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15 December 2011

Dear Trade Union representative

## **GOVERNMENT CIVIL SERVICE PENSIONS FORMAL OFFER**

Set out below is the formal Government offer (full Heads of Agreement attached at Annex 1) for a new pension scheme for the Civil Service.

We believe that we have made sufficient progress to enable you to recommend these fundamental items of the scheme to your Executives, or other appropriate formal approval process. That being the case, we see no reason for further delay.

We will accordingly need your written confirmation, no later than 10.00am on Monday 19 December that you agree that the talks have progressed to the point that you will recommend these elements of the design to your Executives, with a view to agreement.

I should also be grateful if you could confirm that your union will not call for further industrial action (within the Civil Service and schedule 1 bodies) on this matter whilst final details are resolved and you consult your members. I can confirm that in return the Government will not seek to introduce a different pension scheme while you undertake this consultation.

If you feel unable to provide such written confirmation, we will conclude that you have rejected agreement on pension reform and you will no longer be part of these discussions.

### **Main Parameters**

The main parameters of the new scheme are provided below, many of which are modelled on the existing **nuvos** scheme. These are outlined below.

- a. A pension scheme design based on career average;
- b. A provisional accrual rate of 2.28% (equivalent to 1/43.9) of pensionable earnings each year, subject to further agreement on outstanding issues not covered by this agreement (see below).
- c. Revaluation of active members' benefits in line with CPI;

- d. a Normal Pension Age equal to State Pension age, which applies both to active members and deferred members (for new scheme service only);
- e. pensions in payment to increase in line with Prices (currently CPI);
- f. benefits earned in deferment to increase in line with Prices (currently CPI);
- g. Average member contributions of 5.6%, with some protection for the lowest paid (the detailed structure of which is still to be agreed);
- h. Optional lump sum commutation at a rate of 12:1, in accordance with HMRC limits and regulations;
- i. Spouses/Partner pension of three-eighths of pension, in line with the current open scheme ;
- j. Lump-sum on death in service of 2 times salary;
- k. Ill-health benefits in line with those in the current open scheme;
- l. Actuarially fair early/late retirement factors on a cost-neutral basis; and,
- m. As set out in Danny Alexander's letter of 14 December to Brendan Barber, an employer contribution cap to provide backstop protection to the taxpayer against unforeseen costs and risks. As also set out in the letter this cap will also allow for an improvement in member benefits if the value of the scheme falls beyond a fixed level;
- n. The scheme will support the use of partial retirement and will follow the recommended approach set out in the IPSPC report on abatement (further details of which to be agreed in early 2012 – see Annex A)
- o. A guarantee, as set out in Danny Alexander's letter of 14 December to Brendan Barber, of no further reform for the next 25 years.

### **Transitional Arrangements**

Scheme members who, as of 1 April 2012, have 10 years or less to their current pension age will see no change in when they can retire, nor any decrease in the amount of pension they receive at their current Normal Pension Age. They will be allowed to remain members of their existing schemes up to and including the point at which they draw their pension rights and all current scheme rules will continue to apply.

Members who are within a further 3.5 years outside this protected group will have an additional degree of protection, in the form of further accrual in their existing schemes. This protection will be tapered in a linear fashion depending on the age of the member.

### **Areas for further detailed discussion**

The following areas will be discussed in early 2012. The requirement to fit the new scheme within the revised cost ceiling for the Reference Scheme published on 2 November will remain, and agreement on these issues will also be subject to review by HM Treasury to agree the approach taken to risk management and impact on cash flows.

- i) Abatement (for service accrued prior to and post 2015),
- ii) Partial Retirement and re-employment
- iii) Options for drawing part 1 and part 2 pensions before new NPA

(Detail for the above elements will be developed to implement the principles set out in part n above)

- iv) Treatment of members who leave active service but rejoin within 5 years.
- v) Options for giving members greater choice over their contribution rates, subject to HMT agreement over the cash profile of scheme contributions, and minimising the likelihood of scheme opt-outs.
- vi) Treatment of members who transfer between Public Sector Transfer Club schemes
- vii) Contribution rates and structure, including the distribution of years 2 and 3 of planned increases.
- viii) The implications of the pension reforms for Total Reward
- ix) The treatment of ill health retirement and death in service benefits for staff with service before the introduction of the new scheme
- x) The nature of any choice exercise for staff covered by the transitional arrangements (so allowing proper consideration of the costs and the legal implications).

Kind regards



WILLIAM HAGUE

*Sue Gray*

SUE GRAY

## **ANNEX 1**

### **CIVIL SERVICE PENSIONS**

#### **OFFER TO THE TRADE UNIONS: TEXT OF MCO LETTER TO CHANCELLOR**

1. This document sets out the Heads of Agreement on the scheme design for the Principal Civil Service Pension Scheme to be introduced in 2015, on which talks have concluded. The government have made clear this sets out their final position on the main elements of scheme design, which unions have agreed to take to their Executives as the best that can be achieved through negotiations. Further work on the remaining details will take place in the New Year, and Executives will consult members as appropriate. This includes a commitment to suspend any further industrial action while the final details are resolved and Unions are consulting their members.

#### **Scheme design**

2. The main parameters of the new scheme are provided below, many of which are modelled on the existing **nuvos** scheme. Scheme-level discussions will continue in early 2012 on a number of issues not covered by this Agreement. These are outlined at Annex A.
  - a. A pension scheme design based on career average;
  - b. A provisional accrual rate of 2.28% (equivalent to  $(1/43.9)$  of pensionable earnings each year, subject to further agreement on outstanding issues not covered by this agreement (see Annex A).
  - c. Revaluation of active members' benefits in line with CPI; (any change in the method of indexation will be subject to consultation)
  - d. a Normal Pension Age equal to State Pension age, which applies both to active members and deferred members (for new scheme service only);
  - e. pensions in payment to increase in line with Prices (currently CPI);
  - f. benefits earned in deferment to increase in line with Prices (currently CPI);

- g. Average member contributions of 5.6%, with some protection for the lowest paid (the detailed structure of which is still to be agreed);
- h. Optional lump sum commutation at a rate of 12:1, in accordance with HMRC limits and regulations;
- i. Spouses/Partner pension of three-eighths of pension, in line with the current open scheme ;
- j. Lump-sum on death in service of 2 times salary;
- k. Ill-health benefits in line with those in the current open scheme;
- l. Actuarially fair early/late retirement factors on a cost-neutral basis; and,
- m. an employer contribution cap to provide backstop protection to the taxpayer against unforeseen costs and risks (see paragraph 9 below and Annex B). This cap will also allow for an improvement in member benefits if the value of the scheme falls beyond a fixed level;
- n. The new scheme will support the use of partial retirement and will follow the recommended approach set out in the IPSPS report on abatement (further details of which to be agreed in early 2012 – see Annex A)

#### HMT approval

- 3. The scheme design has been reviewed by HM Treasury who have agreed the approach taken to risk management.

#### Scheme actuary verification

- 4. The Government set out the gross cost ceiling of 22.5% and the net cost ceiling of 16.9% in *Public Service Pensions: good pensions that last*, Cm8214. Separate to this Agreement, to support HMT's verification of scheme design costs, is a report by the scheme actuary verifying that the proposed scheme design above is within the cost ceiling. This report has been prepared in accordance with the advice in the Government Actuary's Department's report of 7 October 2011: Cost ceilings for scheme level discussions: Advice on data, methodology and assumptions.

### Transitional protection arrangements

5. Scheme members who, as of 1 April 2012, have 10 years or less to their current pension age will see no change in when they can retire, nor any decrease in the amount of pension they receive at their current Normal Pension Age. They will be offered a choice to remain members of their existing schemes up to and including the point at which they draw their pension rights and in which case all current scheme rules will continue to apply.
6. Members who are within a further 3 to 4 years outside this protected group will have an additional degree of protection, in the form of further accrual in their existing schemes. This protection will be tapered in a linear fashion depending on the age of the member. More details of this protection are provided at Annex C.

### Fair Deal

7. On the basis that the scheme design in this heads of agreement is agreed, the Government agrees to retain Fair Deal provision and extend access to public service pension schemes for transferring staff. This means that all staff whose employment is compulsorily transferred from the Civil Service under TUPE, including subsequent TUPE transfers, will still be able to retain membership of the Principal Civil Service Pension Scheme when transferred. These arrangements will replace the current provisions for bulk transfers under Fair Deal, which will no longer apply.

### Further detail on employer cost cap, NPA/SPA and 25 year guarantee

8. This agreement also covers arrangements for an employer cost cap, the treatment of NPA following any further changes to SPA, and a 25 year guarantee. These are set out in more detail at Annex B.

## **ANNEX A – AREAS FOR CONTINUING DISCUSSION IN EARLY 2012**

1. The following areas will be discussed in early 2012. The requirement to fit the new scheme within the revised cost ceiling for the Reference Scheme published on 2 November will remain, and agreement on these issues will also be subject to review by HM Treasury to agree the approach taken to risk management and impact on cash flows.

- xi) Abatement (for service accrued prior to and post 2015),
- xii) Partial Retirement and re-employment
- xiii) Options for drawing part 1 and part 2 pensions before new NPA

(Detail for the above elements will be developed to implement the principles set out in paragraph 2 part n of the main document)

- xiv) Treatment of members who leave active service but rejoin within 5 years.
- xv) Options for giving members greater choice over their contribution rates, subject to overall average contribution rates remaining at 5.6%, HMT agreement over the cash profile of scheme contributions, and minimising the likelihood of scheme opt-outs.
- xvi) Treatment of members who transfer between Public Sector Transfer Club schemes
- xvii) Contribution rates and structure, including the distribution of years 2 and 3 of planned increases.
- xviii) Ill-health retirement in the context of members with both part 1 and part 2 pensions
- xix) The implications of the pension reforms for Total Reward

## **ANNEX B: FUTURE SPA CHANGES, EMPLOYER COST CAP AND 25 YEAR GUARANTEE**

### Future increases to SPA

1. As set out in the heads of agreement, normal pension age in the Civil Service scheme will be linked to State Pension Age for post 2015 accruals. The Government believes that the SPA should continue to keep pace with increases in longevity to ensure fairness between generations, and, as set out in the 2011 Autumn Statement, is considering how best to continue dialogue on the process that will be used to determine future changes to the SPA. This will be based on demographic evidence and allow for the views of interested parties to be considered. DWP consulted on this over the summer.
2. As recommended by Lord Hutton, the Government will keep under review the link between Normal Pension Age in the public service schemes and State Pension Age to determine whether the link between the two continues to be appropriate.

### Employer Cost Cap

3. As recommended by Lord Hutton, the Government proposes to introduce an employer cost cap. This would provide backstop protection for the taxpayer, protecting them from highly exceptional and unanticipated events which very significantly increase scheme costs. Accordingly, the Government believes this cap is highly unlikely to bite in the next 25 years.
4. The Government intends that only changes to scheme costs due to 'member costs', such as a dramatic change in longevity and as defined by previous cap and share arrangements, would be controlled by the cap. Financial cost pressures, including changes to the discount rate, would be met by employers. The employer cost cap will be symmetrical so that, if there are reductions in member costs such that the cost falls below a 'floor', the savings would go back into the scheme to the benefit of members, such as by improving members' benefits or reducing member contribution rates.

5. Scheme valuations will take place periodically to assess how the cost of the scheme has increased or reduced. In the event that member costs drive the cost of the scheme above the cap or below the floor, there will be a period of consultation, before changes are made to bring costs within the cap and floor. If agreement cannot be reached through consultation, the accrual rate will be adjusted as an automatic default.
6. The employer cost cap will be set following a full actuarial valuation. The cap will be set at 2% above, and the floor set 2% below, the employer contribution rates calculated ahead of the introduction of the new scheme in 2015. Caps will not be based on cost ceilings, but on the full actuarial valuation. Should new evidence arise over the next few months about the likely impact of the cap, the Government will be willing to consider amending the level of the cap and floor.

#### 25 year Guarantee

7. The Chief Secretary set out to Parliament on 2 November 2011 an offer on public service pensions that is fair and sustainable, and one that can endure for 25 years. This means that no changes to scheme design, benefits or contribution rates should be necessary for 25 years outside of the processes agreed for the cost cap. To give substance to this, the Government intends to include provisions on the face of the forthcoming Public Service Pensions Bill to ensure a high bar is set for future Governments to change the design of the schemes. The Chief Secretary will also give a commitment to Parliament of no more reform for 25 years.

## ANNEX C: ADDITIONAL TAPERING FOR TRANSITIONAL PROTECTION

1. Scheme members in **classic** and **premium** who on 1 April 2012 are between 46 years and 6 months and 50 (or who are in **nuvos** and aged between 51 years and 6 months and 55) will continue to accrue additional pension in their existing schemes, on a tapered basis. They will accrue for two months in their existing schemes for every month they are older than 46 years and 6 months (51 years and 6 months for **nuvos**), as set out in the table below.
2. Staff in this ‘tapering group’ will be able to take their “Part 1” pension at their current Normal Pension Age, including any additional accrual they build up post 2015. If they remained an active member after the transitional protection has ended, they would then begin to accrue “Part 2” pension in the new scheme, which would become payable in full from the NPA of the new scheme (or taken early with an actuarial reduction).

### Tapering - Classic and Premium

| Age at 1 Apr 2012 |       | Age at 1 Apr 2015 |       | Months of protection | Age at end of protection |       | Date of end of protection |
|-------------------|-------|-------------------|-------|----------------------|--------------------------|-------|---------------------------|
| year              | month | year              | month |                      | year                     | month |                           |
| 49                | 11    | 52                | 11    | 84                   | 59                       | 9     | Feb-22                    |
| 49                | 10    | 52                | 10    | 82                   | 59                       | 6     | Dec-21                    |
| 49                | 9     | 52                | 9     | 80                   | 59                       | 3     | Oct-21                    |
| 49                | 8     | 52                | 8     | 78                   | 59                       | 0     | Aug-21                    |
| 49                | 7     | 52                | 7     | 76                   | 58                       | 9     | Jun-21                    |
| 49                | 6     | 52                | 6     | 74                   | 58                       | 6     | Apr-21                    |
| 49                | 5     | 52                | 5     | 72                   | 58                       | 3     | Feb-21                    |
| 49                | 4     | 52                | 4     | 70                   | 58                       | 0     | Dec-20                    |
| 49                | 3     | 52                | 3     | 68                   | 57                       | 9     | Oct-20                    |
| 49                | 2     | 52                | 2     | 66                   | 57                       | 6     | Aug-20                    |
| 49                | 1     | 52                | 1     | 64                   | 57                       | 3     | Jun-20                    |
| 49                | 0     | 52                | 0     | 62                   | 57                       | 0     | Apr-20                    |
| 48                | 11    | 51                | 11    | 60                   | 56                       | 9     | Feb-20                    |
| 48                | 10    | 51                | 10    | 58                   | 56                       | 6     | Dec-19                    |
| 48                | 9     | 51                | 9     | 56                   | 56                       | 3     | Oct-19                    |
| 48                | 8     | 51                | 8     | 54                   | 56                       | 0     | Aug-19                    |
| 48                | 7     | 51                | 7     | 52                   | 55                       | 9     | Jun-19                    |

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|    |    |  |    |    |  |    |  |    |   |  |        |
|----|----|--|----|----|--|----|--|----|---|--|--------|
| 48 | 6  |  | 51 | 6  |  | 50 |  | 55 | 6 |  | Apr-19 |
| 48 | 5  |  | 51 | 5  |  | 48 |  | 55 | 3 |  | Feb-19 |
| 48 | 4  |  | 51 | 4  |  | 46 |  | 55 | 0 |  | Dec-18 |
| 48 | 3  |  | 51 | 3  |  | 44 |  | 54 | 9 |  | Oct-18 |
| 48 | 2  |  | 51 | 2  |  | 42 |  | 54 | 6 |  | Aug-18 |
| 48 | 1  |  | 51 | 1  |  | 40 |  | 54 | 3 |  | Jun-18 |
| 48 | 0  |  | 51 | 0  |  | 38 |  | 54 | 0 |  | Apr-18 |
| 47 | 11 |  | 50 | 11 |  | 36 |  | 53 | 9 |  | Feb-18 |
| 47 | 10 |  | 50 | 10 |  | 34 |  | 53 | 6 |  | Dec-17 |
| 47 | 9  |  | 50 | 9  |  | 32 |  | 53 | 3 |  | Oct-17 |
| 47 | 8  |  | 50 | 8  |  | 30 |  | 53 | 0 |  | Aug-17 |
| 47 | 7  |  | 50 | 7  |  | 28 |  | 52 | 9 |  | Jun-17 |
| 47 | 6  |  | 50 | 6  |  | 26 |  | 52 | 6 |  | Apr-17 |
| 47 | 5  |  | 50 | 5  |  | 24 |  | 52 | 3 |  | Feb-17 |
| 47 | 4  |  | 50 | 4  |  | 22 |  | 52 | 0 |  | Dec-16 |
| 47 | 3  |  | 50 | 3  |  | 20 |  | 51 | 9 |  | Oct-16 |
| 47 | 2  |  | 50 | 2  |  | 18 |  | 51 | 6 |  | Aug-16 |
| 47 | 1  |  | 50 | 1  |  | 16 |  | 51 | 3 |  | Jun-16 |
| 47 | 0  |  | 50 | 0  |  | 14 |  | 51 | 0 |  | Apr-16 |
| 46 | 11 |  | 49 | 11 |  | 12 |  | 50 | 9 |  | Feb-16 |
| 46 | 10 |  | 49 | 10 |  | 10 |  | 50 | 6 |  | Dec-15 |
| 46 | 9  |  | 49 | 9  |  | 8  |  | 50 | 3 |  | Oct-15 |
| 46 | 8  |  | 49 | 8  |  | 4  |  | 50 | 0 |  | Aug-15 |
| 46 | 7  |  | 49 | 7  |  | 2  |  | 49 | 9 |  | Jun-15 |
| 46 | 6  |  | 49 | 6  |  | 0  |  | 49 | 6 |  | Apr-15 |

Tapering – Nuvos

| Age at 1 Apr 2012 |       | Age at 1 Apr 2015 |       | Months of protection | Age at end of protection |       | Date of end of protection |
|-------------------|-------|-------------------|-------|----------------------|--------------------------|-------|---------------------------|
| year              | month | year              | month |                      | year                     | month |                           |
| 54                | 11    | 57                | 11    | 84                   | 64                       | 9     | Feb-22                    |
| 54                | 10    | 57                | 10    | 82                   | 64                       | 6     | Dec-21                    |
| 54                | 9     | 57                | 9     | 80                   | 64                       | 3     | Oct-21                    |
| 54                | 8     | 57                | 8     | 78                   | 64                       | 0     | Aug-21                    |
| 54                | 7     | 57                | 7     | 76                   | 63                       | 9     | Jun-21                    |
| 54                | 6     | 57                | 6     | 74                   | 63                       | 6     | Apr-21                    |
| 54                | 5     | 57                | 5     | 72                   | 63                       | 3     | Feb-21                    |
| 54                | 4     | 57                | 4     | 70                   | 63                       | 0     | Dec-20                    |
| 54                | 3     | 57                | 3     | 68                   | 62                       | 9     | Oct-20                    |

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|----|----|--|----|----|--|----|--|----|---|--|--------|
| 54 | 2  |  | 57 | 2  |  | 66 |  | 62 | 6 |  | Aug-20 |
| 54 | 1  |  | 57 | 1  |  | 64 |  | 62 | 3 |  | Jun-20 |
| 54 | 0  |  | 57 | 0  |  | 62 |  | 62 | 0 |  | Apr-20 |
| 53 | 11 |  | 56 | 11 |  | 60 |  | 61 | 9 |  | Feb-20 |
| 53 | 10 |  | 56 | 10 |  | 58 |  | 61 | 6 |  | Dec-19 |
| 53 | 9  |  | 56 | 9  |  | 56 |  | 61 | 3 |  | Oct-19 |
| 53 | 8  |  | 56 | 8  |  | 54 |  | 61 | 0 |  | Aug-19 |
| 53 | 7  |  | 56 | 7  |  | 52 |  | 60 | 9 |  | Jun-19 |
| 53 | 6  |  | 56 | 6  |  | 50 |  | 60 | 6 |  | Apr-19 |
| 53 | 5  |  | 56 | 5  |  | 48 |  | 60 | 3 |  | Feb-19 |
| 53 | 4  |  | 56 | 4  |  | 46 |  | 60 | 0 |  | Dec-18 |
| 53 | 3  |  | 56 | 3  |  | 44 |  | 59 | 9 |  | Oct-18 |
| 53 | 2  |  | 56 | 2  |  | 42 |  | 59 | 6 |  | Aug-18 |
| 53 | 1  |  | 56 | 1  |  | 40 |  | 59 | 3 |  | Jun-18 |
| 53 | 0  |  | 56 | 0  |  | 38 |  | 59 | 0 |  | Apr-18 |
| 52 | 11 |  | 55 | 11 |  | 36 |  | 58 | 9 |  | Feb-18 |
| 52 | 10 |  | 55 | 10 |  | 34 |  | 58 | 6 |  | Dec-17 |
| 52 | 9  |  | 55 | 9  |  | 32 |  | 58 | 3 |  | Oct-17 |
| 52 | 8  |  | 55 | 8  |  | 30 |  | 58 | 0 |  | Aug-17 |
| 52 | 7  |  | 55 | 7  |  | 28 |  | 57 | 9 |  | Jun-17 |
| 52 | 6  |  | 55 | 6  |  | 26 |  | 57 | 6 |  | Apr-17 |
| 52 | 5  |  | 55 | 5  |  | 24 |  | 57 | 3 |  | Feb-17 |
| 52 | 4  |  | 55 | 4  |  | 22 |  | 57 | 0 |  | Dec-16 |
| 52 | 3  |  | 55 | 3  |  | 20 |  | 56 | 9 |  | Oct-16 |
| 52 | 2  |  | 55 | 2  |  | 18 |  | 56 | 6 |  | Aug-16 |
| 52 | 1  |  | 55 | 1  |  | 16 |  | 56 | 3 |  | Jun-16 |
| 52 | 0  |  | 55 | 0  |  | 14 |  | 56 | 0 |  | Apr-16 |
| 51 | 11 |  | 54 | 11 |  | 12 |  | 55 | 9 |  | Feb-16 |
| 51 | 10 |  | 54 | 10 |  | 10 |  | 55 | 6 |  | Dec-15 |
| 51 | 9  |  | 54 | 9  |  | 8  |  | 55 | 3 |  | Oct-15 |
| 51 | 8  |  | 54 | 8  |  | 4  |  | 55 | 0 |  | Aug-15 |
| 51 | 7  |  | 54 | 7  |  | 2  |  | 54 | 9 |  | Jun-15 |
| 51 | 6  |  | 54 | 6  |  | 0  |  | 54 | 6 |  | Apr-15 |