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PRIVATE AND CONFIDENTIAL

Date 18 April 2017

Mr Martin Varley,
Secretary General,
Irish Hospital Consultants Association,
Heritage House,
Dundrum Office Park,
Dublin 14.

Dear Martin,

Public Expenditure and Reform Actuarial Review

As requested, we have reviewed the Department of Public Expenditure and Reform Technical Paper entitled "Actuarial Review of Pension Provision in the Irish Public Service and a Comparison with the Private Sector" from the perspective of Hospital Consultants, a category specifically identified within the Standard Accrual Categories reviewed.

In general, our view is that the assumptions and methodology used result in an overstatement of the gap between public and private pensions. The assumptions used have a large impact on the results and there should be more sensitivity shown in the report to illustrate the variability of the projected costs. Interest rates are at historically low levels which results in the base case assumptions being low relative to historic norms. For a long-term cost assessment, consideration should be given to long-term normal levels of interest rates.

With regard to the varying costs across categories, the report is misleading and overstates the relative cost of pensions for Hospital Consultants for the reasons set out below. Taking into account these factors, **our view is that the employer cost of pensions for hospital consultants is not materially different to any other standard accrual category**.

1. <u>The methodology adopted ignores the different cost of the State Pension for higher and lower earners</u>

The pension scheme is designed to be integrated with the State Pension. By ignoring the State Pension in the calculation, the cost of pensions for higher earners appears more expensive.

The pension benefit for hospital consultants is the same as all other standard accrual categories – a pension of 50% of salary after 40 years when allowance is included for the State Pension. The value of the pension at retirement after 40 years is the same for all categories when expressed as a percentage of final salary and when allowance for the State Pension is included.

The table below illustrates the difference between the levels of pension considered by the report after 40 years of service. For somebody with a salary of €50,000, only €13,000 (26% of salary) of their total pension of €25,000 (50% of salary) is considered. For somebody with a salary of €150,000, €63,000 (42% of salary) of their total pension of €75,000 (50% of salary) is considered. The report compares the cost of funding a 26% of salary pension for one member with the cost of funding a 42% of salary pension for another member even though they both receive a total pension of 50% of salary.

Salary	**€50,000**	**€150,000**
Offset for State Pension	€24,000	€24,000
Net Pensionable Remuneration	€26,000	€126,000
Pension after 40 Years	€13,000	€63,000
Pension as Percentage of Salary	26%	42%
State Pension	€12,000	€12,000
Total Pension	€25,000	€75,000
Total Pension as Percentage of Salary	50%	50%

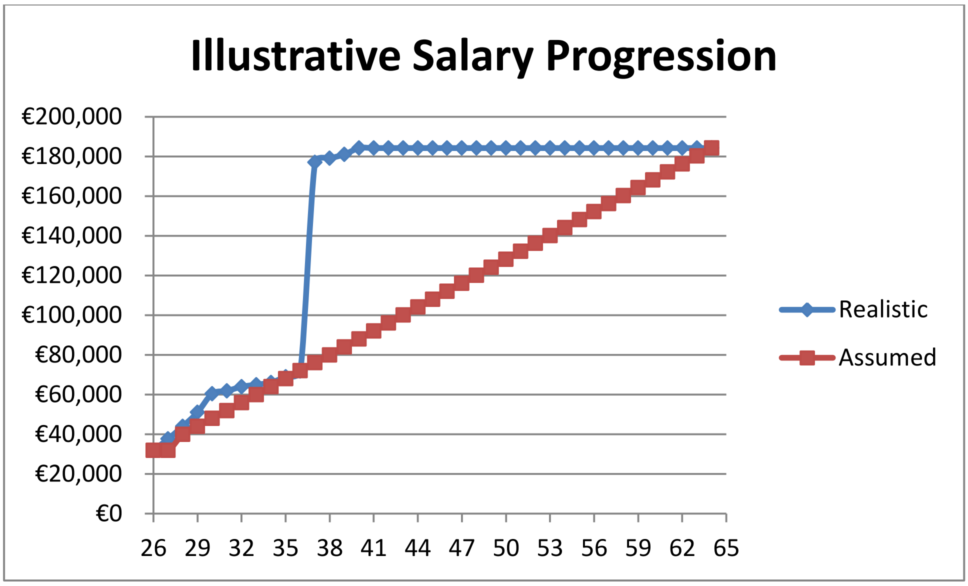
Since the State Pension is a flat amount, it is a much smaller proportion of salary for higher paid employees and, accordingly, the cost of providing the State Pension as a percentage of salary is a lot lower. **Taking the State Pension into account would largely remove the cost differential highlighted in the report.**

In addition, PRSI contributions by hospital consultants more than cover the cost of providing the State Pension they receive whereas the State Pension is largely funded by the State for lower paid employees. The PRSI earnings ceiling was removed so all income (including non-pensionable income) is subject to PRSI.

2. Salary Progression

The methodology adopted appears to assume a relatively smooth progression in salary over the working life.

Salary progression for hospital consultants is non-linear. Average salary increases over the full career are relatively high. However, a high proportion of the salary increase occurs in the early years of employment.



By using an unrealistic salary progression assumption, the value of employee contributions is understated which overstates the amount of the liability that is funded by the employer. This is because if average salaries are higher throughout the career, the value of contributions is also higher.

In addition, the notional value of employer contributions is understated which again overstates the employer cost as a percentage of salary.

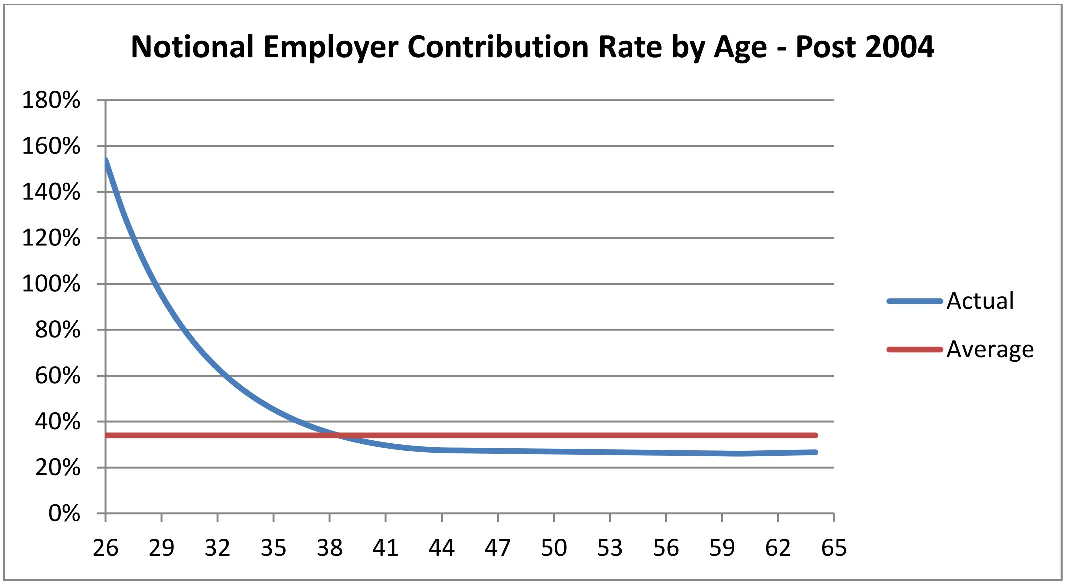
Both of these factors mean that the assumed salary progression being lower than a realistic salary progression results in an overstatement of the notional employer cost.

3. <u>The new entrant methodology is not appropriate for Pre-2013 Joiners.</u>

The net pensionable remuneration for hospital consultants in the model used in the report is assumed to increase by an average of 13% per annum over the full career.

The expected pension at retirement is based on an expected salary of €184,200. For a new entrant, the starting net pensionable remuneration is approximately €7,500. Funding a pension based on a high finishing salary when starting out results in very high contribution rates in the early years. The methodology adopted averages these rates over the full career. However, there are no new entrants in the Pre-2004 and Post-2004 categories. Those in the Pre-2004 category have at least 13 years of service so including the high percentage cost in the early years as part of the average is inaccurate and overstates the costs.

For most Hospital Consultants in the pre-2004 category, they are already at the top of the scale so no allowance above the general salary inflation assumption should be used.



A rate appropriate to the average age of the cohorts would produce a lower employer cost for all categories but this reduction is more pronounced for the Hospital Consultants.

4. Standard Fund Threshold

The report makes no allowance for the excess tax which would be projected to be paid on the value of hospital consultant pensions on retirement. If a new entrant model is used for the pre-2013 categories, allowance should also be made for the rebate the state will receive in respect of all pension over the standard fund threshold.

5. Pension Related Deduction (PRD)

The report notes that the PRD has been excluded and notes that the cost to higher paid groups is higher. The average cost of the PRD is estimated at 5% of salary but the rate for Hospital Consultants is estimated at 9% of salary. Excluding the PRD is only valid if it is to be removed in the short-term.

6. Tax on Pensions

The report compares gross pensions. The average tax rate on Hospital Consultant pensions is considerably higher than the average tax rate on public servant pensions. Using gross figures and expressing the cost of a percentage of salary ignores the lower net cost to the exchequer of providing the pension for the higher paid.

7. Private Sector Comparison

The report compares all Post-2013 joiners with a 100% DC group but the Pre-2013 group is compared to a 70%/30% DC/DB split based on Pension Authority figures without adjustment for the Post-2013 members. If the Post-2013 joiners were excluded from the Pensions Authority figures before calculating the split, it would be more weighted to DB and the private sector employer rate of 11% would be higher.

Conclusion

For the reasons set out above, our view is that the employer cost of pensions for Hospital Consultants is not materially different to any other standard accrual category and, in fact, if a full analysis was conducted of the after-tax cost to the exchequer, the employer cost of pensions for Hospital Consultants, when expressed as a percentage of salary, would likely be lower than the average public sector cost.

Yours sincerely,

John Byrne FIA FSAI
Consulting Actuary / Director