

STATES' SPENDING REVIEW

Pension schemes - status 2008



SECTION ONE ~ INTRODUCTION

1. This paper is the third report of a study of the two major pension schemes provided by the States for its employees: the Public Employees Contributory Retirement Scheme (PECRS) and the Teachers' Superannuation Fund (TSF). These reports are the outcome of a review of these two schemes which was announced in November 2006. The terms of reference for this review are reproduced as Appendix One to this paper.
2. The review was undertaken because the financial obligation to fund these two pension schemes is amongst the larger of the financial obligations contracted by the States of Jersey. It is a significant element of the remuneration package made available to the staff of the States and, in turn, this is the principal item of expenditure incurred by the States.
3. This first report examined the governance of the two pension schemes. A second report examined the effectiveness of the States in managing its financial exposure to these two schemes and this report deals with the status of these two schemes.
4. As will be seen, questions concerning the status of the two pension schemes originally arose in connection with PECRS, but since the TSF is now in an analogous position to PECRS similar arguments apply equally to that scheme.
5. In the following section of this report, I explain the context in which discussion of the status of the two pension schemes has risen and the significance of the issue. In subsequent sections, I will deal with the principal arguments to be considered and in the final section of the report I will set out my recommendations.

SECTION TWO ~ BACKGROUND

Introduction

6. In this section of the report, I describe the circumstances in which discussion of the status of PECRS has arisen and the reasons for that discussion's significance.

Development of PECRS

7. PECRS came into effect from 1 January 1968 under the Public Employees (Retirement)(Jersey)Law 1967 (the 1967 Law), and the Public Employees (Contributory Retirement Scheme)(Jersey)Regulations 1967. It was set up to replace various non-contributory arrangements for public employees and, from its creation, was administered as a fund of the States by the States' Treasury.
8. Until the late 1980's the States' Treasury reported on its management of PECRS to the Finance and Economics Committee which was the committee responsible for investment of the scheme's assets.
9. The Establishment Committee was also involved, in two ways: firstly, it acted as principal employer on behalf of the States, and secondly it was responsible for matters which in most other schemes would be dealt with by trustees.
10. Significant changes were made to the scheme with effect from 1 January 1988 by way of amendments to the existing legislation and promulgation of a number of additional regulations. Designed primarily to implement modifications to the structure of PECRS, its funding and benefit provisions, these changes also introduced a requirement for the scheme to be run by a Committee of Management. The States Treasury continued to administer the scheme but reported to the Committee of Management. The investment of the scheme's assets became the responsibility of the Committee of Management, although the Finance and Economics Committee retained a role in approving the appointment of investment managers and the selection of investment strategy. The Establishment Committee continued to act as the representative of the principal employer but responsibility for other matters was passed to the Committee of Management.
11. Subsequently a further set of regulations entitled Public Employees(Contributory Retirement Scheme)(Former Hospital Scheme)(Jersey)Regulations 1992 were promulgated as part of the process of transferring the assets and liabilities of pension arrangements for medical and auxiliary staff to the scheme. The legislative structure of the scheme therefore became more complex due to the presence of a number of sets of regulations in addition to the 1967 Law and the 1967 Regulations.

Introduction of ministerial government

12. With the introduction of ministerial government, the responsibilities that previously had been discharged by the Finance and Economics Committee were transferred to the Treasury and Resources Minister who is thus now responsible for approving the appointment of investment managers and the selection of an investment strategy.
13. At the same time, the responsibilities that had previously been discharged by the Establishment Committee was divided between the States' Employment Board and the Chief Minister. Consequently, it is the Chief Minister who now would normally deal with recommendations from the Committee of Management concerning changes to the PECRS Regulations.

Committee of Management

14. The current Committee of Management is comprised of seven members nominated by or on behalf of employees and seven members nominated by or on behalf of the employer with an independent chairman. They are all appointed by the States on the recommendation of the Chief Minister. In making his recommendation, the Chief Minister is subject to the provision that one half of the employer nominated members are to be chosen by the Treasury & Resources Minister.¹
15. The member nominated members are nominated by the Public Employees Pension Scheme Joint Negotiating Group. This was set up in 1976 at the request of the Establishment Committee as a co-ordinating panel of union and staff associations to represent the interests of all public employees in negotiations with the Establishment Committee concerning pension provisions. The arrangement was formalised in 1989.

Status of the Committee of Management

16. In the late 1990's some question arose over the status of the Committee of Management. Whilst it was clear that the fund of PECRS was, and remains, a fund of the States, members of the Committee of Management were concerned about the status of the committee and their obligations and liabilities as members of the committee. Consequently, legal advice was sought from Olsen Backhurst Dorey, Advocates, legal advisers to PECRS.
17. The eventual advice which was dated 22 May 1997 first considered what the Committee was not:

'We propose to start by offering our advice as to what the Committee is not. We are of the opinion that the Committee is not a committee of the States of Jersey; further, we are satisfied that it is not a sub-committee of a committee of the States.'

¹ Before the introduction of ministerial government, nominations for appointment of members of the Committee of Management were made by the Establishment Committee.

18. The advice concluded in the following way:

'Having established what the Committee is not, we must next ask what then is the legal status of the Committee? It is undoubtedly a committee, but that is not a concept from which we derive any significant degree of legal comfort – the Oxford English Dictionary provides as much assistance on this score as we can . . .

We have reached the conclusion that, were the Royal Court ever to be the arbiter of the question of the Committee's legal status, it would hold that the Committee is in effect a board of trustees. The trust property is the pension fund and the trust deed is the Scheme and the Regulations which regulate it. We reach that conclusion by default; the Committee cannot, in our view, be anything else. Interestingly, it is certainly our experience to date that the Committee approaches its duties on the basis that it carries a fiduciary responsibility. In our opinion that is an entirely correct stance to adopt.'

19. I understand that H M Attorney General subsequently concurred with this advice.

Proposition P143 (1999)

20. After consideration of this advice it was concluded that it would be beneficial to establish PECRS formally as a trust with no change to the scheme's commitments, operation, funding or benefits save that these would become administered under trust deed and rules rather than under the previous regulations. This conclusion was supported by the Committee of Management, the Establishment Committee, the Finance and Economics Committee and the Joint Negotiating Group, supported by the scheme's legal advisers and actuaries. It was believed that such a change would be in line with modern best practice for large pension schemes.
21. Accordingly, Proposition 143 (1999) was lodged au Greffe on 28 September 1999 by the Establishment Committee and subsequently approved by the States.

Key principles of Proposition P143 (1999)

22. The proposition set out a number of key principles which would form the basis for the establishment of the Scheme under a trust deed and rules:
- (1) The Committee of Management, would, as individuals, be appointed as the initial trustees. The enabling Law (and the trust deed and rules) would allow for trusteeship either through individuals or through a trust corporation, with the power to appoint any such trustees or trustee being retained by the States as had been the case for the appointment of members of the Committee of Management.
 - (2) The Trust (Jersey) Law 1984 (the Trusts Law), would apply.
 - (3) It was intended that the trustees would continue to be indemnified as members of the Committee of Management had been. However, having regard to Article 26(9)² of the Trusts Law which states that "nothing on the terms of the trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fault, wilful misconduct or gross negligence" it would be necessary to refer to fraud and gross negligence, as well as wilful misconduct, as being excluded from the indemnity.
 - (4) It was the intention that the new trust would be an indefinite trust. However under Article 11 of the Trusts Law, the maximum duration of a trust is 100 years. To enable the trust based scheme to exist indefinitely it would be necessary for the legislation enabling its establishment to provide that, the 100 year limitation would not apply to the scheme, as is the case for charitable trusts.³
 - (5) It was intended that the Establishment Committee would carry out all the functions of the principal employer on behalf of the States. In particular, the trustees and Establishment Committee would negotiate and agree any necessary changes to the trust deed and rules. The Establishment Committee would keep the States informed of such changes.
 - (6) The trustees would be fully responsible for the investment, strategy and appointment of the scheme's investment managers. The Finance and Economics Committee would no longer have any direct involvement with the scheme's investments.
23. The proposition was approved by the States which charged the Establishment Committee with arranging for the necessary legislation.

Subsequent developments

24. Following the States' approval of the proposition, the Committee of Management, whose membership included members of the Establishment Committee, commissioned its legal advisers to draft the legal documents necessary to implement the proposition. The drafting of the necessary legislation was undertaken by a team comprising the Technical Sub-committee of the Committee of Management, PECRS' legal advisers, the PECRS actuary and the Assistant Law Draftsman. Although this work was completed some years ago with the preparation of a draft trust deed and rules, the proposed trust still has not been created.

² Following amendment of the Trusts (Jersey) Law 1984 in 2006, the article is now numbered 30(10).
³ This provision is now otiose. By amendments in 2006, the maximum duration period was removed.

SECTION THREE ~ ADVANTAGES AND DISADVANTAGES OF TRUST STATUS

Introduction

25. In this section of the report, I will examine the principal arguments underlying the proposal that PECRS should be re-constituted as a trust.

Advantages of trust status

26. The reason for many large pension schemes being constituted as trusts is that the independence gained offers advantages to all of the parties interested in a pension scheme.

Advantages for scheme members

27. From the point of view of the members of the scheme:
 - (1) the trustees of a trust have a fiduciary duty to observe the interests of the beneficiaries of the trust: i.e. the members of the scheme;
 - (2) the fact that the assets of a scheme are held independently offers a degree of assurance that the assets cannot be manipulated or diverted by one party or another (i.e. the risk that assets are diverted to some purpose other than the purposes of the scheme); and
 - (3) the fact that the assets of a scheme are held independently offers a degree of assurance that the assets are not subject to the financial health of the employer (i.e. the risk that if assets are held by the employer and the employer ceases to exist, the assets may be lost to scheme members).

28. Independence in the form of a trust does not however provide a guarantee of a pension scheme's financial security. Funding of the scheme's liabilities in respect of past service may be inadequate so that the scheme may depend upon the employer for contributions to make good any shortfall. The trustees may manage the scheme imprudently with the result that funding proves inadequate. Nonetheless, establishment as an independent trust offers a degree of assurance that a scheme may be proof against certain forms of mismanagement.

Advantages for employers

29. It should not be forgotten that constituting pensions schemes as independent trusts also presents advantages to employers.
30. There are perhaps two important advantages for the employer.
31. Firstly, the employer is freed from responsibility for management of the pension scheme's funds. If the funds of a scheme form a part of the employer's own funds, and are under the management of the employer, then the employer can hardly avoid responsibility for the consequences of that management. If, for example, the investment policy chosen by the employer proves less successful than had been expected, then the employer may well be unable to resist pressure to make good any funding shortfall.

32. Secondly, if a pension scheme is not constituted as an entity separate from the employer, the employer can be disadvantaged in any negotiations concerning future funding of the scheme. Whilst there are examples of pensions schemes that are not separately constituted (e.g. certain public sector schemes in the United Kingdom), in general they are cases in which the employer has accepted full responsibility for all of the future financial obligations of the scheme.
33. Thus, where an employer wishes to limit exposure to the financial cost of a scheme, establishment of the scheme as an independent trust can be a prudent measure.

Application to PECRS

34. In principle, all of these advantages apply to the position of PECRS. In addition, the re-establishment of PECRS as a trust would have the advantage of resolving the uncertainties surrounding the position of the Committee of Management which ten years ago led to the commencement of the debate over the status of PECRS.
35. Perhaps most importantly from the point of view of the States as employer, there is a risk that for so long as the funds of PECRS are held within the funds of the States and are subject to decisions of the Treasury and Resources Minister, it will not be possible for the States to limit their exposure to the financial obligations of PECRS. This does not seem prudent management of the States' liabilities.
36. Even if the States purport to limit their exposure to PECRS' liabilities, the fact that the States retain responsibility for key investment decisions (among others) implies a degree of responsibility that goes beyond the responsibility of an employer to finance a scheme constituted as an independent trust.

Contrary arguments

37. Notwithstanding these arguments, it is clear from the fact that the 1999 proposition has not been implemented that there remains some doubt whether re-constituting PECRS as a trust would be in the interest of the States. I have therefore considered whether there are contrary arguments that should be taken into account and whether these arguments are of such force that they should divert the States from the policy agreed in 1999.
38. I believe that there are five potential contrary arguments:
 - (1) Trust status would serve no purpose;
 - (2) Trust status would dilute States control;
 - (3) Trust status would be unattractive to potential trustees;
 - (4) Trust status would expose PECRS to court intervention; and
 - (5) Trust status would not save law drafting time.
39. I will consider each of these arguments below.

Trust status would serve no purpose

40. According to the proponents of this argument, if the provisions of the scheme as a private trust were to mirror precisely those of the scheme as a statutory scheme, there would be no point in changing the constitution: nothing would be gained.
41. The answer to this argument is that even if the provisions of the trust were to mirror those of the existing statutory scheme, the position of the scheme would in truth be changed. The Committee of Management would in fact (not just in effect) be a board of trustees. The assets of the scheme would be the assets of the trust (and not of the States). The responsibility of the Treasury and Resources Minister would be removed. The relationship between the States and the scheme would be very different.
42. In short, the advantages which would flow from trust status and which have been described above would come to pass.

Trust status would dilute States control

43. According to the proponents of this argument, the States' staff represent the States' principal resource and the terms and conditions of their employment are thus of major importance. It is therefore advantageous to the States to be able to control the scheme by virtue of the fact that amendments to PECRS' rules require approval by the States Assembly because those rules are in the form of legislation. This degree of control would be severely reduced if the rules of the scheme were to exist as a trust deed and rules.
44. There are several difficulties inherent in this argument:
 - (1) the terms of PECRS are already the subject of negotiation between the States and the representatives of the States' staff. Any attempt by the States Assembly to make changes to the scheme without prior agreement with staff representatives is likely to be problematic.
 - (2) if PECRS were to be re-constituted as a trust, any proposals for changes to the trust deed would remain subject to negotiation between the States as employer and the representatives of the States' staff.
 - (3) if control by the States Assembly of the process by which the terms of the scheme are changed were deemed to be necessary, it could be achieved even if PECRS were re-constituted as a trust by the Assembly passing a resolution requiring that any decision to amend the terms of the scheme should require the approval of the Assembly.
 - (4) the advantages of the Assembly's control over changes to the scheme should be weighed against the financial consequences of that degree of control: i.e. the potential inability to limit the States' exposure to PECRS's liabilities.

Trust status would be unattractive to potential trustees.

45. The proponents of this argument suggest that the scheme is not fully funded because of the pre 1987 debt to PECRS by the States due to the past service liability. It is suggested that on appointment to trusteeship, new trustees would expect to discharge the obligations of the scheme from the assets of the fund. On standing down, trustees would expect to have an indemnity and discharge from their obligations which might not be forthcoming if the States' guarantee of the outstanding debt were for whatever reason to have been called in question. In short, there would be a risk that the trustees of the re-constituted PECRS would require that the outstanding States debt should be paid in full and not over the current payment period.
46. The difficulty inherent in this argument is that the legal advice currently available to the Committee of Management (which I have quoted above) suggests that:

'...the Royal Court ...would hold that the Committee is in effect a board of trustees . . .it is . . .our experience to date that the Committee approaches its duties on the basis that it carries a fiduciary responsibility. In our opinion that is an entirely correct stance to adopt.'

47. It seems to me therefore that in circumstances in which the trustees of a re-constituted PECRS might feel obliged to require immediate payment of the States' debt to PECRS, then the members of the Committee of Management of an un-reconstituted PECRS would feel equally obliged to call for immediate payment. Logically the position would be unchanged.
48. Interestingly, the ten point agreement relating to the repayment of the States debt to PECRS obliges the States to arrange for regular auditors' reports to be made to the Committee of Management of the ability of the States to honour the repayment terms. The purpose of this provision can only have been that a negative report by the auditors would alert the Committee of Management to the possible need to demand immediate repayment of the States debt. I take this as confirmation of my view that this argument is insubstantial.

Trust status would expose PECRS to court intervention.

49. The proponents of this argument suggest that as a statutory scheme, the Courts are less likely to become involved in the scheme's affairs as the only basis for such intervention would be by way of judicial review, the grounds for which are limited to illegality, irrationality or procedural impropriety. As a private trust, it is likely that the Courts would have a wider discretion than under the principles of judicial review using the provisions in Article 51 of the Trusts (Jersey) Law 1984. Whilst this would be unlikely to cause difficulty in many cases, it might be difficult if contentious changes to the scheme were to be proposed such as, for example, an increase in contributions or a reduction in benefits.

50. The difficulty inherent in this argument is that it demonstrates the problem of the present position. On the legal advice obtained in 1997 accepted by the Committee of Management, the Establishment Committee and the Law Officers' Department, the Committee of Management is in effect a board of trustees and the assets of the scheme are in effect the property of a trust. In these circumstances, it seems odd that the normal provisions of trust law should not apply to the scheme. Moreover, it would seem odd that the States Assembly should consider that it has the potential power to act towards PECRS in a manner that would be inconsistent with trust law.
51. The difficulty inherent in this position is already one of the factors which increases the importance of moving by agreement in this area.

Trust status would not save law drafting time.

52. This argument refers to the proposition put forward in 1999 which justified the proposed change in status of PECRS by reference to the avoidance of delays caused by awaiting law drafting time and denies it.
53. As will be clear from the arguments that I have advanced in this report, I regard law drafting difficulties as a relatively minor consideration in the re-constitution of PECRS as a trust.

Conclusions

54. In brief, I am not persuaded by the contrary arguments that I have listed.

SECTION FOUR ~ RECOMMENDATIONS

55. On the basis of this analysis, in my view:
- (1) the current status of PECRS as a fund of the States is unusual and represents a practical constraint on the ability of the States to limit exposure to the obligations of PECRS;
 - (2) in addition, the current position of PECRS leads to difficulties and anomalies in the status and responsibilities of the Committee of Management (which originally led the Committee to seek legal advice);
 - (3) these difficulties and anomalies could be resolved by re-constituting PECRS as an independent trust; and
 - (4) the States should take appropriate steps to implement the decision of the States' Assembly on 12 October 1999 or, if they consider that such a course is not prudent, to take such other course of action that satisfactorily limits the States' exposure and resolves any remaining anomalies.
56. Following reforms implemented with effect from 1 April 2007, the position of the TSF is analogous to that of PECRS. Accordingly, my recommendations concerning the status of PECRS also apply to TSF.

APPENDIX ONE ~ TERMS OF REFERENCE

1. This review is commissioned in accordance with the powers of the Comptroller & Auditor General as set out in the Public Finance (Jersey) Law 2005 to take place in the light of:
 - (1) interest in the costs incurred by the States in making appropriate pension provision for States' employees, and
 - (2) concern about the future management of the States' liabilities in this respect.
2. The purpose of the review is to examine:
 - (1) the development, constitution and governance arrangements of the two principal pension schemes concerned (i.e. Public Employees Contributory Retirement Schemes and the Teachers' Superannuation Fund);
 - (2) the current financial condition of the two schemes;
 - (3) the States' future liability in respect of the two schemes; and
 - (4) any other detailed matters that appear relevant to items (1) to (3) above and the issues to which paragraph 1 above refers.
3. The outcome of the review will be a report prepared and published in accordance with the provisions of the Public Finance Jersey Law 2005.