St Clement's House, 27-28 Clement's Lane, London EC4N 7AE
Tel: +44 (0)20 3207 9380 Fax: +44 (0)20 3207 9134 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

17 December 2010

Lord Hutton
Chairman
Independent Public Service Pensions Commission
1 Horse Guards Road
London
SW1A 2HQ

Dear Lord Hutton

## Independent Public Sector Pensions Commission – Call for Evidence

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to your call for evidence of the second stage of your independent review of public service pension schemes.

Members of the Association are all qualified actuaries and are subject to the Actuaries' Code of the Institute and Faculty of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes, including Local Authority Pension Funds.

The ACA is the representative body for consulting actuaries in the UK, whilst the Institute and Faculty of Actuaries is the professional body.

Members of the ACA provide advice to thousands of pension schemes, including most of the funded public service schemes – most notably the 100 funds that make up the Local Government Pension Scheme or LGPS. Members however are also involved in advising some of the unfunded public service schemes such as the Police and Fire Schemes and the Civil Service Schemes.

The key ACA objective over the last few years has centred around scheme designs that encompass some element of risk and cost sharing. We have produced many papers on the subject and responded in detail to the DWP consultation on risk sharing in 2008. Sadly this was not taken any further.

We are of course available to give oral and fuller written evidence, as required, on risk sharing aspects or any other issues you would like to cover in your report.

Below we set out our thoughts on the questions you have raised.

**Q1) What is an appropriate scheme design for public service pensions? Why?**

We believe that there are a number of objectives that any scheme design should aim for whether in the public or private sector as follows:

- Adequate level of income at retirement that maintains it purchasing power in real terms
- Reasonably predictable level of income
- Flexibility of how pension benefits are drawn down
- Include some "safety valves" to cope with changing circumstances
- Designs that are fair in terms of how costs are met across generations and between employee and employer.
- Designs that are simple for employees to understand and appreciate and that are simple to administer.

We have set out some thoughts on scheme design in the Appendix which we believe might meet these objectives.

**Q2) Which risks associated with pension saving should the scheme members bear, which by the employer and which should be shared? Why?**

The main risks in decreasing order of significance are

- Investment risk (funded schemes)
- Inflation risk (assuming benefits increase in line with some measure of inflation)
- Longevity risk
- Maturity risk (unfunded schemes) – risk of contribution income falling below the level of benefit payments

In terms of risk sharing our view is that the employer should still be the major partner in the risk sharing relationship. Employers have longer timescales over which to manage risk and are generally less risk averse than employees. Pension assets and liabilities will generally represent a smaller element of an employer's balance sheet than an individual's personal balance sheet.

We would also tend to advocate a progressive system of risk sharing in that those employees more able to bear some risk (typically the higher paid) should be allocated more of the risk budget allocated to employees compared to those that are less able to bear any risk.

Thus rather than try to allocate risks we would advocate a scheme design that shares all of the risks between employee and employer but in a progressive manner.

**Q3) What mechanisms could be used to help control costs in public service schemes? For example, is there merit in flexible normal pension ages linked to changes in longevity? What indexation factor should be used in a career average type scheme to ensure a reasonable balance of risk between scheme members and taxpayers?**

Costs can be controlled via the "safety valves" that are included in the overall design. We would suggest that pension ages are linked to State Pension Age which itself should be linked to longevity improvements.

The decision on indexation factor has to be taken in conjunction with the rate of accrual of pension – a lower rate of revaluation will allow a higher accrual rate and vice versa for the same cost. We would advocate a relatively prudent indexation factor such as CPI with a reasonable accrual rate which will mean pension entitlements grow more quickly and so perhaps encourage younger employees to join schemes.

One of the key challenges in implementing the anticipated changes is that it is likely that employees are going to be asked to pay more for less. Having an accrual rate higher than the current rate but with say CPI indexation would mean employees actually accrue more pension in the short term than they currently do although ultimately their pension at retirement is likely to be less than under current final salary arrangements.

Conditional indexation where increases to benefits are dependent on factors such as investment returns achieved or economic performance are an obvious safety valve. There examples of these in Sweden and Holland. Interestingly the view of DWP appears to be that such practices cannot be implemented in the UK under European law!

**Q4) Where and how have risks associated with pensions been effectively shared in private sector companies?**

Under current legislation, a scheme that has even the smallest element of defined benefit built into the design is regarded as a defined benefit scheme for various legislative purposes and so employers thinking about introducing more risk sharing into designs do not see any reduction in the legislative burden. Thus there has been less risk sharing actually implemented than has perhaps been considered.

There are examples of "cash balance" plans (where all the longevity risk is with the employee) in existence and schemes where longevity improvements are allocated in some way to employees,

There are examples of shared cost arrangements where the total cost (required contribution rate) is shared between employee and employer in some fixed proportion. Such arrangements however do have some inter generational equality issues.

**Q5) Which international examples of good practice in the area of risk sharing should the Commission consider when compiling the final report? Why?**

The Dutch pensions systems have arguably the greatest element of risk sharing.

Their collective defined contribution schemes look to share risks across generations rather than between employees and employer.

Here, all contributions are placed into one fund that is then managed on behalf of the members. As in a standard DC scheme, members' pensions will vary according to the value of the underlying investments. However, within CDC schemes there is the option to use inter-generational sharing to smooth the effects of market conditions. There are also economies and efficiencies deriving from the pooling of investment that may boost emerging pension benefits.

They also have schemes that include conditional indexation.

The pension earned is calculated as a percentage of earnings in each year of service and would be revalued each year to ensure that it maintains its value.

Pensions in payment would also be increased each year to maintain their value. The level of revaluation would be equal to the level of indexation of pensions in payment to ensure fairness between active, deferred and retired members.

The key difference between this and a "standard" current career average scheme is that increases to pensions in payment and revaluation of accrued benefits are not guaranteed. Instead, they would be conditional on the funding level of the scheme. However as in the early days of final salary schemes in the private sector schemes, the funding plan would assume some target level of revaluation/pension increases.

This means that if the scheme was fully funded or in surplus, full revaluation and indexation would be paid. If the scheme falls into deficit, it would be able to cut indexation and revaluation to reduce the deficit. When the scheme returns to surplus, indexation and revaluation would be reinstated as a first priority.

There are some reported problems where pensions have to reduce but a modified system where this is not allowed to happen would be possible to implement.

**Q6) What should the split between member and employer contributions look like?**

We would suggest the anticipated long term cost is split somewhere between 50:50 and 33:67 employee:employer.

**Q7) Should there be different treatment of different professions (for example, lower normal pension ages for some public service employees)?**

It is possible to achieve some differentiation between different professions' pay levels in the overall scheme design – see later examples. There remains a strong argument that the uniformed professionals should continue to be able to retire earlier than non uniformed staff reflecting the more physical nature of the work involved. However many uniformed retirees will still be able to contribute to society and so there could be rules that pay lower interim pensions until they reach pension age for non uniformed employees.

**Q8) Should there be different treatment for those at different income levels?**

Yes – via the level of risk sharing.

**Q9) What is the appropriate normal pension age for the different public service schemes? Should this vary across schemes and, if so, why?**

We would encourage the same retirement age for all non uniformed staff. We would encourage the Government to link State Pension Age to an expectation of drawing pension for a certain period (20 years?) based on longevity expectations that are reviewed on a regular basis. Scheme pension ages would then be linked to State Pension Age. We do however that changes to pension ages have to be flagged up well in advance so that those nearer retirement age have time to plan accordingly.

## Adequacy

**Q10) How should the Commission think about measuring adequate levels of resources in retirement?**

**Q11) What should be considered an adequate level of resources in retirement?**

Most pension payments tend to be flat either in nominal or real terms throughout the payment period. Pensioners' income requirements however tend to be close to 100% replacement level at the time of retirement and then probably reduce as their lifestyles change before then increasing again as they approach the end of their lives and require medical care.

The lump sum payments paid by most schemes at retirement will help plug the income requirement gap in the early years of retirement.

Some work has already been completed by Lord Turner on adequate replacement ratios as follows. We believe that these remain appropriate.

| Gross income | Benchmark replacement rate (%) |
|---|---|
| Less than £9,500 | 80 |
| £9,500-£17,499 | 70 |
| £17,500-£24,999 | 67 |
| £25,000-£49,999 | 60 |
| £50,000 and above | 50 |

*Source: Pensions Commission.*

**Q12) Should a full state pension and a full public service pension ensure people have adequate resources in retirement? Or should room be left for individuals to make their own arrangements?**

Due to tax restrictions these days, there is effectively a "pensions ceiling" of £75,000 per annum plus State pension. We believe that it is not unreasonable to have some sort of ceiling below this level which then allows individuals to make their own additional saving if they wish to.

**Q13) How should this change where people work part careers in public service?**

Provided the pensions earned during the periods of public service are fair and consistent with those earned by those who work all of their careers in the public sector then we do not see any need to make any special adjustments. A career average scheme with CPI revaluation (same as deferred benefit revaluation) is more likely to achieve this than a final salary formula.

**Employee understanding and choice**

**Q14) How much do workers value and understand pensions? Is there any evidence this differs between groups (for example, by age, by income)?**

A key reason given for working in some parts of the public sector is the provision of quality pension benefits. However there is a significant proportion (around 30% in the LGPS and perhaps 15% overall) of public sector staff who choose not to participate in their employer's scheme. The reasons given are usually based on affordability rather than lack of understanding of the benefits being provided. Individuals certainly become more interested in pensions as they get closer to retirement and we suspect start to value and understand pensions more than they would have done in the earlier part of their working lives.

Financial literacy in the UK however continues to be well below where it should be and although outside the remit of this review, this is something the Government needs to address via the education system.

**Q15) Which forms of scheme design will encourage employees to save for their retirement? Is there any evidence from pension scheme reforms influencing opt out rates in the private sector?**

Schemes that are simple in terms of the overall design and have some element of flexibility and member choice on how benefits are taken and more likely to encourage employees to save for their retirement. Schemes where employees also feel some personal ownership of their pension assets might also assist.

For example, cash balance plans where the scheme promises a predictable fund at retirement rather than a pension might fall into this category. Employees might favour a career average cash balance scheme that promises say 30% of their salary each year going into a pot rather than 1.67% of their salary as a pension. In reality the costs are similar.

Cash balance plans also have an explicit form of risk sharing in that longevity risk is fully allocated to the employee as they have to purchase an annuity. Some cash balance plans offer their own fixed annuity terms which may be reviewed from time to time to alleviate some of the "annuity risk" inherent when buying on the open market.

**Q16) What best practice exists in the private sector around communication of benefits with scheme members?**

We do not believe that there is any real difference in terms of the quality of communications between public and private sector schemes.

**Q17) Should any new scheme design offer members a degree of choice in the level of contributions paid and benefits received? For example, should members be able to receive a higher pension if they want to take the pension later? Why?**

We believe that there should be a core benefit for all with the same flexibility that we have at present as to when benefits can be drawn – actuarially reduced/increased if taken before/after the agreed pension age.

**Pensions and plurality of provision of public services**

**Q18) Whether and how public service pensions could be structured to support a more level playing field between the public and private sectors when tendering for contracts?**

We understand that the Government intends to review in 2011 its "Fair Deal" guidance on how pensions are handled on staff transfers in public sector contracts, and that this is outside the scope of the current Hutton Review. On the basis of the existing "Fair Deal" guidance, there are nevertheless a number of areas where changes to the structure of public service pensions would make it easier for private and third sector employers to tender for such contracts on a more level playing field. We believe that there are some key elements to such a restructuring as follows:

- Liability for prior service benefits on staff transfers

A major issue for private sector employers taking on public sector employees under the Fair Deal guidance is the uncertain, and potentially very substantial, level of financial risk that they can be required to take on in relation to the transferring employees' accumulated pension benefits relating to pensionable service prior to the employment transfer. Contractors will have gained no economic benefit from this service, yet they are required under the Fair Deal to offer to accept a transfer of the related defined benefit pensions liability and its financial risks. In some cases the contractor will only retain the employees for a relatively short period (many contracts are for 5 or 7 years), but it is required to accept and manage defined benefit pension liabilities relating to much greater periods of service.

There are however scheme designs such as CARE arrangements or collective DC where there would be no need for transferring employees to be offered the facility to transfer their past service benefits to their new employer as there would be no salary-link to be maintained. The liabilities can be left behind with the letting authority at no detriment to the employee.

There are also transitional issues to consider here in terms of how restructuring of public service pensions deals with past service benefits, as well as the future. If the public service pension schemes are restructured to remove the final salary link only in respect of future service benefits, with past service benefits continuing to be linked to future salary growth, then there will continue to be a past service benefits problem on outsourcing contracts for many years under the current Fair Deal guidance. To encourage plurality of public service provision, we would therefore suggest adopting an approach to restructuring public service pensions which breaks the final salary link as quickly as possible for all service, not just for future accrual.

- **Reducing funding risks**

Private and third sector employers typically have considerably less tolerance to the risks of defined benefit pension provision on outsourcing contracts than the public sector. This is partly because of the general reduction in DB provision in the private sector. This is further exacerbated by the short-term nature of many public sector contracts and the Fair Deal rules under which the contractor is effectively required to ensure that the accrued benefits are fully funded at a single point in time – i.e. at the end of the contract. As a result, funding risks that can normally be smoothed out over the long-term in the public sector effectively crystallise on an outsourcing contract at a single point in time for the contractor.

Scheme designs therefore with less risk overall, or, a greater sharing of risks between employee and employer, are likely to be more attractive to potential bidders for public sector contracts.

- **Lower cost public service pensions**

The value of public service pensions is currently much greater than the value of the pension benefits (whether DB or DC) typically provided by private and third sector employers. As a result, employees who transfer to the private and third sectors on public sector outsourcing contracts and are provided with broadly comparable benefits (as required by the Fair Deal) now typically receive much more valuable pensions than their new colleagues who are in the contractor's normal pension arrangements.

This can result in a two-tier workforce situation developing and this disparity in reward can itself be problematic for the contractor and act as a disincentive to taking on this type of contract.

A more level playing field therefore would require a less generous public sector pensions package without necessarily starting a "the race to the bottom".

- **Discount rate for valuing public service pensions**

Another aspect in terms of trying to level the playing field is the approach and assumptions used for assessing the value/cost of public service pensions to the public service employer and those typically adopted in the private sector. There is no "correct" discount rate as the discount rate is a function of the purpose of the valuation but the different approaches does distort comparisons.

The Government of course has recently announced a review of the discount rate to which the ACA will be responding in due course.

- **Simplicity and predictability**

To encourage private and third sector organisations to tender for public sector contracts, it is important that they are able to understand clearly and have some predictability over what the pension requirements are, and that implementation of those requirements is as simple as possible. Complexity and uncertainty increase bid costs substantially and deter potential bidders.

To encourage plurality of provision, it will be important for the restructured public service schemes to be as simple as possible for private and third sector employers both to understand when tendering, and to administer once successful in winning a contract - and that the transitional provisions are clearly laid out and avoid unnecessary "grandfathering" of specific historic provisions.

It is important therefore that a strict discipline of simplicity is diligently applied to the design of restructured public service pensions, both going forward and in the transition from the current arrangements.

**Q19) Which non-public service employees should be eligible for membership of public service schemes?**

There are already many instances where non-public sector employees are members of public service schemes. A large proportion of contracts awarded by local authorities are done so on the basis of pensions being facilitated by participation of the private/third sector contractor as an Admission Body within the Local Government Pension Scheme (Admission Body Status, or 'ABS'). An agreement is made between the contractor and the relevant authority setting out how the various risks associated with pension liabilities will be split between the two parties. The CLG has set out guidelines as to how this split of responsibilities should generally be made. Whilst there are often challenges in reaching agreement, this arrangement has frequently worked very successfully and we believe should be retained going forwards.

In some limited circumstances, participation along the lines of ABS has also been permitted within the PCSPS and NHSPS. However, this is not widespread and is not normally permitted for private sector employers. Where a specific contract is put out to tender, either all bidders should be allowed to participate under an arrangement akin to ABS, or none should be permitted. Currently, it is possible that some of the bidders (e.g. if they are not-for -profit organisations such as charities) would be permitted ABS but others bidding for the same contract might not. This is likely to make the pensions costs lower for those permitted ABS. This prevents a level playing field when assessing the relative costs of all bidders.

Where non-public service employees cannot be members of Central Government schemes such as the PCSPS, this has presented significant barriers to outsourcing. In some instances, these barriers have stopped outsourcing from taking place at all, which means that best value will not be achieved by Government. If ABS were permitted for all contractors within the PCSPS and other Central Government schemes then this barrier would be removed. Lack of ABS creates the following problems under the current Fair Deal rules and public service schemes:

- A transfer of past service pension rights to the contractor is required which involves a significant cheque being written out by the public sector at the start of the contract. This would not be required under ABS.

- As described in the response to Question 18, the costs of providing pension outside of a public service scheme are likely to be significantly higher then the apparent cost within the corresponding public service scheme. This is due to explicit allowance for prudence and risks being required within the funding of private sector pension schemes, exacerbated by the current high discount rate used for assessing the costs of public service schemes. This makes an in house bid appear to have lower pension costs than those of a private sector contractor, whereas this is unlikely, in reality, to be the case.

It may be appropriate to make a distinction between contracts where a specific service, the provision of which is the long-term responsibility of the public sector, is being outsourced on a short-term contract to improve efficiency and service delivery, and contracts involving more fundamental change, for example where an organisational unit is effectively being transferred permanently out of the public sector. In the former situation, we believe the arguments for offering an ABS-style arrangement are very strong, whereas in the relatively rare latter cases, we recognise that it is more likely that a full transfer (for future service only) to the new employer's own pension arrangements would be appropriate.

### Administration costs

There appears to be a wide variation in the administration costs across different public service schemes, and costs seem to be higher than those in the private sector in some cases. The final report will consider whether there is scope for rationalisation and cost reduction.

**Q20) What evidence is there on administration costs (excluding fund management costs) of private sector pension schemes? How do these compare with those in the public service schemes?**

There are several sources of information on administration costs with varying average cost per member. Measurement of costs is also dependent on what actually constitutes pensions administration costs – definitions vary. Some schemes will also offer members services that others do not – on line enquires etc and varying levels of communication material.

CIPFA, the public sector accounting body measures administration costs for LGPS funds. Their average administration cost for the LGPS is around £19 per scheme member compared to their private sector in-house costs of £47 per member and private sector outsourced costs of £41.00 per member.

The Department for Communities and Local Government's (DCLG) 2010 report on LGPS administration costs confirms that these vary significantly between types of authority with values ranging from £22.48 to £55.64 per member. The average across all authorities is £28.31 per member.

Capita, who administer schemes in both the public and private sector, suggest that large private sector schemes might have average costs of between £20 and £25 per member. They also state that the annual cost per member for the Teacher's Scheme (an unfunded scheme) is around £10 per member.

**Q21) How do private sector schemes ensure that there is good quality and efficient scheme administration? Which measures can be applied to public service schemes?**

The factors which result in good quality and efficient scheme administration are the same across private and public sector schemes and include data quality, IT systems, processes and the effective use of technology. Of course, quality of administration staff and their training and the overall quality of member communications also play key parts.

**Q22) Is there scope for rationalising the number of local government pension funds? If so, how could this be achieved?**

LGPS Funds range in size from £150m to over £10bn with over 90% of Funds above £500m. LGPS Funds are therefore already large pension funds. The average fund is approaching £1.5bn.

The argument for combining funds is usually that larger funds achieve greater economies of scale in terms of administration costs and investment management costs. However larger funds tend to have less flexibility and find it more difficult to change tack in areas such as investment strategy.

Combining Funds may improve efficiency levels but at the expense of reducing local democracy of decision making and would be at odds with the Government's localism policies.

We believe that a simpler and more democratic way to increase efficiency would be via shared working.

There is already a great deal of collaboration between Funds either, via local regional groups or at national level, on administration and communication issues. Our view is that greater encouragement of sharing pensions related services in the same way that a number of local authorities are looking at sharing other services would be maintain the local democracy element within the LGPS and help improve the overall efficiency of the management of the LGPS.

There are already examples of this where Funds have got together to procure certain services such as actuarial and investment services and so reduce costs and others where neighbouring Funds are considering combining administration functions.

There are also issues in combining funds particularly for those with different funding and investment strategies, not forgetting that mergers also incur costs.

On balance therefore we believe that there may be a case for combining some of the smaller funds but combining the larger funds we believe would not result in significant savings especially where there is some element of joint working and sharing services. There would also be some political issues associated in combining funds that should not be underestimated.

## Transition issues

### Q23) How can the Commission ensure an effective transition to the new arrangements?

The issues and amount of work involved associated with moving for one benefit structure to another should not be underestimated.

Public service schemes have adapted to changing circumstances in the last 10 years or so although the different public sector schemes have tackled changes in different ways. The unfunded schemes have usually closed the existing scheme to new recruits and offered the new arrangements to new staff but in some cases allowing existing staff to move across to the new scheme if they wish.

The LGPS has generally tried accommodate the changes within the one scheme and changed future benefits for all staff but with transitional protections for staff closer to retirement age. This leads to some very complex arrangements which are ultimately more difficult and costly to administer and communicate.

Our view is that there should be one overall design for all public service schemes based on some agreed principles with some sector specific modifications for say uniformed staff or other "niche" parts of the public sector.

On the grounds of simplicity we would also advocate that there should be a "clean break" with all existing staff leaving the existing scheme and then joining the new scheme.

The key issue here is how to deal with accrued rights.

There is considerable debate on what exactly accrued rights. Our view is that they are benefits based on contribution paid or service to date and payable from the existing retirement age.

The key issue is whether these benefits maintain the final salary linkage until the existing normal retirement age or provide early leaver deferred benefits. In their review of the MPs' Scheme, the Senior Salaries Review Body recommended the latter approach. In reality as MPs' are not salaried as such, the difference in approach is not significant.

However we suspect that this would be a more contentious issue in the public service schemes. Removing the final salary link for accrued benefits would be a complete "clean break" and would be consistent with keeping things simple. In the current economic climate with no or limited pay increases in the public sector then we may find that employees, particularly those nearer retirement age might actually favour accrued benefits increasing with CPI rather than future uncertain pay increases.

A compromise might be to offer "enhanced" revaluation of either national average earnings increases or CPI plus perhaps 1% or 2%.

### Q24) What can the Commission learn about moving to a new scheme from best practice in the private sector and internationally?

Any changes to pension terms, which may not be that widely understood in the first place, usually results in mis-informed speculation and unnecessary angst.

Communication of change is therefore key and the transition budget in terms of time and cost should not be underestimated.

**Q25) How have accrued rights been protected or transferred during changes in schemes in the private sector?**

By law it is not possible to reduce an employees' accrued rights below those that they would have been entitled to, had they just left the pension scheme, without their consent. As mentioned earlier in our response, the key issue is whether the accrued benefit continues to be linked to future pay increases (in a final salary scheme) or statutory increases of deferred benefits (CPI) or something greater than this. We would advocate that, in the interests of simplicity, the final salary link is broken, perhaps with some enhanced revaluation, to compensate for losing the final salary link.

We hope that you find our comments of assistance. As we indicated earlier in this response, we are available to meet with you to build on these comments ahead of your final report and recommendations.

Yours sincerely

**Graeme D Muir FFA**
**ACA Main Committee**

# Appendix – Scheme Designs Principles

In our response to Q1 we suggested that any scheme design should try to meet the following objectives.

- Adequate level of income at retirement that maintains it purchasing power in real terms

- Reasonably predictable level of income and flexibility of how pension benefits are drawn down

- Include some "safety valves" to cope with changing circumstances

- Designs that are fair in terms of how costs are met across generations and between employee and employer.

- Designs that are simple for employees to understand and appreciate and that are simple to administer.

## Core Care

We would advocate a "core care" arrangement on an agreed first tier of earnings (e.g. £50,000) with an agreed accrual rate (expressed as a percentage rather than a fraction – say 1.75% to help with the perception of breaking the link with final salary schemes), guaranteed revaluation and indexation of pensions in payment at an agreed level (say CPI) and a retirement age linked to State Pension Age.

The accrual/revaluation mix is important. We would favour a higher accrual and lower revaluation so that pension benefits are built up more quickly and so employees who have several employments throughout their career are not disadvantaged compared to those who stay in the one job for all of their careers. A key challenge in implementing reform is how to sell the "pay more for less" concept. Having a slightly higher accrual rate – say 1.75% compared to the typical 1/60$^{th}$ or 1.67% would help achieve this.

If some element of risk sharing was deemed appropriate for all public sector employees then the "core care" element could be cash balance rather than pension based. So the accrual rate could be 20 times the pension accrual rate (e.g. 30% of pay) which also might help with the "more for less" issue. Some of the "annuity risk" could be shared with the employer via scheme specific and reviewable annuity conversion rates.

## Conditional Care

To introduce some element of progressive risk sharing we would advocate one of the following designs on earnings above the agreed level.

- "Conditional Care" – same accrual and retirement age as the core care element but a level of revaluation and indexation that is conditional on underlying investment returns (smoothed over a period). For unfunded schemes there may have to be some notional returns but could be based on economic factors such as growth in GDP for example. We would suggest a floor of zero so that benefits cannot reduce – akin to with profit bonus systems but with greater transparency of how the return is calculated.

- "Cash Balance" – same retirement age and revaluation as the core care element but an accrual rate of say 20 times the core care accrual (assuming a pension based core care) with the member being able to draw down from the accumulated fund or annuitise. Possible to have scheme specific conversion rates to share the "annuity risk"."

- Conditional Cash Balance" – as Cash Balance but with conditional revaluation – akin to the notional Swedish DC model.