THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

COMMITTEE *FOR* EMPLOYMENT & SOCIAL SECURITY

UPRATING POLICY FOR STATES PENSION

The States are asked to decide:

Whether, after consideration of the policy letter entitled 'Uprating policy for States pension', dated 20th January 2020, they are of the opinion:

1. To rescind resolution 1 on Article VIII of Billet d'État XVIII of 2015, setting the guideline for the annual uprating of the old age pension (soon to be renamed "States pension").

2. To approve that the guideline for the annual uprating of the old age pension/States pension, is an increase of RPIX plus one third of the real increase in median earnings.

3. To set, from 1st January 2021, the contribution rates for employers at 6.9%, as set out in Table 5 of that policy letter.

4. To set, from 1st January 2021, the contribution rates for employees at 6.8%, as set out in Table 5 of that policy letter.

5. To direct the Committee *for* Employment & Social Security to report back to the States no later than the last quarter of 2021, with further proposals to secure the financial sustainability of the Guernsey Insurance Fund.

6. To direct the preparation of such legislation as may be necessary to give effect to the above decisions.

The above propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

COMMITTEE *FOR* EMPLOYMENT & SOCIAL SECURITY

UPRATING POLICY FOR STATES PENSION

The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

20th January 2020

Dear Sir

1. Executive summary

1.1. Having considered a policy letter entitled 'Benefit and contribution rates for 2016'[1], the States of Guernsey resolved:

> "3. That the Committee [*for* Employment & Social Security] be directed to review the guideline for the annual uprating of statutory old-age pensions no later than 2020, having regard to progress made in establishing supporting policies to enhance personal pension provision and the actuarial projections for the Guernsey Insurance fund at that time".

1.2. This policy letter seeks to fulfil the above resolution and to set a baseline for the uprating of the old age pension (soon to be formally renamed "States pension", the term used hereafter), which future Committees can use as a starting point when preparing the annual uprating report.

1.3. After reviewing a variety of options and their potential impact on the longevity of the Guernsey Insurance Fund ("the Fund"), the Committee *for* Employment & Social Security ("the Committee") is proposing that the guideline uprating policy will be annual increases of RPIX + ⅓ of the difference between RPIX and the annual change in median earnings (hereafter referred to as "the ⅓ uprating policy"). In the event that the median earnings increase

[1] Billet d'État XVIII of 2015, Article 8, Resolution 3

is less than the RPIX increase, then RPIX alone would be used. This is in line with the uprating policy that has been used for several years now.

1.4. In order to improve the funding position of the Fund, the Committee is also proposing that, with effect from 1st January 2021, contribution rates should increase by 0.3% and 0.2% for employers and employees respectively. Based on core assumptions, this will not be sufficient to offset the projected long-term funding shortfall. However, it will partially offset it until such time that a more thorough review can provide a better projection of long term funding requirements.

2. Introduction

2.1. Over the years, annual increases to the States pension have varied considerably. In many years, increases have been proportionate to some measure of inflation and/or median earnings increases, but in some years the uprating has been untethered from these measures in response to the economic circumstances of the day. Every year it is important to consider the correct uprating policy in light of current economic circumstances. Those circumstances include both the financial hardship of those relying on the States pension, and the financial hardship of the working age population, who will have to support the additional cost. As a result it is most accurate to call this proposal a guideline. The intention is that, should the Committee decide to deviate from this in any given year, it should provide reasons for doing so in the annual uprating report. A decision to change the guideline is one which should be supported with more detail than is usually contained in the annual uprating report.

2.2. The present guideline is that the pension should be increased every year by RPIX + ⅓ of the difference between RPIX and the increase in median earnings. This has been the case for a number of years. The October 2015 uprating report for 2016 benefit and contribution rates, proposed that this guideline was formally established, and that from 2025, a policy of uprating by RPIX only would be adopted[2]. This policy letter asks the States to reconsider this guideline in light of the Committee's concerns that this conservative uprating policy will ultimately result in increased pensioner poverty and inconsistent and unpredictable uprating in future.

2.3. The Committee is aware that actuarial reviews provide the best evidence of the sustainability of the Fund. In the case of the Guernsey Insurance Fund, the reviews are produced at 5-yearly intervals. The next review, covering the period 2015 to 2019, and with 60-year forward projections, is expected to be available in late 2020. In the next political term, the Committee may wish to

2 Billet d'État XVIII of 2015, Article 8, Resolution 1

review the uprating guidance in light of these forthcoming projections. However, at present, the Committee is of the view that it is appropriate to set a guideline based on the best information available internally, having built on the last review undertaken by the Government Actuary's Department (GAD).

3. Background

3.1. When considering pension increases, two metrics are often considered. The first is the movement in inflation (RPIX or RPI) and the second is the movement in median earnings. Broadly speaking, these two uprating indices represent two different ideals of what the pension should achieve. By following RPIX, the increases should keep pace with the cost of living and the pension should represent the same buying power for essential goods and services. Alternatively, by following median earnings increases, the pension should keep pace with the experience of the working population. This means that the pension should retain its value relative to the income of the wider population, and the difference in the quality of life between the retired and non-retired population should remain stable (disregarding the impact of any private or occupational pensions).

3.2. The application of an uprating policy which is based on a point between RPIX and median earnings increase is perhaps best explained by way of an example. A calculation using an uprating policy of RPIX + ⅓ of the real increase median earnings is shown in the table below.

Table 1 – Example: calculating an uprating policy of RPIX +⅓ of the real increase in median earnings

	Rate	**Notes**
RPIX	2.0%	
Median earnings increase	6.0%	
Real median earnings increase	4.0%	Median earnings increase (6%) minus RPIX (2%).
⅓ of real median earnings increase	1.3%	This is always rounded to one decimal place.
Uprating	**3.3%**	**RPIX (2%) + ⅓ of real median earnings increase (1.3%)**

3.3. Historically, median earnings increases have been greater than RPIX increases. However, in recent years this effect has diminished, to the point where RPIX has sometimes exceeded median earnings increases. Based on the assumption that median earnings will at least partially recover, it is projected that a model of uprating based on median earning increases would be a more expensive option and result in the Fund depleting more quickly.

3.4. The difference between the two metrics can be quite stark. Table 2 below shows the impact of applying these policies over a 50 year horizon, effectively one working life. The table assumes that RPIX is equal to 2.5% per annum over the long term and that the median earnings increase is an additional 1.5% per annum, which is in line with the base projections used in the last actuarial report, for the period 2010-2014 inclusive.

Table 2 – Illustrative pension rates based on alternative uprating policies

	2020	**2030**	**2040**	**2050**	**2060**	**2070**
RPIX	£222.58	£284.92	£364.72	£466.88	£597.64	£765.03
Median earnings increase	£222.58	£329.47	£487.70	£721.92	£1,068.61	£1,581.81

3.5. The effect of this policy can, to a certain extent, be seen by comparing the UK Basic State Pension to the Guernsey States pension. From 1980 until 2010, the UK strictly followed a policy of inflation-based uprating. Meanwhile, Guernsey followed a more variable method, which in many years factored in at least an element of earnings-based increases. In November 1980, the full UK Basic State Pension was £27.15 per week for a single person, and in 2010 it was £97.65. The full Guernsey States pension was £27.00 in November 1980, and £174.65 in 2010. This demonstrates how, over less than one working lifetime, a purely inflation-based uprating policy could leave pensioners in a significantly worse position than if the policy was linked partly or fully to the increase in earnings.

3.6. To provide some historical context, Table 3 overleaf shows the increases applied in previous years, along with the accompanying reason or reference to the policy applied.

Table 3 – Historic pension uprating policies approved by the States

Year of increase	Percentage increase	Policy
2020	2.3%	RPIX + ⅓ of real median earnings Increase
2019	2.4%	RPIX only (median earnings increase was less than RPIX)
2018	2.8%	RPIX only (median earnings increase was less than RPIX)
2017	0.8%*	RPIX + ⅓ of real median earnings increase
2016	1.7%	RPIX + ⅓ of real median earnings increase
2015	2.1%	RPIX only
2014	2.1%	RPIX only
2013	3.6%	RPIX + 0.5%
2012	3.6%	RPIX + ½ the projected long term real median earnings increase
2011	2.9%	RPIX + 0.5% - this was lower than the policy of RPIX + ½ of projected long term real median earnings increase, which was the approved policy at the time.
2010	2.0%	0.7% under RPIX** but 3.3% above RPI, the measure used until that point. The less generous uprating was based on the economic conditions of the time.
2009	6.5%	RPI +1.0%
2008	6.0%	RPI +1.3%
2007	3.4%	RPI only – in light of economic concerns
2006	5.4%	RPI+ 0.8% - reduced from previous years in light of economic circumstances and draw down of the fund
2005	7.0%	RPI +2.5% - due to concerns about pensioner poverty
2004	7.4%	RPI +3.1% - due to concerns about pensioner poverty
2003	7.5%	RPI +4.2% - due to concerns about pensioner poverty

* 2017 benefit rates were later restated to a 1% increase, this was to reflect a change in the methodology for calculating median earnings. This was implemented through an uplift from 2018 onwards and was not backdated.

** From 2010, the States-approved measure of inflation used for uprating changed from RPI to RPIX.

3.7. In 2006 (the earliest year from which annual figures are available), the annual median earnings figure was £23,660. At the end of 2018, the figure was £33,622, which was an increase of approximately 42%. The RPIX increase over the same period was approximately 38%. In 2006, the full rate States pension was £146.50 and as of 1st January 2019, was £217.36, which was an increase of approximately 48%. This indicates that over the past 13 years, pension increases have modestly exceeded the real terms increase in both median earnings and RPIX.

4. Impact of initiatives encouraging private savings

4.1. The propositions that the Committee has lodged regarding the establishment of a Secondary Pensions Scheme[3], if approved, will deliver significant improvements to retirement incomes, over time. This will be a great step forward for private pension saving, enabling far more people to take increased control over their retirement income. That said, the Secondary Pensions provisions are only part of the picture, and their full benefits will not be realised for many years, as it will take time for individuals' pension funds to build up.

4.2. As has been indicated in that policy letter, the Secondary Pensions Scheme is intended to reinforce existing retirement incomes[4], not to replace the States pension. For an individual with a lower quartile income contributing for their whole working life, the States pension is still projected to form around 50% their retirement income. In the case of a median earner, the States pension is projected to make up 40% of their retirement income.

4.3. Even with the combination of the States pension and the proposed Secondary Pensions Scheme, a person with a lower quartile income is only just likely to reach their target replacement rate of 80% of their income. This target replacement rate is the amount of income projected to be necessary for an individual to transition into a reasonably comfortable retirement. The Secondary Pensions Scheme will not be delivering extravagant retirement incomes. Instead, it is intended simply to be a comfortable retirement, when offered alongside the States pension.

4.4. The importance of the States pension is twofold. Firstly, it is re-distributive, which means that its value recognises the duration of participation, not the sum contributed to the Fund. This is vital to those who contribute long-term, but have lower incomes. If the States are to ensure that the most financially vulnerable have a reasonably secure retirement, there must be some kind of re-distributive effect. Providing for an adequate retirement on personal income alone is simply not viable for the lowest income households.

4.5. The second important point is that the States pension provides for those who, for reasons of circumstance, cannot contribute to a private pension. In many cases, working age individuals are not actively earning and are not able to

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3 Billet d'État IV of 2020, Article 2

4 Retirement income here refers to the income a person has when they are retired and of pensionable age. It mainly includes income from the States pension, private pensions and occupational pensions.

contribute to a private pension. Examples of this would be parental leave, unemployment or long-term sickness, being reasons which are either socially beneficial, or unavoidable. While these individuals are not working, contribution credits may preserve their entitlement to long-term benefits, such as the States pension, and prevent a gap forming in their contribution record.

5. Possible uprating policies

5.1. The Committee considered a number of options, including the following:

- RPIX only,
- RPIX + ⅓ of the real increase in median earnings until 2025 and thereafter RPIX only (This is the current States-approved policy),
- RPIX + ⅓ of the real increase in median earnings,
- RPIX + ½ of the real increase in median earnings, and
- Median earnings.

5.2. These options have been modelled internally and, therefore, may not be as accurate as those that would be produced via an external actuarial review. However the Committee is satisfied that they are sufficient for the setting of a guideline, which by its nature can be deviated from and should be reviewed as new information becomes available. These projections are based on an assumed median earnings increase of RPIX + 1%, which is 0.5% lower than the assumption used in the last actuarial projection. The reason for this is that over the past decade, the real increases in median earnings have been substantially lower than they were prior to 2000. This may be an anomaly, but if it is, it has continued for quite some time.

5.3. Table 4 overleaf indicates that, irrespective of the pension uprating option used, the Fund is projected to be exhausted unless contribution rates are increased. The exhaustion point of the Fund actually changes relatively little based on the uprating policy applied, which demonstrates just how rapidly Guernsey's demographics are due to change. The increases in contribution rates required to avoid the exhaustion of the Fund, would need to be applied immediately, in order to be effective, of course, depending on which uprating policy is approved, and the required minimum balance of the Fund. If increases in contribution rates are not made soon, then greater increases will need to be applied in the future. It should be noted that these figures are subject to a number of sensitivities, including population growth, life expectancy, median earnings increases and investment returns. It should also be noted that the cumulative effect of small differences in those sensitivities, could substantially improve or worsen the situation.

Table 4 – Projected impact on the Guernsey Insurance Fund of various uprating policies.

Policy option	Exhaustion of the Fund	Additional contribution rates for positive Fund balance in 2065	Additional contribution rates required to maintain two years of expenditure in the Fund
Current policy	2040	1.0%	1.3%
RPIX only	2042	0.7%	1.1%
⅓ earnings	2039	1.5%	1.8%
½ earnings	2038	1.9%	2.2%
Full earnings	2036	3.3%	3.6%

5.4. It should be noted that, the current States-approved policy is that a buffer of a minimum of two years of expenditure should be maintained in the Guernsey Insurance Fund[5]. The additional increase in contribution rates required to maintain this buffer is shown in the final column of Table 4 above.

6. Sustainability of the Fund

6.1. Cursory consideration of the matter would conclude that the most financially prudent approach would be to adopt an RPIX-only uprating policy. The Committee is of the opinion that this is not the case. A restrictive uprating policy leads to an undervalued pension and the marginalisation of those reliant on it. The end result is that, sooner or later, political pressure will build and the result will be a demand for a substantial increase over a short period of time. The value of the States pension can only diminish so far before it becomes unacceptable. Care must be taken to retain financial constraint while not pushing people into poverty.

6.2. When dealing with a long-term financial liability, minimising uncertainties is of great benefit. Planning to meet pension liabilities is much easier if consistency and predictability can be secured wherever possible. Accepting this from the outset will allow the States to consider reasonable funding levels, rather than going through the pain of contribution increases, only for further and more substantial increases to be levied when benefit rates are substantially increased once they prove to be unacceptable.

7. Proposals

7.1. Although the Committee would like to be able to recommend a generous uprating policy with a median earnings-based increase, it recognises that this is very unlikely to be financially achievable in light of other budgetary

5 Billet d'État IV of 2015, Article 1, Resolution 9

pressures. It is proposed that the uprating guideline should be RPIX + ⅓ of the real increase in median earnings. This would be the same as the current policy, but removing the commitment to reduce to uprating the States pension by RPIX only from 2025[6]. The Committee is of the opinion that this is likely to be the optimum affordable option.

8. Funding and costs

8.1. The projections shown in Table 4 demonstrate that, based on core assumptions, contributions into the Fund would need to increase substantially in order to support even the least generous uprating policy. The Committee has said repeatedly throughout this political term that contribution rates will need to increase. It is a difficult reality to confront, but it is one which cannot be ignored.

8.2. Having regard to the fact that an actuarial review of the Fund will take place during 2020, and noting how carefully the sensitivities mentioned in paragraph 5.3 will need to be considered, the Committee does not believe it is advisable to rigidly base its uprating proposals on the additional contribution rates indicated in Table 4. It is quite possible that the new projections could present a different picture. Instead, the Committee is minded to take a smaller interim step, which will narrow the funding gap. Further steps can be taken in future years, once the report on the forthcoming actuarial review of the Fund is available to provide more accurate guidance.

8.3. The Committee is proposing that, with effect from 1st January 2021, the Class 1 contribution (which is comprised of employer and employee contributions) is increased by 0.5%. To achieve this, it is proposed that the employer's contribution will increase by 0.3% and the employee's contribution will increase by 0.2%. This is broadly in line with the current ratio for contributions to the Guernsey Insurance Fund, as set out in Table 5 below.

Table 5 – Proposed Contribution Rates from 2021

	Current Rates	Proposed Rates
Employer	**6.6%**	**6.9%**
Guernsey Insurance Fund	5.0%	5.3%
Guernsey Health Service Fund	1.6%	1.6%
Long-term Care Insurance Fund	-	-
Employee	**6.6%**	**6.8%**
Guernsey Insurance Fund	3.5%	3.7%
Guernsey Health Service Fund	1.3%	1.3%
Long-term Care Insurance Fund	1.8%	1.8%

6 Billet d'État XVIII of 2015, Article 8, Resolution 1

8.4. The Committee is aware that there has been concern about the impact of contribution rate increases on self-employed and non-employed people, particularly since the corporate tax reforms of 2008 and the consequent increases in upper earnings limits. The 2015 Personal Tax, Pensions and Benefits Review[7] resulted in a number of States Resolutions which require the Committee to pay particular attention to the equitability of the rates charged for these contributors. The impacts of increases in contribution rates, and the increases in the upper earnings limits are felt all the more by self-employed and non-employed people, as there is no employer to share the cost with.

8.5. In view of the foregoing, the Committee considers it appropriate to leave the contribution rates for self-employed and non-employed people unchanged.

8.6. If the States approves the propositions, the increases would come into effect on 1st January 2021, as part of the annual process of uprating benefit and contribution rates. This should provide adequate time for the States to make appropriate adjustments to systems and legislation, as well as allowing businesses time to plan and prepare.

8.7. It is estimated that the additional 0.5% on the Class 1 contribution rates will provide income of approximately £6m per annum to the Guernsey Insurance Fund.

8.8. The increase in the employer's contribution rate will have a cost to the States in their role as employer. It is estimated that the additional cost to General Revenue will be £600,000 per annum.

8.9. The increase in the employee's contribution rate will also have a cost to the States under income support. This is because the assessment of a claimant's income takes account of earnings after deduction of social security, tax and pension contributions. It is estimated that the additional cost to General Revenue for income support will be £100,000 per annum.

9. Consultation

9.1. During the drafting of this policy letter, the Committee has consulted with the Policy & Resources Committee. It is understood that the Policy & Resources Committee will support the proposition concerning the uprating policy, but will oppose the propositions which seek to increase contribution rates.

9.2. The Committee has also consulted with the Law Officers regarding the legal implications and legislative drafting requirements resulting from the propositions set out in this policy letter.

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[7] Billet d'État IV of 2015, Article 1

10. Conclusion

10.1. Having re-examined the uprating policy for the States pension, the Committee has concluded that the most appropriate balance in the interests of contributors, pensioners, and public funds, is to maintain the current uprating policy of RPIX plus one third of the real increase in median earnings, but removing the obligation to reduce this to an increase of RPIX only from 2025. The Committee makes this recommendation in the knowledge that the improvement in people's retirement incomes through the Secondary Pensions Scheme, presuming approval by the States, will not be substantial until people's accounts have accumulated over 20 years or more. Until such time as the Secondary Pensions Scheme does begin to have a material effect, the Committee would not support an uprating policy restricted to RPIX only.

10.2. The Committee has included in this policy letter a recommendation to increase the Class 1 contribution rate for social insurance contributions by 0.5%, with 0.3% being paid by the employer and 0.2% being paid by the employee. This proposal would take effect from 1st January 2021. The Committee makes this recommendation in the belief that the forthcoming actuarial review of the Guernsey Insurance Fund, and any other associated fiscal reviews, will inevitably find that a contribution rate in excess of that amount is required for the long-term sustainability of the Fund. Given that belief, the Committee takes the view that the earlier that initial 0.5% can be applied, the more effective it will be.

10.3. The Committee's propositions accord with the Committee's purpose:

> "To foster a compassionate, cohesive and aspirational society in which responsibility is encouraged and individuals and families are supported through schemes of social protection relating to pensions, other contributory and non-contributory benefits, social housing, employment, re-employment and labour market legislation."

10.4. In particular, the propositions are aligned with the priorities and policies set out in the Committee's Policy Plan, which was approved by the States in June 2017 (Billet d'État XII, Article 1). The Committee's Policy Plan is aligned with the States objectives and policy plans.

10.5. In accordance with Rule 4(4) of the Rules of Procedure of the States of Deliberation and their Committees, it is confirmed that propositions 1, 2, 5 and 6 have the unanimous support of the Committee. Propositions 3 and 4, concerning increases in contribution rates, are supported by a majority of the Committee, with Deputy Shane Langlois dissenting.

Yours faithfully

M K Le Clerc
President

S L Langlois
Vice-President

J A B Gollop
E A McSwiggan
P J Roffey

M J Brown
Non-States Member

A R Le Lièvre
Non-States Member