Isle of Man public sector pensions – fact and fiction

Public sector pensions are in the spotlight again with the publication of the "Fairness and Sustainability" report and the subsequent Tynwald resolution calling on the Public Sector Pensions Authority (PSPA) to undertake an in-depth consultation.

Consultation on public sector pensions must be based on a good understanding of the actual position of the relevant schemes. Misunderstandings can lead to the wrong solutions being implemented.

For this reason, Prospect has produced this public sector pensions "myth buster" for members.

It aims to debunk the most common misconceptions. We hope you find this useful, that it helps you understand the background to the process currently underway and that it equips you with the facts so you can correct errors about the current position when you hear them in your daily lives.

MYTH #1
Public sector pensions are a 'Ponzi scheme'

Let's start with the most outrageous claim made about public sector pensions. You may have read comments online or even heard politicians describe public sector pensions as 'Ponzi schemes'.

Ponzi schemes are fraudulent schemes where later entrants typically lose their entire investment to the scheme operator and perhaps a few lucky early investors who got their money out in time.

They typically offer high returns to attract new investors – but their money is not actually invested in order to achieve real returns. It is simply paid directly to the operator and previous investors. False returns and audits are required to keep the fraud going.

Public sector pension schemes are not Ponzi schemes. The Isle of Man government is not a fraudster producing doctored accounts to trick public sector workers into handing over their money.

Membership of a public sector pension scheme comes with a job. The government's income goes on current expenditure and capital investment and is subject to careful scrutiny and forecasting.

MYTH #2
Public sector pensions are gold-plated

Public sector pensions are good pension schemes that provide a pension that allows members to enjoy a decent standard of living in retirement after a career in public service. That is what pension schemes should do. But it is important to keep the level of benefit provided in context.

According to the 2013 actuarial valuation of the PSPA schemes the average pension in payment from GUS at 31 March 2013 was £7,600. This is not a bad level of pension but is a far cry from the extreme figures that are sometimes reported in the press and can hardly be described as "gold plated".

MYTH #3
The cost of providing public sector pensions is rising

Public sector pensions on the Isle of Man are unfunded. This means that contributions paid by members do not go into a fund that is invested on their behalf in order to pay their pension when it is due, but instead are used to pay current pensioners.

Private sector schemes have to be funded because members cannot rely on their employer being around when they retire to pay their pension; the money needs to be paid up front.

We know that the government will still be around when we retire so there is a choice for public sector schemes to be funded or unfunded. There are good arguments for and against public sector pensions being funded or unfunded.

Many public sector pension schemes in the UK, such as the civil service and the NHS schemes, are unfunded; others, such as the local government schemes, are funded.

When schemes are unfunded the cost can rise significantly when the scheme matures and increasing numbers reach pension age.

It is important to realise that these increases in cost do not represent increases in the cost of providing benefits for current public sector workers. They are simply a consequence of not having put aside money in the past to pay for today's pensioners' benefits.

Every three years, actuaries calculate the actual cost of providing pensions to today's public sector workers when they carry out an actuarial valuation of the schemes.

At the last valuation, when the actuaries estimated the employer future service contribution rate, the estimated cost of providing the benefits fell by 17% between 31 March 2012 and 31 March 2013. The cost is expected to fall further in the future as savings from the introduction of GUS feed through.

MYTH #4

The current schemes should be closed and replaced by defined contribution schemes

Some politicians insist that public sector pension schemes are unaffordable. They say that in order to manage the liabilities, they should be closed immediately and replaced by defined contribution schemes.

This totally misunderstands how public sector pension schemes operate on the Isle of Man and the nature of the challenge facing us.

As noted above, contributions from current members pay the pensions of current beneficiaries in the Isle of Man's public sector pension schemes.

If the schemes were shut and public sector workers had to contribute to their own defined contribution pension pots, that money would no longer be available to help with the cost of current pensions. This would greatly increase the short-term cash flow problems the PSPA is trying to deal with.

Put simply: the Isle of Man cannot afford to close these schemes.

MYTH #5

The schemes' liabilities amount to more than £3 billion

Actually, we have cheated a bit with this myth because, on the latest estimates using a particular basis, the liabilities are in excess of £3 billion.

There are a wide range of bases that can be used for estimating a pension scheme's liabilities and the estimate would be significantly lower on other bases.

The main point about this, or any other estimate of the schemes' liabilities, is that, by itself, it tells us nothing about their sustainability or affordability.

£3 billion is an estimate of the value, in today's terms, of all the future payments to current pensioners, former public sector workers and current public sectors workers that have been built up to date.

If £3 billion had to be paid out today, then there would be an affordability problem.

But consider the youngest member of the scheme and the pension he has built up to date. He may work for another 45 years before he draws his pension and might well live for another 30 years after that. When he dies, he could well be survived by a spouse who is younger than him and lives for a further 15 years.

In other words, the estimated liabilities cover payments that are to be made over the next 90 or more years.

Put in its proper context, the £3 billion estimate does not represent such a challenge to the schemes' finances as first appears.

Myth #6

Private sector workers are being forced to work to 74 while public sector workers can retire at 55

One of the most disingenuous interventions in the Tynwald debate on public sector pension reform in July 2015 was an attempt to create a false divide between the impact of state pension reform and public sector reform. Everyone on the Isle of Man qualifies for state pension through their National Insurance contributions whether they work in the public sector or the private sector. Increases in State Pension Age will affect all equally.

Many employees have additional occupational or personal pension provision on top of what is provided through the state pension.

The current rules allow everyone to access these benefits from age 55. Again, this is the same for those in the private sector and the public sector. Any benefits accessed at such an early age will be reduced significantly to reflect the fact that they will be in payment for longer.

Of course many of the factors causing pressures on the state pension system (eg improved longevity) also impact on public sector pensions and it is in everyone's interests to ensure that both are fair and sustainable.

MYTH #7

Public sector pensions are unaffordable

What is meant by affordable? This is a key question that Prospect has been asking for many years. Affordability was one of the four overarching principles approved by Tynwald in May 2008 for developing public sector pension policy. In our submission on the proposals that emerged, we pointed out that there was no clear and consistent definition of what Tynwald meant by affordability and that this could result in problems further down the line.

No-one is more concerned about the affordability and sustainability of public sector pensions than the members of the schemes themselves. They will be relying on the schemes being able to pay their pension in retirement.

Prospect members will support proposals that ensure public sector pensions are affordable and sustainable. This is an achievable aim. Proposals must be fair and enduring and not subject to constant tinkering, revision or ideological attack.