

Report of the Special Group on Public Service Numbers and Expenditure Programmes

Pension Issues:

In summary, the Group proposes that the following bodies be amalgamated:

- The *Health Insurance Authority* and the *Pensions Board* with the *Financial Regulator*;
- The *Pensions Ombudsman* with the *Financial Services Ombudsman*;

Programme adjustments

Under the *National Pensions Reserve Fund Act 2000*, 1% of GNP (€1.7bn in 2009) is paid into the NPRF each year. The Group considers that continuation of this annual payment is not justified at a time of huge public borrowing and should be suspended. This would have no impact on the General Government Balance, but would reduce the annual Exchequer Borrowing Requirement.

Increase in retirement age to cope with pensions crisis

The Group considers that the State pension schemes now face a funding crisis. This is mirrored by similar problems in private sector schemes. The funding crisis is driven in large part by the sharp rise in longevity. Poor investment returns have also contributed to the problem. Changes in the demographic profile mean that fewer workers are supporting the payments for a growing number of pensioners.

The Group recognises that work has been carried out on the issue of the sustainability of the pension system. However, it is of the view that an increase in the retirement age for all State pension schemes will have to be considered as an element of any policy proposals to address these problems. This could, for example, involve an increase of the retirement age for *State pension (contributory and non-contributory) schemes*, to be phased in over a number of years. Moreover, the continued increases in State pension levels over the past decade (from €157.30 per week in 2000 to €230.30 per week in 2009 for the *contributory pension*), while originally intended to address perceived problems of poverty among the elderly, have taken the State pensions system beyond the point of affordability.

Public service pensions

The cost implications of public service pensions, both in the shorter and longer terms, are an area of concern to the Group. The real annual cost of providing public service pensions is some €7.7bn each year, made up of an annual accrual cost of €5.4bn each year over and above the €2.3bn cash cost of existing pensions in 2009 (on the assumption of an accruing pension cost of, on average, 30% of nominal salary).

Public servants are generally entitled to retire on a full Defined Benefit pension (calculated at half of the average annual salary over the final three years of service), after 40 years' service, together with a lump sum of up to one-and-a-half times the final salary. Employees may retire after reaching the age of 60 (the compulsory

retirement age is 65), with *pro rata* reductions for those with fewer than 40 years' service, although those retiring between the ages of 50 and 60 incur an 'actuarial reduction' to reflect the longer retirement period. (The key benefit of the recently-introduced *Incentivised Scheme for Early Retirement* is that it eliminates the actuarial reduction for this age group.) After retirement, it has been the practice to index pension rates in line with earnings, which carries a very high actuarial cost and is not generally available in the private sector.

In addition to the basic public service pension system, the Group notes the existence of a range of accelerated / 'added years' arrangements across various areas of the public service. These accelerated arrangements are more costly to the Exchequer, and their existence and budgetary implications do not appear to be widely known or appreciated by the general public. For example, Gardaí are free to retire on full pension at the age of 50 (an effective 10 years' added service on the assumption of an entry age of 20); some engineers, who might enter the public service at the age of 35, would accrue full pension entitlements at age 65 (again an effective 10 added years); teachers with 35 years service are eligible to retire from age 55 on; some hospital consultants may be entitled to up to 10 added years of service; and a High Court judge, who might typically be appointed to the bench at 50 years of age, is entitled to full pension at age 65 (an effective 25 added years). Accelerated accrual terms also apply in certain top-level public sector posts although it must be said similar pension arrangements at these levels can apply in the private sector.

Given the above arrangements, the Group observes that the annual cost of purchasing similar pension arrangements (including the earnings-linking of pension benefits) in the private sector would be very high indeed: ranging from around 27% of annual salary in the case of a typical civil servant employed prior to 2004 to 31% for a teacher entitled to retire at age 55; 33% for a hospital consultant; 48% in the case of a Garda member; and as high as 87% of annual salary in the case of a High Court judge.

The cost of providing similar benefits in a Defined Contribution arrangement, which is more generally applicable in the private sector, would be significantly higher in all cases. Partly in response to the cost pressures outlined above, the Group notes that pension terms have been revised in recent years. For public servants entering the service after April 2004, the option of retiring on full pension at age 60 has been removed, and no maximum retirement age is specified – the intention being that exit mechanisms (including performance management systems) should be applied to non-performing staff at whatever age in the future.

The Government's *Green Paper on Pensions* was published in September 2007, again with the aim of promoting adequate pension provision in a sustainable, modern and flexible manner. In this context, a range of reform options were mooted, including:

- raising the minimum public service pension age;
- increasing the rate of pension contributions from staff;
- modifying the earnings-linking of pensions;
- removal of fast accrual terms; and
- moving to the calculation of pensions on the basis of "career average" earnings.

A review of the pensions area is beyond the scope of the Group's exercise. However, the Group urges that all of the above options be pursued and implemented. It would

also add a number of other considerations and alternative / modified reform options that are appropriate in light of the dramatically worsened position of the public finances since the *Green Paper* was published:

- it seems prudent to reinstate a mandatory retirement age and not run the risk that low performing members of staff would end up being retained indefinitely;
- the ages at which people qualify for pension in both State occupational and social welfare schemes should be revised upwards, taking account of the significant recent increases in longevity;
- better transparency should be brought to bear on the true cost of accrued pensions arrangements, and accelerated arrangements should be phased out or eliminated as soon as possible; and
- there should be a move as soon as possible away from full earnings-linking of pensions to include an element of inflation-indexing, as in some other EU countries.

The Group also notes that, apart from the Defined Benefit pension model (in which all of the affordability risk is borne by the employer / the State), other models are in place across the private sector, including Defined Contribution systems (in which the scheme beneficiary bears the risk), or hybrid arrangements to allow for balanced risk-sharing.

Reforms along the lines set out above, while undoubtedly significant in terms of longer-term affordability and sustainability if applied to new entrants, will not yield any immediate savings for the public finances unless they are applied for the existing cadre of public servants and pensioners. Finally in this regard, the Group observes that the burden of budgetary adjustment, both in terms of the measures introduced over the past year and of the measures proposed in this Report, will be borne broadly across most areas of society, with the exception of those people currently in receipt of public service pensions. Bearing in mind that such pensioners in many cases have earnings linked pensions at present, the Group believes there is a case for the Government to consider how best to secure an appropriate contribution from this sector of society.