

The background of the page is a photograph of a tree with thin, light-colored branches against a pale sky. A semi-transparent teal band runs horizontally across the middle of the image, serving as a backdrop for the chapter title.

CHAPTER 13

PUBLIC SERVICE PENSIONS

Introduction

13.1 This chapter outlines the defining features of public service¹⁴⁹ pensions and the significant reforms that have been implemented in this area since the mid-1990s. It describes relevant work being undertaken by the Public Service Benchmarking Body and the Review Body on Higher Remuneration in the Public Sector. It also considers the rising cost of public service pension arrangements, the factors driving this increase and outlines possible options for consideration to offset this cost in the longer term.

13.2 A central theme of this Green Paper is the challenge to the sustainability of our pensions system in the 21st century presented by demographic trends. Policy on public service pensions cannot be developed in isolation from these trends or from developments in relation to occupational pension coverage for workers outside the public service. In this respect particular regard must be had to social policy, generally, including the development of strategies to deal with an ageing population.

13.3 The overall cost of public service pensions is set to rise considerably in the coming decades. It is important to note that significant measures have already been put in place most notably on foot of the Government's 2004 public service reform package which followed on from the recommendations made by the Commission on Public Service Pensions. However, current indications are that a combination of factors will mean that the future cost will be greater than was anticipated by the Commission. As this rising cost forms part of the challenge to the sustainability of our pensions system, so too must options to address this cost form part of the debate on the arrangements necessary to ensure sustainability in the long term.

Public Service Pensions System

13.4 Public service pensions are an important part of the pensions landscape in Ireland, covering

some 300,000 staff and some 90,000 pensioners. Pension schemes provide benefits on retirement for staff in the Civil Service, Local Authorities, Garda Síochána, the Defence Forces, the Health and Education Sectors and in non-commercial State Bodies. Employee coverage is close to 100% across the public service, with most new recruits, including atypical and part-time workers, having access to schemes.

13.5 Public service pension schemes are mainly statutory, set up by or under Acts of the Oireachtas, and virtually all are financed on a *Pay As You Go* basis, that is, as part of current expenditure, voted in the annual estimates. Schemes, in general, comprise a main superannuation scheme and an associated contributory spouses' and children's scheme. The main scheme may be contributory or non-contributory, but for staff recruited since April 1995, is generally contributory.

13.6 As a result of the Public Service Superannuation (Miscellaneous Provisions) Act 2004, the minimum age at which pension benefits are payable to most public servants appointed from 1 April 2004 is 65 years and, for most such staff, there is no compulsory retirement age. For most staff appointed before 1 April 2004, pension benefits are generally payable from age 60, and a compulsory retirement age of 65 applies. In a few areas, where the nature of the work places special demands e.g. Gardaí, Permanent Defence Forces and firefighters, arrangements for pension payment and retirement at an earlier age are in place.

13.7 The majority of public service pension schemes have a *defined benefit / final salary structure*. This means that retirement benefits – lump sum and pension – are calculated by the application of pre defined formulae to length of service and pay (pensionable remuneration) at retirement.

13.8 Maximum superannuation benefits (achievable after 40 years' pensionable service), in general, consist of a retirement lump sum of 1½ times final pay and a pension of half final pay¹⁵⁰.

149 For the purposes of this paper the term *public service* excludes commercial state bodies.

150 Pensions for staff who pay full PRSI are integrated with the State Pension (Contributory) (see paragraph 13.16 below).

13.9 Notional added years of pensionable service are granted to certain public servants recruited in professional, technical and specialist grades. These years are intended to compensate for the inability of individuals in such positions to qualify (by pension age) for a full pension based on 40 years' service because of the essential requirements for appointment to the job e.g. specialist qualifications and/or length of required experience.

13.10 Most schemes provide members with an option to buy additional years of service, on an actuarial basis, to meet a shortfall in the maximum pensionable service of 40 years by normal retirement age. *Additional Voluntary Contribution* schemes, distinct from the main superannuation scheme (and offered by private sector providers), are available in some organisations to allow members to make extra contributions, within Revenue limits, toward additional retirement benefit.

13.11 The *Public Sector Transfer Network* enables an employee who transfers from one participating public sector employer to another to transfer the earlier service, and so be given credit in pension terms for that service, by the new employer. A similar network exists for the local government sector.

13.12 In general, there is no automatic entitlement to pension increases under the terms of public service pension schemes. A typical provision in a public service scheme would be that increases may be granted under the scheme as may be authorised from time to time by the Minister responsible, with the consent of the Minister for Finance. In the Civil Service, increases in pensions are awarded at the discretion of the Minister for Finance under Regulations made by him/her under Section 29 of the Pensions (Increase) Act 1964. The Act does not prescribe what form the increases should take or how they should be calculated.

13.13 In the Civil Service, for over 20 years, the application of the Minister's discretion in this regard has been based on 'full parity'. This followed an announcement in the 1984 Budget that, in the case of general pay increases, full parity would be implemented from 1 February

1984 onward. The Minister subsequently announced in the 1986 Budget that the Government had decided that full pension parity in relation to special increases would be introduced with effect from 1 July 1986. This commitment was made in the context of public service pay negotiations.

13.14 'Full parity' means that, where increases paid to serving staff are being passed on to pensioners, the pension increases are effective from the same date as the increases being paid to serving staff. For the most part, general increases have been passed on to pensioners on the same basis as to serving staff and in the case of special pay increases some are passed on to pensioners, others are not, depending on the nature of the increase.

Public Service Pension Reform Process

(i) Contribution by public servants towards the cost of pension benefits

13.15 Most public service occupational pension schemes are contributory. A main scheme contribution of 5% applies to a number of groups, including teachers and local authority and health service personnel. The contribution rate for spouses and children's benefits is, generally, 1.5%. Thus the combined pension contribution made by many public servants is 6.5%.

13.16 In 1995, the Government decided that established civil servants (and public servants generally) appointed on or after 6 April 1995 should be subject to the Class A rate of PRSI contribution and that their occupational and State pensions should be 'integrated'. 'Integration' means that, in effect, the public service pension awarded on retirement is reduced by the amount of the State pension. At the same time, explicit pension contributions (approximately 5%) were introduced for new members of most schemes which had formerly been non-contributory and the pay scales of these new entrants were increased, effectively to match the contributions being levied.

(ii) Reforms recommended by the Commission on Public Service Pensions

13.17 The Commission on Public Service Pensions was set up by Government in 1996, and deliberated for four years before producing its Final Report in 2000. Its membership was wide-ranging including employers, unions, academics, pension industry experts and civil servants working in the area. The Commission's terms of reference asked it to examine public service pension arrangements by reference to several criteria, including present and future Exchequer costs, claims for improvements in terms, evolving work patterns and the operational needs of the services concerned.

Pension age, retirement age and standardisation

13.18 The Commission's Final Report found that the *pay as you go/ defined benefit structure* of public service pensions should be retained. Beyond that however, it went on to recommend an extensive set of changes impacting on the cost, design and functioning of the system. The Government accepted the thrust of the Commission's recommendations in 2001, and over the period since then, has progressively implemented individual Commission recommendations. This process is ongoing, though the major changes arising have already been put in place.

13.19 The most far-reaching reform recommended by the Commission was that the pension age for the generality of new entrants to the public service should rise from 60 to 65 years. As previously noted, this major cost-saving change was implemented in 2004 with the enactment of the Public Service Superannuation (Miscellaneous Provisions) Act. That legislation also exempted new entrants from the then public service norm of compulsory retirement at age 65.

13.20 In an important change complementing the raising of pension age, the 2004 Act also provided that standard public service pension terms, including normal accrual and the revised minimum pension age of 65 years, would henceforth apply to certain groups which had enjoyed more advantageous arrangements up to that point. This '*standardisation*' affected, for example, new entrant teachers (who, if recruited prior to 2004, could retire on pension at age

55 subject to a minimum of 35 years' service) and new entrant members of the Permanent Defence Forces for whom a minimum pension age was introduced.

13.21 For some categories of public service workers (e.g. psychiatric nurses and officers in the Fire Service), '*standardisation*' meant that the doubling of service after 20 years for pension purposes (effectively allowing a full pension to be obtained after 30 years' service rather than the standard 40 years) would not apply to new entrants.

13.22 In summary the Act:-

- 1) increased by 10 years the minimum age at which pension may be paid to new entrant psychiatric nurses i.e. from 55 to 65;
- 2) increased by 10 years the minimum age at which pension may be paid to new entrant teachers i.e. from 55 (subject to 35 years' service) to 65;
- 3) introduced a minimum age of 50 at which pension may be paid to new entrants to the Permanent Defence Forces (previously pensions were linked to length of service only and could be paid to staff retiring as young as their early 30's (depending on rank and service));
- 4) increased by 5 years the minimum age at which pension may be paid to new entrants to the Garda Síochána and the Prison Service i.e. from 50 (subject to 30 years' service) to 55;
- 5) increased the compulsory retirement age for new entrants to the Garda Síochána from 57 to 60, subject to health, fitness and capability conditions;
- 6) revoked 'fast accrual' terms from new entrant psychiatric nurses and fire officers (i.e. increased by 10 years the length of service required for full pension, from 30 to 40 years);
- 7) increased by 5 years the minimum age at which pension may be paid to all other new entrants to the public service i.e. from 60 to 65;
- 8) provided that all other new entrants to the public service would not be required to retire on grounds of age.

13.23 Having legislated on pension age in early 2004, the Government announced in September of that year that, following discussions with ICTU, it had ratified an agreed approach to the remaining Commission recommendations. The key feature of the Government decision was the immediate authorisation for implementation of six key Commission recommendations which were directed at introducing flexibilities and generally modernising disparate features of pension provision. These were as follows:

- **Cost-neutral early retirement:** A facility which allows public servants to retire early (from age 50/55, as appropriate) with immediate payment of pension and lump sum, actuarially reduced to reflect the earlier payment.
- **Revised integration formula:** A new method of integrating social insurance and public service pensions to boost the retirement income of lower-paid staff.
- **Integration 'pro rata':** A more favourable integration method ('pro rata' integration as opposed to 'full' integration) applied in the calculation of pension entitlements for part-time public servants.
- **Notional added years:** Existing schemes replaced for new entrants by a single 'transitional' scheme (to be reviewed in 2015). The main impact of the change was to reduce maximum awards from 10 to 5 years.
- **Compound interest rate:** The rate on pension-related repayments, such as marriage gratuity, was reduced from 6% to 4%.
- **Reckoning of allowances for pension purposes:** Revised calculation based on 'the best three consecutive years in the ten years preceding retirement' (instead of being restricted to the last three years of service, only).

13.24 Five of these six reforms were implemented in 2005 by means of Department of Finance circulars. Only the last mentioned (reckoning of allowances) is outstanding (it has been held up by technical difficulties but is expected to be put in place shortly).

13.25 As also provided for in the September 2004 Government decision, other Commission recommendations are currently being considered further, notably:

- **Changes to Spouses' and Children's Pension Schemes** (including benefits for non-spousal partners). A management/union Working Group established to examine the feasibility of implementing the proposed changes completed its final report in July 2007. The report will be submitted to the Minister for Finance / Government in due course.
- **Introduction of SPEARS** (a single AVC-type scheme for the public service) – an agenda for a management/union Working Group is under discussion with ICTU.

13.26 As agreed by Government, a small number of recommendations are not under active consideration. These include a proposal for the introduction of an additional explicit 1% pension contribution and an alternative system of increasing pensions based on an average of pay increases in the public service as a whole which, the Commission recommended, should be guaranteed by means of legislation.

(iii) Effect of reforms to date – summary

13.27 The extent of the reduction in public service occupational pension benefits arising from changes made in 1995 and 2004 depends on the area of the public service and on the individual circumstances of each employee. The effect of the reforms might best be shown by a hypothetical example; assuming in all three cases (shown beneath) that the person retiring has 40 years' reckonable service and a final pensionable remuneration of €50,000:-

Pre 1995 civil servant:	Pension €25,000 payable at age 60
Post 1995 civil servant:	Pension €14,000 payable at age 60 (plus State pension of €11,000 - <i>rounded for purposes of example</i>)
Post 2004 civil servant:	Pension €14,000 payable at age 65 (plus State pension of €11,000)

(iv) Cost savings from the Commission and related reforms

13.28 When fully realized around mid-century, it is expected that net annual savings of some €350 million (in constant 2007 pay terms) will flow from the reforms put in place by Government following the Commission's report. The bulk of these savings flow from the pension age increase, and to a lesser degree 'standardization' (curtailment of special fast-accrual terms), which, as already noted, were legislated for in 2004.

13.29 The process of reform leading to these savings has been characterized by a spirit of partnership given effect, in particular, through extensive union involvement in various advisory Working Groups established under the *Programme for Prosperity and Fairness* and subsequently.

Future Outlook for Public Service Pensions

13.30 Demographic and budgetary realities are central to the changes introduced on foot of the Commission's report. These reforms, collectively, constitute a significant reshaping of the public service pension system in Ireland and combine measures designed to curb cost escalation, along with a range of modernising initiatives which serve to enhance flexibility, fairness and choice.

13.31 The completion of this reform programme and the task of securing its smooth operation throughout the public service are key policy objectives. However, vigilance will be needed towards emerging trends which could impact significantly on the affordability or functioning of public service occupational pensions. Relevant developments in this regard could arise on any of several fronts, including demography, mortality, migration, economic growth and taxation policy. Future pay rates and the structure of future pay increases will also be a crucial factor for so long as a system of 'pay parity' exists.

13.32 Furthermore, policy on public service pensions must have constant regard to developments

in relation to both the State pension and occupational pension provision for workers outside the public service. For example, if policy were to move in the direction of a mandatory or quasi-mandatory pension system (which may involve the payment of contributions significantly in excess of the levels that are generally payable at present in the private sector) there is likely to be pressure for the public service to 'share the pain', either in the form of a curtailment in benefits or increased contributions.

13.33 Cost containment is crucial and a continuing process of examination and implementation of well founded changes is vital to the proper management of future public service pensions expenditure and its budgetary impact.

Main reasons for projected increase in public service pension costs

13.34 At the time of the Commission on Public Service Pensions (which used projections as of 1997) expenditure on public service pensions was projected to remain relatively fixed as a proportion of GNP from 1997 to 2007 and then to increase steadily from 1.6% to 2.4% by around 2027; thereafter the projection was for the outgo to gradually fall to around 1.8% of GNP by 2050.

13.35 Estimates of the future cost of public service pensions have since been revised. The projected bill in 2027 is now forecast to be 2.6%, somewhat higher than the 2.4% forecast in 1997. Furthermore, the likely post 2027 position now looks very different. Whereas in 1997 the share of GNP absorbed by public service pensions was expected to decline post 2027, it is now expected to rise and to reach 3.0% by around 2050, over 60% in excess of the previously expected level. This change is mainly due to the increase of around 70,000 in public service numbers since the time of the Commission along with the impact of an assumed improvement in life expectancy.

Options for further changes to public service pensions

13.36 The Government values public servants and is committed to providing them with good quality pension arrangements. Such arrangements will continue to be a defining feature of

employment in the public service. However, in common with the general population, public servants are living longer than in the past and this and other factors are increasing the cost of providing pensions. While the implementation of many of the Commission recommendations represented a significant element in the reform of the public service pension area, the process of modernising and restructuring the system must continue in light of demographic and budgetary realities which pose excessive future risk to the Exchequer. Ireland's demographic profile, with one of Europe's youngest populations means that any future changes can be timed to peak at the time of real need – towards mid-century. In light of this and the other factors mentioned above it is envisaged that any changes decided upon would be applied to future appointees to the public service only.

- 13.37** In this context the Government intends to research and consider a number of further possible options to address future challenges. These include:-
- raising the minimum public service pension age,
 - increasing the rate of pension contributions,
 - modifying the 'pay parity' basis for post-retirement increases in pensions,
 - removal of fast accrual terms,
 - abolition of certain notional added years arrangements,
 - options for accounting for pension costs,
 - a slower accrual rate in respect of retirement pension and lump sum,
 - moving to calculation of pensions on the basis of 'career average' earnings.

- 13.38** The Government is not committed to implementing any or all of the options mentioned above. They are put forward in the context of a comprehensive debate on the factors shaping the development of our pensions system in the 21st century. Each would require very careful examination and consideration. Their industrial relations impact and their implications for other policies would also have to be considered, particularly in relation to the recruitment and retention of staff and for public service pay determination.

Also, the extent of savings realised from such measures would depend on the precise nature of the changes adopted and the groups to whom the changes were applied.

The Link Between Pensions and Pay Determination: The Benchmarking Body and Review Body

- 13.39** In addition to the link between pay and pensions formed by the application of 'pay parity' (see paragraph 13.14) public service pension issues have formed a significant part of the pay determination process.

The Benchmarking Body and Review Body

- 13.40** At present, the Public Service Benchmarking Body and the Review Body on Higher Remuneration in the Public Sector are carrying out reviews of the appropriate levels of remuneration of the categories of public service grades coming within their respective remits. The terms of reference of the Benchmarking Body state that:

"the Body should have regard to the differences between the public service and the private sector and between the various public service groups within its remit in working conditions, the organization of work, perquisites, and conditions of employment and other relevant benefits, including security of tenure and *superannuation benefits*".

- 13.41** The Review Body on Higher Remuneration in the Public Sector, which deals with the pay of top public servants above the level of those covered by benchmarking, said in its June 2005 interim report that *"It seems to us that the relevance of superannuation arrangements in the public service as a component of overall remuneration has assumed a greater importance than was the case at the time of the last general review"*.
- 13.42** The Department of Finance in its submission to the Benchmarking Body pressed the Body to give particular attention to this aspect of its mandate. The submission dealt very extensively with the pensions issue.

13.43 The Benchmarking Body and the Review Body have engaged consultants to carry out an assessment of public service pension benefits relative to those of comparable jobs in the private sector. The two bodies are due to report in the second half of 2007.

13.44 If it is found that the pension benefits of public servants at some or all levels are of greater value than those generally available to private sector comparators, the Body or Bodies will presumably apply appropriate discounts in arriving at the recommended pay rates for the relevant public service grades. This will modify the level of increase in future pension costs for

the grades affected both in respect of serving and future staff and, because of the pay parity arrangement, in respect of existing pensioners from those grades.

13.45 If the value of public service pensions is reduced by the implementation of further changes, as outlined in paragraph 13.37 above, the extent to which public service pay rates should be discounted on foot of pension benefits is likely to be reduced in the future as the proportion of serving staff affected by the changes in pension arrangements increases. The same effect will arise if the relative average value of private sector pensions increases over time.

Public Service Pensions

This Chapter details the defining features of public service pensions and the significant reforms that have been implemented in this area in recent years. It shows that pension coverage is close to 100% across the public service and that most public service pension schemes are contributory, *pay as you go*, defined benefit schemes.

It gives details on the programme of reform which was based largely on the recommendations of the Commission on Public Service Pensions. The key cost containment aspect in this programme was the raising in 2004 of the minimum pension age for new entrants to the public service from 60 to 65. The mandatory retirement age of 65 years was abolished for most new entrants at this time also.

The Chapter also considers the cost of public service pensions, which are set to rise significantly in the medium-term (mainly because of increases in the number of public servants and improved life expectancy), notwithstanding implementation of the reform programme.

The Chapter outlines a number of further reform options which the Government intends to research and consider in respect of future appointees to the public service to address demographic and other developments since the Commission reported in 2000. These include:

- raising the minimum public service pension age
- increasing the rate of pension contributions
- modifying the 'pay parity' basis for post-retirement increases in pensions
- removal of fast accrual terms
- abolition of certain notional added years arrangements
- options for accounting for pension costs
- a slower accrual rate in respect of retirement pension and lump sum
- moving to calculation of pensions on the basis of 'career average' earnings.

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Questions for Consideration

1. How should the cost of funding public service pensions be met?
2. Which individual reform options offer the most realistic potential?

