

# EXECUTIVE COUNCIL

## CONFIDENTIAL

**Title of Report:** Retirement Pension Scheme – Assistance and Contribution Policy

**Paper No:** 96/10

**Date:** 29 April 2010

**Report of:** Director of Corporate Resources

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### 1. Purpose

- 1.1. To confirm overall Government policy in regard to pension assistance and contributions.

### 2. Recommendations

- (a) To endorse the approach of advance funding of pensions, primarily by means of individual and employer contributions, and to note the role of welfare in retirement provision, pending specific recommendations for scheme amendment. (Which will be based on information awaited from the Government Actuaries Department.)
- (b) To agree that pension contributions and contribution credits be treated in the same manner for Camp & Stanley, and to encourage a 'responsible employer' approach for voluntary contributions by the lower paid.
- (c) That FIG should consider options to increase numbers required to contribute to the Retirement Pension Scheme.

### 3. Summary of Financial Implications

None as the impact of the recommendations is already included in the budget. Future consideration of pension funding options, however, will have a substantial financial impact.

### 4. Background & overview of issues

- 4.1. Pensions funding has enormous costs. As these are mainly in the future and can only be projected, there is a risk of underestimating the potential burden for both Government and tax payers. Pension funding is becoming increasingly challenging in the context of FIG budget deficits, reduced income and mounting costs and there are a number of complex interacting issues as

background to the contribution arrangements.

- 4.2. Section 5 outlines the details of the Falklands state pension scheme. In 2001 special relief was made available for Camp residents, at a potential annual cost of around £100,000 pa. It was agreed during 2009 that this would be merged with the arrangements for Stanley, but this measure was not popular with camp residents, and a review was been requested. Whilst this could be reversed, there would obviously be costs involved and there are underlying issues affecting both Stanley and Camp which deserve consideration.
- 4.3. Section 5 indicates relevant background information on the scheme:
- **Cost to FIG:** There is currently a Government subsidy of £300,000 per annum, with a further £345,000 paid as an employer, plus costs for credits paid for eligible persons, giving a total annual cost to FIG of around £700,000 (more if Camp Assistance were restored).
  - **Deteriorating funding:** Despite these contributions the funding position of the scheme is deteriorating significantly, and a separate exercise is ongoing to look at options such as increased charges and later retirement (Exco paper 54/09 refers).
  - **Demographics:** On current demographic patterns the number of pensioners is expected to double over the next 30 years whilst numbers of contributors decline, leading to potential exhaustion of funds.
  - **Decreasing entitlements:** Pensions are now proportionate to lifetime contributions, which will lead to progressively increasing numbers with partial (or even zero) entitlement. (The majority of those affected live in Stanley.)
- 4.4. Contribution credits can provide contributions for the unemployed and others unable to work due to ill-health or care responsibilities. The particular issue is therefore for those working but with an income below the contribution threshold. Section 6 outlines possible options to facilitate contributions from the lower paid:
- Encouragement of a **‘responsible employer’ code of practice**, as now undertaken by FIG and FLH, whereby the employer will meet their share of pension payments for any lower paid employees wishing to participate.
  - **Adjusting the lower limit** to bring more employees into the band at which the employer pays 50%. Freezing at current levels over time is likely to be the least contentious way of achieving this.
- 4.5. Section 7 outlines some key underlying considerations to decisions on a long term approach to provision for retirement:
- **Individual or FIG funding of pensions:** A pension is ultimately a benefit to the individual concerned, and it appears reasonable that they should fund it, provided the amount is affordable. Whilst FIG has substantially underwritten and supported the scheme, with current financial pressures the Government needs to exercise caution in limiting its commitments.

- **Camp & Stanley:** Whilst support for camp is accepted, in terms of the state pension, unless there are specific differences to be allowed for, it would appear reasonable for the same rules to apply throughout the Islands.
- **Welfare or pensions:** Given limited Government resources welfare provision is far more financially effective than FIG funding pensions – the ultimate cost to FIG via the welfare route should be less than 50% that of funding a full pension.
- **Pension funding in advance or ‘pay as you go’.** The Government could save money now by reducing contributions to pension funding, and hope to meet the ultimate costs from future increases in tax and contribution rates. Given the relatively small size of the economy, if there were adverse events such as reduction to revenues or increases in costs, this could jeopardise pension payments and impose an undue burden on the public at the time. Attempting to fund pension liabilities adequately from the outset is therefore a far more prudent approach.

## 5. Retirement Pension Scheme

### 5.1. Scheme background

The Falkland Islands Government runs a state pension scheme to ensure that widespread personal contributions are made to fund future pensions in retirement. The FIG currently makes a substantial ‘top-up’ payment of £0.3m pa to support the fund and subsidises resident rates. As outlined in Exco paper 54/09 the scheme has declined from 60% to 50% funding, there are large commitments for future increases in numbers of pensioners, and the balance of contributions and benefits needs significant adjustment. Given the current economic situation, caution is necessary to contain the extent of additional Government commitments.

### 5.2. Lower earnings limit

Under the previous (1952 ordinance) scheme which ran until 1996, payment was compulsory for all men irrespective of whether they were employed, although wives could not contribute. Partial pensions were not provided, but a full pension could be gained with 14 (or more) continuous years of contribution immediately prior to retirement at 64. This continues to apply, allowing previous members of the scheme to qualify for full pensions on the same basis, including cases where partial pensions would be paid under the new scheme.

The new scheme provided a wider basis of contribution to include everyone regardless of sex, and pensions are based on the number of contributions (2,200 for a full pension). An earnings limit was introduced (originally £35 per week) below which contributions became voluntary rather than compulsory. The earnings limit was increased from £70 to £160 in 2002, removing significant numbers from the requirement to make contributions (and reducing the cost for employers). Table 1 summarises the different forms of contribution under the scheme. There is provision for pension credits to be paid by the Government on behalf of individuals unable to work for various

reasons or in receipt of family allowance, and voluntary contributions may also be made.

Table 1: Categories for contributions

Category	Compulsory	Eligible for Contribution Credits	Voluntary
Earning >£180 pw	Yes		
Earning <£180 pw			Yes
Non-working			Yes
Unfit for work (health)		Yes	
Unemployed - seeking work		Yes	
Receiving Family allowance		Yes	
Carer for person with Attendance Allowance		Yes	

The earning category includes self-employed.

Contribution credits are paid on application (& subject to confirmation of eligibility).

Table 2 gives estimates of numbers in various contribution categories, from which it appears that around 15% of the total eligible population are not currently gaining pension rights under the RPS. This will include a number of short term workers (and partners), who are unlikely to remain in the Islands to draw pensions and others who will contribute at other times. However, for those contributing after 1997 the requirement for 42 years of contributions to gain a full pension means that many will only gain partial pensions.

Table 2: Estimated numbers by category

Category	No.
Employee/Employer	1167
Self-Employed	20
Con Creds - Stanley	32
Con Creds - Camp	22
Employment Programme	18
Voluntary	
Local	37
Overseas	8
Active members	<b>1291</b>
Wages below threshold:	
Camp	91
Stanley	245
Subtotal	<b>336</b>
Credits & EP	(72)
Voluntary conts	(37)
Non contributing:	<b>227</b>

Note:

1. These figures have been estimated from a combination of pensions data (contribution numbers) and tax data for income below the contribution threshold. Numbers are intended to be full time equivalents (i.e. if 2 contributors each contribute for 6 months, this is only included as 1 contribution).

2. The numbers are indicative. They vary from year to year and as the tax data is not collected for this purpose and may over or under-estimate the actual position in relation to the pension scheme.

## **6. Pension Contributions**

### **6.1. Camp assistance & contribution credits**

In 2001 relief was introduced specifically for camp residents, allowing crediting of pension contributions for those not having to make compulsory contributions. This cost FIG around £100k per annum, but this was changed in the 2009 budget, with eligibility for assistance with contributions being brought back to the same basis as for Stanley. Some camp residents are able to claim contribution credits instead of camp assistance to maintain their pension record. Contribution credits are paid by FIG (on application) for persons eligible due to:

- ill health preventing work (with medical evidence)
- being unemployed and actively seeking employment
- being in receipt of Family Allowance
- caring for a person who is entitled to an Attendance Allowance

However, the contribution credit scheme does not apply to employees merely falling below the earnings limit (and so not having pension payments automatically deducted). They would have to fulfil at least one of the other criteria to be eligible.

### **6.2. Voluntary contributions**

Voluntary contributions to the scheme are permitted. The overseas rate (£31.50) is set to cover the full actuarial cost of the provision, whilst the local rate (£25) is subsidised by FIG. For qualifying employed persons, there is a direct contribution by the employer of £12.50 and an additional £12.50 deducted from wages. However, if an employee earning less than £180 per week decides to make voluntary contributions they have to meet the full £25 themselves, as they need to fund both the £12.50 normally deducted from employees and the £12.50 otherwise paid by the employer. The cost to the individual is therefore double that of better paid employees.

### **6.3. Options to facilitate contributions**

There are various measures that could help address this issue, but since the scheme exempts those not earning and on lower pay from compulsory contributions, only a minority can realistically be expected to contribute voluntarily. As the pension is a personal benefit which will be paid irrespective of circumstances (unlike welfare) the scheme is primarily based on personal contributions. It has not been designed to provide universal pensions, and it would be uneconomic for the Government to attempt to fund this in the current economic climate.

Increasing contributions to pensions by lower paid persons will be beneficial, irrespective of whether they live in camp or Stanley. However, as welfare provision is available for all elderly persons in financial need, if Government funding is involved, welfare is financially far more efficient for FIG than paying personal pension contributions (see Section 4).

Options for increasing personal pension contributions include the following:

1. **‘Responsible employer’ code of practice:** FIG recognised this issue and has formalised a voluntary code of ‘responsible employer’ practice, whereby FIG meets the employer’s costs for any qualifying lower paid FIG employees wish to contribute to a pension. FLH has now adopted a similar approach for lower paid employees wishing to contribute. This practice could be publicised and other employers encouraged to adopt it.

2. **Reduction to the lower earnings limit:**

The long term pensions position for the lower paid could be improved without any additional administrative complexity of subsidy requirements if the contribution ‘net’ were extended by reconsideration of the lower earnings limit.

(a) The overall earnings limit could be adjusted down, and the view taken that the 130% increase in 2002 took too many earners out of the net. Reduction of the limit to £160 could add around 50 contributors. However, this would involve some additional costs for both employees and employers.

(b) Alternatively the earnings limit could be set lower just in camp, arguing (for example) that the same pay would go further in camp. However, this would be difficult to justify to the low earners in Stanley, and there would still be some additional cost for employers and employees.

(c) Even if limit is not reduced, ‘freezing’ it at the current level would result in progressively more of the lower paid making pension contributions over time.

## **7. Underlying issues for pension funding**

There are several underlying principles that are relevant to decisions on pensions:

- To what extent are individuals, as opposed to Government, responsible for funding their pensions
- Does camp require different treatment?
- Where Government provides social support for the less well off, is this better targeted via welfare systems or in support of pension contributions?

### **7.1. Individual & FIG funding of pensions**

The beneficiary of a pension is the individual concerned, and it is therefore reasonable that they should fund it, provided that the amounts are affordable. Compulsory contributions are normally required to national pension schemes, in recognition of the fact that people frequently fail to provide for the future whilst they can afford it, and thus end up needing state provision. For persons in employment, an element is usually required to be funded by the employer, but as this is part of the overall remuneration package, it still relates to the individual concerned. Recognising the social benefits of pensions for those in retirement, FIG has substantially underwritten and supported the current scheme. However, with current financial pressures and Government deficits,

the Government needs to contain its commitments.

## 7.2. **Camp & Stanley**

Whilst support for camp is recognised, in terms of state pension and benefits, unless there are specific differences to be allowed for, it would appear reasonable to apply the same rules throughout the Islands.

## 7.3. **Is support better provided through Government funding for welfare or for pensions?**

The best use of limited Government resources has to be considered. As background, the RPS Government subsidy is currently £300,000 per annum. This is based on the last actuarial review in 2006, and funding requirements are likely to have increased significantly since then. FIG also pay a further £345,000 as an employer and additional amounts for contribution credits, giving a total annual cost to FIG of around £700,000. In comparison the total welfare assistance budget is less than £160,000. Attendance allowance comprises a significant proportion of this, and income support is mainly provided for mothers with young children rather than persons of pension age.

The Retirement Pension Scheme operates on a funded basis, with contributions held in a fund towards future liabilities, rather than immediately paid out as pensions for others. If FIG increases subsidies for pensions, Government costs will increase now, in the hope of benefits to individuals later. However, it is impossible to target such support in a way that guarantees that the most needy will benefit, because it is impossible to forecast accurately what individuals' circumstances will be the time when pensions are drawn.

Even if substantially more Government funding were provided for pensions, many cases of need could still slip through the net and ultimately require welfare support, whilst others with low pensions will leave the Islands or have other financial resources available, and never actually need welfare support. If instead of increasing overall Government funding for pensions, Government's support for the elderly is targeted as welfare specifically to those ultimately needing it, value for money will be multiplied. Those most in need will be supported, whilst the associated cost deferred until such time as actually required. This is illustrated in table 4 which indicates that the ultimate cost to FIG via the welfare route should be around 40% of funding a full pension.

Table 4: Potential funding costs for elderly through pensions and welfare

	£	Comment
Cost to fund a full pension	69,313	2200 contributions over 42 years at full 26.7% actuarial rate (£31.50 pw)
Additional investment returns needed to fund a full pension	53,737	GAD calculations assume 2% annual 'real' returns
<b>Full cost for full pension</b>	<b>123,050</b>	(Paid for 20 years)
Welfare at 83% of full pension	102,132	(Paid for 20 years)
Less persons leaving the Falklands @ 15%	(15,320)	Pension but not welfare payable outside Islands
Other cases not requiring full welfare @ 35%	(35,746)	Other household income/work/savings, partial welfare.

<b>Net welfare cost/pensioner</b>	<b>51,066</b>	
Welfare cost as % of fully funding a pension	42%	

Note: The investment returns are part of the cost of the pension. If they do not occur then additional cash has to be injected to pay the same level of pension. Otherwise they are tied up in the pension, and not available for use elsewhere in Government.

There is therefore a strong case that limited Government funds can be more effectively used in support for the elderly as welfare rather than additional pension subsidies. It is, however, also worth considering measures to increase the numbers contributing to the scheme, particularly where they might otherwise be likely to be reliant upon welfare, provided any additional Government cost is limited.

Are welfare payments adequate to support pensioners in retirement? Comparing welfare payments with pensions (see table 5), current welfare rates are 83% of a full pension for a single person and 61% for a couple, but additional payments are available for those reliant on long term support and welfare can be paid in addition to other income. This demonstrates that welfare payments, particularly for single persons, provide a broadly comparable income to a pension. It is reasonable that welfare support is typically somewhat lower than a full pension and requires demonstration of need, as otherwise the incentive to save for the future would be removed.

An increasing number of partial pensions will be paid under the 1997 scheme, many of which will be lower than the welfare amounts, so welfare provision is likely to become progressively more significant in financial provision for the elderly. This does not alter the case that value for money will be maximised by targeting Government funding to the most needy through some form of welfare system, as opposed to FIG attempting to fund more generous pension provision.

Table 5: Current welfare & pension rates (£/week)

	Full welfare £	Full pension £	Welfare as %
Single	98	118	83
Couple	144	118 x 2	61

## 8. Financial implications

- 8.1. The body of the paper outlines the relevant financial issues. The future liabilities, even for the relatively basic retirement pension scheme run to many millions of pounds. The current scheme already involves Government payments, credits and subsidies in the order of £0.7m per year, despite being only partially funded, and not necessarily providing a full pension. There are significant numbers not currently contributing to the scheme (the majority being in Stanley).
- 8.2. Additional contribution assistance of around £100,000 p.a. was provided for contributions for camp residents from 2001 until it was agreed in 2009 that



this would be merged with standard contribution credit arrangements. FIG is aware of the need to contain its financial commitments, particularly in the current deficit situation, and separate analysis of possible options for the scheme is ongoing.

- 8.3. Pensions are not the sole Government provision for support in retirement and, as outlined at 7.3, welfare provision is much more effective than pension assistance in providing a 'safety net' for those who may ultimately have pension shortfalls. Even if substantially more Government funding were provided for pensions, many cases of need could still slip through the net and ultimately require welfare support, whilst others with low pensions will leave the Islands or have other financial resources available, and never actually need welfare support. However, there is also an argument for increasing the numbers required to contribute to their own future pensions whilst they can afford it.

## **9. Legal Implications**

None

## **10. Human Resources Implications**

None