Forget the £39 Billion Brexit divorce bill – it just went up to £40.24 Billion, overnight.

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Annual accounts of the European Union 2018

LIABILITIES

2.9. PENSION AND OTHER EMPLOYEE BENEFITS

Net employee benefit scheme liability

EUR million

	Pension Scheme of European Officials	Other retirement benefit schemes	Joint Sickness Insurance Scheme	31.12.2018 Total	31.12.2017 Total
Defined Benefit Obligation	*70 017*	*1 865*	*8 990*	*80 871*	*73 560*
Plan assets	*N/A*	*(119)*	*(296)*	*(415)*	*(438)*
Net liability	**70 017**	**1 746**	**8 694**	**80 456**	**73 122**

The E.U. accounts are out. With 16 weeks to go until a possible Brexit, the EU has only just declared in its accounts, published without fanfare, that its Pensions Liability Bill went up €7.3Billion in just one year. I warned this would happen last December. It has happened. It's important because the EU will now ask the UK to pay approaching another €1 Billion upon leaving.

Again, as I warned, the Brexit divorce bill is not the £39 Billion everyone keeps talking about, but now we need to talk of it being over £40 Billion – and it could rise further even after a Brexit of whatever description. The new Prime Minister and the new E.U. top brass will have to slug this out at some point in the very near future.

The non-Pension Brexit Divorce bill is calculated by most at £31 Billion. Last year the E.U. Pensions Liability share was assessed by the EU at £8.4 Billion. This new €0.9 Billion added (a small matter of £820 Million) makes a total of £9.24 Billion for pensions.

So the Brexit Divorce Bill has now passed £40 Billion – and now stands at £40.24 Billion.

Time to lose the old £39 Billion tag.

EU Pension Scheme Liabilities	Liability	Nominal Discount Rate	Inflation	Real Discount Rate
2018	€ 80.456	1.9%	1.4%	0.5%
2017	€ 73.122	1.9%	1.5%	0.4%
2016	€ 67.231	1.7%	1.4%	0.3%
2015	€ 64.242	2.0%	1.4%	0.6%
2014	€ 59.053	2.0%	1.3%	0.7%
2013	€ 46.818	3.7%	1.9%	1.9%
2012	€ 42.503	3.6%	2.0%	1.6%
2011	€ 34.835	4.9%	1.8%	2.4%

The total 'liability' of E.U. civil servants Pension Scheme (there is no fund) was only €73.122 Billion this time last year. Somehow, and (some might say) by a statistically odd sleight-of-hand, the E.U. has now added exactly 10% onto the liability in one year. All the legendary, complex calculations that are involved in pensions jiggery-pokery, and they end up adding €7.3 Billion to the €73Billion. How 10% curious.

Only eight years ago in 2011, the liability was at €34.835 Billion. So it has more than doubled in that eight year period.

How does the Liability Garden grow?

Using a discount rate formula from a pre-economic crash time-capsule, and which has fallen to 0.5% or less because of the E.U.'s own central bank policy of Quantitative Easing has been the main cause. The lower the discount rate used, the higher the liability. This liability inflation gets duplicated across the entire pensions accounts, massively pushing up the value of liabilities, current service costs and interest added. This creates liabilities which are (putting it simply) at least 5 times what they might have been had the rate of 8 years ago been used. And that means adding tens of €billions to the bill.

But these handy ‘revaluations and recalculations’ for the books, such as happened this year, are another main cause.

If 10% was simply added in one year, will the EU do the same next year and deliver a further bill on top of that? Had parliament voted May’s deal through the U.K. would have been obliged by international treaty to pay this increased amount and any other future increases as assessed by the E.U.

€59.053 Billion was the original known bill for the pensions liability when the referendum happened on 23rd June 2016. So since the referendum result the EU have stealthily added €21.4 Billion to the bill. It has increased by well over a third (36.2%, to be precise).

Reassessments and recalculations

The EU has decided to come up with a series of reassessments and recalculations to add this extra 10% in one year, this year.

The extra magical €7.3 Billion comes from a current service rate and discount rate magnified by the low discount rate (€3.074 Billion), a suddenly appearing recalculation called “Remeasurements” amounting to a cool €3.3 Billion and a “change in financial assumptions” bringing in another sudden €1.1Billion addition to the bill that wasn’t there last year!

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2.9.1. Pension Scheme of European Officials

As was already noted in the 2017 annual accounts, the relevant Commission services have been worki to strengthen data collection methods, as well as improving assumptions and calculation methods. O result of this work has been a more precise valuation of the liability in relation to the pensions surviving persons (i.e. where the member is deceased) using the most up to date actuarial practice. T impact of this improved method on the 2018 liability is a EUR 2.1 billion increase.

And, looking further into the accounts, one of the new entries to the re measurements chart, making up 2/3 of the extra €3.3 Billion sum, is the €2.1 Billion added to the calculations for paying pensions to the surviving partners of deceased civil service pensioners. They continue to receive 60% of their deceased partner’s pension until they themselves die. This rather rare (these days) provision has been looked at again and they’ve added €2.1 Billion to the bill this year, all of a sudden.

Credit where credit's due

In addition, the EU decides (unlike others reporting such matters) not to credit against the current service costs the actual contributions of the civil servants to their pensions this year. So the bill is higher still. Even worse, as many have pointed out, the E.U. has not deducted the entire contributions of E.U. officials over time and in the future to set against the final liability figure.

The U.K. should be due a rebate on these things.

Credit The Underhang

But more importantly, the U.K. should get a massive rebate from its bill due to the EU not carrying out a complete and proper actuarial valuation of the entire fund from its inception. If there's a fund, the U.K. should only actually be obliged to pay the full U.K. share of pensions paid to those who served as officials for their entire career post January 1st 1973. The U.K. should only have started paying its eighth share of full pensions only as recently as 2006.

Otherwise the UK is ending up paying pensions for service by E.U. civil servants before it joined, and paying for full, rather than partial service, after it joined. I term this the 'Underhang'.

Is the bill £0.00?

The E.U. Pension Scheme is not funded, has no assets and is simply managed on a year-to-year basis with balance created by annual contributions from all member states. I have made the case that the pensions bill should be zero anyway. The very principle of the EU pension scheme is that it is an in-balance scheme which is dealt with out of revenue and shared across member states according to the usual formula.

In other words, the annual pensions bill paid out to the retired EU civil servants is covered off as an effective subscription payment. You pay it when you join the EU club and when you leave the club, you simply stop paying the bill.

How to get the Credit

Firstly, it would appear that some new negotiations will be attempted by a new Prime Minister’s team over the summer. I have been astonished that previous U.K. negotiators have simply accepted the pensions bill offered by the E.U. as being uncontestable. There firstly simply needs to be challenge.

The E.U. pensions bill is better removed in its entirety and left to later determination by legal processes which cover the correct ground and involve actual calculations. And in a legal forum acceptable to both sides. Otherwise it will be for the ECJ to decide on current provisions.

In conclusion, all of the above suggests to me that, in the event of a No Deal Brexit, any suggested £9.24 Billion U.K. to E.U. payment has to come into play as part of access fees as part of trade deal negotiations. Until then a new negotiating team should negotiate it out of any deal entirely.