STATES OF JERSEY

MEDIUM TERM FINANCIAL PLAN 2013 – 2015 (P.69/2012): SIXTH AMENDMENT

Lodged au Greffe on 23rd October 2012
by Senator L.J. Farnham

STATES GREFFE

PAGE 2, PARAGRAPH (f) –

After paragraph (f) insert a new paragraph (g) as follows -

> “(g) to agree that, further to the proposal contained within the Medium Term Financial Plan to increase the Public Employees Contributory Retirement Scheme (PECRS) Pre-1987 debt repayments by £1 million in 2013, £2 million in 2014 and £3 million in 2015 in order reduce the long-term costs to the States of the repayment, the Minister for Treasury and Resources be requested to present to the States no later than 31st July 2013 further options for the early repayment of the PECRS Pre-1987 debt and the Jersey Teachers Superannuation Fund (JTSF) Pre-2007 debt to provide significant additional long-term cost reductions.”

SENATOR L.J. FARNHAM

REPORT

Background to the development of the pension PECRS pre-1987 debt and Jersey Teachers Superannuation Fund (JTSF) pre-2007 debt

In 1987 the States approved proposition P.123/87 dated 30th June 1987, which recommended significant changes to the Public Employees Contributory Retirement Scheme (PECRS). This included the transfer of responsibility for payment of pension increases from the States to PECRS. This transfer of liability created a debt known as the PECRS Pre-1987 Debt. This was identified by the Actuary in 1986 terms to be in the region of £55 million.

No capital lump sum was paid into PECRS to fund the take-on of the £55 million pension increase liability. The Employer's contribution rate was set at a rate which at the time was thought to be sufficiently above the then cost of benefits to leave a margin which was expected to pay off the liability over the long term. Since the 1980s there have been significant improvements in longevity, which means that the cost of providing pensions has increased by around 30%. Such significant improvements in longevity were not predicted in the 1980s and could not have been expected to be predicted.

Over time, it became evident that the Employer's contribution rate was not providing the funding necessary to repay the Pre-1987 Debt and, in November 2003, a framework was agreed by the then Policy and Resources Committee for dealing with the Pre-1987 Debt. This agreement, known as the 10 point plan, confirmed the States' responsibility for the Pre-1987 Debt, which by 31st December 2001 had grown to £192.1 million. An 82 year repayment period for the debt was established. The States commenced annual repayments in respect of the Pre-1987 Debt which started at £2.55 million in 2002, and have subsequently increased to £4 million per annum in 2012, in line with the agreement to increase payments by salary inflation over the 82 year term. Changes to market rates and, in particular, the reduction in long-term interest rates, have contributed to further increases in the value of the Pre-1987 Debt such that as at the end of 2011 it was valued at £252 million.

In 2007, the Jersey Teachers Superannuation Fund (JTSF) completed a similar transfer of liability as PECRS had completed in 1987. From 2007 onwards, the responsibility for payment of pension increases for teachers transferred from the States to JTSF. Since 2007, the States has been paying an additional 5.6% of teachers' pensionable salaries over and above the normal employer contribution rate to reflect the need to repay this debt over the long term. This arrangement was established pending a formal agreement by the States to accept the debt and establish annual repayments until full settlement is made.

In October 2012, the JTSF Management Board, on the advice of the Scheme Actuary, confirmed that in light of the latest actuarial funding position of the scheme, the level of the Pre-2007 Debt at 1st January 2012 was £94.6 million.

Structure of the PECRS pre-1987 debt

The PECRS Pre-1987 Debt is structured such that repayments are linked to the increase in pensionable salaries. This means that debt repayments are heavily weighted towards the end of the 82 year period.

Year	**Annual Pre-1987 Debt Current Repayment Plan**
2012	£4 million
2032	£10 million
2052	£28 million
2072	£76 million
2083	£131 million
Total payments by 2083	£2,708 million

The total projected future cost of repaying the States Pre-1987 Debt under this arrangement is estimated to be £2.7 billion, with the debt fully repaid by 2083.

Existing proposal within the Medium Term Financial Plan

The Medium Term Financial Plan identifies one of the most important local issues that needs to be considered, which is how best to manage the Pre-1987 Debt. Between 2013 and 2015, an additional contribution of £1 million in 2013, rising to £2 million in 2014 and to £3 million in 2015, is planned so as to repay the Pre-1987 Debt over a shorter period and reduce the long-term cost.

For example, the total projected future cost of repaying the States Pre-1987 Debt under the current proposal contained within the MTFP is estimated to be £0.9 billion, with the debt fully repaid by 2054 (as opposed to 2083). The existing proposal therefore reduces the term of the loan by 29 years and reduces the long-term cost of repayment by over £1.7 billion, making it clear that the allocation of relatively small additional payments to the repayment of the Pre-1987 Debt has the potential to significantly reduce the long-term cost to the States.

Year	**Annual Pre-1987 Debt MTFP Repayment Plan**
2012	£4 million
2032	£18 million
2052	£47 million
Total payments by 2054	£935 million

One option could be for the States to replace the total pension debt on the balance sheet with an independent loan product of £350 million over 20 years, bearing an APR of 2.5%, the total cost of payments would be approximately £445 million. It would therefore be prudent to expeditiously explore further options around how the PECRS Pre-1987 Debt and JTSF Pre-2007 Debt could be repaid more quickly.

The rationale for early repayment

The structure of the Pre-1987 Debt with the repayments linked to pensionable salary increases and the interest rate assumptions inherent within the calculations of the repayment profile mean that it is advantageous for the States to repay the Debt early.

The linking of repayments to increases in pensionable pay means that the debt outstanding will increase in the early years, as the States is not paying a sufficient amount to meet the interest costs. The proposal contained within the Medium Term Financial Plan goes some way to address this, by increasing the regular repayments to over £7 million per annum by 2015. However, it remains the case that given the structure of the Debt, repayments in the early years will continue to be insufficient to cover the interest until such time as they increase in line with pensionable salaries by a sufficient amount to cover the interest costs.

At the time the Pre-1987 Debt agreement was reached, the structure of the debt arrangement may have appeared attractive, but the market environment has now changed and interest rates fallen to levels previously unexpected. Long-term interest rates are now at all-time lows, and the interest rate inherent in the Pre-1987 Debt no longer looks competitive. In addition, the structure of the debt means that the States is paying interest on the interest at this relatively high rate during the early years of the debt. It is for this reason that the proposal included within the Medium Term Financial Plan has such a significant impact on reducing the long-term costs to the States.

The States has a strong balance sheet and the Medium Term Financial plan has identified the need to actively manage the balance sheet with the most significant issue being the pension scheme liabilities. By managing the States assets and liabilities more effectively, a solution to reducing the considerable costs of the pension debts could be achieved.

It therefore stands that if the States were to adopt this amendment and the Minister for Treasury and Resources was to return to the States in 2013 with proposals for significantly earlier repayment of the Pension Debts than currently proposed, then further reduced costs amounting to hundreds of millions of pounds could be achieved in the medium term.

Financial and manpower implications

The proposal requests that further options are considered for the early repayment of the PECRS Pre-1987 Debt and the JTSF Pre-2007 Debt so as to reduce long-term costs to the States.

There are no additional manpower implications arising from this proposed budget amendment.