

**Don't let this crisis go to waste**

A simple and affordable way of increasing retirement income

MICHAEL JOHNSON



**Self-sufficiency is the key**

Addressing the public sector pensions challenge

MICHAEL JOHNSON



# Sustainability of public service pensions

21 March 2013

Michael Johnson



[www.cps.org.uk](http://www.cps.org.uk)

**Simplification is the key**

Stimulating and unlocking long-term saving

MICHAEL JOHNSON



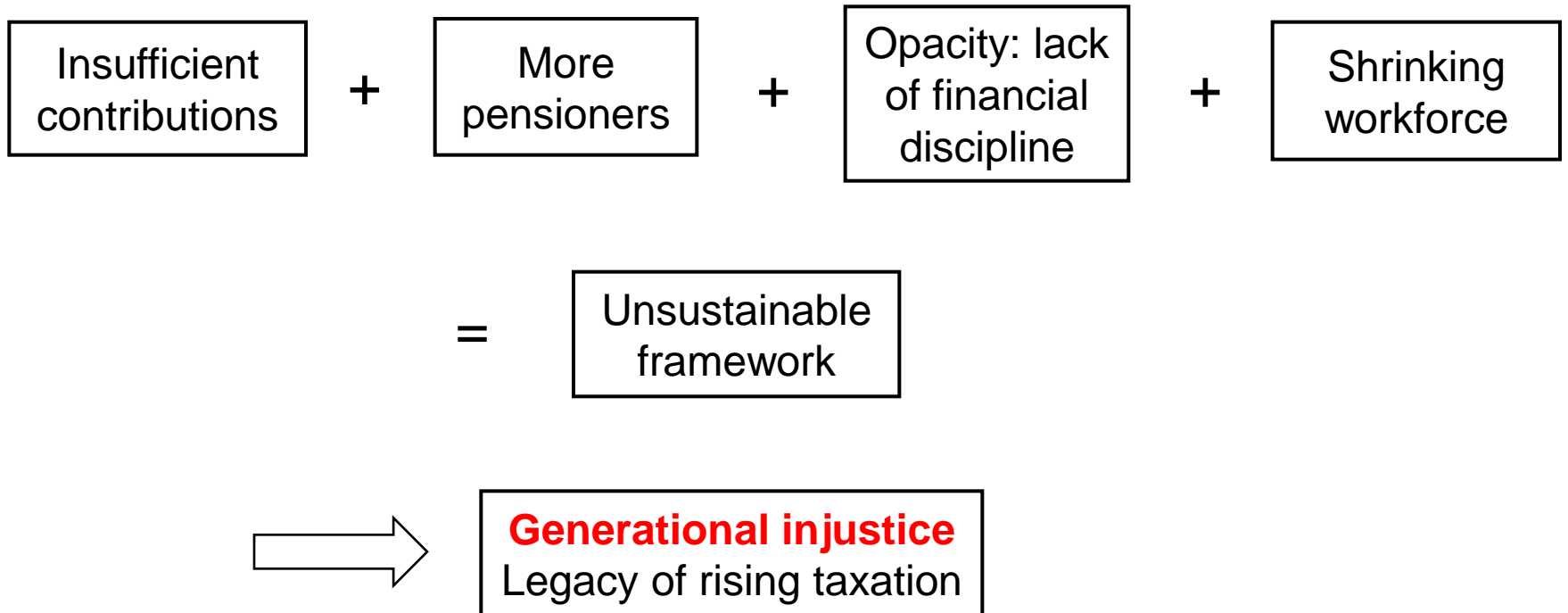
**Put the saver first**

Catalysing a savings culture

MICHAEL JOHNSON

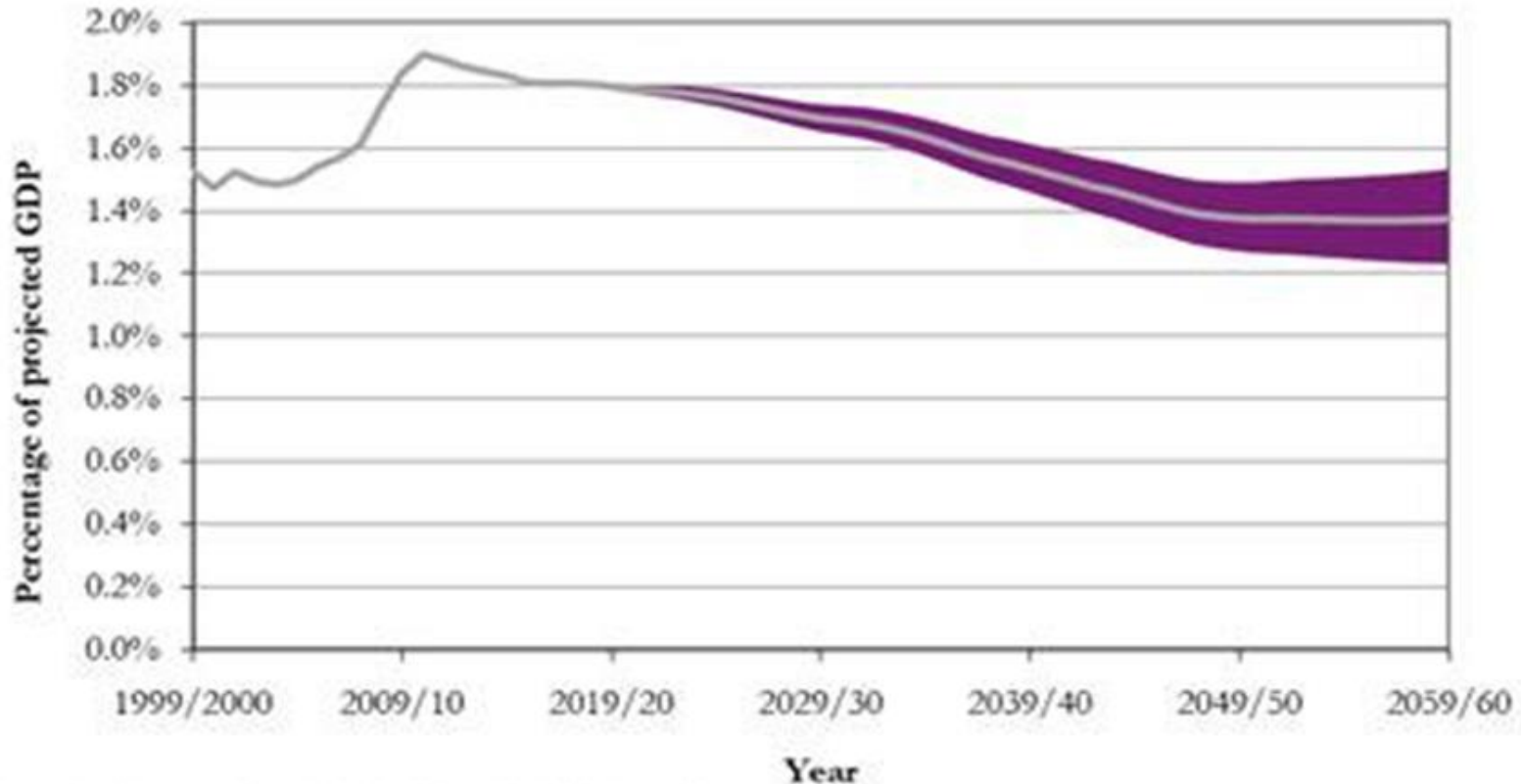


# Madoff economics



# Lord Hutton: justification (?)

Chart 1.B: Projected benefit payments as a percentage of GDP – sensitivity analysis



<u>Assumptions</u>	<u>Hutton</u>	<u>What if?</u>
Workforce	0.25%	-0.25%
Productivity	2%	1%
Real earnings	2%	0%

Modelling risk: GDP growth?  
 → Focus on cashflow

# Cashflow: mind the gap (unfunded schemes)

<i>£ billion</i>	'05-06	'06-07	'07-08	'08-09	'09-10	'10-11	'11-12
Total contributions	£17.4	£18.0	£19.2	£19.4	£20.7	£21.4	
less p-in-payment	£17.6	£19.1	£21.4	£22.6	£24.4	£26.0	
<b>Cashflow shortfall</b>	<b>£0.2</b>	<b>£1.1</b>	<b>£2.2</b>	<b>£3.2</b>	<b>£3.7</b>	<b>£4.6</b>	<b>£8.0</b>

## OBR forecasts

	'12-13	'13-14	'14-15	'15-16	'16-17	'17-18
3/11 ( <b>pre</b> -reforms)	£7.8	£8.0	£8.7	£9.7	-	-
3/13 ( <b>post</b> -reforms)	<b>£10.5</b>	<b>£11.1</b>	<b>£12.4</b>	<b>£13.6</b>	<b>£14.9</b>	<b>£16.2</b>
Increase	£2.7	£3.1	£3.7	£3.9	-	-

*But this is not the whole picture.....*

# Toxic tangle: the single-tier pension (STSP)

- Public Service Pension Bill (13 Sept 2012)
    - RIA: £5bn annual saving.....emerging v. slowly
  - DWP White Paper (14 Jan 2013)
    - End of contracting out
    - Loss of employers' NICs rebate
- + £3.4 bn p.a. cost, from 2017 (i.e. immediate)
- Longevity: + £2 bn p.a. ?

# Toxic tangle: costly additional STSP accruals

- 25 year “no change” pledge: consequences.....
  - Private vs. public sector (discriminatory?)
- E.g.: 30 years work, £40K

*\* incl. £100 for CO substitution*

	<b>BSP</b>	<b>+</b>	<b>ASP</b>	<b>=</b>	<b>FA</b>	<b>Occup.</b>	<b>Future accruals</b>
<b>CO</b>	£107.45		£0		£107.45	£300*	£4.11 pw / year
<b>CI</b>	£107.45		£100		£207.45	£200	£Nil

- Additional cost\* = c. £4 billion p.a.  
 → The Bill should be scrapped

*\* As 5.2m employees x 4 years x £4.11 x 52 weeks less higher NICs*

# Fairness: the official data (HMT, ONS)

<u>Pensions</u>	<u>Median</u>	<u>Mean</u>
LGPS (funded)	-	£4,000 (>50% part time, c75% women)
Main unfunded schemes	-	£6,500
All public sector	£5,600	-
Private + public sector	£3,900	-

	<u>Private</u>	<u>Public</u>	
<b>Average gross weekly pay</b>	£581	£605	+4%
<b>Total reward</b>	£614	£692	+13%
= gross pay			
+ employer pension contributions			
	←		<i>Unrelated to real cost of meeting pension promises</i>

Use contributions as proxy for pension value:

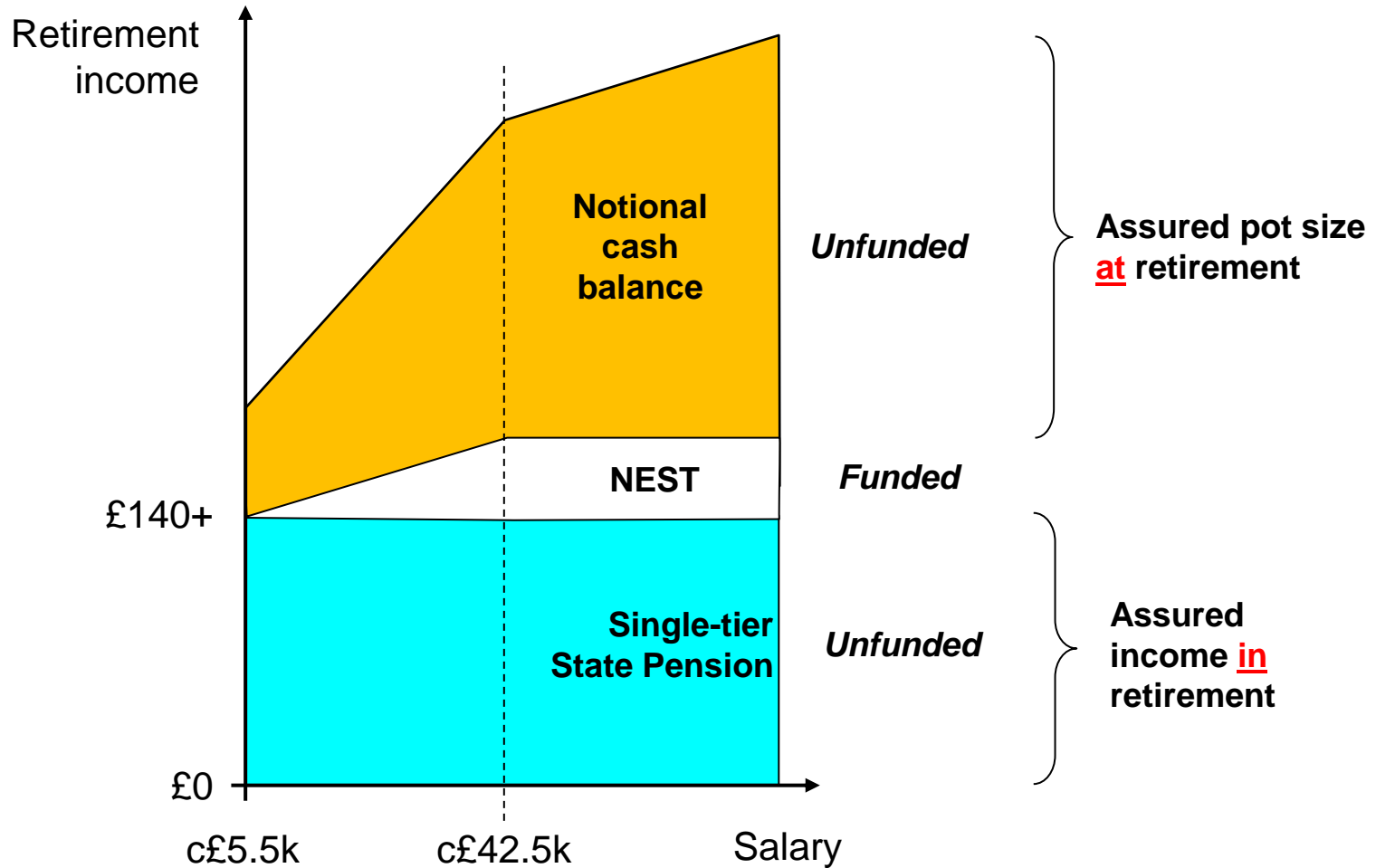
Average private occup. DC	12%	} 3x
To match equiv. public sector earner's pension:	37%	

# The way forward (unfunded schemes)

- Compulsory NEST participation + interim period of CARE DB
  - Using contribution increases
- Golden opportunity to help catalyse a savings culture
- + 10 years: notional cash balance alongside NEST
- Thereafter, employers should be pensions self-sufficient
  - HMT door shut (ref. cashflow gap)
  - Taxpayers' contribution capped at 65% of pensions in payment
  - Employers: complete discretion



# Vision for 2023 (unfunded schemes)



NEST's ceiling for contributions

# The LGPS

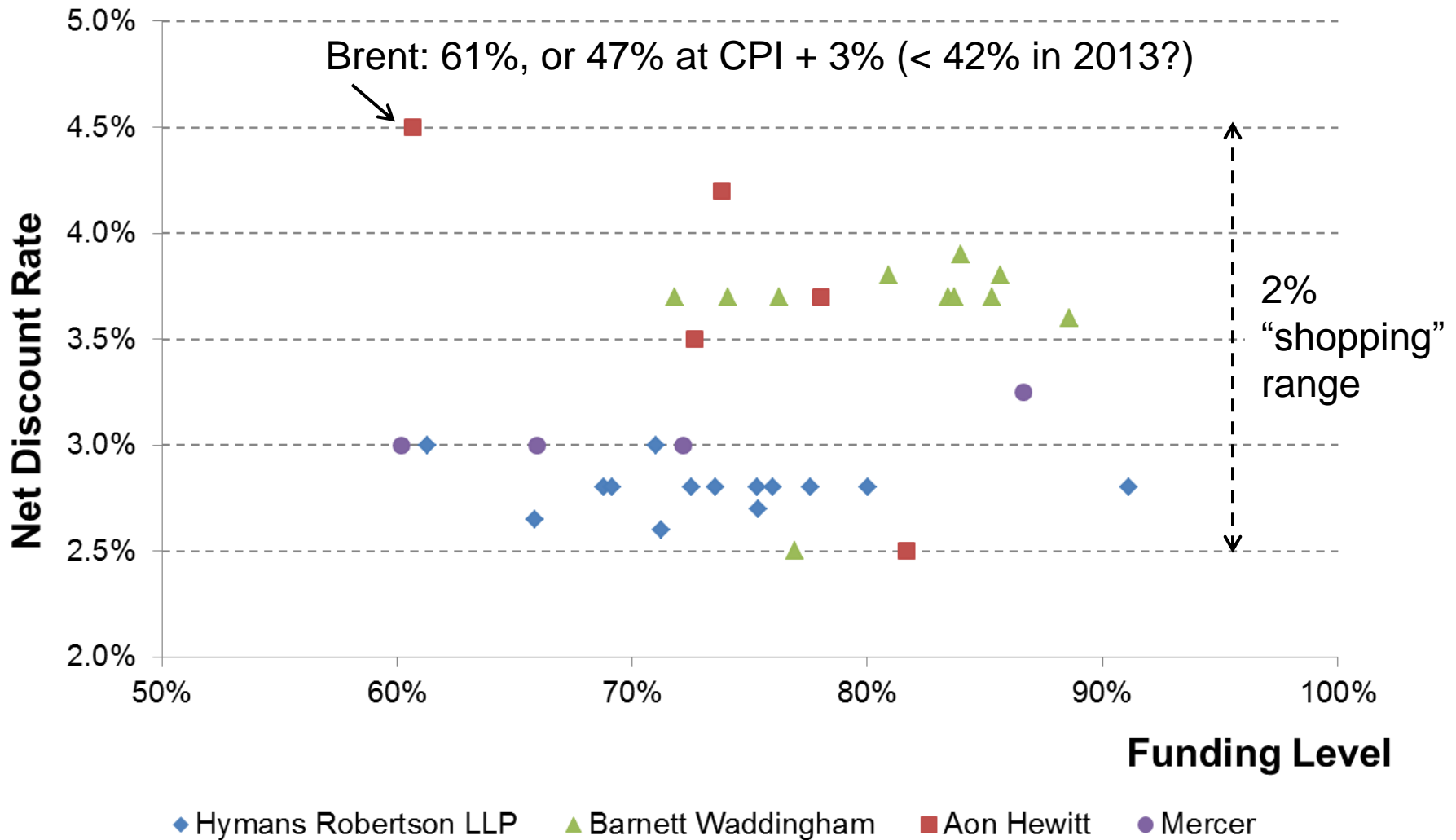
- An empire
- Mature, and underfunded
  - Death spiral
- 101 funds: sub-optimal size & performance  
→ Scale up

## **Funding ratio, 31 March 2010**

Waltham Forest	60%
Brent	61%
Havering	61.3%
Hackney	65.8%
Croydon	66%
North Yorkshire	67%
Sutton	69%
Worcestershire	69%
Haringey	69.2%

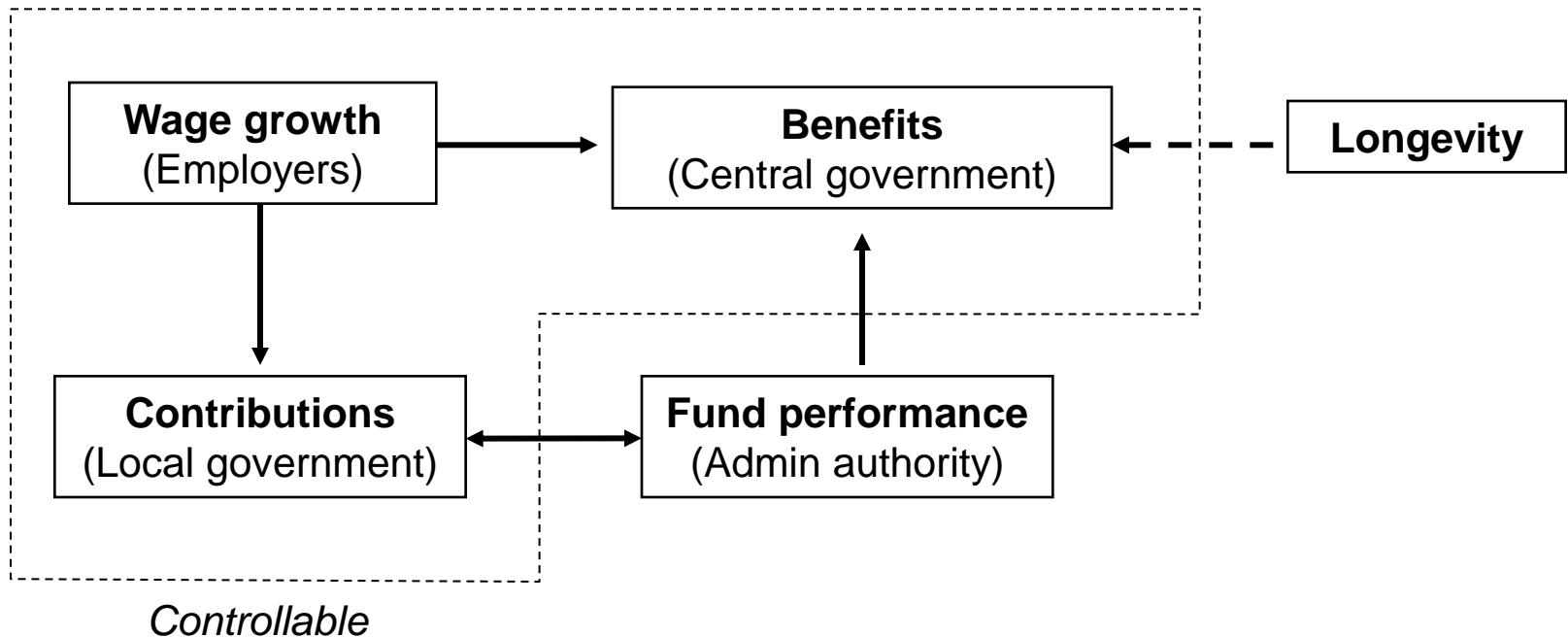
- 6 funds x £30 bn.
  - Take IM in-house, centralised admin and procurement
  - London: proof of concept?
  - Consistent with Operation Big Fat Pots
- Compare with USS, Ontario Teachers PP

# London LGPS funds: discount rate spread over CPI



Mercer discount rates split pre- / post-retirement: average illustrated here

# LGPS governance; a tripartite tragedy?



- Single trust-based Board required for each scheme, incl. employers, government (local / central) and admin authority

# The LGPS: suggested next steps

- Standardisation
  - 2013 valuation: SCAPE rate of CPI + 3%
  - Data
- Transparency: publish
  - *all* data (e.g. portfolio turnover?)
  - portfolio performance, costs, charges, entertainment received
  - recovery programmes
- TPR oversight (incl. trustee boards)
- Opposition: vested interests abound
  - Weak vs. strong funds.....central gov't g'tee?

# Conclusion

- Public Service Pensions Bill: *fait accompli*
  - But cost cap mechanism not finalised !
- Sustainability = Affordable + Fair for Everyone (SAFE)
  - A new 80:20 rule.....societal schism?  
→ A second round of reform needed
- LGPS: scale up and become “expert clients”
- The vision: pensions equality across employment sectors
- DC inevitable: concentrate state’s limited capacity for longevity risk into State Pension

**Don't let this crisis go to waste**

A simple and affordable way of increasing retirement income

MICHAEL JOHNSON



**Self-sufficiency is the key**

Addressing the public sector pensions challenge

MICHAEL JOHNSON



# Sustainability of public service pensions

21 March 2013

Michael Johnson



[www.cps.org.uk](http://www.cps.org.uk)

**Simplification is the key**

Stimulating and unlocking long-term saving

MICHAEL JOHNSON



**Put the saver first**

Catalysing a savings culture

MICHAEL JOHNSON

