best outcome for each of the stakeholders and what is

[†] This requires every UK employer to provide access to a workplace pension scheme and pay a minimum level of contributions into that scheme. The default provider for auto enrolment (NEST) provides pensions on a defined contribution basis.

4. Proposed benefit structure (continued)

achievable through negotiation in practice. In practice, there might be insurmountable resistance to the introduction of a defined contribution scheme. In particular, at the Panel hearing on 23 April, the JNG chairman said “I think one of our lines in the sand was that we would find totally unacceptable any move to a defined contribution scheme, ie away from the defined benefit scheme...”. He then went on to say that a CARE scheme “gives certainty and we like that idea”.

We recommend that the Panel consider whether they consider whether the arguments put forward by the TWG and the JNG for a CARE scheme are compelling.

4.5 Principal Changes

The key changes for members under the proposed new CARE arrangements are:

phased increases in members' contribution rates

the linkage of pension age to State Pension Age for non-uniformed staff

the increase in pension age for uniformed staff to 60

an accrual rate of 1/66th

introduction of CARE style benefits, revalued at a rate of 1% pa in excess of Jersey RPI

guaranteed minimum pension increases of 50% of Jersey RPI (with 100% being the target)

increase in death in service lump sum

inclusion of nominated co-habiting partner if move to CARE structure

protection from changes for specified categories of members (see Section 8.3.1)

the introduction of contribution caps for the employer and the employee

the introduction of risk-sharing in the event that the benefits are not fully funded

improved governance arrangements

4.6 Protection

While all members will be required to pay the higher contribution rates, some will have the option to continue to accrue benefits under the existing PECS structure. The fairness of the protection arrangements is considered in section 8.3.1.

All members' benefits accrued prior to 1 January 2015 are to be fully protected. Therefore the changes only affect benefits in respect of service from 1 January 2015 onwards. Consequently the changes will have the least impact on those close to retirement (even before the effect of the protections discussed in section 8.3.1).

4. Proposed benefit structure (continued)

4.7 Comparison of Benefits

The table below compares the benefits which we understand are expected to be provided from 1 January 2015, if the proposed reforms are accepted:

	PECRS From 2015 onwards under protection	CARE
Type of Scheme	Final Salary	Career Average Revalued Earnings (CARE)
Pensionable Earnings	Contractual earnings + shift pay	Contractual earnings + shift pay
Accrual rate	1/80, 1/70, 1/60 or 1/45	1/66
Normal Pension Age <ul style="list-style-type: none"> Non-uniformed Uniformed 	60 or 65 55	Linked to State Pension Age 60
Eligibility <ul style="list-style-type: none"> Permanent staff Fixed term contract 	Compulsory Optional	Compulsory Optional
Minimum Age of joining	20	None
Maximum Age of joining	60	None
Final Pensionable Earnings	Best 365 days in last 3 years	Best 365 days in last 10 years for PECRS benefits
Member contribution rates <ul style="list-style-type: none"> Non-uniformed Uniformed 	8% 10.1%	8% 10.1%
Phasing in period of new contribution rates <ul style="list-style-type: none"> Non-uniformed <£30K pa Non-Uniformed > £30K pa Uniformed 	4 years 3 years 5 years	4 years 3 years 5 years
Minimum Pension increase	0%	50% of RPI
Lump Sum on death in service	2 x Pensionable Earnings	3 x Pensionable Earnings
Dependants' pensions	Spouse/Civil Partner	Spouse/ civil partner/nominated Co-habiting partner
Ill health retirement	1 tier approach	2 tier approach
AVCs	Permitted	Permitted
Lump sum at retirement	25% increasing to 30% Conversion rate £1 pa → £13.50 Lump sum	30% Conversion rate £1 pa → £13.50 Lump Sum
Flexible retirement	Not permitted	Permitted

4. Proposed benefit structure (continued)

4.8 Increases in members' contributions

It is proposed that all members' contributions will be increased, whether or not they opt to retain the existing benefit structure if they are entitled to protection or move to the CARE structure. This is fair since all members will be being treated in the same way. The affordability issue of a rise in contributions has also been mitigated by the phasing in of the increases for existing members. New employees from 1 January 2015 will however be required to pay the full rate on joining the scheme. Therefore not all members are being treated equally in the short term, but this is a trade off between fairness and affordability.

4.9 Normal Retirement Age

The linkage of normal retirement age with increases in SPA is one way of managing the cost of increasing life expectancy. The downward effect is twofold on the contribution rate; there is a longer period over which to pay the contributions and pensions are less costly to provide because they will be payable for a shorter period. Normally these two effects outweigh the additional cost of the extra benefit that accrues due to the longer period of pensionable service.

The proposal is for the non-uniformed staff to have their normal retirement age linked to SPA changes; this will have the effect of phasing in the effect so that it only applies to the younger staff. The increase will be gradually introduced between 2020 and 2031 and therefore will affect all employees who are aged 59 or less at the current time, with the full effect of an increase in normal retirement age to 67 for members under around age 50 at the current time.

For uniformed staff the increase is an immediate rise in normal retirement age from 55 to 60 from 1 January 2015. However, there is no agreed linkage with changes in SPA beyond this at the current time.

4.10 Accrual rate

The proposed CARE accrual rate of 1/66th is equivalent to benefits accruing at the rate of just over 1.5%pa. The vast majority of members in PECRS are on an 1/80ths accrual rate (or 1.25%) at the current time so this represents an improvement. However, for the members on 60ths it will be a reduction. Benefits are proposed to be protected for the members who currently have an accrual rate of 1/45ths³ (2.22%). We consider the fairness of the protection arrangements in section 8.3.1.

4.11 Revaluation of CARE Benefits

The benefit accrued each year under a CARE scheme increases in some objective way between the year in which it is accrued until the date the employee leaves employment.* This is generally referred to as "indexation". Based on the information that was supplied to us by the Treasury on their analysis of the different types of CARE structures being negotiated within the UK public sector, the rates of indexation in the UK range from in line with UK CPI increases (in some cases plus an additional percentage of up to 1.6% pa) to in line with increases in average earnings.

³ See section 3.2.4

* If the member does not retire immediately, the benefit would then be increased in line with deferred pension increases until retirement.

4. Proposed benefit structure (continued)

4.11.1 Proposed Jersey indexation

The TWG's starting position was indexation in line with average earnings increases (assumed to be equivalent to RPI+1.5%pa for costing purposes). However, as part of the negotiations, the indexation rate was altered to RPI +1%pa in return for an improvement in the accrual rate from 1/70ths to 1/66ths, (ie a 6% improvement in the accrual rate). This change in indexation breaks the direct link with earnings growth.

In relation to this change, the Chairman of the COM commented to the Panel during the hearing on 23 April:

“one can understand why staff representatives would rather go for the certainty of RPI or RPI plus something, rather than rely on a link to earnings where they feel that earnings can be under significant employer influence.”

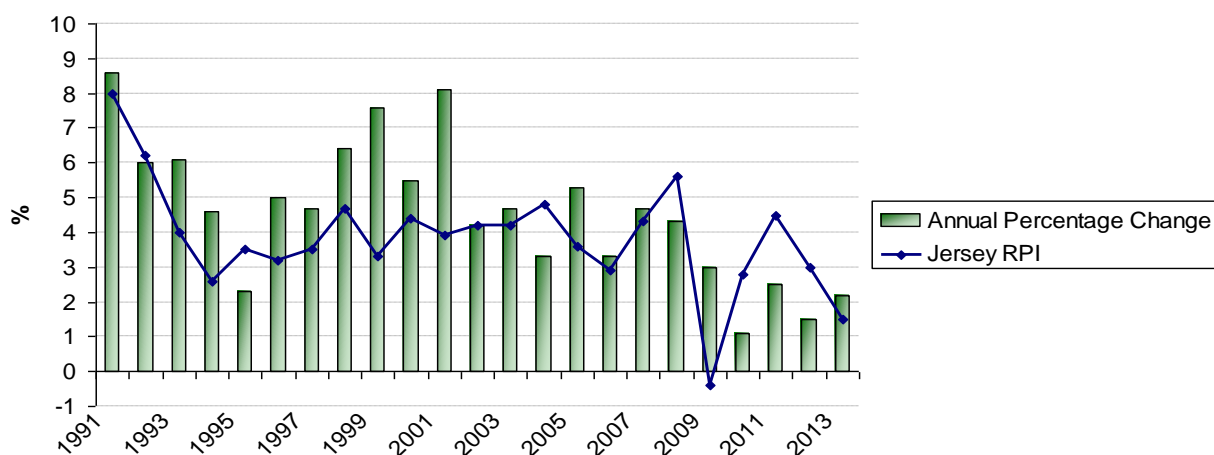
4.11.2 Jersey Average Earnings Increases

The States Statistics Unit collates information on average earnings increases in Jersey and publishes data showing the historical increases since 1991.

This chart show the annual increases in average earnings together with the annual RPI increases. Over the period since 1990, average earnings in Jersey have increased by 4.5%pa, whereas RPI has increased by an average of 3.8%pa. Therefore over this period average earnings have grown at a rate of 0.7% pa in excess of inflation.

The graph also illustrates that earnings increases have been quite volatile, with the lower observed increases from 2010 onwards reflecting the economic conditions generally.

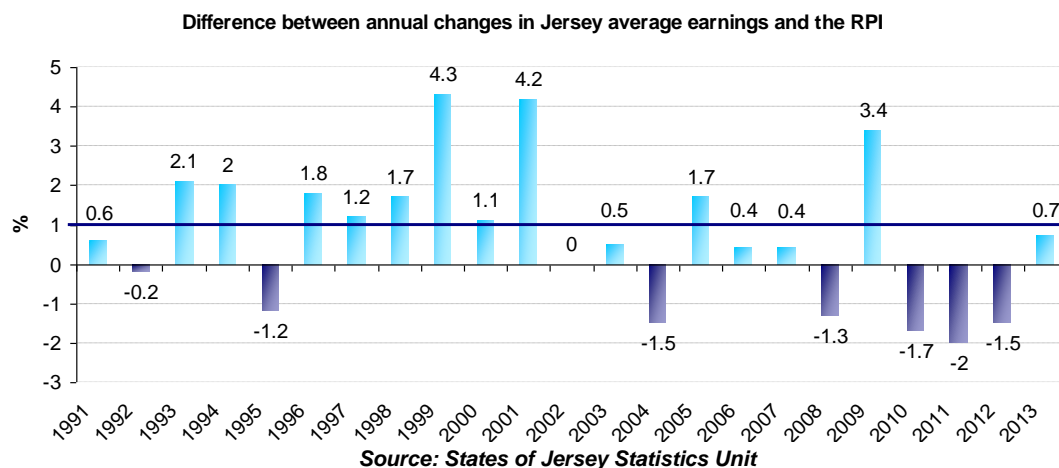
Annual percentage change in Jersey average earnings



Source: States of Jersey Statistics Unit

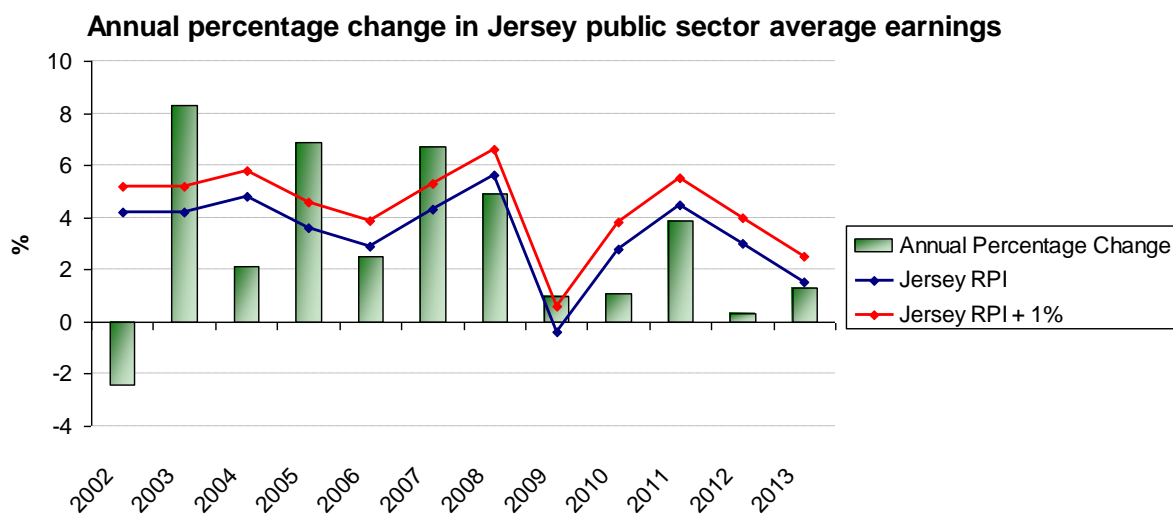
This second graph focuses on the real earnings increases, ie increases in excess of RPI. This illustrates more clearly how volatile real earnings growth can be. The dark blue line illustrates how accrued benefits would have been indexed in line with the RPI +1% indexation under the CARE scheme proposal.

4. Proposed benefit structure (continued)



4.11.3 Jersey Public Sector Average Earnings increases

Since 2002 the Statistics Unit has also been publishing the information separately for the private and public sectors.. The graph below illustrates changes in public sector average earnings increases, relative to RPI over the period. We have also added the red line at a rate of RPI +1% to illustrate what the CARE benefits indexation would have been had the structure been in place over that period.



We understand that some of the volatility in the average earnings increases in the earlier years is as a result of the 2 year pay deals in the public sector. As a consequence, while earnings have been reviewed annually, increases were not always been applied annually. Over this 12 year period, average earnings in the public sector increased by 3.1% pa whereas RPI increased by 3.4%pa. While this has been a difficult period economically, over this period, the proposed CARE revaluations of RPI +1% pa look to be quite generous based on published historical experience.

4.11.4 Comments on indexation structure

We would highlight that by indexing the CARE benefits to uncapped RPI, the employer has no influence over the actual rate of revaluation. There is therefore a risk of very high inflation increasing the cost of the benefits substantially. With valuations being undertaken once every

4. Proposed benefit structure (continued)

three years and taking a year or so to complete, it might be some time before there is the opportunity to take any remedial action. This may then require a large adjustment to benefits through the risk-sharing mechanism.

From the information provided, it is also not clear what would happen if there were a period of deflation such that the RPI index fell by more than 1%. However, we have subsequently been advised by the Treasury, that benefits would not be cut back.

5. Analysis of Costs

5.1 Assumptions

For the avoidance of doubt, this section focuses on the assumptions for the CARE scheme. Different assumptions are used to place a value on the accrued PECRS benefits for funding purposes.

Aon Hewitt's Benefit Costings paper dated 11 April 2014 concludes that the proposed benefit structure is within the 24% cost envelope based on the assumptions used. However, their report makes it clear that further work would be required to confirm what funding methodology and assumptions would be appropriate for contribution-setting purposes.

The TWG report dated November 2012 states that, provided the investment strategy for the new scheme includes at least 50% growth assets, the Scheme Actuary's view was that the costing assumptions were a prudent assessment of the future at that time. However, this comment provides no indication as to the level of prudence incorporated into the assumptions. Prudent assumptions could mean anything from a 51% chance of success to a near 100% chance of success.

It is critical that the initial costing assumptions (subject to changes in market conditions) would be acceptable to all parties as prudent funding assumptions for future valuations. If the costing assumptions are not deemed to be sufficiently prudent then the proposed contribution rates will not be sufficient to meet the funding costs within the 24% cost envelope.

5.2 Financial Assumptions

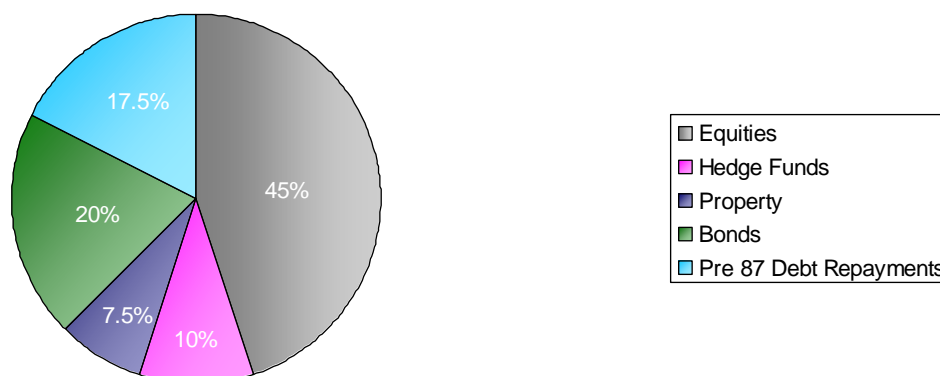
The two key financial assumptions are the discount rate and the assumed inflation rate. In particular, it is the difference between these two assumptions, rather than their absolute values, which is critical to the value placed on the pension liabilities. Therefore it is important to consider both of these assumptions together.

5.3 Discount Rate

If a higher investment return is achieved on the assets held by a pension scheme then, all else being equal, lower contributions will be required. This is factored into the actuarial valuations through the discount rate. The discount rate can therefore be thought of as the investment return that is expected to be achieved on the assets held to meet the pension liabilities. In view of this, the discount rate for funding valuations is typically set based on a prudent assessment of the investment return expected to be achieved on the assets held. This means that, before an appropriately prudent discount rate can be determined, the relevant parties must have decided on a suitable investment strategy for the CARE scheme. We understand that this aspect of the new arrangements has not yet been considered in detail. However, we have been advised verbally by the Treasurer that it is anticipated in the short-term that the investment strategy will be the same as for PECRS. This is illustrated in the graph below, based on the benchmark strategy shown in PECRS's 2012 Annual Report. This shows that the strategy, after treating the expected income stream from the Pre 1987 Debt contributions as a salary-linked bond, is broadly 55% return seeking assets and 45% bond type assets. It is however recognised that as PECRS becomes more mature, the investment strategies of PECRS and the CARE benefits scheme might need to diverge.

5. Analysis of Costs (continued)

Investment Strategy Pie Chart



Source: PECRS 2012 Annual Report

The discount rate for the Benefit Costings paper was set at 5% pa. This was derived as 3% pa above the UK Government's target for future CPI inflation. This follows the approach adopted in the UK for setting the discount rate for unfunded public sector pension schemes. We understand that initially this discount rate was adopted by Aon Hewitt to enable the proposed Jersey changes to be benchmarked against UK public sector schemes. However, whilst this discount rate derivation may be an appropriate methodology for largely unfunded UK public pension schemes, we cannot see a logical argument for why it would necessarily be a relevant methodology for determining funding costs for a funded Jersey pension arrangement. Section 7 of Aon Hewitt's paper of 15 July 2011 also considers what might be an appropriate discount rate to use to illustrate the cost of possible benefit scenarios. In particular it states quite rightly " it is not possible at this stage to select a discount rate with regard to the scheme's investments and we are required to use an alternative approach." This alternative approach of using assumptions set by the UK Government to compare the cost of UK public sector pension arrangements by reference to expected growth in UK GDP, whilst helpful to compare the overall "generosity" of the Jersey CARE proposals with the UK arrangements, is not necessarily an appropriate basis on which to set the long term cost envelope.

While historically most funded private sector defined benefit pension schemes invested heavily in equities, more recent equity market volatility combined with the closure of most defined benefit schemes has led many pension schemes to de-risk their assets. Typically most defined benefit schemes now hold bond type investments to match their pensioner liabilities, whilst retaining equities to back the non-pensioner liabilities over the period until they reach retirement.

Ultimately it will be a decision for the COM and the SEB as to whether, as an open public sector scheme, the CARE scheme wishes to take a more aggressive investment strategy than the typical closed private sector defined benefit scheme. A more return seeking investment strategy will reduce the expected costs of the scheme. However, return-seeking assets produce volatile investment returns and this exposes the employer and members to the risk of benefit cuts and additional contributions if the anticipated investment returns do not materialise.

5. Analysis of Costs (continued)

Once the investment strategy has been agreed, the level of prudence to be incorporated into the assumptions needs to be determined. It is intended that the assumptions for the CARE scheme will be determined on a prudent basis. However, as the degree of prudence can be subjective, we recommend that the intended level of prudence is agreed at the outset and written into the regulations. This will ensure consistency between valuations and avoid the risk of the level of prudence reducing over time, as has occurred in PECRS actuarial valuations in more recent years.

5.4 Inflation Assumption

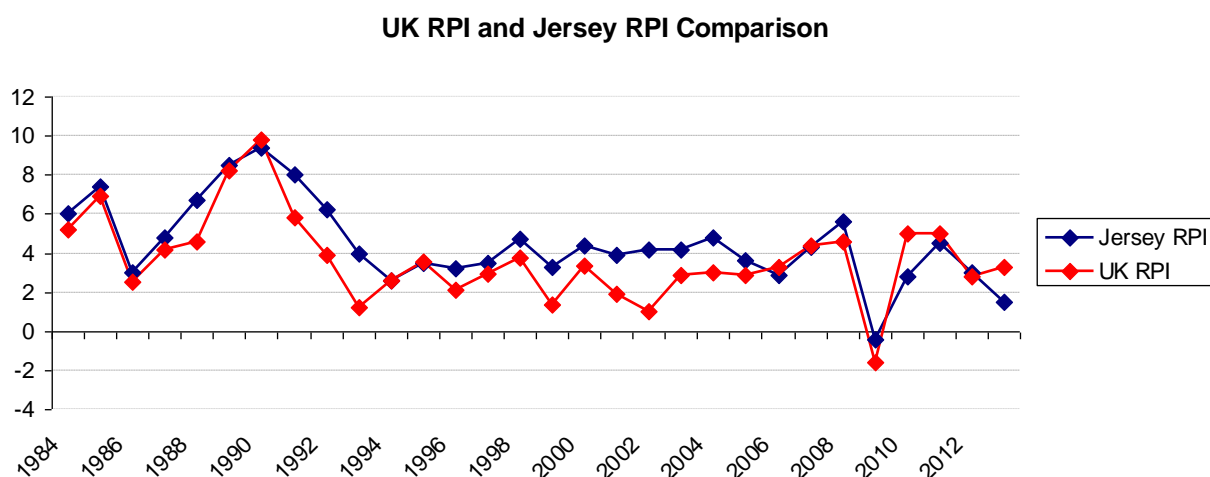
The inflation assumption used for the Benefit Costings paper was 2.75% pa, set as the Bank of England's target for CPI (2% pa) plus an allowance for the expected long term difference between UK RPI and CPI (0.75%). We would highlight that:

- the Bank of England's target for CPI is only a target and actual CPI has significantly exceeded this in recent years. Therefore, we would not classify this as a prudent CPI assumption.
- the long term difference between CPI and RPI is a difficult assumption to determine, but we suggest that Aon Hewitt are asked to provide their best estimate assumption and, if possible, the level of prudence incorporated in an assumed differential of 0.75%.

Jersey inflation has been assumed to be in line with UK inflation. There was a sustained period between the mid-1980s to the mid-2000s where Jersey inflation exceeded UK inflation. When asked for his opinion on this issue, Jersey's Economic Adviser said: "The difference between UK RPI and Jersey RPI is a tricky one. The long-term difference between the two is 0.25% (1950-2013). In recent years the differential has been low or in fact the other way. Over the very long-term it would be hard to argue that Jersey could persistently see higher inflation than the UK (especially given the starting point where this has persisted in the past) as that would push prices higher and higher relative to the UK. However, it is also difficult to completely ignore past trends that have persisted over the long-term. That suggests to me that using a range of a differential of 0-0.25% might be sensible to recognise the uncertainty".

- The COM may therefore wish to consider whether it would be prudent to make an allowance for Jersey RPI to exceed UK RPI in the valuation assumptions. Alternatively, the converse view is that Jersey would become uncompetitive if local inflation consistently exceeded UK inflation over the long term. In addition, Aon Hewitt may wish to factor into their determination of an appropriate Jersey inflation assumption any differences in the RPI calculation methodology between the UK and Jersey. The graph below compares UK and Jersey RPI over the last 30 years.

5. Analysis of Costs (continued)



5.5 Demographic Assumptions

The Benefit Costings report is based on the same demographic assumptions as adopted for the 2010 valuation of PECRS. More recent mortality tables have been published since the valuation and we understand that the most recent costing figures include an allowance for updated mortality rates.

5.6 Funding Method

The Benefits Costings report notes that the calculations are based on the Projected Unit funding method with a 1 year control period. However, the paper states that Aon Hewitt are not advising on the funding methodology adopted. The Projected Unit method is most appropriate to use to assess the cost of future benefit accrual where the average age of a pension scheme's active membership is expected to be fairly stable. It might not be appropriate if a significant change in the membership were expected in future which might affect the age profile of the membership. We are not aware of any such change at the current time, but there may be a risk of this in the future if say any of the Admitted Bodies were to leave the scheme. We recommend that the Scheme Actuary is asked to comment on the suitability of the funding method and we have included this in the list of questions for Aon Hewitt in section 5.7 below.

5.7 Additional Calculations

As noted above, we believe that it is important that the benefit costings are calculated on a basis that is consistent with the basis that will be adopted for the regular valuations. In addition, calculating contribution rates for PECRS on this same basis will allow a direct comparison of the costs of the two benefit structures. We therefore recommend that the Panel consider whether the following additional information should be sought:

5. Analysis of Costs (continued)

- 1) The COM are asked to provide details of the investment strategy that is expected to be implemented for the CARE benefits
- 2) The Scheme Actuary is asked to:
 - a. Determine best-estimate valuation assumptions based on the proposed investment strategy
 - b. Determine prudent valuation assumptions, based on three different levels of prudence (see table below)
 - c. Confirm that they believe the Projected Unit funding method to be an appropriate method for future funding valuations
 - d. Complete the table below summarising the future service contribution rates (including expenses) for PECRS, CARE with the target level of pension increases and CARE with the minimum level of pension increases. This will then provide a better guide to the affordability and sustainability of the proposed arrangement and will also highlight comparative costings against the existing scheme.

Future Service Rate % of salary	Best Estimate	Prudent 60% chance of success	Prudent 70% chance of success	Prudent 80% chance of success
CARE – Target pension increases				
CARE – Minimum pension increases				
PECRS				

5.8 Funding Risks

It is important to appreciate that actuarial valuation assumptions are only one set of assumptions about the future. There is no guarantee that they will be borne out in practice and inevitably actual experience will differ from the assumptions made. With hindsight, the actuarial valuations of the past under-estimated future life expectancy and over-estimated future investment returns. This has led most private sector defined benefit schemes to have significant funding shortfalls and to replace their defined benefit schemes with defined contribution arrangements for future service. Any defined benefit scheme remains exposed to these risks in the future.

5. Analysis of Costs (continued)

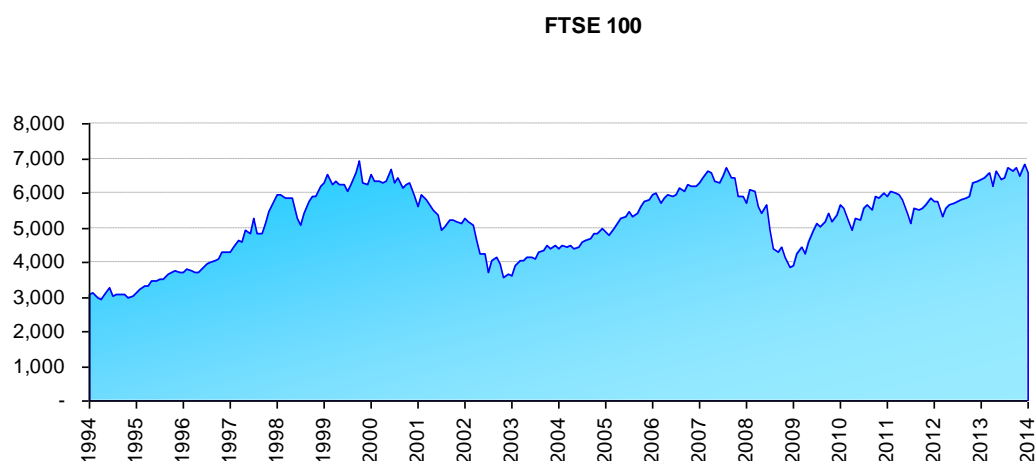
5.9 Longevity Risk

Whilst current actuarial valuations are making a greater allowance for future longevity improvements than has been the case in the past, there still remains the risk that the assumptions underestimate the future improvements. For example, further significant increases in longevity could occur as a result of a medical breakthrough. This would increase the cost of the benefits being provided.

5.10 Investment Risk

If the CARE scheme intends to invest in growth seeking assets such as equities then, over the long term, these are expected to produce higher returns than investment in bonds. However, there are historical periods where the reverse has occurred.

The main risk from equity investment is that volatile markets will lead to volatile funding levels. The graph below shows the variability in the FTSE100 equity index over the last 20 years. If the CARE scheme had been in place over this period then, depending on the dates of the actuarial valuations, the extreme equity swings could have pushed the funding level outside the proposed 95%-105% funding corridor, leading to benefit cuts when the markets fell.



5.11 Inflation Risk

There appears to be no cap on the benefit increases awarded in times of high inflation (other than limiting the inflationary element to 50% as a result of funding reviews). Although we are currently in a relatively low inflation environment, there were periods in the 1970s when UK inflation exceeded 20%pa. There is a risk that future periods of very high Jersey inflation will substantially increase the CARE scheme's liabilities. This risk could be controlled by imposing a cap on the annual increase that will be applied to benefits. We understand from the treasury team that the possibility of including such a cap was considered as part of the refinement of the proposals but was subsequently discounted. However, we do not know the reason why it was decided not to pursue this..

A further risk is that during periods when the outlook for future inflation is very low, reducing increases to 50% of assumed inflation will have less of an impact on the funding level of the CARE scheme benefits than in times when the outlook for inflation is higher.

5. Analysis of Costs (continued)

5.12 Contribution Cap

The proposed employer contribution cap will limit the risk to the States of Jersey. We understand that this cap is intended to apply to the combined contributions required for future service benefits, together with any contributions needed to meet past service deficits in relation to either PECRS or the CARE scheme benefits, to the extent that such deficits cannot be eliminated through reduced benefit increases.

Therefore if the future service, benefits together with the required deficit contributions, cannot be met within the contribution cap, future service benefits would be reduced. This means that new members would be paying contributions equal to the contribution cap but part of their contribution would be funding the shortfall in respect of past service for existing members. In other words, new members would be paying for more than the benefits they are accruing because they are being required to contribute towards the deficit in respect of existing members. The impact of this could be compounded if deficit contributions towards the PECRS benefits are also included within the contribution cap. This does not appear to be fair to new members.

6. Affordability

6.1 Stakeholders

The affordability of the proposals needs to be considered from the point of view of the three principal stakeholders:

- employees
- employers
- taxpayers

We consider each of these in turn, comparing the existing costs with the proposed changes.

6.2 Affordability for Employees

Membership of the pension arrangements is currently a condition of employment for all permanent staff and we are not aware of any plans to change this. Therefore all members must pay regular contributions, calculated as a percentage of their pensionable earnings*.

From an employee's perspective, the affordability of the new pension arrangements will depend on the impact of the increase in the contributions on their disposable income, relative to the current position. We have focused our affordability considerations on the lower paid members, since they will have the lower disposable incomes and consequently they are those mostly likely to experience affordability issues.

85% of the membership pays contributions of 5% of their pensionable earnings. The other members pay either 6% or 6.25%.

Under the proposed changes non-uniformed staff would pay 8% of pensionable earnings and uniformed staff would be required to pay 10.1%. Therefore the maximum increase in contributions would be:

- Non-uniformed staff: 3%
- Uniformed staff: 5.1%

To mitigate the financial impact of a jump in contributions, contribution increases will be phased in at a rate of 1% pa or so for most members. In addition, there are special provisions for non-uniformed staff with a basic salary of less than £30,000 pa. For these cases, the increase in contribution rate would be phased in over 4 years at 0.75% pa. For a non-uniformed employee with a basic salary of £30,000 pa or more the phasing in would be over a 3 year period. We understand that there are no corresponding special provisions for uniformed staff since there are no staff with a full time equivalent basic salary of less than £30,000 pa.

The table shows the gross monthly contributions for a range of salaries under the current structure and over the phasing-in period for non uniformed staff.

* Essentially contractual pay and shift pay but excludes overtime payments or other fluctuating emoluments.

6. Affordability (continued)

Basic Salary £pa	Phasing in period years	Monthly contributions				
		Current £	2015 £	2016 £	2017 £	2018 £
20,000	4	83.33	95.83	108.33	120.83	133.33
29,999*	4	125.00	143.75	162.49	181.24	199.99
40,000	3	166.67	200.00	233.33	266.67	266.67
60,000	3	250.00	300.00	350.00	400.00	400.00
80,000	3	333.33	400.00	466.67	533.33	533.33

The table illustrates that for someone with pensionable earnings of £20,000 pa, the monthly increase in contributions in 2015, before the effect of tax relief, would be £12.50. For an employee with pensionable earnings of £80,000, the monthly increase in contributions would be £66.67.

In practice, the impact would be reduced due to the effect of tax relief. The vast majority of members will receive full tax-relief on their contributions. Under Income Tax legislation, tax-relief is phased out for those earning in excess of £150,000 pa, with no tax-relief being available for those earning £200,000 pa or more.

6.3 Affordability for Employer

6.3.1 2013 Costs

The States Treasurer has advised that the pensionable earnings payroll for PECRS members in 2013 was around £240M pa. From the figures provided, it appears that on average, pensionable earnings represent around 95% of total pay. The percentage that pensionable earnings represent of total earnings will vary between different categories of member, depending on the extent to which their total pay is pensionable.

At the current time the employer is paying contributions to PECRS at the rate of 13.6% of pensionable earnings plus 2% pa for Pre 87 Debt contributions. Under the proposals the 13.6% will increase to 16% of pensionable earnings (subject to cap of 16% [or possibly 16.5%]). The 2% of pensionable earnings would be required for the Pre 87 Debt payments would continue. However, we have been advised by the Treasurer that these Pre 87 Debt contributions would be met from existing department budgets.

The employer contributions to PECRS in 2013 were:

	£M
• Regular contributions of 13.6%	32
• Pre 87 Debt contributions	<u>4</u>
Total	36

6.3.2 Impact of contribution rate increase

Under the proposals, the employer's contribution rate would increase to 16% of pensionable earnings.

* The phasing in period is reduced to 3 years if basic salary is £30,000 pa or more

6. Affordability (continued)

If this had been applied in 2013 then the required PECS contributions would have been:

	£M
• Regular contributions of 16%	38
• Pre 87 Debt contributions	<u>4</u>
	42

Therefore the proposals would have increased the 2013 contributions by £6M.

6.4 Affordability for Taxpayer

6.4.1 2013 Costs

While the cost envelope for the reformed pension arrangements has been set at 24% of pensionable earnings, split in a 2:1 ratio between the employer and the member, we have not seen any evidence that the 16% [or possibly 16.5%] employer cost would be affordable for the tax-payer in the long-term and we recommend that the Panel consider whether they wish to seek further evidence to satisfy themselves on this point.

The risk-sharing arrangements, which form part of the package of reforms, are designed to limit the employer's contributions to 16% [or possibly 16.5%] of pensionable earnings. A cap of 16.5% is equivalent to an annual contribution of £39.6M, whereas a cap of 16% would be around £1.2M pa lower at £38.4M, based on a pensionable payroll of £240M.

7. Sustainability

7.1 What does sustainable mean?

Sustainability means the ability to be maintained. In a pensions context this is taken to mean a benefit structure that is not only affordable now but that is also expected to continue to be affordable in the future.

7.2 Measures put in place

Three different measures are proposed with a view to making the CARE arrangements sustainable for the target period of at least 25 years. These are as follows:

- Prudent valuation assumptions
- Risk-sharing
- Revised governance arrangements

7.2.1 Prudent Assumptions

The CARE benefits are to be funded on “prudent” actuarial assumptions. The most significant of these assumptions will be the assumed real rate of investment return (ie the nominal investment return less the assumption for future increases in Jersey RPI).

At the Panel hearing on 23 April, in response to the question as to how critical prudent funding assumptions are on the success and sustainability of the CARE benefits, the chairman of the COM said:

"I think that it is a very important factor in the sustainability of the new arrangements".

He went on to say:

"They would not be sustainable if there was reluctance by the States to pay an increased contribution. If a demand for increased contributions can be avoided then the scheme is much more likely to be sustainable. So there is almost a direct link there."

While he agreed that the concept of prudence should be reflected in the legislation, initially he did not feel able to say whether it should be in the Draft Law or the regulations. He subsequently indicated that the regulations should specify that the funding should be prudent.

We would recommend that the Panel push for the concept of prudent funding to be included in the regulations. If this is not done, then there is a very real risk that the degree of prudence in the assumptions drifts more towards “best estimate” over time. This might happen for example if there were pressure to have a funding level within the funding corridor of 95%-105%, perhaps to avoid the need to reduce benefits.

There is some evidence to suggest that prudency drift may have happened in PECRS historically. The Chairman of COM said at the hearing that when the current arrangements were set up in 1988 they were funded on prudent assumptions.

From the information that we have reviewed, it is not clear why the PECRS funding basis has moved to “best estimate” more recently. However, it appears to have at least been in part to manage the funding levels in the absence of increases in the contribution rates when deficits would have been revealed on more prudent assumptions.

7. Sustainability (continued)

To avoid this happening in the CARE scheme, we recommend that the Panel pursue the inclusion of prudent funding assumptions within the regulations. On an associated point, we also recommend that the Panel consider whether the employer and the COM should be advised by separate actuarial firms. This is considered further in section 11.5

7.2.2 Risk-sharing arrangements

Within traditional defined benefit schemes it is the employer who picks up the balance of the cost if there is a funding shortfall. Over recent years the cost of providing pensions has increased and many employers have ceased providing defined benefit pension arrangements because they have become unaffordable.

This is not expected to occur in PECRS or the CARE scheme due to ability to reduce both past and future service benefits. If the target benefits are not fully funded then benefits would be reduced through lower benefit revaluations, thus improving the funding position. Consequently a large proportion of the underfunding risk is passed to members.

However, there is to be a minimum level of benefits that must be provided from PECRS and CARE scheme. If after reducing increases to their minimum levels the assets are still deemed insufficient to meet the liabilities then further contributions would be required. It is not clear that the States have committed to meeting any such shortfall.

Aon Hewitt have already produced some modelling to indicate the probability of pension increase cuts in the future, and some of these outcomes show pension increases at their minimum levels. This implies that underfunding remains a possibility even, once benefit increases have been cut to their minimum levels. We suggest that Aon Hewitt are asked to expand their modelling to calculate the probability of the funding level (on the minimum benefit structure) falling below 100% at future time points if joint contributions of 24% of pensionable earnings are paid. Aon Hewitt could be asked to complete the following table to summarise their modelling. This could be done separately for PECRS and the CARE scheme.

Probability of funding level being below x% on minimum benefits when a 24% joint contribution rate has been paid continuously	31/12/2020	31/12/2025	31/12/2030	31/12/2035	31/12/2040
x% = 100%					
x% = 95%					
x% = 90%					
x% = 80%					

7. Sustainability (continued)

These calculations would highlight how high the risk that additional contributions are required is and hence demonstrate whether the proposed benefits are sustainable.

7.2.3 Governance arrangements

Both the chairman of the JNG and the chairman of the COM alluded to the breakdown in communications with the employer around the time of the 2007 valuation as being one of the reasons why the deficit at the 2007 valuation was not addressed. This ultimately led to the reduction in pension increases to eliminate the deficit.

Going back over time, there appears to have been a tendency towards procrastination in dealing with funding shortfalls, evidenced by the fact that the approach to dealing with the 1987 Debt issue was not resolved until 2002, and only then with a repayment plan of 82 years. There were further delays in implementing the 10 point plan (see section 3.3) to repay the debt, with the regulations dated 2005. The reasons for this apparent historical reluctance of the States as employer to address the pension funding on a timely basis are beyond the scope of this report.

With a greater focus on the governance arrangements around the new arrangements, it would appear that in future there will be more collaboration between the employer and the COM, with oversight by the Treasury.

7.3 Comments on sustainability

It is critical that the CARE benefits are funded on prudent assumptions, to maximise the chances of the actual investment performance exceeding that expected. If this can be achieved then it is more likely that the CARE benefits can be fully funded, without the need to resort to limiting members' pension increases and revaluation of CARE benefits.

Once Aon Hewitt have provided the probabilities noted in section 7.2.2 above, the relevant parties will be able to assess whether the risks are considered small enough that the proposals are deemed to be sustainable.

8. Fairness

8.1 What does fairness mean?

Intuitively the concept of fairness is about treating people equally and avoiding any discriminatory treatment. However, it is recognised that there may be some situations where there are objective reasons for treating people differently. In some circumstances the perception of what is fair and equitable can be subjective.

8.2 Are the current arrangements fair?

Concerns have been expressed around the fairness of the existing PECRS benefits structure in a number of areas. These stem from:

- The nature of a final salary scheme
- The cross subsidy between uniformed and non-uniformed staff
- Different accrual rates
- The approach to dealing with surpluses and deficits

8.2.1 Final salary benefits

The retirement benefits provided by PECRS are dependent on members' salary progression in the three years prior to retirement or leaving service. Therefore an employee who receives a substantial promotion three or so years before retirement will benefit from a substantial increase in their accrued pension, despite only paying contributions on their higher salary for a short period. Therefore they benefit substantially more from a final salary scheme than a member with similar length service but without a late promotion.

8.2.2 Cross Subsidy

At present some uniformed members have a normal retirement age of 55 while many non-uniformed members have a higher normal retirement age of 65. The age at which a person can retire with an unreduced pension is an important factor in determining the cost of providing that pension. It has long been recognised that the value of the pension benefits for uniformed staff is significantly greater than the pension benefits of non-uniformed staff, yet the contribution rates they pay are currently the same. Therefore the non-uniformed members are effectively cross-subsidising the uniformed members' benefits.

8.2.3 Different accrual rates

As noted in section 3.2.4, there are four different accrual rates at the current time within PECRS, ranging from 1/80ths to 1/45ths. Therefore there is a significant difference between members which appears to be unfair.

8.2.4 Method of dealing with surpluses and deficits

Although PECRS has the appearance of a defined benefit scheme to its members, in practice the States have operated it as if it were a defined contribution scheme, by keeping the rate at which they contributed to the scheme broadly fixed. As a result the States have accounted for PECRS as a defined contribution scheme within its accounts. If it were treated as a defined benefit

8. Fairness (continued)

scheme then the States would need to account for the funding position of PECRS on the prescribed basis under accounting standards applicable to defined benefits schemes within its accounts. This would be expected to result in a substantial deficit having to be disclosed. The notional PECRS deficit under accounting standard IAS19 disclosed in the States accounts for 2012 was £766.8M (2011:£698.0M).

In an effort to maintain the “fixed” contribution rate, both the actuarial valuation assumptions and the funding method have been adjusted over the years to manage the funding position. However, this approach became unsustainable as a result of the size of funding shortfall revealed at the 2007 valuation. The regulations governing the operation of PECRS permit a reduction in the pension increases, or even a cut in benefits to restore the funding position. Consequently the COM reduced the level of pension increases to RPI - 0.3%pa following the 2007 valuation. Therefore, despite the appearance of a defined benefit scheme, the underfunding risk is effectively borne by the members.

8.3 Are the proposals fair?

In considering whether the CARE proposals are fair, we have focused on any differential treatment within the proposed CARE scheme.

8.3.1 Protection

There are two groups of members who are eligible to continue accruing final salary benefits. These are:

- those within 7 years of normal retirement age on 1 January 2015
- those with a 45th accrual rate

We have been advised that the starting point from the TWG was that there should be no protection, other than that accrued benefits would not be affected. However the protection was introduced as part of the negotiation process with the JNG.

“7 Year” Protection

The members within 7 years of normal retirement age will be the oldest members of PECRS and therefore it is likely that they will already have substantial service and benefits built up within PECRS. As such it is likely to be those who already have the best benefits who are being afforded protection. This appears to be unfair to the younger members.

In addition, whilst Jersey does not yet have anti-age discrimination legislation, we understand that it is expected to be introduced at some point in the next few years and there is a risk that the protection could be challenged on those grounds. Even if it is acceptable from a legal perspective, it does appear to be intrinsically unfair to other members. It also appears to be unfair to taxpayers. We have been advised by the treasury team that the cost of this protection is estimated to be 0.2%pa of pensionable earnings if spread over a 10 year period.

On the issue of the fairness of the protection arrangements, the Chairman of the COM commented to the Panel during the hearing on 23 April:

8. Fairness (continued)

"... by definition, those who are close to retirement have enjoyed the final salary benefits under PECRS, which have been fully protected up to the date of change, and so they are actually least affected by the change. So we are taking a piece of this cake and we are using it to protect those close to retirement when they are in fact the least affected by the change ..."

He continued to say:

"It became very much an employee relations issue. Incidentally, in the UK a 10 year protection period was built in. So the staff representatives, of course, knowing that, argued quite vociferously for it, but the Technical Working Group report - did not recommend protection. It was a product of the negotiations between employer and employee. ... you could argue that is an unfair aspect of the proposals, because a particular group are getting greater protection than others".

45th accrual protection

In our view the protection being offered to the members who are receiving benefits on a 45ths accrual rate (regardless of age) is also unfair to other members. It is hard to see how this can be justified, other than it only relates to a small number of members.

We recommend that the Panel consider whether the fairness of these protections should be challenged.

8.3.2 Cross subsidy issues

The proposals make changes to contribution rates in respect of both the uniformed and the non-uniformed staff. However the increase is greater for the uniformed staff, reflecting the fact that they still have a lower normal retirement age than the non-uniformed staff. Therefore the new contribution structure appears to be fairer than previously, since it better reflects the differences in the values of their respective benefits. It is generally recognised that the lower retirement age for uniformed staff is necessary for operational reasons.

In relation to cross subsidy issues between uniformed and non uniformed staff, the Chairman of the COM commented to the Panel during the hearing on 23 April:

"... we [the COM] have raised that issue and felt that the employers of uniformed services should have been paying a higher rate and probably so should the members."

8.3.3 Increases in members' contributions

It is proposed that all members' contributions will be increased, whether or not they opt for the protection to retain the existing benefit structure. This is fair since all members will be being treated in the same way. The affordability issue of a rise in contributions has also been mitigated by the phasing in of these increases, but only for existing members of PECRS. New employees from 1 January 2015 will however be required to pay the full rate on joining the scheme. Therefore, not all members will be treated equally in the short term, but this is perhaps an inevitable trade off between fairness and affordability.

8. Fairness (continued)

8.3.4 Normal Retirement Age

The proposed changes to Normal Retirement Age were outlined in section 4.9. The extent of the change and the phasing in periods are different for uniformed and non-uniformed staff. However, we understand that these differences are required to reflect the operational needs of the uniformed staff.

8.3.5 Accrual rate

We outlined the changes to accrual rates in section 4.10 and we considered the fairness of the protection arrangements in section 8.3.1. As all members of the CARE scheme will be on the same accrual rate, all employees will be treated fairly (except those with the protections noted in section 8.3.1).

8.3.6 Co-Habiting Partners Benefit Enhancement

The extension of the payment of a spouse's pension to co-habiting partners removes the current unfairness for non-married members.

8.3.7 New Members

As part of the risk-sharing arrangements, it appears that if the accrual rate is reduced for the CARE benefits as a result of their being insufficient scope within the contribution cap to manage the existing past service deficits and the future service cost, then new members would be effectively subsidising the benefits of a previous generation of members, while still paying the full member contribution rate. This appears to be unfair to new members as they will not receive full value for the contributions that they are required to pay.

8.3.8 AVCS and Transfers In

It is understood that members will continue to have the option to pay additional voluntary contributions ("AVCs") to secure additional benefits. However, it is not clear from the information provided how the risk-sharing would apply to these AVC benefits. It would seem to be unfair if the level of pension increases on AVC benefits were to be reduced, unless the member fully appreciated the risks involved in paying AVC to the fund. It might be preferable for AVC benefits to be provided on a money purchase basis.

There is a similar potential issue for transfers in where the risk-sharing may lead to lower benefits than anticipated at the point of transfer. This is potentially a wider concern because we understand that the ability to attract employees transferring from the UK was a key consideration when designing the CARE scheme. It may be that the CARE scheme does not meet this objective as a result of the uncertainty around the benefits that will ultimately be paid. While this uncertainty is also present in PECRS, it was perhaps not fully appreciated by those who have transferred previously. The proposed new arrangements are therefore more transparent in this regard and therefore may not necessarily assist in attracting employees from the UK.

8.3.9 Expenses of the CARE Scheme

We understand that the expenses of setting up the CARE scheme will be met from the contributions to the CARE scheme and therefore there is not expected to be any cross-subsidy with PECRS. However, typically when private sector employers initiate a benefit review or set up a new arrangement, they meet the costs of the exercise directly.

8. Fairness (continued)

8.3.10 Expenses of the CARE Scheme

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9. Risk-sharing arrangements

9.1. Overview

The risk-sharing arrangements around the costs of both PECRS and the proposed CARE scheme are not reflected in the primary legislation. However it is expected that risk-sharing will be covered by the regulations.

The proposed risk-sharing arrangements are complex. However, a degree of complexity is perhaps inevitable in view of the need to try to balance the affordable, sustainable and fairness principles that have been made central to the review of PECRS. While we have been provided with an extensive note on the practical application of the risk-sharing methodology, we are unclear how it would apply in all circumstances, as explained in section 9.3 below.

9.2. Summary of Risk Sharing Arrangements

Our understanding is that essentially the financial positions of PECRS and the CARE benefits will be assessed and managed separately going forward. While it is proposed that the assets will be combined for investment purposes, PECRS and the CARE scheme will effectively be treated as two separate pension schemes. This approach is designed to minimise the risk of cross-subsidy between different generations of members.

All of the liabilities giving rise to the Pre 87 Debt were accrued over 25 years ago. Consequently the Pre 87 Debt contributions will be added to PECRS assets as they are received.

An actuarial valuation of PECRS will be carried out as at 31 December 2014 so that the funding position at the outset will be known. The assets earmarked to cover these liabilities will be ring-fenced and the administration system will be able to identify the PECRS benefit entitlements separately from the CARE benefits. This will be important in ensuring that pension payments are met from the right section's assets.

From the information made available to the Panel to date, it is not clear what the mechanism would be if one of the Admitted Bodies wished to leave the scheme. We recommend that the Panel pursue this in Phase 2 of their review, to ensure that it is reflected in the regulations.

9.2.1. PECRS Risk Sharing

The key elements of the risk sharing arrangements for PECRS appear to be as follows:

- an actuarial valuation will be carried out as at 31 December 2014 on a "best estimate" basis to identify the PECRS liabilities and the funding position at that date.
- The PECRS assets at 31 December 2014 will be ring-fenced and any future contributions in respect of the members who have opted for protection together with the Pre 87 Debt contributions will be notionally allocated to those assets.

9. Risk-sharing arrangements (continued)

- The existing 0.15%pa reduction to the full RPI pension increases will be reviewed. If there is a deficit, future pension increases will be further reduced (which reduces the cost of providing the pensions) to restore the funding level to 100%. If there is a surplus that is sufficient to reimburse the reduction in full and restore pension increases to full RPI then this will be done. If the surplus is not sufficient to achieve this then it will be carried forward until the next valuation when the situation will be reassessed.
- With effect from the valuation due as at 31 December 2017, the 95% to 105% funding corridor will be implemented. This means that no action will be taken if the funding level on best estimate assumptions is within this corridor, unless all parties agree to do otherwise.
- Members' pension increases will continue to be reduced if the funding level deteriorates, but will be subject to a floor that the current pensions in payment will not be reduced. Only if the funding position were such that existing pensions had to be reduced to maintain 100% funding would additional contributions limited to the cost caps be discussed.

9.2.2. CARE Scheme Risk Sharing

The key elements of the risk-sharing arrangements for the CARE benefits appear to be as follows:

- an actuarial valuation as at 31 December 2017 will be carried out on prudent assumptions to identify both the funding position and the cost of the future service benefits
- a 95% to 105% funding corridor will apply
 - if the funding level is below 95%, the level of future pension increases and revaluation of the CARE benefits will be reduced to restore the funding level to 100%, until the results of the next actuarial valuation are known
 - if the funding level is above 105% then the level of pension increases and revaluation of benefits will be restored, up to a maximum of 100% of RPI and any further surplus carried forward
- the pension increases and benefit revaluations are subject to a guaranteed minimum of 50% of RPI (plus 1% for revaluations) and if the funding level were not able to support this then additional contributions would be required in a 2:1 employer: members ratio from within the contribution cap.
- The future service contribution rate will also be calculated as part of the valuation. If this is outside of the total contribution caps then the accrual rate would be adjusted to reduce the cost of benefits accruing.

9.3. Comments on proposed arrangements

While complex to administer in practice, the risk-sharing arrangements have been designed to give members an element of certainty over the minimum and maximum pension increases that they can expect to receive and so provide a degree of financial security. They have also been designed so that the employer's contribution cap cannot be breached without a change to primary legislation (assuming that one of the two amendments to the Draft Law to specify the employer's contribution cap is adopted).

9. Risk-sharing arrangements (continued)

Within PECRS benefits, the risk of underfunding continues to rest almost exclusively with the members. However, the guarantee that pensions can not be reduced below their current levels is an improvement compared with the current position. In practice, most members may not have appreciated that their pensions could have been reduced historically. We understand that the funds to meet this guarantee will come from within the contribution cap. If PECRS is underfunded even after removing all increases to pensions in payment, the States would make additional contributions to PECRS up to the cost cap. If this were not sufficient We understand that the States would seek to reduce the new accrual in the CARE scheme to finance the deficit within PECRS. Consequently it would appear that new members would be subsidising PECRS which would not be fair. We understand that the risk-sharing within the CARE scheme; if the CARE scheme became underfunded on the minimum level of pension increases, would be operated in a similar way

The proposed funding corridor is designed to smooth out short-term fluctuations in the funding position. In particular, where the funding level at a particular valuation is between 95% and 105% no action need be taken. However, if the funding level were to fall below 95% then the scope to adjust the future pension increases should provide flexibility to manage all but the most extreme changes in the funding levels. Provided that the actuarial valuations of the CARE benefits are always carried out on sufficiently prudent assumptions, the risk of adverse funding positions emerging in relation to the CARE benefits will be lower than in PECRS. As PECRS will be valued on a "best estimate" approach to the financial assumptions, there is a greater chance of the investment performance not delivering the expected returns.

9.4. Amount of Risk-Sharing

With the initial contribution rates set equal (or nearly equal) to the cost envelope there appears to be little scope for the sharing of risks. If the States will not increase their contributions beyond the cost cap, in practice it will be the members who bear all the risk through benefit cuts if the schemes become underfunded and could be considered unfair.

10. Draft primary legislation

10.1. Overview

The legislative changes required to implement the proposed pensions changes will be introduced in two phases. The first phase is the primary legislation, which is largely an enabling document, setting out the framework of the proposed new pension arrangements. The detailed benefit structure and parameters within which the scheme is to be operated will be set out in a series of subordinate regulations. At the current time only the draft primary legislation has been published.

BWCI are not legal advisers and we are not qualified to provide any legal advice. Consequently our comments on the draft legislation are necessarily a lay opinion and nothing stated in this report should be treated as an authoritative statement of the law on any aspect.

10.2. Published Information

The Draft Public Employees (Pensions) (Jersey) Law 201 - ("the Draft Law") was lodged at the Greffe on 11 March 2014 and is due to be debated by the States on 13 May 2014. It is accompanied by a report which summarises the historical background to the existing pension arrangements, the case for reform and that a CARE scheme structure is being proposed going forward. Neither the report nor the draft primary legislation provides detailed information about the proposed benefit changes. However, there is extensive information available on the changes and the transitional provisions for members of PECRS on the States website which can be found at:

<http://www.gov.je/Working/WorkingForTheStates/Pensions/PublicEmployeesContributoryRetirementScheme/Pages/StatesEmployeesPensionReview.aspx>

An example of one of the documents available from the website is appended to this report. In addition, the detailed changes are set out in the letter from the States Treasurer to the Chairman of the JNG dated 8 April 2014.

10.3. Overview of Primary Legislation

The Draft Law outlines the areas where regulations may be prescribed at some future date to cover the various aspects of setting up, operating and managing a pension scheme. It also contains limited aspects of the detailed reform proposals.

At this stage it is important to ensure that the primary legislation is framed sufficiently widely to allow regulations to be put in place, as needed, in the future. As part of our review, as well as considering the provisions which are included, we have also identified some aspects where it might be helpful to widen the scope of the areas for future regulations, to try to "future-proof" the new arrangements as far as possible. In practice, it may be that it is intended that these areas would be covered by the regulations but are not listed explicitly in the Draft Law. However, we felt that it would be helpful to identify them now, prior to the formal review of the draft regulations.

10.4. Review of the Draft Law

Much of the content of the Draft Law would appear to be uncontentious, setting out the very high level structure of the new arrangements. However, we have highlighted in this section areas

10. Draft primary legislation (continuation)

where we have some concerns about the risk of potential ambiguity in the interpretation of the primary legislation could potentially adversely impact upon members' benefits.

10.4.1. Retrospective Provision

Article 8 of the Draft Law covers the requirement to seek the consent of persons who might be adversely affected by retrospective changes to the pension arrangements. While this is an important safeguard for the scheme members and in our view should be included within the legislation, we would question whether it is currently framed in too subjective a way. In particular Article 8(1) states:

"Where Scheme Regulations.... propose making retrospective provision which appears to the Minister-

(a) to have significant adverse effects in relation to..."

1(b) applies a different procedure where the effects are not "significantly adverse" but are "unfavourable".

The distinction between "significantly adverse" and "unfavourable" could be a difficult judgement to make in practice. In addition, this judgement appears to be based solely on the opinion of the [Chief] Minister.

We recommend that the Panel consider whether the text of the Draft Law should be reviewed, in the light of the risk of ambiguity in interpreting "significantly adverse". We would also recommend that the Panel consider whether the legislation should require the Minister to first seek appropriate legal and/or actuarial advice.

10.4.2. Link to State Pension Age

For information, the one key feature of the new arrangements to be reflected in the primary legislation, rather than the regulations, is the process by which a person's normal pension age in the scheme is to be automatically linked to increases in the State Pension Age (SPA). It would appear to be necessary for this to be included in the primary legislation since an increase in normal pension age would generally be to the detriment of an individual member and so would otherwise require the consent under Article 8 discussed above.

It is worth noting that paragraph (4) of Article 9 provides for regulations to be made so that this automatic linkage of increases in normal retirement age and with SPA does not need to apply to prescribed classes or persons. This would provide for the flexibility to have different arrangements for the uniformed and non-uniformed staff, or indeed other classes of membership.

10.4.3. Conflicts of Interest

Article 4(4)(c) requires that no person serving on the COM has a conflict of interest (excluding an interest which arises purely as a result of being a member of the scheme). We wonder whether this restriction is too tight? In our experience trustees of pension schemes often have conflicts as a result of their "day job". However this does not preclude them from adding value to the trustee board (provided all conflicts are declared and managed). We suggest that the Panel considers whether it to be realistically possible for members of COM not to have any conflicts of interest. If not, we recommend that the legislation is amended to preclude irreconcilable conflicts, but permit

10. Draft primary legislation (continued)

other conflicts provided that they are declared and members abstain from certain votes if necessary.

10.5. Scope of Scheme Regulations

Schedule 1 of the Draft Law lists 19 areas where regulations may be made in relation to the Scheme.

Item 14 (e) of the Schedule sets out the following areas where scheme information may be published. These are:

- (i) accounts
- (ii) funding, assets and liabilities
- (iii) membership
- (iv) employer and member contributions
- (v) administration and governance

In the interests of transparency and the intention to fund the CARE benefits on "prudent" assumptions and PECRS benefits on "best estimate" assumptions, we recommend that the Panel consider whether it would be helpful to expand this list to cover the following explicitly:

- investments, investment strategy and returns
- prudent and best estimate funding assumptions
- conflicts of interest declared

This would be consistent with the commitment to transparency given by the Chief Minister at the Panel hearing on 22 April, together with the Treasurer's agreement to look into how the intention of a level of prudence of 80% might be reflected within the regulations, to ensure that there is a consistent approach over time to the degree of prudence.

10.6. Pension Sharing on Divorce

Unlike the position in the UK, we understand that at the current time there is no specific legislation covering pension sharing on divorce in Jersey. As a pension benefit is often a significant part of the assets taken into account as part of a divorce settlement, we wonder if it would be useful to provide for regulations in this area, should the legislation be introduced at some point in the future?

10.7. Draft Regulations

The regulations which will set out the detailed arrangements are currently in the process of being drafted. While BWCI has had sight of a working draft, at this stage they are confidential and not yet complete. However, we have been advised by the Treasurer that they are intended to reflect the detailed proposals set out in the letter dated 8 April 2014 to the JNG.

We would highlight the challenging timetable for the completion of the drafting, review and scrutiny of the regulations if they are to be debated by the States in July 2014. The final paragraph of the written evidence dated 15 April 2014 provided by the JNG says:

10. Draft primary legislation (continued)

"The JNG looks forward to playing a full role in reviewing the Regulations that give effect to the pension proposals. It is essential that JNG members have enough time to review them in a meaningful and effective way. We must have the opportunity to comment and suggest changes where appropriate, especially to ensure the Regulations reflect the detail and spirit of what we understand to have been agreed during the course of the negotiations."

We would recommend that the Panel satisfy themselves that the timetable is achievable in practice and allow the COM, JNG and the Panel itself sufficient time to be able to review what are expected to be complex regulations adequately.

11. Governance

11.1. Driver for change

The employer's actuary has advised the employer to seek greater influence in the operation of the pension arrangements and this is the key driver for changes to the governance arrangements. The current chairman of the COM appears to have been content with the existing governance arrangements. Nevertheless, he has welcomed the widening of the representation of the composition of the COM and recognises that the new risk-sharing arrangements will require the employer and the COM to work closely together. The lack of engagement of the employer historically to address financial issues in PECRS is a particular area of concern which it will be important to avoid in the CARE scheme.

11.2. Composition of the COM

It is proposed that the composition of the COM will maintain the equal balance between employer and employee representatives. However, the pool from which the representatives may be drawn is to be widened to include two pensioner representatives. In addition, there will be one representative from the Admitted Body employers. Each member will be appointed for a 5 year term, with a maximum of 2 terms. The terms will be staggered to avoid significant change to the COM over a short period of time. All of the appointments will be made in line with the Jersey Appointments Commission guidelines.

11.3. Independent Chairman

The COM will continue to have an independent chairman who will also be appointed for a 5 year term. However, unlike the members of the COM, there will be no maximum number of terms for the independent chairman.

11.4. Duties and responsibilities of the COM

11.4.1. Training

There will be a requirement for all members of the COM to provide evidence that they are undertaking appropriate training to keep up to date and to be able to make a contribution to the COM. This training and knowledge requirement is similar to the trustee "knowledge and understanding" requirement which is imposed on trustees of UK pension schemes and is to be welcomed.

11.4.2. Appointment of advisors

The COM will be responsible for appointing various advisors, but in some cases the appointments will be subject to the approval of either the Treasurer or Treasury Minister.

11. Governance (continued)

11.5. Role of the Actuary

The governance proposals set out the role of the actuary to the scheme. This includes advising the COM, as well as consulting and agreeing with the Chief Minister, the Treasury and Resources Minister or the Treasurer on matters specified in regulations. The governance document also makes reference to the actuarial code of professional conduct in relation to advising pension schemes (APS P1). This code includes detailed guidance on conflicts of interest which can arise when one actuary is advising both the trustees of a pension scheme (which is broadly equivalent to the COM in the case of PECRS) and the sponsoring employer in relation to issues connected to the funding of the scheme. The actuarial guidance takes the view that the starting point in such a situation is that there is an irreconcilable conflict. It is then for an individual actuary to consider why this might not be the case and record the reasons for that decision if he/she intends to advise both parties.

At present the COM and the employer are both advised by different offices of Aon Hewitt. The provision of advice from different offices provides a physical separation of advisers and should enable the advice to be independent and confidential. However, the inadvertent sharing of confidential information is always a risk if the same company is providing independent advice to two parties. In addition, a further risk is that, although the advice is being provided by separate advisers, both consultants will be influenced by the Aon Hewitt “house view”.

Conversely, the benefit of having the same company advising both parties is that both consultants can utilise a shared calculation team, thus reducing the cost of providing the actuarial advice. It will be for the COM and the SEB to decide whether the cost savings outweigh the potential risks. A compromise would be to retain the current set up but appoint an independent actuary to review the funding assumptions.

11.6. Publication of Scheme Documentation

We note that the following documents in relation to the scheme will be made available to members and stakeholders:

- communications strategy
- funding strategy statement
- administration strategy
- risk management strategy
- statement of investment principles
- governance statement
- annual report and accounts

This is to be welcomed. In addition, at the hearing on 22 April, the Project Director-Pensions agreed that she would look into whether it would be possible to make available copies of the minutes of COM meetings, subject to removing any details of discussions in relation to individual members on confidentiality grounds. We recommend that the Panel consider whether it would be in the best interests of all parties for appropriate sections of the COM minutes to be publically available.

11. Governance (continued)

11.7. Comments on Governance Arrangements

The new governance arrangements should provide a firm framework from which to operate the pension arrangements in future. However, we recommend that the Panel considers whether they are satisfied with the current arrangements whereby actuarial advice to both the COM and SEB is provided by separate offices of the same company.

12. Administrative arrangements

12.1. Overview

The pensions administration function for PECRS is undertaken by the Dedicated Pensions Unit ("DPU") under an administration agreement with the COM. It is proposed that the CARE benefits will also be administered by the same team, using the existing computer administration system.

12.2. Administration Systems and Software

The Treasurer has advised that the current administration system was replaced relatively recently, as the previous system was felt not to be fit for purpose. She also confirmed that the new system can be extended to accommodate the additional data and benefit calculation routines that will be required to administer the CARE benefits. However, this will require software amendments to be made. We have been advised that the treasury team are currently in discussions with the software provider to specify the changes required, but the cost of this software upgrade is not yet known.

12.3. Data Requirements

The Project Director- Pensions has stated verbally that adequate historical data is already held to enable the calculation of CARE benefits. However we have not attempted to independently verify this at this stage.

12.4. Transitional Issues

At the Panel hearing on 22 April 2014, the Treasurer advised that the upgrade of the computerised administration system is not expected to be ready to deal with the new CARE benefit structure from the proposed date of the implementation of the CARE benefits on 1 January 2015. Consequently, there will be a transitional period where benefit calculations will need to be done manually, prior to the software being fully operational.

There is a risk with any manual calculations that errors may occur. There is perhaps a higher degree of risk of error during this early phase of implementation of the CARE benefits while the staff of the DPU become fully familiar with the new arrangements.

Therefore we recommend that the Panel investigate the training that is planned for DPU staff, as well as satisfying themselves that the additional resources to be provided will be sufficient and adequately trained to enable them to administer the CARE benefits with effect from 1 January 2015. In addition, the Panel may wish to recommend that the results of any manual calculations carried out during the early part of 2015 be used as test cases for the new software once this becomes available, to identify any potential inconsistencies between the automated calculation process and the manual calculations. This would help to identify any isolated calculation errors, as well as any systematic errors.

12.5. Implementation Costs

The Treasurer has advised that additional staff resources will be required in the DPU during the first year to support the implementation of both the new software and the administration of the benefit structure. The cost of these additional temporary staff and the software upgrade will be met from PECRS and so there is no additional external cost.

12. Administrative arrangements (continued)

However, while there will not be any immediate impact on the cost of the administration of PECRS to the employer/tax payers, ultimately these costs need to be met from somewhere and in due course will be reflected in the funding position of PECRS either as a smaller surplus or a larger deficit and potentially have an impact on members' benefits.

12.6. Additional administrative complexities

The TWG report highlights the complexities of operating the existing arrangements within PECRS. Under the proposals all members' benefits accrued up to 31 December 2014 will be protected so there will be no simplification of the administration in that respect. In practice, we would anticipate that the administration will become more complex, as it will be necessary to administer a second tranche of benefits arising from the CARE benefits, including initially the phased contributions and different rates for new employees.

Further complexities will arise from the phasing in of the changes to normal retirement date for those members who will reach SPA during the 2020-2031 transitional phase, as well as the new feature for members to be able to take a lump sum from age 55 but remain in the scheme accruing benefits. It will be important to ensure that the specification for the changes to the administration system covers all of these details and is tested thoroughly before being launched.

It is possible that the SPA may be further increased and it would be advisable to build in as much flexibility to the current changes as possible to reduce the additional time and costs of adapting the software again at a later date.

12.7. Comments on Administration Arrangements

We recommend that the Panel consider whether these additional internal administration costs should be identified explicitly, so that they can be managed within an appropriate budget.

We also recommend that they satisfy themselves that adequate resources will be in place to cope with the additional administration if the CARE arrangements are introduced.

13. Member Communications

13.1. Overview of communication strategy

From the information that we have reviewed, it would appear that the members of PECRS have been kept informed of progress with the proposed reforms of the pension arrangements.

Communication of pension-related issues can be an uphill challenge, since pensions can often be perceived as complex. While those members approaching retirement will be more focused on their financial planning in retirement, younger employees may not see pensions issues as particularly relevant to them at the present time and therefore it is important to use a variety of communication methods to maximise member engagement, whilst maintaining a consistent and accurate message.

13.2. Methods of Communication

A number of different channels of communication have been used to explain the issues to members.

In March 2013 the States Chief Executive wrote to members providing a summary of the background to the review and advising them that a move to a CARE benefit structure and linking pension age in the scheme to increases in SPA were the main options being considered.

Page 9 of the 2012 PECRS Annual Report provides similar information and also notifies members that the TWG had presented the SEB with a set of options.

Information about PECRS can also be found on the States of Jersey website through a simple internet search on “Jersey Public Sector Pensions”. This leads to the webpage below.

<http://www.gov.je/Working/WorkingForTheStates/Pensions/PublicEmployeesContributoryRetirementScheme/Pages/index.aspx>

13.3. Online Information

We would expect that a significant proportion of the members of PECRS will use the web-based material as a key source of information. It is also the most readily accessible source of up to date information for other stakeholders, and in particular taxpayers. Therefore given its wide potential audience, it is particularly important that this information is accurate and transparent.

A copy of the website page is reproduced below. The second section in the right hand column headed “States employees’ pension review” links to a page dedicated to the changes. This includes a calculator so that members can see at how they might be affected, together with a booklet entitled “Your Simple Guide”, a copy of this guide is appended to this report. There is also a short video animation which explains the key points succinctly.

13. Member Communications (continued)

The screenshot displays the States of Jersey website's page for the States of Jersey employees' pension scheme (PECRS). The header includes the States of Jersey logo, the text 'Online information and public services for the island of Jersey', and a search bar. A navigation breadcrumb trail shows the path: Home > States of Jersey public service pensions > States of Jersey employees' pension scheme. The main content area is titled 'States of Jersey employees' pension scheme (PECRS)' and features several sections: 'States of Jersey pension scheme' with a piggy bank icon, 'How PECRS works and key benefits for employees' with a magnifying glass icon, 'Joining PECRS as an employee' with a group photo icon, 'PECRS benefits' with a coin icon, 'States employees' pension review' with a nest icon, 'PECRS forms and publications' with a document icon, and 'Pension calculator (States employees)' with a calculator icon. A left sidebar lists various subject categories, and a right sidebar contains contact details and 'See also' links.

13.4. Content of Information

13.4.1. Misleading drafting style

While the information is well-set out and easy to identify with the consistent “nest-egg” branding, we would highlight that some of the online communication material appears to be a little misleading. This is because the text gives the impression that the changes will definitely be implemented.

An example of this is the link from the main PECRS information page to the review says “...find out what changes **will** be made to the scheme in 2015...”

The same comments apply to “Your Simple Guide”. While this uses graphics well to highlight key changes, again the document implies that the changes “will” happen. It does not make it clear that they are still subject to acceptance by employees.

The final details of the proposals have yet to be agreed with the employees, but it is understood that the unions are expected to ballot their members shortly, with the results of the ballots expected to be available by the end of May 2014 - mid June.

13. Member Communications (continued)

13.4.2. Member Protection

There is also a passing reference to the protection arrangements in “Your Simple Guide”. In our view this might also be slightly misleading, as it makes it appear to be an insignificant feature of the changes. In particular, it states “Employees will move to the CARE Scheme (Apart from a small group who are deemed protected and will have a choice)”

Slide 8 of Part A of the Treasury presentation of the proposals to the Panel states that 1,200 members will have the choice of protection and 5,900 will not. Therefore around 17% of active members are expected to have the option of protection, which is perhaps not what would generally be considered a “small group”.

The cost of this protection has been estimated to be 0.2% pa of pensionable earnings for the first 10 years of the new arrangements (Slide 11 of Part A). This equivalent to around £0.5M pa initially.

We would recommend that the Panel consider whether they view some of the online member communication material as slightly misleading and whether any action should be taken as a result.

13.4.3. Online Calculator

We have reviewed the online calculator feature for members. This provides a tool for members to see at a range of ages how their pension expectations might change under the existing and proposed benefit structures. Members are advised that they need a copy of their 2013 benefit statement which assists them to input the correct information.

The model assumes that salaries will grow at a rate of Jersey RPI +1.5%pa and then shows the member’s projected pensions at three possible retirement ages. The pension is expressed both as a percentage of salary and also as a projected monetary amount (in current day terms).

This model should be helpful in assisting those members with the option of protection to decide whether it might be beneficial for them to remain in PECRS. The model could be improved if it could be made more flexible to enable the user to vary the rate of future salary increases relative to RPI. There is a risk that in having a fixed rate within the projector that it could set unrealistic salary expectations for some employees and potentially be used as a minimum in subsequent pay negotiations. In addition, for those expected to have a rapid salary progression, the value of the CARE benefits might be substantially over-stated as a percentage of their salary.

14. Conclusions

14.1 Overview

We have reviewed the proposed new CARE scheme arrangements and have identified a number of issues that the Panel may wish to pursue further as part of their review. In this final section of our report we draw together our key conclusions.

We have considered the extent to which the proposals are affordable, sustainable and fair for each of the three principal stakeholders: the employees, the employer and the taxpayers.

14.2 Scheme Design

The first decision to be made is around the type of benefit structure. The more detailed benefit design then follows from this. Essentially the choice of benefit structure is between a defined contribution and a defined benefit arrangement. A defined benefit scheme gives the employees an element of certainty over their retirement benefits, whereas a defined contribution scheme gives the employer and the taxpayers certainty over the costs.

The CARE structure proposed, together with the risk-sharing arrangements, make the structure appear to be defined benefit in nature for the employees, but from the employer's point of view it is viewed more as defined contribution in nature.

The solution needs to try to achieve balance between the optimal outcomes for each of the stakeholders with what is achievable in practice through negotiations.

We recommend that the Panel discuss what they consider whether the arguments put forward by the TWG and the JNG for a CARE scheme are compelling, or whether a defined contribution scheme should be considered instead.

14.3 CARE Benefit Design

Our analysis of increases in average earnings in Jersey since 1991 suggests that the negotiated rate of indexation of the CARE benefits accrued each year (1%pa in excess of RPI) appears to be quite generous. In particular, an employee who does not expect to receive significant promotional increases over the remainder of their period of service in the CARE scheme could potentially receive a significantly higher pension than under PECS.

14.4 Funding of new arrangements

We would highlight that the basis on which the illustrative costings have been calculated may not necessarily be appropriate for the funding of the CARE benefits on a prudent basis, leading to funding deficits emerging at a relatively early stage. If the costing assumptions are not deemed to be sufficiently prudent then the 24% cost envelope may not be adequate to provide the proposed benefits.

14. Conclusions (continued)

We recommend that additional sensitivity testing is carried out to determine the funding contribution rates on a range of assumptions, as well as further modelling to quantify the risk of underfunding even after benefit increases have been reduced to the minimum levels over the sustainability time horizon of 25 years.

We recommend that the intended level of prudence is agreed at the outset and written into the regulations to prevent any deliberate or unintended drift from prudent towards best estimate assumptions as has happened historically within PECRS.

With a greater focus on the governance arrangements around the new arrangements, it would appear that in future there will be more collaboration between the employer and the COM, with oversight by the Treasury.

14.5 Affordability

From the employees' perspective, the phasing in of the increase in the contribution rate should assist with the affordability issues in the short term. However it is noted that the full level of new rates is expected to apply to new employees from 1 January 2015.

While the cost envelope for the reformed pension arrangements has been set at 24% of pensionable earnings, split in a 2:1 ratio between the employer and the employees, we have not seen any evidence that the 16.5% [or possibly 16%] cost cap would be affordable for the taxpayer in the long-term and we recommend that the Panel may wish to seek further evidence to satisfy themselves on this point.

From the information provided, it has not been possible to make a direct comparison of the costs of PECRS and the new CARE scheme benefit structures on consistent actuarial assumptions and we recommend that the Panel consider whether to seek further information to enable this comparison to be made.

14.6 Sustainability

It is important to appreciate that actuarial valuation assumptions are only one set of assumptions about the future. There is no guarantee that they will be borne out in practice and inevitability actual experience will differ from the assumptions made. With hindsight, the actuarial valuations of the past under-estimated future life expectancy and over-estimated future investment returns. We are recommending that some additional sensitivity testing be carried out by the actuary to quantify the risk of underfunding after cutting benefits to their minimum levels over the sustainability time horizon of 25 years.

14.7 Fairness

We have highlighted the apparent unfairness of the protections offered to the members within 7 years of normal retirement age and all of those on 45ths accrual. We recommend that the Panel consider whether the fairness of these protections should be challenged.

14. Conclusions (continued)

14.8 Risk -sharing

The proposed risk-sharing arrangements are complex and we are unclear how they would apply in all circumstances as discussed in section 9 of the report.

From the information made available to the Panel to date, it is not clear what the mechanism would be if one of the Admitted Bodies wished to leave the scheme. We recommend that the Panel pursue this in Phase 2 of their review, to ensure that it is reflected in the regulations.

14.9 Draft Legislation

We recommend that the Panel consider whether the text of the Draft Law should be reviewed, in the light of the risk of ambiguity in interpreting “significant” in Article 8(1). We would also suggest that the Panel consider whether the legislation should require the Minister to first seek appropriate legal and/or actuarial advice.

We have also highlighted where it may be helpful to expand the list of areas for potential regulation.

14.10 Legislative Process

We recommend that the Panel satisfy themselves that the timetable is achievable in practice and allows the COM, JNG and the Panel itself sufficient time to be able to review what are expected to be complex regulations adequately.

14.11 Governance

We recommend that the Panel considers whether they are satisfied with the current arrangements, whereby actuarial advice to both the COM and SEB is provided by separate offices of the same company.

14.12 Administration

We recommend that the Panel consider whether the additional internal administration costs as a result of the additional temporary staff resources and the software upgrade should be identified explicitly, so that they can be managed within an appropriate budget.

In addition, we recommend that the Panel review whether the additional staffing resources to be provided will be sufficient and staff are expected to be adequately trained to enable them to administer the CARE benefits with effect from 1 January 2015.

14.13 Member Communications

We would recommend that the Panel consider whether the communication with members, whilst giving the impression of being very transparent, could be considered a little misleading and whether any action should be taken as a result.

14. Conclusions (continued)

14.14 Conclusions

We have identified a number of points that the Panel may wish to pursue further as part of their review. However, we would highlight in particular the apparent unfairness of the protection arrangements that have been negotiated with the unions and the apparent lack of "stress testing" of the cost envelope to a range of prudent assumptions which could potentially result in members' benefits having to be cut back at an early stage.

PECRS Reform - Terms of Reference

1. To consider proposed reforms to the Public Employees Contributory Retirement Scheme (PECRS) and the sustainability, affordability and fairness of those reforms, with a particular regard to the following:
 - a) Implementation of a Career Average Revalued Earnings (CARE) scheme
 - b) Contribution rates
 - c) Indexation of benefits
 - d) Risk-sharing
 - e) Actuarial valuation methodology
 - f) Accrual rates
 - g) How the proposed reforms would affect different classes of PECRS member; and
 - h) Governance of the Scheme
2. To compare the proposed structure for PECRS with the current structure, with particular regard to the items listed under Term of Reference 1
3. To consider the future liability of the States within a revised PECRS.
4. To consider the impact that the proposed reforms would have on the repayment of the PECRS Pre-1987 Debt; and
5. To consider how the proposed reforms compare with developments in other jurisdictions.

This appendix sets out the documents that we have considered as part of the review in addition to the draft primary legislation and subsequent amendments.

Technical Working Group (TWG) reports

Options for change to PECRS	November 2012
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AonHewitt Documents

Review of PECRS Proposed High Level Scheme Design	15 July 2011
PECRS Actuarial Valuation at 31 December 2010	23 May 2012
Illustrative Benefit Projections	24 October 2012
PECRS-TWG risk sharing proposals- Results of financial modelling	3 July 2013
Cost Comparison with other public sector schemes	23 October 2013
Benefit Costings	11 April 2014

LCP Reports

Scheme Review	2 December 2011
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PECRS Member Communications

Annual Report 2012	
The NEW 2015 CARE Pension Scheme for States Employees- Your Simple Guide	
PECRS pension review (employee information)	online
Letter from Chief Minister's Department to members of PECRS	21 March 2013

Treasury and Resources Documents

Report on Future Risk Sharing Arrangements (Draft - Version 10)	14 April 2014
Corporate Services Scrutiny Panel Presentation (Parts A and B)	Presented February 2014

Other Information

Letter from Chairman of COM to Panel	14 April 2014
Letter from the States Treasurer to Chairman of JNG	8 April 2014

Briefing note: Origins and History of the PECRS Pre-1987 Debt	10 September 2009
Summary of UK changes to date	8 April 2014
Briefing note on PECRS and JTSF*	undated
States of Jersey Financial Report and Accounts 2012	
Jersey Retail Prices Index: Statistics Unit report	March 2014
Index of Average Earnings: Statistics Unit report	June 2013
Transcripts of Scrutiny Panel hearings on 22 and 23 April 2014	
Conference call with Jonathan Teasdale (Aon Hewitt)	15 April 2014
Submission from the JNG to the Scrutiny Panel	15 April 2014
Email from the Director of Accounting Services	29 April 2014
Benefits Calculator	online

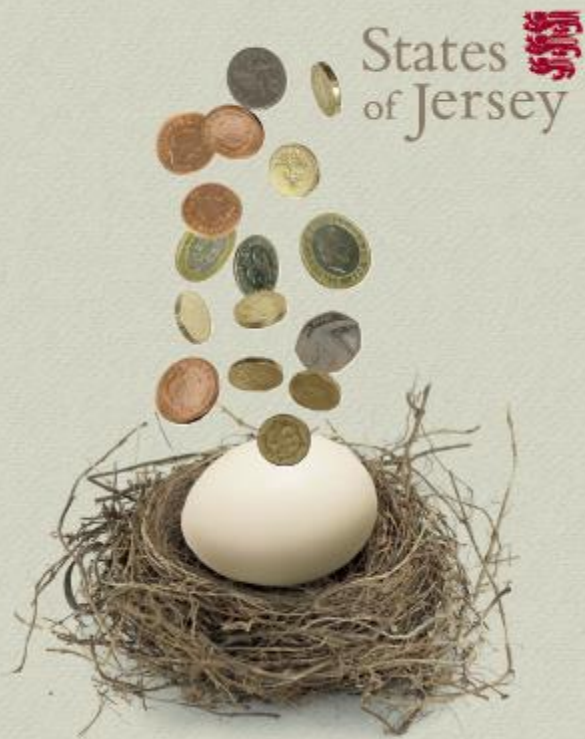
* Jersey Teachers Superannuation Fund

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States of Jersey

The **NEW** 2015 CARE Pension Scheme for States Employees

Your Simple Guide

www.gov.je/pensionreview

Setting out options
that are...

**Sustainable
Affordable
Fair**

The States employees' pension scheme offers a variety of benefits, for example:

- Retirement pension
- Opportunity to buy additional pension
- Opportunity to retire early subject to an actuarial reduction
- Lump sum before or on retirement
- Medical retirement benefits
- Death in Service Lump Sum
- Terminal illness commutation of pension
- Widows/widowers/children/civil partner nominated cohabiting partners pensions
- Relationships commencing after retirement recognised for benefits
- Tax Relief means the cost to you of participating is less than the headline contribution rate

Employees will
move to the
CARE Scheme



(Apart from a small group who are deemed protected and will have a choice)

A Career Average Revalued Earnings ('CARE') scheme means that benefits you build up are worked out using your pensionable pay each year rather than your final salary.

Your pension earned each year is added to your pension record and inflation is then added to the pension you've built up on your record so it maintains its value.

Your pension built up before Jan 2015 Will be PROTECTED



Some members will be able to opt to remain in the current scheme. These are:

- All employees on a 1/45th Accrual rate
- All employees within 7 years of their normal pension age as at 31st December 2014
e.g. if your normal pension age is 65 you must be age 58 as at 31st December 2014
- Your pension built up before January 2015 will be linked to your final pay on retirement or leaving the scheme. Pension built up after January 2015 will be calculated on the new career average scheme

Additional contributions will be phased in

 **Non uniformed employees 8%**

 **Uniformed employees 10.1%**

The contribution rates will increase for everyone as shown above and will be phased in.

For further information regarding the phasing of additional contributions please visit the pension review website: www.gov.je/pensionreview

The 'accrual' rate is the proportion of earnings that the Scheme pays as a pension for each year of membership

The accrual rate for all members in the new scheme will be 1/66th of your annual pensionable earnings.



New retirement ages

 **Non uniformed staff 65 → 67**

 **Uniformed staff 60**

The normal pension age for all non uniformed employees will be in line with changes made to the Jersey State Pension Age (which is due to be phased in gradually from 2020).

The normal pension age for uniformed members is increasing from age 55 to age 60 on 1st January 2015.

Early retirement option for medical reasons will still apply with an enhancement for those unable to work in any other capacity

There will be a 2 tier medical retirement process.

Tier 1 – not enhanced
Tier 2 – enhanced

Further details regarding the medical retirement process will be available at a later date.



Increase in Death in Service lump sum

x3

Pensionable Earnings

There are now no qualifying periods for any benefits except Ill Health Retirement. The Death-In-Service lump sum will now be payable at 3 x pensionable salary no matter how long the member has been in the scheme.



For every £1 you give up you will receive

£13.50

One-off option to take a lump sum from age 55 or when you retire

CARE members will have the option to commute some of their pension for a lump sum, but they no longer have to wait until they retire.

A 'one off' lump sum can be taken from age 55 even whilst in employment. However, there will be no further option to take an additional lump sum, for example at retirement.

States of Jersey



If you would like to know more about the changes that are being made or wish to read the 'frequently asked questions' page please visit

www.gov.je/pensionreview

If you have any questions, you can email us at

pensionreview@gov.je