

Report to: Financial Forward Planning Committee, 30 October 2017

Subject: Costs and risks of keeping the Pension Scheme open to new joiners

Purpose of report: to follow up on the issue as requested in previous meetings of the Financial Forward Planning Committee

1. Background

1 The Library is somewhat unusual in that the defined benefit pension scheme it offers to staff remains open to new joiners. This is a situation that has been questioned by the Committee in the past, and a report of the matter has been commissioned from the Actuary (attached).

2. Assessment by the Actuary

2.1 The main conclusions from the Actuary's report are:

- If the Scheme is closed to new members then the contribution rate required from the Library will increase over time
- If the Scheme remains open then the liabilities of the pension scheme will be larger as a result of the accrued pension rights

2.2 Other factors to consider are:

- The Scheme remains at or around a fully funded position
- Significant changes have recently been made to the Scheme requiring staff to move to a normal retirement age of 65 or pay 3% more to retain the current age of 60
- The Remit Letter from the Cabinet Secretary has requested that the Library considers how it could align the Library's terms and conditions with those of the Civil Service.

2.3 Given the above it is the view of the Executive Team that the Scheme should not be changed for the time being, unless there are new circumstances that give a compelling case to do so. In this context, the most immediate issue that would cause the Library to look at its costs would be the Grant-in-aid (GIA) settlement from the Welsh Government. There is considerable uncertainty over the level of GIA that the Library will receive in 2018/19 and beyond, and if there is a material cut then the Library will have to consider how it will reduce its costs to live within its budget. In these circumstances the Library may well be required to consider radical changes in pension provision, including a move to defined contribution provision.

3. Recommendations

3.1 It is recommended that the Scheme is not changed for the time being, but that cuts to GIA may require the Library to consider the wider issue of pension provision.

National Library of Wales Staff Superannuation Scheme (the “Scheme”)

Potential costs / risks associated with keeping the Scheme open to new joiners

To the Library

1 Introduction

- 1.1 The Library has asked us to consider the potential costs / risks to the Scheme associated with keeping the Scheme open to new hires versus the alternative of closing to new joiners. This paper focuses on the potential impact on the Scheme and does not consider the wider implications of alternative benefit arrangements for new joiners.
- 1.2 The impact of closing the Scheme to new hires is very dependent on the likely turnover / recruitment profile that might be expected. For example, if the Library were to cease recruitment for the next 5 years then a decision to close the Scheme to new hires would have no real impact over this period.
- 1.3 For illustration purposes, we have therefore assumed that a typical recruitment pattern for the Library would be to aim to maintain the age / salary profile of employees at the current level.

2 Pension Cost

- 2.1 It is a feature of defined benefits pension schemes that, under most reasonable economic assumptions, the cost of providing future service benefits for an individual member will increase as that member gets older. This is because the period over which investment returns can be earned is shorter for older members than it is for younger members.
- 2.2 The single rate of contributions that is payable to the Scheme (currently a rate of 30.2% is payable for member with an NRA of 60, including 3% which is payable by members) is therefore determined by the weighted average age of the Scheme’s membership. Over time, if the average age of the membership increases then, all other things being equal, the Library’s contribution requirement to the Scheme will increase.
- 2.3 The following figures are for illustration only, but show how the contribution rate to the Scheme might change over time.

Assume that the Scheme has the following membership profile:

Age	25	30	35	40	45	50	55	60
Number of members	30	30	30	30	30	30	30	30
Pensionable Salary (£'000 pa)	12	14	16	18	20	22	24	26
Contribution rate required for 1 year of benefit accrual	26%	27%	28%	29%	30%	31%	32%	34%

- 2.4 The average weighted contribution rate of the sample scheme above is ~ 30.2% per annum i.e. the same as the joint rate payable by the Library and members for those with an NRA of 60.

2.5 Scenario 1 – the Scheme remains open to new joiners

If we assume that anyone reaching age 60 takes retirement and that new hires join the Scheme at age 25 (at the rate of 30 new hires every 5 years i.e. broadly 6 new hires per year) then in 5 years' time the age profile of the Scheme and therefore the average contribution rate will be broadly unchanged.

In 5 years' time, then, all other things being equal, the total annual contribution rate is expected to remain at 30.2% per annum (including 3% which is payable by members).

Similarly, in 10 years, 15 years and 20 years' time, the contribution rate should remain broadly unchanged, as follows:

	In	5 yrs' time	10 yrs' time	15 yrs' time	20 yrs' time
Pensionable payroll (£m pa)		4.6	4.6	4.6	4.6
Contribution rate required for 1 year of benefit accrual		30.2%	30.2%	30.2%	30.2%
Contribution amount (£m pa)		1.4	1.4	1.4	1.4

2.6 Scenario 2 – the Scheme closes to new hires

If instead we assume that anyone reaching age 60 takes retirement but that no new hires are allowed to join the Scheme then in 5 years' time the age profile of the Scheme and therefore the average contribution rate will have changed.

In 5 years' time, then, all other things being equal, the total annual contribution rate is expected to increase to 30.6% per annum (including 3% which is payable by members). However this increase *in rate* is offset by the fall in pensionable payroll, leading to a reduction in the cash contribution payable.

Similarly, in 10 years, 15 years and 20 years' time, the contribution rate is expected to increase but will be offset by the fall in pensionable payroll, as follows:

	In	5 yrs' time	10 yrs' time	15 yrs' time	20 yrs' time
Pensionable payroll (£m pa)		4.2	3.8	3.3	2.8
Contribution rate required for 1 year of benefit accrual		30.6%	31.0%	31.4%	31.9%
Contribution amount (£m pa)		1.3	1.2	1.0	0.9

2.7 **Political factors** – the Cabinet Secretary for Economy and Infrastructure has asked that the Library works towards harmonising staff terms and conditions with those of the Welsh Government. The Library will need to consider whether closing the defined benefit scheme to new members might be in contradiction of this request.

2.8 **Other factors** - clearly there are factors, other than the membership profile of the Scheme, that will impact the future cost of benefit accrual but the effect of these on the contribution rate will be similar, regardless of whether the Scheme is closed to new joiners or not. The most significant of these are:

- a economic factors such as future investment returns and future inflation
- b demographic factors such as changes in longevity / mortality.

Closing the Scheme to new joiners will however reduce the pensionable payroll of the Scheme (as shown in the table under Scenario 2 above) and so the impact of any economic or mortality changes on the total cash cost of the Scheme to the Library will reduce.

For example, if economic and mortality changes lead to a 15% uplift in contribution rates, then the contributions in 10 years' time would be:

- 34.7% (i.e. 30.2% x 1.15), or £1.6m pa for a Scheme that is open to new joiners; vs
- 35.7% (i.e. 31.0% x 1.15), or £1.4m pa for a Scheme that is closed to new members.

2.9 The illustrative figures assume the Trustee retain the same investment strategy for the Scheme over time. However, the closure of the Scheme to new hires will mean that the Scheme's liabilities have a finite end point and, as the Scheme matures, there may be a move towards a more de-risked asset strategy, which would likely reduce the discount rate and increase the contribution rate.

3 Impact on funding risk

3.1 An important consideration for the Trustees is that closure to new entrants will limit the extent by which the Scheme's liabilities grow in future and will therefore help to reduce the level of funding volatility inherent in the Scheme (in cash terms).

3.2 In very broad terms, the liabilities of the Scheme, based on the current funding assumptions and other assumptions as outlined in this paper might be around £5m to £10m lower in 20 years' time if the Scheme is closed to new joiners today vs if it remained open.

3.3 If we were to assume that a 1 in 20 downside event might worsen the funding level of the Scheme by ~ 10% to 15% then the additional deficit risk in 20 years' time that the Library is exposed to as a result of keeping the Scheme open to new joiners might be around £1m to £2m.

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September 2017

Limitations and reliances

This paper was prepared for the National Library of Wales for the purpose of illustrating the potential costs / risks to the Scheme associated with keeping the Scheme open to new hires versus the alternative of closing to new joiners, under the terms of our engagement with you. It may not be suitable for use in any other context or for any other purpose and we accept no responsibility for any such use.

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