

eNews from GAD

Actuarial analysis from the public sector

Issue 20, July 2015



Welcome to eNews – GAD's regular newsletter. The relative levels of public and private sector pay are an important consideration for government because of the implications for recruitment and retention of the best staff. Take-home pay is arguably a more important consideration than gross pay for individual employees and some of the factors affecting only the former can have an impact on this comparison. In this issue, Sue Vivian explores why workplace pensions are one such factor, looks at the implications of public service pension reform for take home pay distribution, and the questions that employers may wish to consider.

Paul Nixon sets out GAD's new five year strategic plan. Our mission is to support effective decision-making and robust reporting within government as the first choice provider of actuarial and specialist analysis, advice and assurance. The new GAD strategy sets out an ambitious programme of change and our values which underpin our plan.

I hope that you enjoy this issue; previous issues of eNews are available on our website www.gov.uk/gad.



MARTIN CLARKE, GOVERNMENT ACTUARY

NEWS FROM GAD

GAD Report and Accounts

The GAD 2014/15 Annual Report and Accounts have now been published on our [website](#). Details of GAD strategy to 2020 are included as well as the financial statements.

GAD actuary President-elect of UK profession

The Institute and Faculty of Actuaries (IFoA) has announced that Colin Wilson, Deputy Government Actuary, has been elected as the next President-elect of the IFoA.

DEVELOPMENTS

OBR: Fiscal sustainability report

The OBR's [Fiscal Sustainability Report](#) considers the sustainability of the UK's public finances over the long-term, finding that public finances are likely to come under pressure over the longer term, primarily as a result of an ageing population. OBR's [Welfare Trends report](#) is published in relation to its role in respect of the cap on certain welfare payments. The [Economic and Fiscal Outlook](#), published alongside the Summer Budget, sets out forecasts for the economic and public finances. A HM Treasury [review](#) will report in the summer, focusing on the OBR's role in enhancing fiscal credibility.

TPR: Defined benefit scheme funding

The Pensions Regulator has [published](#) its 2015 [Annual Funding Statement](#), setting out key messages for trustees and employers relating to the funding of Defined Benefit pension schemes. Supporting analysis and evidence is also [available](#). TPR has also published [scheme funding statistics](#), analysing over 1,800 valuations and recovery plans of UK DB and hybrid schemes.

Firefighters' commutation factors

The Pensions Ombudsman [published](#) his [determination](#) in a case concerning the lump sum paid to a firefighter on his retirement. The case will have relevance to many firefighters and police officers who retired in the early 2000s. See GAD's [Technical Bulletin](#) for an overview of the case and its implications and a recent [update](#) on facilitating redress.

Summer Budget 2015

Following new [ministerial appointments](#) after the General Election and the [Queen's Speech](#) outlining the government's legislative plans for the next parliamentary year, the Chancellor of the Exchequer presented his [Summer Budget](#) on 8 July. GAD's [Technical Bulletin](#) focuses on two significant pensions taxation announcements, with the introduction of a tapered Annual Allowance for high earners and a consultation on reforming pensions tax relief.

REFLECTIONS ON PUBLIC SERVICE PAY AND PENSIONS

Differentials between public and private sector pay are often commented on. The October 2014 report by the [Institute for Fiscal Studies](#) noted that in raw terms pay levels in the public sector remain higher than those in the private sector, with the differential being close to that at the start of the financial crisis despite recent pay restraint policy. The IFS report suggests that part of the reason for the continuing gap between public and private sector pay is timing, and if OBR forecasts over the coming four years are borne out then the position will reverse resulting in public sector pay lagging private sector pay to an extent last seen in the late 1990s when some parts of the public service experienced recruitment and retention difficulties. Actually the situation is more nuanced.



Sue Vivian

The differential in public and private sector pay is markedly different by education level, particularly for men, being most marked for low-educated men and negative for highly educated men. Recent government policy has reinforced the compression of the distribution of public sector pay with the lowest paid being protected from the effects of the pay restraint policy.

Most commentaries on pay differentials concentrate on gross pay. What is less commonly discussed is the impact of government policies on take-home pay and how that affects the changing differentials across different categories of worker over time.

For a fixed-cost envelope the winners in a move from final salary pension benefits to career average benefits are those with limited career progression, at the expense of those with substantial career progression. These categories tend to align to overall pay levels.

These scheme changes act to further compress the distribution of public sector pay, both through the contribution tiers and the redistributive nature of the benefit reforms via the move to career average provision.

‘Scheme changes act to further compress the distribution of public sector pay.’



Interaction with taxation changes

Further, over the last Parliament very significant changes have been made to the income tax system, increasing the amount which may be earned before any income tax is payable, reducing the threshold for higher rate tax and incrementally reducing (to nil) the personal allowance for those with earnings in excess of £100,000. This was on top of the changes made to ‘pensions’ tax which has significantly increased the scope of individuals potentially subject to a tax charge owing to their pension scheme membership.

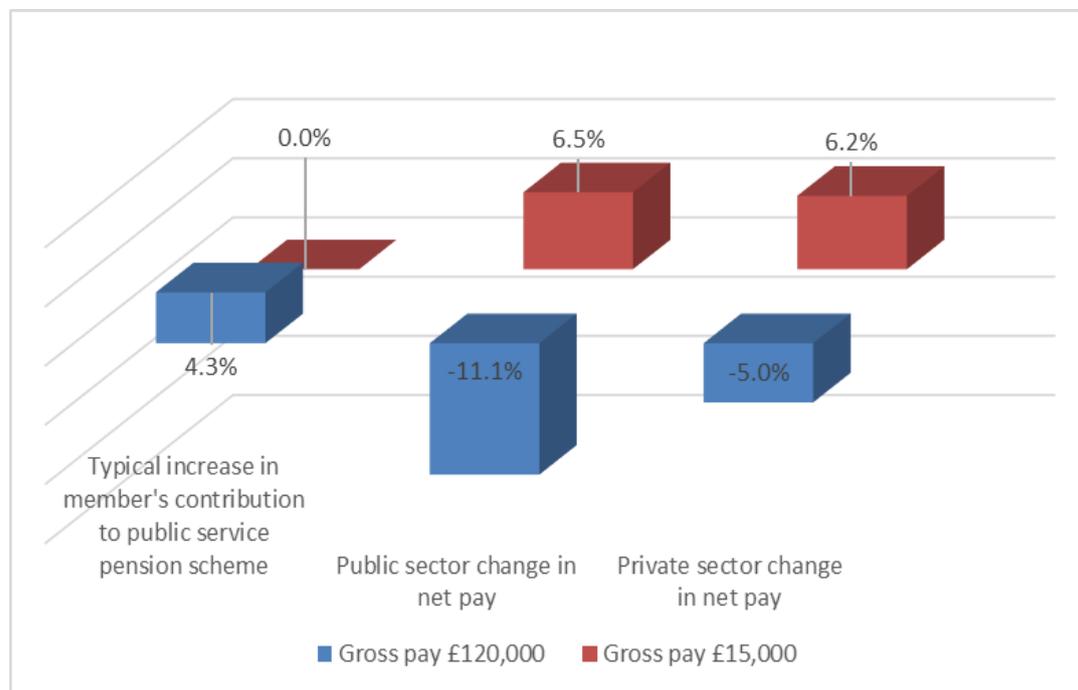
Overall, the effect of both the increases in member contributions and the tax changes has acted to the relative benefit in net terms for lower paid public servants with typically the opposite effect for the better paid. Although the tax changes will have had a similar redistributive effect for workers in the private sector the pension scheme changes are very much a public sector issue.

The effect of public service pension reforms

Many readers will be familiar with the recent reforms to the public service schemes which followed the [recommendations of the Independent Public Service Pensions Commission](#) chaired by Lord Hutton. The reforms follow a three-year period of implementation of increases to member contribution for almost all the schemes. These increases were implemented in a manner intended to minimise opt outs from the schemes, specifically protecting low-paid workers from material increases with most schemes adopting tiered rates of contribution dependent on member’s pay.

REFLECTIONS ON PUBLIC SERVICE PAY AND PENSIONS (continued)

Figure 1: The relative impact of pension scheme contribution increases



The chart above illustrates the relative impact of the increase in pension scheme contributions and the changes in income tax - for example, high and low earners. For comparison, the impact of just the tax changes is shown to provide a comparison of how public and private sector workers have typically been affected.

‘What is less predictable is the behavioural impact [which] will have a direct read-across to employment costs.’

Whilst the theoretical impacts on take-home pay can be demonstrated, what is less predictable is the behavioural impact of the policies - how these feed into workforce costs and, in the longer term, affect wealth distribution across the population. Any behavioural effects resulting from public service pension reforms will have a direct read-across to employment costs, given the substantial rate of employer contribution to these schemes. Members do not always make ‘financially rational’ decisions and commonly underestimate the value of the employer contribution. Whilst member opt outs may have short-term advantages at an employer and possibly service level (savings in employer contributions may be recycled to provide more staff), this will not necessarily align with government intentions on pension provision for the public sector.

What questions need to be considered?

Public sector employers may wish to investigate the following areas when considering the implications of these issues:

- How government policies have affected different sectors of their workforce. Is this in line with the intention when the contribution rates were agreed?
- Looking forward, how do the government’s tax policies interact with the scheme sponsors’ aims?
- When considering pay and pensions strategies, what do departments and other stakeholders consider? Should these considerations be broader than just looking at headline (gross) amounts?
- How do scheme sponsors align the many facets of opt-out behaviours to best deliver to overall government policies?

If you are interested in the issues raised above and would like to discuss further, please contact your usual GAD advisor or our [enquiries team](#).

BUILDING A BETTER GAD—THE NEW GAD STRATEGIC PLAN

The new GAD Strategic Plan for the five-year period from 2015 to 2020 was published in April. This article highlights the key areas of the new strategy and values which GAD has developed to help it achieve its mission. Martin Clarke, the Government Actuary, describes the strategy as ‘an ambitious programme of change’, noting that ‘our comprehensive programme of continuous improvement will have helped us to review, redesign and refresh the way we do things to ensure we continue to offer high quality and value for money’. The full Strategic Plan document can be found on the [GAD website](#).



Paul Nixon

Mission

To support effective decision-making and robust reporting within government as the first choice provider of actuarial and specialist analysis, advice and assurance.

2020 vision

We aim to ensure that GAD becomes a single, high-performing team that:

- is recognised throughout government as a high quality source of innovative thinking and specialist advice across many sectors
- has substantially enhanced its reputation for efficiency and value for money
- achieves high levels of consistency and standardisation in its operations and business processes
- is widely recognised for its development of analytical, actuarial and business skills in its people.

Values

Our values are encapsulated in the word ADEPT, as set out in the diagram below.

A	D	E	P	T
Agile	Dedicated	Expert	Partnering	Trusted
through technical innovation and flexible working to meet evolving client needs	to delivering timely advice and first class and cost-effective customer service	and focused on quality of analysis to provide robust assurance on decision making	with our clients to understand their business needs and develop solutions that add value for them	to deliver a professional service with integrity

Strategic themes

GAD's Strategic Plan is centred on four 'Strategic themes' – Clients, Leadership, People and Processes .

- **Clients** GAD's absolute priority is providing a high level of service to our clients by identifying their requirements and delivering them as effectively and efficiently as possible.
- **Leadership** People at all levels, across all teams, should have the opportunity to be leaders at GAD.
- **People** In order to be successful as a professional services organisation it is essential for GAD to effectively recruit, retain, manage, motivate and develop professional actuaries and those in roles supporting them.
- **Processes** GAD's operational processes should be organised in order to maximise efficiency throughout the department.

Within each theme, the full Strategy document provides more detail on our key objectives and focus in each area, exploring the relevant issues in more detail and setting out how we will seek to use our values to achieve our overall vision and mission.

What this means for you

The focus of GAD's new Strategic Plan is on continuing to provide a high level of service to meet our clients' evolving needs. In order to do this, we recognise the need to improve our structure, skills and processes to ensure that we continuously develop and improve our performance over time. Our new values are designed to underpin how we go about our work on a daily basis, from both an internal and external perspective, for the ultimate benefit of all of our clients.

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For details of our management team and office address please visit:

<https://www.gov.uk/government/organisations/government-actuaries-department#people>

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