Second Submission to the Independent Public Service Pensions Commission

December 2010

FDA's Second Submission to the Independent Public Service Pensions Commission

Executive Summary

1. Introduction

The FDA welcomes the opportunity to make a further submission to the Commission (1.2).

2. The FDA's first submission

Key Points

- pay levels at the more senior grades within the civil service have been set at lower levels than for comparable jobs in the private sector (2.2);
- the gap in pay between the civil service and the private sector represents, in part, the contribution to pensions made by FDA members. This gap has increased substantially in recent years. As a consequence, pay rates in the more senior civil service grades, are:
    - between 21.7% and 97.6% lower than for comparable jobs in the private sector and between 12.2% and 31.3% lower than for comparable jobs in the wider public sector (2.3);
- any consideration of savings and affordability in relation to the cost of civil service pension provision must be undertaken within the context of a review of all aspects of total remuneration (2.6).

Objectives

- accrued rights must be fully protected (2.7);
- any scheme must be defined benefit, and of high quality (2.7);
- pension provision must not be considered in isolation from other elements of total reward (2.7);
- any proposals for change must be subject to detailed consideration and negotiations with the relevant unions (2.7).

3. The Commission's interim report

- the FDA welcomes a number of aspects of the Commission's interim report (3.1);
- the FDA disagrees with the Commission's conclusion that there is little evidence that pay in the private sector is higher than for comparable jobs in the public sector (3.3) and its arguments against the continuation of final salary schemes (3.8);
- the FDA is seriously concerned that the Commission's conclusions in relation to final salary schemes, together with its initial observations on accrued rights suggest the possibility of the closure of final salary schemes to all public servants and their enforced transfer to alternative arrangements (3.16);
- the FDA and its members will strongly oppose any attempt to implement such an enforced transfer (3.17).

4. CSR statement

- the FDA remains strongly opposed to the prospect of increased contributions being imposed upon its members (4.7);
- the Chancellor's CSR statement raises the very real prospect that members may be faced with the prospect of higher pension contributions when their pay has been suppressed over a number of years, will be frozen for at least two years and is significantly lower than pay for comparable jobs in the wider public and private sectors (4.7);
- FDA members will resist the imposition of higher pension contributions, and this resistance will be intensified if the Government's intention is that higher pension contributions are to be followed by an enforced transfer to alternative and inferior pension arrangements (4.7);
- any proposals for increased contributions and/or other significant changes to the existing structure of pension provision can only be fairly considered as part of a wider review of total remuneration (4.8).

5. Scheme design

- FDA members retain a preference for the continuation of final-salary pension schemes. They recognise, nevertheless, that the civil service career average scheme (Nuvos) is a high-quality, defined-benefit scheme and as such one that is consistent with the union's objectives for any future pension scheme design (5.1);
- the Nuvos scheme has a number of key elements that ensure the delivery of high quality pensions. If retained and developed, these may also be attractive to some members of existing final salary schemes. These are:

Uprating

- the use of the RPI in Nuvos for uprating purposes is a key feature (5.4);
- the decision of the Government to uprate pensions in line with the CPI in future will progressively reduce the value of all public sector pensions and is strongly opposed by the FDA (5.5);
- the most significant impact of this decision will arguably fall on those who are members of the Nuvos pension scheme because it will substantially reduce the value of their accruing benefits, as well as the value of the pensions when in payment (5.7) (5.8);
- the impact of the switch to CPI on members of the Nuvos scheme is equivalent to a 25% reduction in the value of pension benefits (5.7);
- the FDA rejects the Government's rationale for switching to CPI for uprating pensions whether they are in payment, on deferment or accruing (5.11);
- the FDA believes that there is a strong argument that a mechanism linked to earnings growth across the whole economy is the most appropriate means of uprating accruing benefits in a career average scheme (5.12).

Rate of accrual

Maintaining an accrual rate of at least the current rate of 2.3% in the Nuvos scheme will be an essential element in reaching agreement on any new pension arrangements that have a career-average structure. Indeed, the FDA believes that there would be a strong case for increasing the rate of accrual above the current rate, given the significant adverse impact on Nuvos of the switch from RPI to CPI for uprating pensions outlined earlier in this submission (5.15).

Same scheme – same terms

- the FDA believes that all civil servants must continue to be eligible for membership of the same pension schemes and on the same terms (5.16) (5.17).

Procedure for change

- the decision to switch to CPI was made without consultation and has undermined the trust in the pension promise that has been made to public servants. The FDA will be seeking a clear and accountable procedure for any changes to civil servants' pensions (5.21).

6. Risk sharing

- the FDA reiterates that any discussions on identifying savings, whether through increased contributions or changes to pension benefits, cannot be in isolation from a review of total reward (6.2).

7. Adequacy

- the FDA believes that scheme members should continue to be allowed to accrue pension up to or around a level of two-thirds of final salary (7.2).

8. Employee understanding and choice

- FDA members place a great value on their pension. This is borne out when considering that in 2005, members voted in favour of a national strike in response to the Labour Government's intention to increase the pension age to 65 (8.1);
- FDA members will constructively consider proposals for change that are fair and have been subject to full negotiation (8.2).

9. Transition Issues

- the FDA does not consider that a case has been made for changing the existing pension provision and any change must be in the context of a review of the overall remuneration package (9.1);
- the FDA believes that there are a number of factors that are crucial to ensuring effective transition to any new pension arrangement (9.2);
- pensions must be recognised as a key element of the 'contract' between the Government as an employer and civil servants (9.4);
- any proposals for change must be subject to meaningful negotiations (9.3);
- pensions cannot be considered in isolation from the wider aspects of total reward (9.5);
- any new arrangements should apply to new entrants and should be subject to a "choices" exercise for existing employees, giving them a choice between remaining on current terms (salary and pension arrangements) or switching to the new arrangements on the total reward package (9.6).

Accrued Rights

- addressing the issue of accrued rights will be crucial (9.10);
- the FDA believes that the best way to deal with accrued rights would be to allow the preserved pensions of those who agree to switch to the new arrangements to be calculated on the basis of final pensionable earnings at the time of retirement (9.10).

Full Submission

1 Introduction

1.1 The FDA is the trade union and professional association dedicated to representing the interests of senior managers and professionals in public service. Our 18,000-plus members include civil service administrators, policy advisers, tax inspectors, schools inspectors, NHS managers, lawyers, economists, diplomats, senior museum staff and statisticians.

1.2 The FDA welcomes the opportunity to make a further submission to the Commission. Before proceeding to outline the FDA's response to the Commission's invitation for further evidence and views, we would like to summarise the key points from our first submission and to comment on the Commission's interim report.

2 The FDA's first submission

Key Points

2.1 Pension provision has great importance within the civil service, and is at the heart of the 'contract' between civil servants and the State.

2.2 Historically, pay levels in the more senior grades of the civil service have been set at lower levels than for comparable jobs in the private sector. Partly this reflects the value of pension provision in the total reward package.

2.3 The gap in pay between the civil service and the private sector represents, in part, the contribution to pensions made by FDA members. This gap has increased substantially in recent years. Successive governments have suppressed increases in senior civil service pay compared to the wider public sector. As a consequence, pay rates in the more senior civil service grades, are:

- between 21.7% and 97.6% lower than for comparable jobs in the private sector; and
- between 12.2% and 31.3% lower than for comparable jobs in the wider public sector.

2.4. Base pay represents a much smaller proportion of total remuneration in the private sector (between 49% and 73%) than it does in the public sector (80% to 83%).

2.5 Although pension provision may be generally inferior in the private sector, the value of other benefits more than compensates for the difference.

2.6 Any consideration of adverse changes to current pension arrangements, including savings and affordability in relation to the cost of civil service pension provision, must be undertaken within the context of a review of all aspects of total remuneration.

Objectives

2.7 The FDA believes that good quality pension arrangements should be available to all workers, whether in the public or private sector. The following key objectives should set the framework for any future change to pension provision:

- accrued rights must be fully protected;
- access to pension provision must be open to all and on equal terms;

- any scheme must be defined benefit, and of high quality;
- public sector must set a standard for the wider economy of pension provision;
- pension provision must not be considered in isolation from other elements of total reward;
- recruitment and retention needs of employers must be a key consideration;
- any proposals for caps or restrictions must have universal application and not be confined to the public sector;
- any proposals arising from this review must not prescribe a 'one size fits all' solution, but should be capable of application, as appropriate, on a scheme-specific basis;
- any proposals for change must be subject to detailed consideration and negotiations with the relevant unions within each of the different public sector pension schemes, with a view to finding solutions appropriate for each specific workforce.

3. The Commission's interim report

3.1 The FDA welcomes a number of the observations and conclusions set out in the Commission's interim report. Some of these are consistent with the objectives for the framework for any future changes identified by the FDA in our first submission. We welcome, in particular, the Commission's:
- efforts to dispel the myths about public sector pensions being "gold plated";
- rejection of the "race to the bottom" approach of those who suggest that public sector pension provision should follow the same course as the private sector;
- declaration that the public sector should continue to set a good standard as an employer, and that this includes a good standard of pension provision as a benchmark for the private sector to aim towards;
- preference for any new scheme to be defined benefit in structure, although we are concerned that this will be seriously compromised if the Commission recommends an earnings cap together with a defined-contribution top-up arrangement;
- commitment to further consider the crucial issue of the protection of accrued rights, which is extremely important to FDA members.

3.2 The FDA must, however, make clear our disagreement in relation to two of the Commission's conclusions:
- pay comparability between the public and private sectors;
- the ending of final-salary pension arrangements.

Pay comparability

3.3 The FDA does not accept the Commission's generalised conclusion that there is little evidence that pay in the private sector is higher than for comparable jobs in the public sector. This is patently not the case so far as more senior posts in the civil service are concerned. The FDA's initial submission set out clear evidence comprising data taken from salary surveys commissioned by the Cabinet Office and data used in the Government's own evidence to the Senior Salaries Review Body. This exposed the full extent of the pay gap between the more senior grades in the civil service, and the wider public and private sectors. We summarise again the evidence in this submission.

3.4 The evidence set out in our first submission has recently been confirmed by the interim report of the Hutton Review of Fair Pay in the Public Sector. That report includes a number of findings that are crucial to a fair consideration of pay and pensions in the public sector. These include:

“Comparison of average pay figures in the public and private sectors are misleading because they ignore differences in skill levels and composition of the two workforces. The myth of the overpaid public servant is just that.”

“In general pay at the top of the public sector, even allowing for the value of defined benefit pension schemes…is lower than in comparably sized listed companies and further reduces as comparator organisations grow in size. Yet many public sector organisations pose no less managerial challenge even if they are different in character than their similarly sized private sector counterparts. Nor has the growth in top pay been anything like as fast.”

“Even when paying a premium to recruit externally public sector bodies can never hope to match the pay levels on offer for the very top jobs in the private sector. Large complex public sector organisations, such as government departments whose budget may run into billions of pounds, could thus find themselves paying more to recruit externally but still failing to attract candidates with experience of jobs of comparable weight.”

“Executives with portable skills are typically able to demand high remuneration, and in the civil service there is clear evidence that external recruits do command higher salaries than internally-recruited colleagues. With a majority of external recruits coming from the private sector, this to some extent reflects the premium needed to attract such candidates (it also reflects the fact that a premium is needed to attract candidates from elsewhere in the public sector, as pay levels in the senior civil service are generally lower).”

“Across a range of sectors, median top executive pay has seen steady increases in real terms over recent years. The exception to this is the civil service where the median pay of permanent secretaries has declined in real terms between 2005 and 2009.”

3.5 Chart 2J from the Hutton fair pay review (Annex 1) shows the annual average salary growth for top management positions, and bottom of the pay spine, for selected public sector workforces between 2001 and 2008. For the purpose of this submission the reference to this chart relates only to the evidence that it provides about the suppression of pay growth for top managers in the civil service over this seven year period by comparison with other parts of the public sector.

3.6 Chart 2N from the same source (Annex 2) shows a comparison of annual pay growth across the public, private and third sectors during the same period of 2001 to 2008. Pay growth in the private sector during this period far exceeds pay growth in those parts of the public sector identified. Annex 1 shows clearly that the civil service had the lowest salary growth in the public sector. Comparing the data in both charts demonstrates that annual average pay growth in large private sector organisations was up to four times greater than for comparators in the civil service during this period. It can also be seen that pay growth at the top end of the civil service was, during this period, also lower than the growth of median earnings across the whole economy.

3.7 This suppression of pay rates is not confined to permanent secretaries and other top managers in the civil service, but has impacted on all of the more senior civil service grades in recent years. The data shows clearly that low pay rates at the top end of the civil service have, in recent years, become even less competitive in comparison to the wider public and private sectors. The findings in the interim report of the Hutton review of fair pay add considerable weight to the FDA's demand that pension provision must not be considered in isolation from other elements of total reward.

The ending of final salary pension arrangements

3.8 The Commission has concluded that "long term structural reform is needed" in public service pension schemes which cannot be achieved "through provision of traditional final salary defined benefit schemes". The FDA rejects the arguments against the continuation of final salary schemes advanced by the Commission and others, most notably the Pensions Policy Institute (PPI).

3.9 The Commission argues that final salary defined benefit pension arrangements disproportionately benefit "high earners who progress rapidly through the salary scales". This conclusion is based on analysis undertaken by PPI, which also contends that "long stayers are subsidised by short stayers" in final salary schemes.

3.10 The logic of these arguments is that final salary pension schemes unfairly reward those who:
- choose to make a career in the public service;
- are loyal and long serving;
- make the effort to develop and enhance their skills, qualifications, and professionalism;
- gain promotion during their career;
- take on additional responsibilities;
- may be awarded larger pay rises because they are high performers;
- are vital to the effective functioning of the public sector.

3.11 These descriptions apply to FDA members, who are generally long-serving committed public servants who are considered to be high earners. They may, because of long service and career development, get a proportionately greater benefit from a final-salary scheme, but so also will those not considered to be high earners, such as junior staff promoted over time into middle management roles. The Commission's focus on high earners is therefore wholly misplaced. There will be an element of cross subsidy in any pension scheme, however it is constructed. The FDA does not accept that it is somehow 'morally' wrong for long-serving staff, who may also be high earners, to derive a greater benefit from a pension scheme. Pensions are deferred pay. Longer-serving staff will have more of their career earnings deferred, inevitably leading to a higher pension. We believe that it is wholly legitimate and reasonable for pension arrangements to benefit those who are loyal, ambitious, capable and long serving. This is clearly to the mutual benefit of the scheme member and the employer.

3.12 The Commission's terms of reference require that it has regard to "the needs of public service employers in terms of recruitment and retention". Ruling out final-salary pension schemes takes no account of the vital contribution that such schemes make to the recruitment and retention of those with the requisite skills and experience to support the effective operation of the public sector.

3.13 Civil servants place a great value on their pension arrangements and consider them to be a key element of their total remuneration package. Members of the final salary schemes value, in particular, the security and certainty that is intrinsic to arrangements which promise a pension that is based on length of service and the salary in the final year, or years, before retirement.

These arrangements are easy to understand and allow members to calculate, with reasonable certainty, the pension that they are likely to draw at retirement. This in turn facilitates the ability to plan their financial affairs and to tailor these to their individual needs and requirements for security of income in retirement. The value placed on final-salary, defined-benefit pension arrangements is a key factor for FDA members in their career decisions both to join and stay within the civil service and their rejection of the potential for substantially larger pay packages in the private sector. It is clear that this element of the remuneration package has been key to the ability of the civil service to recruit and retain high quality staff.

3.14 The existing pension arrangements are a significant element of not only the formal contract of employment between civil servants and their employer, but also the psychological contract, which is the understanding of their mutual obligations towards each other. These obligations will often be informal and imprecise, but civil servants consider that their pension arrangements are intrinsic to the relationship with the employer, and are both a ‘promise’ and an ‘expectation’. Any significant adverse changes to those arrangements will shatter that contract to the detriment of both the individual and to the effective operation of the civil service.

3.15 The FDA argues that there is a strong case for the retention of final-salary pension arrangements. We do not consider it appropriate for the Commission to make recommendations that may result in an alternative structure of pension provision being imposed on all public sector schemes. Establishing the appropriate structure of pension provision must remain a matter for determination at scheme level and through the relevant negotiation process.

3.16 The FDA is seriously concerned that the Commission’s conclusions in relation to final salary schemes, together with its initial observations on accrued rights that “it should be possible to make changes to pension schemes for existing members relating to their future service”, suggest the possibility of the closure of final-salary schemes to all public servants and their enforced transfer to alternative arrangements.

3.17 The FDA and its members will strongly oppose any attempt to implement such an enforced transfer. Those who are members of any civil service pension scheme, but especially those with final salary pension arrangements, will regard any adverse changes to their pension arrangements, particularly an enforced transfer, as being a fundamental breach of the basis on which they joined the civil service.

3.18 In 2005, FDA members voted to take industrial action in response to proposals for changes to their pension arrangements that amounted to an arbitrary reduction in their core remuneration. Any similar attempt to impose changes that are detrimental to the total pay and benefits package of the union’s members is likely to provoke a similar response. It is essential therefore that the Commission’s recommendations do not set parameters that will restrict the ability of the FDA to negotiate pension arrangements that are both appropriate and acceptable to our members.

3.19 The FDA is prepared to negotiate alternative pension arrangements. We will seek to build upon the existing civil service career-average scheme (Nuvos), as part of the development of a “new deal” on total reward. We will return to this later in this submission when setting out the FDA’s approach to future scheme design. Fundamental to our approach would be that members have the opportunity to transfer to any new arrangements on a voluntary basis and not on the basis of an enforced transfer.

3.20 It is essential that the Commission's recommendations do not set parameters that restrict the ability of the FDA to negotiate pension arrangements that are both appropriate and acceptable to our members.

4. CSR statement

4.1 The Commission's terms of reference invited it to "consider the case for delivering savings on public service pensions within the spending review period". The conclusion reached by the Commission is that there is "a strong case for looking at some increase in pension contributions for public service employees". Whilst acknowledging that "it is a matter for the Government to decide the manner and level of any increases in contributions necessary", the Commission proposed that the Government should consider "staging any increases in contributions especially in the context of the current pay freeze" and suggested that "there may be a case for targeting contribution increases at high earners or to introduce tiered contribution levels".

4.2 The Chancellor of the Exchequer responded to the recommendations in the Commission's interim report in the Comprehensive Spending Review statement on 20 October. The Chancellor accepted the conclusions of the interim report, including the rationale provided by the Commission for public servants to make greater contributions. The Chancellor stated that the Government would await the Commission's final recommendations before determining "the precise level of progressive contribution required". The Chancellor, nevertheless, set out the Government's intention to "implement progressive changes to the level of employee contributions that lead to an additional saving of £1.8 billion a year by 2014-15, equivalent to three percentage points on average to be phased in from April 2012".

4.3 This £1.8 billion is additional to the £1.0 billion savings the previous government had estimated would flow to the Treasury from the "cap and share" cost sharing mechanisms introduced into the main public sector schemes.

4.4 The detail on exactly how savings of this magnitude are to be achieved will be set out in the Chancellor's 2011 budget statement. At this stage it is difficult to see how the civil service scheme will achieve its contribution to this level of savings without either:

- compromising the Government's commitment to protect those on low incomes; or
- imposing substantial increases to the pension contributions paid by those earning in excess of the civil service median salary of £22,850 per annum.

Neither of these possibilities is reasonable or acceptable.

4.5 The earnings profile of those employed within the civil service shows the inevitability of one of these possibilities. Civil Service Statistics 2010 published by the Office for National Statistics on 19 November 2010 sets out data on the full-time equivalent earnings for civil servants, showing that:

- 25% of civil servants earn less than £17,780 per annum - (lower quartile);
- 50% of civil servants earn less than £22,850 per annum - (median);
- 25% of civil servants earn between £22,850 and £29,080 per annum; and
- 25% of civil servants earn more than £29,080 per annum (upper quartile).

4.6 This data suggests a significant risk of increased levels of opt outs from the civil service pension schemes if those on low incomes are required to pay increased pension contributions. It also suggests increased attrition rates at middle and senior levels, if substantial increases to contributions result in highly skilled and qualified employees re-evaluating the value of their total reward package in comparison to the alternatives available in the private sector.

4.7 The FDA is strongly opposed to the prospect of increased contributions being imposed upon members. In common with all public servants, FDA members are making a considerable contribution to the Government's deficit reduction program not least because their pay has been frozen for at least two years. The Chancellor's CSR statement raises the very real prospect that they may be faced with the prospect of higher pension contributions when their pay has been suppressed over a number of years, will be frozen for at least two years and is significantly lower than pay for comparable jobs in the wider public and private sectors. FDA members will resist the imposition of higher pension contributions. This resistance will be intensified if the Government's intention is that higher pension contributions are to be followed by an enforced transfer to alternative and inferior pension arrangements.

4.8 The FDA's initial submission to the Commission highlighted a substantial shortfall in the base pay and total remuneration of those in the civil service grades represented by the FDA, in comparison with comparable jobs in both the wider public and the private sectors. We made clear that any proposal for increased contributions and/or other significant changes to the existing structure of pension provision could only be fairly considered as part of a wider review of total remuneration.

4.9 Until we have had an opportunity to consider both the detailed recommendations that will arise from the Commission's final report and any detailed analysis of total reward that may be produced, it would be wholly unacceptable for the Government to seek to impose increased contributions on our members.

5. Scheme design

5.1 The Commission has set out a number of possibilities for future scheme design and is inviting responses on the appropriate design for public service pensions. The Commission's interim report clearly rules out final salary arrangements as being an appropriate option for future public sector pension provision and signposts a preference for alternatives such as career-average, defined-benefit and/or some form of collective defined contribution arrangement. FDA members' clear preference, as stated previously, is that final-salary pension arrangements should continue. They recognise, nevertheless, that the civil service career average scheme (Nuvos) is a high-quality, defined-benefit scheme and as such one that is consistent with the union's objectives for any future pension scheme design.

5.2 The Nuvos scheme is the most significant career average scheme in the public sector with around 75,000 civil servants in active membership. The scheme came into existence in 2007 with the agreement with the Council of Civil Service Unions - the umbrella body for all civil service unions - and following extensive negotiations. The scheme is a radical departure from the traditional civil service structure for pension arrangements. But Nuvos maintains the civil service tradition of high quality defined benefit pension arrangements.

5.3 The scheme has a number of key elements that ensure the delivery of high quality pensions. If retained and developed, these may also be attractive to some members of existing final-salary schemes. These elements are also essential in constructing pension arrangements that, as a key part of a "new deal" on total reward, will underpin the recruitment and retention of those with the requisite skills and experience to ensure the effective operation of central government services. The key elements are:

- the provisions for uprating;
- the rate of accrual;
- access to the same scheme on the same terms.

Uprating

5.4 A key part of the agreement which led to the introduction of Nuvos was the establishment of a mechanism for uprating benefits. Determining the most appropriate means for uprating benefits, both accruing and in payment, was a major consideration in the negotiations on Nuvos. Negotiations focused on uprating in line with earnings growth or increases in the level of prices. The agreement provides for all benefits to be uprated in line with prices and specifically to increases in the level of the Retail Prices Index (RPI). The Retail Prices Index has subsequently been used to uprate all pensions, whether they are accruing in deferment or in payment.

5.5 This agreement has, of course, been broken by the Government's decision to uprate all public sector pensions in future in line with the Consumer Prices Index (CPI). This decision will progressively reduce the value of all public sector pensions and is strongly opposed by the FDA. The most significant impact of this decision will fall on those who are members of the Nuvos pension scheme because it will substantially reduce the value of their accruing benefits as well as the value of the pensions when in payment.

5.6 Pensions Policy Institute (PPI) research, quoted in the Commission's interim report, demonstrates this. The most recent report from PPI (The Future of the Public Sector Pensions - November 2010) estimates that the impact of the change to CPI has, on average, reduced the value of the pension benefit from 20% of salary to 17% of salary for those who have joined the four main public sector pension schemes since the implementation of the Labour Government's reforms in 2007-08.This is equivalent to a 15% reduction in the overall value of pension benefits.

5.7 The PPI analysis shows, however, that the impact of the switch to CPI on members of the Nuvos scheme is greater than this. PPI estimate that the value of Nuvos benefits has declined from 20% of salary to just 15% of salary as a consequence of the switch to CPI. This is equivalent to a 25% reduction in the overall value of pension benefits.

5.8 The fact that members of Nuvos, a career-average scheme, are more adversely affected by the switch to CPI is not unexpected. The FDA does, however, expect the impact to be greater than the 2 to 3% difference estimated by PPI in comparison with other public sector final salary schemes. This is because the switch to CPI has an immediate impact predominately on those members of final-salary schemes whose pensions are either in deferment or in payment. For those who continue to accrue benefits in a final-salary scheme, the impact of the switch to CPI starts to bite only at retirement when an individual scheme member starts to draw their pension. This is not the case in a career-average scheme, where accruing benefits are uprated each year in line with prices. Those who are accruing benefits in a career-average scheme are therefore adversely affected earlier and to a much greater extent by the switch to CPI than those who are accruing benefits in a final salary scheme.

5.9 The FDA believes that the Government's decision to switch to CPI has seriously undermined the case for a career average structure to any future pension arrangement. We urge the Commission to instigate some further research on the impact of the switch to CPI on the Nuvos scheme if, as appears likely, it intends to recommend that career average is the most appropriate structure for public sector pension schemes in future.

Flawed rationale

5.10 The FDA has made clear that the union is strongly opposed to the switch to CPI. We believe that the rationale given by the Government for this switch is seriously flawed. In a statement made on 8 July 2010, Steve Webb, the Minister of State for Pensions, said: "The Government believes the CPI provides a more appropriate measure of pension recipients' inflation experiences."

5.11 The FDA rejects the Government's rationale for switching to CPI for uprating public sector pensions whether they are in payment, in deferment or accruing. The Government's rationale justifies CPI solely in terms of what is the most appropriate index to use for public sector pensions in payment. It does not consider what may be appropriate in other circumstances e.g. for uprating accruing benefits in a career-average scheme.

5.12 The FDA believes that there is a strong argument that a mechanism linked to earnings growth across the whole economy is the most appropriate means of uprating accruing benefits in a career-average scheme. In a final salary scheme a pension is generally determined by the peak level of earnings at or close to the end of a career. If an individual's own ultimate earnings are no longer to be the key determinant of their pension in retirement, then ensuring that an accruing pension is staying in line with earnings growth across the economy over many years is the fairest means. Earnings growth is also a better measure of the general state of the economy and linking public sector pensions to their growth would allow them to grow in line with increasing prosperity in good times and be restrained in periods of depression/recession thus ensuring that they remain affordable to taxpayers.

Rate of accrual

5.13 The rate of accrual in the Nuvos scheme is 2.3%. This means that each year a Nuvos pension will build up by an amount equivalent to 2.3% of salary. This amount is uprated, in subsequent years, in line with the general level of increase in prices (we return to this in the next section). Over the period of scheme membership, the build up of each year's pension becomes the final pension that is paid upon retirement. The rate at which the pension builds up each year, and thus the rate of accrual, is crucial to the delivery of a reasonable pension in retirement.

5.14 The Commission has remarked that the rate of accrual in Nuvos compares "favorably" with many other career average schemes, although no evidence is provided to support this assertion. Superficially, the Nuvos 2.3% accrual rate does compare with accrual rates of 1.25% (1/80th) or 1.66% (1/60th) in a typical final-salary scheme. However the accrual rate in a final-salary scheme works together with a salary level at retirement (when traditionally in the civil service, and indeed many other sectors of the economy, career earnings are at a peak) to determine the level of a pension. This is not the case in a career-average scheme and it is therefore appropriate, and fair, that the rate of accrual is higher in these schemes in order to provide some degree of balance against the fact that the peak level of salary is not used to determine a pension.

5.15 Maintaining an accrual rate of at least the current rate of 2.3% in the Nuvos scheme will be an essential element in reaching agreement on any new pension arrangements that have a career average structure. Indeed the FDA believes that there would be a strong case for increasing the rate of accrual above the current rate, given the significant adverse impact on Nuvos of the switch from RPI to CPI for uprating pensions outlined earlier in this submission.

Same scheme - same terms

5.16 The FDA's first submission to the Commission highlighted the fact that all civil servants from the head of the civil service to the lowest civil servant are covered by the same pension arrangements. Currently, the only determinant on which scheme a civil servant will be a member of is their date of entry. There are, in other words, no special pension arrangements for Senior Civil Servants. This is in stark contrast to the position in parts of the private sector where pension provision for senior managers can be substantially more generous than for other employees.

5.17 The FDA believes that all civil servants must continue to be eligible for membership of the same pension schemes and on the same terms. This is the basis on which the Nuvos scheme operates. Any limits on pension accrual must apply equally to all civil and public servants regardless of their level of earnings. The Nuvos scheme does not operate an earnings cap but incorporates a restriction on the accrual of pension benefits over a career which is set at 75% of the highest scheme earnings. The FDA believes that allowing all staff to participate on equal terms is an essential element of any future scheme, whether the structure is to be on a career-average basis or otherwise.

5.18 The FDA, therefore, rejects the concept of hybridity as a possible way forward for public sector pensions. A hybrid scheme would, we understand, operate on the basis that an earnings cap would restrict participation in a future defined-benefit (and most likely) career-average pension arrangement. Scheme members would be eligible to participate in any future scheme up to the level of an earnings cap. A top-up scheme would allow those with earnings in excess of the prescribed earnings cap to build up additional pension, but in a scheme that is not defined benefit.

5.19 This concept appears to reverse the position in some parts of the private sector where directors have abandoned decent pension provision for their employees whilst retaining, and in some cases improving, their own high-quality, defined-benefit pension provision. The TUC Pensions Watch Survey 2010 highlights this disparity of pension provision in the private sector and makes the point that "different arrangements for directors and employees risk undermining good workplace relations". The TUC is calling for "directors and employees to be members of the same pension schemes on the same terms". The FDA strongly endorses this call, which is consistent with a rejection of the concept of hybridity for future pension arrangements in the public sector. It is vital that the public sector gives a lead on this and applying differential treatment to its own employees based on income level would be inconsistent with that objective.

5.20 Moreover, we believe that the Government could significantly improve the prospects of restoring decent pension provision in the private sector by granting tax exemptions and reliefs only to those schemes that allow all employees to participate on the same terms. This would replicate the current requirement for HMRC approval of share incentive plans and Save as You Earn share option schemes.

Procedure for change

5.21 The decision to switch to CPI was made without consultation. It was made without any commitment that the savings that it would generate would either be shared with scheme members or taken into account when the Government develops proposals for further changes following receipt of the Commission's final report. A significant impact of the Government's decision to switch to CPI has been the extent to which it undermines not only the value of pensions but also trust in the pension promise made to public servants. Pensions are deferred pay and a long-term commitment. Individuals want some certainty around their pension arrangements to allow them to plan for their future. The fact that a key element in that equation can be changed at a stroke by order of a Minister, without even the debate attendant upon primary legislation, does not inspire confidence that any arrangement put in place for the future will be sustainable and not subject to fundamental change by further Ministerial diktat. It is now clearly evident that civil and public servants will, because of the way this major detrimental change has been effected by the Government, require more than just firm assurances that the key elements of any new scheme are sustainable. The FDA will be seeking a clear and accountable procedure for any changes to civil servants' pensions.

6. Risk sharing

6.1 The previous government introduced a risk-sharing process for the main public sector schemes. The 'cap and share' approach set clear parameters in relation to costs that should be shared, for example those generated by longevity, and those that would continue to be the responsibility of the Government, such as any changes to financial assumptions including a change in the discount rate. The process also set a limit on the level of employer contributions and introduced governance arrangements to facilitate an enhanced employee involvement in scheme management and decision-making on contribution levels and benefit structures. Work on how the increased costs being faced by civil service pensions should be shared commenced earlier this year, but has now been suspended pending the outcome of the Commission's final report and the review of the discount rate currently being undertaken by the Treasury. It would appear that as a consequence, cost sharing in its current form is effectively dead. Yet the Government is, nevertheless, still seeking to realise the savings that the previous Government had estimated would be delivered by the cost sharing process it had established. It is unclear at this stage what involvement scheme members and their unions will have in determining exactly how those savings should be achieved.

6.2 The FDA reiterates that any discussions on identifying savings, whether through increased contributions or changes to pension benefits, cannot be in isolation from a review of total reward. Changes to the pensions package and agreement on a new risk sharing framework might be possible as part of a "new deal" on total reward. Salary levels and all other aspects of total reward could be set by reference to comparability with both the wider public and private sectors. Central to this might be a determination of the value to be placed on pension arrangements within the package and appropriate flexibility for individuals to be able to enhance their pension benefits to meet individual need or personal choice.

6.3 The FDA recognises, as stated earlier, that the Commission is likely to recommend a switch from a final salary to career average structure for future pension arrangements in the public sector. The recent PPI report explains that career average schemes reduce the risk to employers of having to pay a pension based on a high final salary but receiving contributions on a lower current salary. We have explained earlier that a career average scheme based on the key elements of the Nuvos scheme could prove to be attractive to those who are currently members of final-salary schemes and could provide a basis for establishing a new risk-sharing approach. But the way forward must be on the basis of negotiation and agreement, not imposition.

7. Adequacy

7.1 The current civil service pension arrangements allow scheme members to accrue a pension equivalent to 75% of highest scheme/final earnings. To reach this level, members of the final salary schemes would be required to attain 45 years' service. Very few civil servants achieve this level of service and the limit is, in general, notional. Civil servants in the more senior grades have a clear sense of the adequacy, or otherwise, of their prospective pension and many choose to enter into contracts to buy added years or added pension in order to top up their pension to a level that will provide an adequate pension for retirement.

7.2 A consistent benchmark of where that level may be has been around two-thirds of final salary. The FDA believes that scheme members should continue to be allowed to accrue pension up to or around a level of two-thirds of final salary. We recognise, however, that this is a higher replacement rate than considered to be necessary by others including the Turner Pensions Commission. The benchmark replacement rates established by the Turner Commission as a "reasonable judgement to guide assessment of adequacy" have been uprated in the recent PPI report. These suggest that an appropriate replacement rate for those with earnings in the range of £30,000 to £60,000 is 60% and for those with earnings in excess of £60,000 is 50%. The FDA considers a range from 50% to 66 2/3% as defining the appropriate boundaries of acceptability for the union's members.

7.3 The key is to ensure that the structure of any future pension arrangements make it possible for FDA members to achieve a replacement rate that is, and they consider to be, of an appropriate level.

7.4 Analysis undertaken by the PPI shows the possible replacement rates for high earners after working for 40 years under various alternative pension scheme arrangements. This analysis shows that a high earner would achieve a replacement rate of:

- 55% in a final salary scheme with accrual rate of 60ths;
- 43% in a final salary scheme with an accrual rate of 80ths;
- 47% in a career average scheme with no earnings cap;
- 39% in a career average scheme with an earnings cap of £37,000 and a top up defined contribution arrangement (hybrid scheme); and
- 31% in a defined contribution scheme with funds increasing in line with national average earnings.

7.5 This analysis confirms both that a career-average scheme based on the key elements of Nuvos may provide a reasonable alternative to current final-salary schemes, and that a hybrid scheme with an earnings cap set as low as £37,000 would not.

8. Employee understanding and choice

8.1 FDA members place a great value on their pension. A recent survey of FDA members found that more than four in five consider pensions to be one of the most important issues confronting the union. This was the highest percentage response in relation to a question on challenges and priorities for the union. This response was not unexpected when you consider that in 2005 FDA members voted in favour of strike action in response to the Labour Government's intention to make detrimental changes to pensions.

8.2 The Commission's interim report refers to a recent survey of public sector workers which found that 21% had chosen employment in the public sector specifically for the pension and 32% said they would consider a move to the private sector if their current benefits were reduced. The feedback that the FDA receives from members on this issue suggests far greater depth of feeling on this issue. FDA members do not seek changes in relation to pensions. However, we believe that our members will be prepared to consider proposals as a result of a full and fair negotiation process. We outline elsewhere in this report the key issues that will need to be among those addressed in negotiations over any changes to pension arrangements.

8.3 We have no evidence about the value and understanding of more junior staff of the pension arrangements, but have no reason to doubt that many feel at least as strongly as do our members in the more senior grades of the civil service. Moreover, our experience is that relatively young civil servants in the grades that we represent have a keen understanding of the importance of adequate pension arrangements and feel no less strongly than older members.

9. Transition issues

9.1 The FDA considers that a case has not been made for changing the current pension arrangements. Any change must be in the context of a review of the overall remuneration package for senior public servants, in particular in the civil service where pay has been suppressed by successive governments.

9.2 In the event that a case for changing the current pension arrangements can be made, the FDA believes that there are a number of factors which would be crucial in ensuring effective transition to any new pension arrangements.

9.3 Firstly, as with all proposals for pension change, any transitional arrangements must be the result of meaningful negotiations with the relevant trade unions.

9.4 Secondly, pensions are a key element of the contract between the Government, as employer, and civil servants. Any changes to long-standing arrangements must be carefully considered and only implemented after full account has been taken of the impact on those who will be affected by change. This means that a realistic timetable needs to be set for any change, which must be phased in in a manner that allows individuals an effective opportunity to revise their plans in good time, avoiding 'cliff edges', and does not damage those near to retirement.

9.5 Thirdly, the FDA believes that pensions cannot be considered in isolation from the wider aspects of total reward. We have presented evidence to show that the pay of those in the more senior grades of the civil service has fallen substantially behind pay levels for comparable jobs in the wider public and private sectors. The Commission has survey evidence that individuals join the public sector because of the pension provision and will look elsewhere if their pension arrangements are changed. Any new pension arrangements must form part of a "new deal" on total reward.

9.6 Fourthly, assuming that agreement can be reached to establish a “new deal” on total reward, this could be implemented immediately for all new entrants. For current employees a “choices” exercise must be undertaken with the option of remaining on current terms (salary and pension arrangements) or switching to the “new deal” on total reward. The protection of accrued rights will be a crucial factor in determining the choice that individuals will make.

Accrued rights

9.7 The interim report sets out the Commission’s intention to consider “the extent of accrued rights, their protection and the implications for future pension terms”. It also sets out the Commission’s current understanding of accrued rights: “Pension awards already made would not be changed and neither would the years of pensionable service built up so far, based on a particular pension age, that have been accrued by those still building up pension rights.”

9.8 If we assume that this is an accurate and acceptable description of what constitutes accrued rights, then it means that those opting to switch to a new “total reward” package would have their accrued pension preserved in their current scheme for payment at their current normal pension age, for example age 60. A crucial factor for those making a decision on whether to switch will be how that preserved pension will be uprated between the date of a switch and when they come to draw that pension.

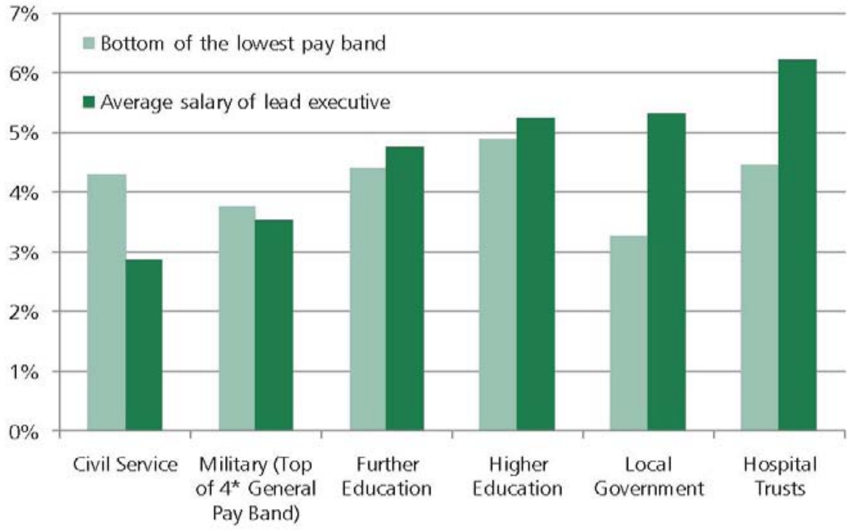
9.9 The recent PPI report shows how leaving a final salary scheme early reduces the value of future pension benefits (Chart 10 on page 43). This is because on leaving service the salary link is broken. The pension accrued is preserved on the basis of the salary at, and service to, the date of departure. The preserved pension is then uprated in line with increases in the level of prices (previously RPI now CPI) until normal pension age. The PPI analysis shows the significant impact on a pension of breaking the link with earnings growth and leaving an accrued pension to be uprated in line with CPI.

9.10 Addressing this issue will be crucial. The FDA believes that the best way to resolve this would be to allow the preserved pensions of those who agree to switch to be calculated on the basis of final pensionable salary, that is, the salary at the time of retirement, as defined in the current scheme rules.

Annex 1

Chart 2.J: Average annual salary growth for top management positions and bottom of pay spine for selected workforces between 2001 and 2008

In the NHS, local government and further and higher education, top salaries have been growing at faster rates than entry level salaries



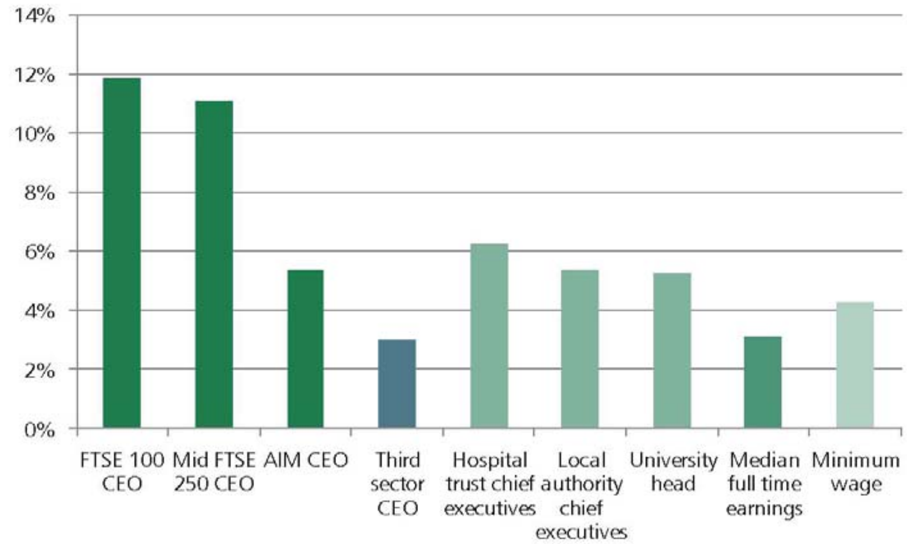
Source: Fair Pay Review analysis of various sources, see notes to Chart 2.I.

Average annual growth rates for Further Education are for 2003-2008.

Annex 2

Chart 2.N: Average annual pay growth across public, private and third sectors with comparators, 2001 – 2008

CEOs of FTSE 100 and FTSE 250 companies have experienced the fastest growth in pay but managers in both the public and private sectors have grown faster than median earners



Source: Fair Pay Review analysis of various sources, see Chart 2.I. Median earnings from ASHE. National Minimum Wage from Low Pay Commission website.

Third sector chief executive pay growth rate is for 2003 to 2009