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PUBLIC SERVICE PENSIONS

I thought it would be helpful to set out the progress we have made in discussions on Lord Hutton's recommendations for reform of public service pensions, ahead of the summer recess.

2. The Government and the TUC have held a series of, what I believe have been constructive meetings to discuss public service pension reform. These discussions have covered Lord Hutton's key recommendations, and the Government's proposed contributions increase.

3. These meetings have established a basis for agreement in several areas: the importance of transparency; equality impacts; participation rates and opt-outs; scheme governance; and high level principles to inform the basis of consultations on public service pension reform at a scheme level.

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4. The meetings have also established a shared understanding of the specific circumstances of the Local Government Pension scheme.

5. The Government is committed to retaining a form of defined benefit pension in the public sector. It is clear that the certainty defined benefit pensions provide is much valued by public sector employees. The Government is also committed to protecting accrued rights: the benefits that members have earned will be protected. For those closest to retirement, there will no change in pension benefits.

6. As we discussed at our meeting on 13 July, the Government proposes that to further inform the discussions on Lord Hutton's recommendations, initial discussions on reform should be opened at a scheme by scheme level, on the basis set out below. The central process will continue alongside this, as set out below. These discussions are necessary to ensure a fuller understanding of the implications of reforms exists, before final conclusions can be reached.

7. Because of the previously agreed 'cap and share' arrangements contribution increases in some schemes were anticipated to be required in 2012. To meet the 2012-13 savings target from increased contributions announced in the Spending Review a formal consultation will shortly commence on each schemes' proposals for increases from April 2012, to secure savings of £1.2bn in that year across the unfunded schemes. These consultations will be completed by the end of October, in order to ensure implementation by April 2012. This will replace 'cap and share', which will be suspended.

8. The Government remains committed to securing in full overall savings of £2.3bn in 2013-14 and £2.8bn in 2014-15, as announced at Spending Review 2010. This means each scheme finding savings equivalent to a 3.2 percentage



point increase. How to deliver these savings in 2013-14 and 2014-15 will be considered in scheme discussions.

9. The armed forces will be exempt from any increase.
10. In considering the structure of contribution rates, the Government will ask the schemes to include protection to minimise the impact on the lowest paid.
11. DCLG will invite the Local Government Group to conduct discussions with the Local Government Trade Unions with the aim of establishing a package of measures to secure the required short-term savings, equivalent to the 3.2 percentage point contributions increase in other schemes. The package will include protection from contributions increases for the lowest paid. Other issues important to the long term sustainability of the scheme shall also be discussed. DCLG will then begin the statutory consultation exercise to implement the necessary Scheme amendments so that they can come into force on 1 April 2012.
12. It has been agreed that further discussions and further work will be carried out as follows:
 - a) Scheme by scheme discussions on short-term savings to be delivered in 2013-14 and 2014-15: as described above. These are to report by the end of October 2011.
 - b) **Cost ceilings**: The Government will set a cost ceiling to ensure that public service pensions remain affordable and sustainable. This builds on and replaces the principle of cost capping agreed under 'cap and share' in 2005. Cost ceilings will be based on Lord Hutton's proposals but will go



further and ensure that the pension individuals receive at normal pension age would be broadly as generous for low and middle income earners as it is now.

Cost ceilings will determine total contributions rates and the maximum employer contribution rates. These will be established by the Treasury, with advice from the Government Actuary's Department and after discussion with the schemes, by October 2011. The Treasury, with advice from GAD, will establish these based on consistent and transparent assumptions and valuation methodology.

- c) Risk: Cost ceilings alone cannot manage the risks that taxpayers are exposed to in defined benefit schemes. This is why Lord Hutton recommended that the normal pension age should be linked to the State Pension Age. The Government continues strongly to believe that this is the right approach to managing the rising and uncertain costs of longevity.

Schemes should consider their preferred approach to managing risks, especially longevity risk. However, since risks ultimately lie with the taxpayer, any approach will need to be agreed with the Treasury.

- d) Headline scheme terms: Scheme talks will be asked to provide initial proposals for reformed schemes in headline terms (within the cost ceiling and cost envelope) by the end of October 2011. Further work will then be needed to finalise detailed scheme design, on a timetable that enables relevant legislation to be enacted by Parliament in the 2012-13 session to allow implementation of the new schemes from 2015. Final scheme designs will require Treasury approval.



e) **Fair Deal:** The Government will respond to the formal consultation on Fair Deal in due course.

f) **Central Process:** The central process will continue alongside scheme specific discussions as required. Discussions on consistent and transparent assumptions and valuation methodology for cost ceilings should take place before cost ceilings are finalised in October 2011.

Discussions to consider headline proposals for schemes will be held prior to detailed scheme design work taking place.

There will be a further meeting to review progress at the end of September.

13. I am grateful for the constructive way discussions have been carried out. I trust that you are content to continue our discussions as proposed.

Best wishes

A handwritten signature in black ink, appearing to read "Danny Alexander".

DANNY ALEXANDER