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2 November 2011

Brendan Barber,

PUBLIC SERVICE PENSIONS: REVISED COST CEILINGS

I am grateful for the constructive discussions we have had over the past eight months on Lord Hutton's recommendations for reform of public service pensions.

2. My letter to you on 18 July 2011 set out a number of areas where we had already established the basis for agreement, including on:

- the importance of transparency, with proposals for the design of new schemes based on consistent assumptions and methodology and costed by the Government's Actuary Department (GAD);
- the importance of the Government ensuring that there is a full Equality Impact Assessment before changes are implemented;
- minimising opt outs and maximising participation rates in schemes, including among low earners, young workers and part time workers; and
- developing shared principles on best practice in scheme governance and administration.

3. Since our exchange of letters in July, the Government and the TUC have continued to meet on a regular basis to discuss the reforms. Alongside this, there have been discussions at scheme level for each scheme. I am grateful for

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the constructive and considered way that both the TUC and employers have approached all of these discussions.

4. When the Hutton review reported earlier this year, the Government made clear its intention to follow Lord Hutton's recommendations without cherry-picking. Consistent with this, we are committed to continuing to offer public service workers a generous, defined benefit pension. I am also clear that the Government should continue to pay more towards public service pensions than the workforce. In addition, I have set out in our meetings and publicly that it is my intention to ensure that most low and middle earners working a full career will receive pension benefits at least as good, if not better than they get now at retirement. I believe that with the introduction of career average schemes, public service pensions would also be put on a fairer basis.

5. Based on these commitments, I wrote to you on 7 October 2011 proposing cost ceilings with accrual rates of 1/65ths for the Local Government Pension Scheme, the NHS Pension Scheme, the Principal Civil Service Pension Scheme and the Teachers' Pension Scheme. As I said in that letter, these cost ceilings represented a serious offer for meaningful engagement about the trade-offs to be made at scheme level. I asked for schemes to take forward discussions based on these cost ceilings and stressed the importance of both sides showing flexibility in order to reach an affordable settlement and to be sure that the reformed schemes meet the objectives that the Government has set out.

6. At a meeting last week to discuss the cost ceilings between the Trades Union delegation, Francis Maude and myself, you pressed me on the level of the cost ceilings for each scheme, the degree of transitional protection and whether the Government is prepared to commit to maintaining the design of the reformed schemes for at least a generation.

7. I have discussed your proposals with Cabinet colleagues. Based on these discussions, I plan to set out an enhanced offer, conditional on the Trades Unions and the Government reaching agreement on the reforms. Given the significance of the offer, I will need to announce it to Parliament at the earliest available opportunity. The enhanced offer will involve three significant changes to the proposals that I set out to you in my letter of 7th October.



8. First, in place of an accrual rate of 1/65ths, I will propose a more generous accrual rate of 1/60ths. This will result in higher cost ceilings for the Local Government Pension Scheme (England and Wales); NHS Pension Scheme (England and Wales); Principal Civil Service Pension Scheme (England, Wales, Scotland and Home Civil Servants in Northern Ireland); Teachers' Pension Scheme (England and Wales). This change provides an increase of around eight per cent in the amount of money scheme negotiators have to work with.

9. Second, I have accepted your argument that there should be transitional protection. It is my objective to ensure that those closest to retirement should not have any detriment either to when they can retire nor any decrease in the amount of pension they receive at their current Normal Pension Age. Over and above the cost ceiling, the Government's objective is to provide this protection to those who on 1 April 2012 are within ten years of Normal Pension Age. Schemes and unions should discuss the fairest way of achieving this objective, and for providing some additional protection for those who are just over ten years from their current Normal Pension Age. I would be willing to consider tapering of transitional protection over a further three to four years. Full account must be taken of equalities impacts and legislation, while ensuring that costs to the taxpayer in each and every year should not exceed the OBR forecasts for public service pension costs – ie. those forecasts made before the further reforms set out in this letter.

10. Third, these proposals should form the basis of a deal that will last a generation. Our objective is to arrive at a fair and sustainable set of pension reforms and to ensure that no further reforms to scheme design and contribution rates are necessary for at least the next twenty-five years. The only way that this will be sustainable for the taxpayer is if we link the Normal Pension Age in scheme designs with the State Pension Age – in place of the previously agreed cap and share arrangements, which would have been likely to require regular increases in member contributions to manage changing longevity costs – and cap the employer's contribution, as recommended by Lord Hutton. This link to the State Pension Age is essential to fairness – we are asking public servants to work as long as everyone else. It is also essential to sustainability: the flexibility which a link to the State Pension Age gives is what makes a defined benefit pension a viable offer for future generations.



11. This is a generous offer that is reasonable both to public service employees and to other taxpayers. Public service pensions remain generous compared to the pensions that similar employees receive in the private sector. The Government's offer is conditional on reaching agreement. If agreement has not been reached, we may need to revisit our current proposals.

12. Once again, I expect that public service schemes in the Devolved Administrations will continue to be modelled on the rest of the United Kingdom. If the Devolved Administrations were to pursue an alternative approach, any additional costs and cost risks would have to be met from devolved budgets. I expect cost ceilings for the Firefighters' Pension Scheme in England will be set by the end of November, to allow for further consideration of workforce assumptions with the relevant Trades Unions. This will not delay the overall timeline for delivering a final scheme design. Cost ceilings for other schemes (the police, armed forces and the judiciary) will be set within the first few months of 2012.

13. A number of the recommendations in the Hutton report concerned improvements in the governance of schemes. Like you, we believe that improvements can be made for the benefit of scheme members and taxpayers. We have therefore agreed to set up a small working group made up of scheme managers, TUC and union officials and the Cabinet Office to deliver these changes. There will also be a sub-group looking exclusively at the governance of funded schemes.

14. Apart from governance, the main outstanding issues are future policy on Fair Deal and the methodology for setting the employer cost caps. The Government will respond to the consultation on Fair Deal in due course.

15. I should stress again that it is vital that we conclude discussions on reform of public service pensions by the end of the year so that the relevant legislation can be enacted by Parliament in the 2012-13 session. It is right that the Government should give people the pensions they deserve after a lifetime of public service. Reaching agreement on this offer will ensure that public service workers can plan with certainty for the future.

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16. The Minister for the Cabinet Office and I are grateful for the constructive way you have engaged in the central discussions over recent months.

All the best,

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

DANNY ALEXANDER

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