Civil Service Pensions
Department of Finance
Waterside House
75 Duke Street
Londonderry
BT47 6FP

Department of Finance
An Roinn Airgeadais
www.finance-ni.gov.uk

Consultation on Rectification of the Cost Cap Floor Breach

and

Adjustments to Employee Pension Contributions

Effective from 1 April 2019

26 November 2018

Contents

INTRODUCTION, SCOPE AND TIMEFRAME FOR CONSULTATION

1. Introduction

1.1. This consultation covers proposals to address;

(a) Cost Cap Rectification

- The cost cap floor breach of 4.9% identified in the provisional valuation results for the Northern Ireland Civil Service, NICS, Pension Schemes as at 31 March 2016.

(b) Employee Pension Contributions

- The impact of retrospective pay awards and other arrears payments on employee pension contributions; and
- Anomalies requiring adjustments in employee pension contribution thresholds.

2. Cost Cap Rectification

2.1. In respect of the cost cap floor breach, the NICS Scheme Advisory Board considered various options to bring the scheme cost cap cost back to the target of 18.3% and notified the scheme manager of their advice which was to increase the:

- Death In Service Lump Sum from twice final pensionable earnings to three time pensionable earnings; and,
- Accrual rate from 2.32% to 2.75%.

2.2. In their advice, the NICS Scheme Advisory Board requested that Civil Service Pensions, CSP, of the Department of Finance, DoF commence an 8 week consultation with the NICS Trade Unions Side (TUS) with a view to reaching agreement on their recommendations in respect of the cost cap floor breach. To that end, CSP is consulting with the Pensions Forum, as representatives of all NICS Pension Scheme members, on the measures listed above to rectify the cost cap breach. The remedy to increase the accrual rate for the cost cap will only to apply to members in the alpha scheme, however it is proposed to extend the enhanced death in service provision to all members.

3. Employee Contributions

3.1. When there are retrospective payments of pensionable pay some members can move into a higher employee pension contribution band for that month. This issue came more to the fore with the retrospection which was applied with the 2017 pay award. Also, there are two groups of staff who cross the employee contributions thresholds under the current 2017 pay scales – these are staff at AO and G7 (and analogous) grades.

3.2. CSP undertook a review of the processing of employee contributions, employee salary bands and contribution rates with the aim of exploring options and implementing a fairer system. As a result of this review, CSP proposes the following:

- Introduce a process to exclude any arrears of pensionable pay from the annualisation calculation for setting contribution rates; and

- Align the employee pension contributions thresholds with NICS pay and grading structures.

3.3. These changes will apply to all members.

4. Consultation Timeframe

4.1. This consultation launches on 26 November 2018 and CSP will accept responses until **5pm on Friday 18 January 2019.**

4.2. For the avoidance of doubt, no proposal in this consultation paper adversely affects any member of the NICS Pension Schemes, i.e. members of classic, classic plus, premium, nuvos, alpha or Partnership. However, a considerable number of employees will benefit from the changes proposed.

4.3. Responses are invited to this consultation about any aspect set out in this paper and some illustrative examples have been included to demonstrate benefits to members where applicable. Any examples provided are purely illustrative to demonstrate the changes to processes recommended within this consultation and do not reflect actual financial implications or benefits.

4.4. Each set of proposals will now be detailed separately within this consultation document.

RECTIFICATION OF THE COST CAP FLOOR BREACH

5. Background - Scheme Valuation and Cost Cap Mechanism

5.1. Valuations of the public service pension schemes are undertaken every four years. This is the first time that a full assessment of the pension schemes has been undertaken since the government introduced reformed schemes in 2015. The reform of the schemes addressed the rising cost of pensions, rebalancing taxpayer and member costs to ensure that public pensions were put on to an affordable and sustainable footing. The valuations are important as they ensure that the full costs of the schemes are understood and fully recognised by government.

5.2. The 2016 valuation of the NICS Pension Schemes was undertaken in accordance with DoF valuation directions. The Government Actuary's Department (GAD) was commissioned by the DoF to carry out this valuation for the Civil Service Schemes.

5.3. The main purpose of the scheme valuation is to:

(a) Determine the level of employer and employee contributions required to pay for the cost of benefits being earned by members each year; and

(b) Assess the cost of the NICS Pension Schemes as part of the cost cap arrangement for managing the cost risks within the scheme.

6. Requirement to Consult

6.1. Article 3(2) of the Superannuation (Northern Ireland) Order 1972 and section 21(1) of the Public Service Pensions Act (Northern Ireland) 2014 places a requirement on the Department to consult with trade unions representing those affected by any change made in secondary legislation to the civil service pension and compensation schemes.

6.2. The Employer Cost Cap is legislated for under The Public Service (Civil Servants and Others) Pensions Regulations (Northern Ireland) 2014. Regulation 159 requires the Department must consult such persons (or those appearing to the Department to represent such persons) as likely to be affected by any steps that will be taken, with a view to reaching agreement on the steps required to achieve the target cost for the scheme.

6.3. To this end CSP on behalf of DoF hereby formally opens the consultation process with the NICS Pensions Forum which is a composite representation of main relevant Trades Unions.

7. Provisional Results of the 2016 Valuation and Commissioning of Scheme Advisory Board

7.1. The provisional valuation results as at 31 March 2016 for the NICS Pension Schemes, based on the amending regulations issued by the DoF indicate a cost cap cost to the scheme of 13.4% which is 4.9% lower than the employer cost cap of 18.3% as set in the 2012 valuation and alpha Scheme Regulations. The provisional results also indicate an increased employer contribution rate required over 2019 to 2023 implementation period of 29.8% after default rectification adjustment to scheme benefits to address the cost cap breach.

7.2. Confirmation of the cost cap breach in the Civil Service Pension Schemes generated a process whereby the NICS Scheme Advisory Board was commissioned to seek to agree steps to rectify the breach. The Scheme Advisory Board was invited to advise the Scheme Manager on which scheme improvements (or combination of such improvements) should be adopted to enable the cost cap breach to be rectified. In presenting such advice, the Scheme Advisory Board was asked to indicate what considerations it took into account - in particular, how it considered fairness amongst different categories of member.

8. Proposed Remedies and Guiding Principles

8.1. The Scheme Advisory Board considered options for rectifying the cost cap breach in line with the following principles;

1) Fairness and equality (spread any gain fairly and equitably) which is consistent with the Department’s/Government’s aims for fairness to members and the taxpayer;

2) Attractiveness to members;

3) In line with wider Government policy to encourage adequate saving for retirement and longer working lives;

4) Administrative ease i.e. not unduly complex or disproportionately expensive to administrate and consider retrospection and timing issues; and,

5) Helpful to employers in terms of recruitment and retention.

8.2. In order to return scheme costs to the cost cap set level of 18.3%, the Scheme Advisory Board considered the following improvements along with any associated impacts and applied the guiding principles outlined above;

- Specific member benefits;
- Members Options;
- In-service revaluation (applying Consumer Price Index (CPI) plus);
- Member Contributions;
- Death in Service; and,

- Accrual Rate.

8.3. In their consideration of specific member benefits (such as improvements in ill health, early retirement benefits, dependant benefits) and member options (such as early retirement, commutation etc.), the Scheme Advisory Board concluded that these options did not comply with the fairness and equality principle as the implementation of these changes would only impact on specific groups within the scheme. This is because not all members will depart under ill health, qualify for dependant's benefits or opt for early retirement, higher lump sum, or added pension for example.

8.4. Consideration of a change to the In-Service Revaluation Rate (applying CPI plus) would involve greater complexity, be more costly and could also impact on scheme member withdrawals. In the Proposed Final Agreement, CPI only and not CPI plus was agreed and the Scheme Advisory Board concluded that to change this now would result in going back on the principle agreed under the Proposed Final Agreement. In addition, a change to CPI plus would benefit some members and not others depending on their length of service.

8.5. The Scheme Advisory Board did not recommend adjusting member contributions as this change would only provide a short term gain for members, have retrospection implications and would be contrary to HMT's current assessment of the UK's fiscal position. Furthermore, should a decision be made to adopt this approach, a commensurate reduction will be made in HMT's departmental financing. In these circumstances, any proposal which includes a reduction in members' contributions is an additional cost and would consequently reduce the funding available to key public services such as health, criminal justice, education and infrastructure. Another factor in the Scheme Advisory Board's decision to rule out this option was that the Directions previously written implied a single contribution mechanism. However, any decrease in employee contributions for protected members would not rectify the cost cap breach. Therefore, this would indicate the need for a dual contribution structure which would be contrary to the ethos of the Directions. Moreover a dual approach would not be fair or equitable to certain members, be very complex and expensive to implement. Also such a complex change could not be to be implemented by 1 April 2019.

8.6. The Scheme Advisory Board however considered that an option to increase the alpha scheme Death in Service Lump Sum from two times final pay to three times final pay was an attractive proposition, albeit this change would only equate to a **0.1%** increase in the cost cap cost and further corrective measures would be required. In addition, although not a part of the cost cap remedy, in the interests of consistency and fairness to all members, the Scheme Advisory Board considered that this benefit should also be extended to all members of the Civil Service pension schemes. This change therefore, if accepted, will ensure consistency for all members.

8.7. The Scheme Advisory Board determined that the option to increase the accrual rate would benefit members in the longer term, be advantageous to *all* active members of the alpha scheme and is the only viable option to meet each of the five principles outlined above. The impact of an increase to the accrual rate will be long term as it will be beneficial to members for the duration of their employment and further into their retirement. This is because the accrual rate is the percentage amount used to determine the members pension build up each year which will impact for every year the member is in the scheme. Even if the accrual rate reduces in future years, the years of the increase will continue to have a positive impact on members' pension benefits as demonstrated in the examples below. Furthermore a change to the accrual rate can be implemented very quickly, will not impact on member behaviour and retrospection would not be an issue as it will be a positive change.

8.8. ***Example based on current accrual rate of 2.32% (without in-service revaluation applied):***

ACCRUAL RATE 2.32% (A)

David joins alpha on 1 April 2018 and his earnings for the year 1 April 2018 to 31 March 2019 were £24,429 (based on point 1 on 2017 pay scales).

He will earn a pension of:

£24,429 x 2.32% = £566.75

With a one-step pay progression, David earns £24,695 in the following year to 31 March 2020 so his benefits 'banked' for that year would be:

£24,695 x 2.32% = £572.92

With another one step progression, David earns £24,960 in the following year to 31 March 2021 so his benefits 'banked' for that year would be:

£24,960 x 2.32% = £579.07

TOTAL ACCRUED BENEFITS = £1,718.74

NOTE: This example demonstrates how pension benefits are accrued on an annual basis only, it does not reflect the application of in-service revaluation to accrued benefits at the beginning of each scheme year.

8.9. ***Example based on proposed accrual rate of 2.75% applied from 1 April 2019 (without in-service revaluation applied):***

ACCRUAL RATE INCREASES TO 2.75% FROM YR2 (B)

David joins alpha on 1 April 2018 and his earnings for the year 1 April 2018 to 31 March 2019 were £24,429 (based on point 1 on 2017 pay scales).

He will earn a pension of:

£24,429 x 2.32% = £566.75

With a one-step pay progression, David earns £24,695 in the following year to 31 March 2020 so his benefits 'banked' for that year would be:

£24,695 x 2.75% = £679.11

With another one step pay progression, David earns £24,960 in the following year to 31 March 2021 so his benefits 'banked' for that year would be:

£24,960 x 2.75% = £686.40

TOTAL ACCRUED BENEFITS = £1,932.26

Additional accrued benefits under proposed accrual rate 2.75% = £213.52

NOTE: As with the previous example, this example demonstrates how pension benefits are accrued on an annual basis only, it does not reflect the application of in-service revaluation to accrued benefits at the beginning of each scheme year.

9. Summary of Recommendations – Cost Cap Breach

9.1. After detailed deliberations on the varying remedy options at their meetings on 2 October and 2 November 2018, the Scheme Advisory Board's recommendations are as set out below:

Recommendations to Rectify the Cost Cap Breach

1) Increase member accrual rate from 2.32% to 2.75% for members in the alpha scheme.

2) Increase death in service benefits from 2 times salary to 3 times salary to ensure consistency for all members.

10. Default Position

10.1. Regulation 159 (3) of The Public Service (Civil Servants and Others) Pensions Regulations (Northern Ireland) 2014 provides that, should agreement not be reached following this consultation, the accrual rate of the alpha pension scheme will be adjusted for the implementation period (1 April 2019 to 31 March 2023). Calculations undertaken by the scheme actuary indicate that this default option will result in an increase in the alpha accrual rate from 2.32% to 2.76% for the implementation period.

EMPLOYEE PENSION CONTRIBUTIONS

11. Background – Employee Pension Contributions

11.1. The current rates and thresholds of employee pension contributions is set out below for ease of reference.

11.2. This will be helpful in understanding the proposals set out in this section. These changes will mean some members paying **less** in employee pension contributions and no member will pay more.

Current rates and thresholds 01/04/2018 to 31/03/2019

Annualised rate of pensionable earnings	*Member contributions rate (gross rates – i.e. without tax relief)*
Up to but not including £21,637	4.6%
£21,637 to but not including £51,516	5.45%
£51,516 to but not including £150,001	7.35%
£150,001 and above	8.05%

11.3. Contributions are paid and annualised figures based on all elements of pay which are pensionable (that is, basic pay and all pensionable allowances and bonuses). An employee's pension contribution rate in a pay period is based on which tier their annualised pensionable earnings falls in. This means that;

- If the member is paid monthly then the pensionable earnings paid in the month are multiplied by 12 to get the annualised amount;
- If a member is paid other than in monthly instalments then the amount paid in the pay period is divided by the relevant number of days in that period and then multiplied by 365.

11.4. This section of the consultation covers proposed interim solutions to;

- pension contribution issues created due to the retrospective payment of pay awards or other arrears of pensionable pay or allowances; and
- anomalies where certain grades cross contribution bands.

11.5. These arrangements will be kept under review as a more complex solution may be necessary.

12. Retrospective Pensionable Pay or Allowances

12.1. Currently, if there is a retrospective pay award or there are arrears of pensionable pay for any other reason (whether or not those arrears relate to a previous scheme year) then the applicable employee contribution band will relate to the annualised amount of pensionable earnings actually paid in the relevant pay period. This means that the back pay or other arrears may cause the applicable band and associated contribution rate to shift upwards for just that pay period and return to the "usual" rate for the next pay period.

12.2. ***Example using the Current Annualisation Process***

Sarah earns £20,487 (point 2 on 2016 pay scales) and receives a pay increase to £21,375 as a result of the 2017 pay award (pay point 3 on 2017 pay scales), backdated to August 2017 and paid in July 2018.

June 2018
Pensionable earnings = £20,487 / 12 = £1,707.25
Annualised rate of pensionable earnings = £ 1,707.25 x 12 = £20,487
Member contribution rate based on annualised rate of pensionable earnings = 4.60% (contribution band 2 £15,001.00 – £21,636.99)
Member contributions = £1,707.25 x 4.60% = £ 78.53

July 2018
Pensionable earnings = £21,375 / 12 = £ 1,781.25
Backdated arrears of pay = £814.00 (£21,375 - £20,487 /12 = £888 / 12 = £74.07 x 11)
Revised Gross Pensionable Earnings = £2,595.25
Annualised rate of pensionable earnings = £ 2,595.25 x 12 = £31,143
Member contribution rate based on annualised rate of pensionable earnings = 5.45% (contribution band 3 £21,637.00 to £51,515.99.
Member contributions = £2,595.25 x 5.45% = £141.44

August 2018
Pensionable earnings = £21,375 / 12 = £1,781.25
Rate of member contributions = £ 1,781.25 x 12 = £21,375 (annualised rate of pensionable earnings)
Member contribution rate based on annualised rate of pensionable earnings = 4.60% (contribution band 2 £15,001.00 – £21,636.99)
Member contributions = £1,781.25 x 4.60% = £ 81.93

As a result of the current process the member crossed contribution bands in July 2018 and reverted back down to the lower rate in August 2018.

12.3. It is proposed that for the 2019 scheme year, any arrears of pensionable earnings is not factored into the annualisation calculation for determining a member's contribution rate. This will mitigate against members moving up to a higher pensionable earnings tier as a result of arrears of pay or the payment of any other arrears and subsequently returning to their "normal" tier the following pay period. It should be noted that the proposed new annualisation calculation will differentiate between those members who would be going up to the next tier anyway as a result of a promotion or temporary promotion etc.

12.4. ***Example using the Proposed Annualisation Process (Excluding Arrears of Pensionable Earnings)***

Sarah earns £20,487 (point 2 on 2016 pay scales) and receives a pay increase to £21,375 as a result of the 2017 pay award (pay point 3 on 2017 pay scales), backdated to August 2017 and paid in July 2018.

June 2018
Pensionable earnings = £20,487 / 12 = £1,707.25
Annualised rate of pensionable earnings = £ 1,707.25 x 12 = £20,487
Member contribution rate based on annualised rate of pensionable earnings = 4.60% (contribution band 2 £15,001.00 – £21,636.99)
Member contributions = £1,707.25 x 4.60% = £ 78.53

July 2018
Pensionable earnings = £21,375 / 12 = £ 1,781.25
Backdated arrears of pay = £814.00 (£21,375 - £20,487 /12 = £888 / 12 = £74.00 x 11)
Total Revised Gross Monthly Pay = £2,595.25
Annualised rate of pensionable earnings (excluding arrears of pensionable earnings) = £ 1,781.25 x 12 = £21,375.
Member contribution rate based on annualised rate of pensionable earnings = 4.60% (contribution band 2 £15,001.00 – £21,636.99)
Member contributions = £2,595.25 x 4.60% = £ 119.38

August 2018
Pensionable earnings = £21,375 / 12 = £1,781.25
Annualised rate of pensionable earnings = £ 1,781.25 x 12 = £21,375
Member contribution rate based on annualised rate of pensionable earnings = 4.60% (contribution band 2 £15,001.00 – £21,636.99)
Member contributions = £1,781.25 x 4.60% = £ 81.93

As a result of the proposed process the member would have remained at the same contribution rate in July 2018 and not cross the contribution bands threshold.

Saving to the member by moving to proposed structure = £22.06

13. Employee Contribution Thresholds

13.1. There are two groups of staff who cross the employee contributions thresholds under the current pay scales (as at August 2017) – these are staff at AO and G7 (and analogous) grades. The outcome of this is that when a member moves up the pay scale their pay increase is eroded somewhat due to higher employee pension contributions.

13.2. None of the proposals in this consultation change the percentage rate of members' employee pension contributions. This consultation sets out the

principles proposed in order to correct the anomalies outlined above where certain thresholds require adjusting upwards so that some staff at AO and G7 level do not cross into a higher contribution band.

13.3. It is proposed that the upper thresholds for the 4.6% and 5.45% contribution rates are increased. The actual level of the increase is still to be determined.

13.4. In order to future proof these interim arrangements, it is proposed that all thresholds will be increased by CPI plus 2% each April.

13.5. The outcome of these proposed changes will result in significant benefits to members. It is estimated that around 90% of AOs (and analogous) will see a reduction from 5.45% to 4.6% and likewise around 66% of G7 (and analogous) will see a reduction from 7.35% to 5.45%. It should be noted that these percentages are gross and are subject to tax relief. Also, there are some staff at other grades who will benefit due to reduced working patterns. Conversely, there may be some at AO and G7 who may still cross the threshold due to being temporarily promoted from time to time or being in receipt of a significant pensionable allowance. For these reasons we are considering, in the longer term a more comprehensive review of the contributions regime. It should also be noted for completeness that the impact on the scheme yield has been assessed and these changes are affordable.

14. Pensions Forum Engagement

14.1. CSP and TUS have held preliminary discussions about member contributions and agreed that a review of the current structures was necessary. It was also suggested that the review would not consider reverting to the previous position of calculating member contributions payable on arrears at the date due rather than the date actually paid.

14.2. Informal discussions took place during August between CSP Officials and TUS at the Pensions Forum to facilitate engagement on determining the employee contribution rate structure for the NICS Pension Schemes to apply from 1 April 2019. The general principles agreed to be applied for the review are protection of the lower earners, mildly progressive contributions net of income tax and the avoidance of ‘cliff edges’ (in particular increases to contribution rates due solely to backdated pay). A further meeting took place on 2 November 2018, also attended by the GAD Scheme Actuary, during which the Pensions Forum considered the proposals and agreed to the commencement of a consultation on the employee contribution rate combined with the consultation on rectifying the cost cap breach.

15. Summary of Recommendations – Employee Contributions

15.1. Proposed Employee Contributions Final Recommendations;

1) Change the annualisation process to exclude any pensionable arrears in the calculation for determining the contribution rate payable.

2) Increase the current value of the following contribution thresholds;

   - **£21,637** to have all AO staff at the 4.6% rate; and

   - **£51,516** to have all G7 staff at the 5.45% rate.

3) Increase all thresholds by CPI plus 2% each April.

16. Equality Screening

16.1. CSP conducted an Equality Screening Exercise and the introduction of the recommendations detailed in this document and the associated legislative amendments will not differentially impact adversely on any of the Section 75 groups.

17. What Next?

17.1. CSP is required to consult with persons affected (that is, scheme members) or their representatives before changes are made to the scheme. Accordingly, Civil Service Pensions is consulting all Civil Service Trade Unions on the **five changes** recommended in this consultation document.

17.2. Following receipt of comments from TUS and any other stakeholders, CSP will respond to the consultation and progress implementation of the agreed changes by 1 April 2019.

18. Contact Details for Response

18.1. Responses can be e-mailed to:

PLCconsultations@finance-ni.gov.uk

or by post to:

Policy & Legislation Consultations
Civil Service Pensions
Waterside House
75 Duke Street
Londonderry
BT47 6FP

18.2. CSP will accept responses until **5pm on 18 January 2019.**

18.3. CSP will then publish the Department's response, which will give final details of the changes to be adopted.

18.4. CSP will consider requests to produce this document in other languages or in alternative formats – Braille, audio, large print or as a PDF document. If you require the document in these or other formats please contact us using the details above, or telephone 028 7131 9000.

18.5. CSP will then consult formally, in line with requirements on any technical amendments to the Scheme Rules / Regulations to give effect to the change(s) as announced.

19. Confidentiality of Consultations

19.1. The Freedom of Information Act 2000 gives the public a right of access to any information held by a public authority, namely the Civil Service Pensions (Northern Ireland) in the Department of Finance in this case. This includes information provided in response to a consultation. Civil Service Pensions (Northern Ireland) cannot automatically consider information supplied to it in response to a consultation to be confidential. However, it does have a responsibility to decide whether any information provided by you in response to a consultation, including information about your identity, should be made public or be treated as confidential. If you do not wish information about your identity to be made public please include an explanation in your response. However, please be aware that confidentiality cannot be guaranteed, except in very particular circumstances. Civil Service Pensions (Northern Ireland) will process your personal data in accordance with the Data Protection Act 1998, should you respond in an individual capacity. This means that your personal information will not be disclosed to third parties should you request confidentiality. You should be aware that Civil Service Pensions (Northern Ireland) will publish a synopsis of responses to the consultation.