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Dear Martin

The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions 2022 - Calculation and Payment of Interest

Background

1. As you will be aware, HM Treasury have developed a set of policies to remedy the discrimination resulting from the transitional protection arrangements introduced when public service pension schemes were reformed under the Public Service Pensions Act 2013.

2. This discrimination ceased from 1 April 2022 with the closure of the legacy schemes to accrual and all active members becoming members of the new schemes. Affected members are entitled to a retrospective remedy, which will apply to a member's 'remediable service'. This is the period of eligible service from when their new scheme was first introduced up to the closure of their legacy scheme. In most cases this is 1 April 2015 to 31 March 2022.

3. Members eligible for the remedy include both those who originally received transitional protection, as well as those who did not. For all workforces apart from Judges and local government workers, non-pensioner members who are in-scope will receive a 'deferred choice'. This will operate as follows:

    1) When remedy is implemented, those members who did not originally receive transitional protection will have their remediable service retrospectively moved from their new scheme into their legacy scheme.
    2) On reaching retirement, all in scope members will be given a choice between receiving legacy or new scheme design benefits for their remediable service.

4. The remedy takes a slightly different form for Judges and local government workers. Judges will get an immediate choice of benefits with respect to their remediable service once the remedy has been implemented. Local government workers will have an automatic underpin applied to provide the higher pension between the legacy and new scheme benefit design.

5. In-scope members who retired before the remedy is implemented will be given an immediate choice as to which set of scheme benefits they wish to receive. This choice will be applied retrospectively back to the point of retirement, with any corrections to previous benefit

payments made as appropriate. There will also be a choice of benefits for cases where an in-scope member died, or otherwise left the scheme, before remedy was implemented. Similarly, for local government workers, the automatic underpin will be retrospectively applied.

6. The legislative framework for the remedy is set out in the Public Service Pensions and Judicial Offices Act 2022 (the Act).

7. Sections 27, 62 and 85 of the Act enable HM Treasury to make Directions regarding certain features of the remedy set out in the Act. As required under Sections 27(4), 62(4) and 85(4) of the Act, Directions that relate to the calculation and payment of interest may only be made after consultation with the Government Actuary.

8. HM Treasury has considered the appropriate determination of interest payments in relation to the remedy and will set these out in Directions. I am formally writing to you to ask for your professional opinion on the proposed approach to determining interest payments as set out in this letter. This approach will be set out in Directions in due course to enable schemes to amend their regulations and begin to implement the remedy.

Situations where interest will apply

9. There are various situations where interest may be awarded, or charged, to members by their public service pension scheme as part of the wider remedy. Generally, interest will be applied to any corrections to past cashflows which occur as a result of the remedy.

10. Application of interest will be required in the following scenarios:

    1) Payments made from the scheme to the member as a result of the implementation of the remedy:

        i. pension and/or retirement lump sum back-payments for pensioners, or dependants of deceased members, if these members (or the decision-maker) choose to receive alternative scheme design benefits which results in historic benefit payments having been underpaid.

        ii. member contribution refunds - When eligible members' remediable service is moved from their new to legacy scheme, some members may require a refund if the new scheme contributions they previously paid were higher than the legacy scheme contributions. Affected members will primarily be members of the 2006 Police and Fire pension schemes who did not originally receive full transitional protection.

        iii. voluntary member contribution refunds. When those members who did not originally receive transitional protection have their remediable service moved to the legacy schemes, in certain circumstances they may elect for a refund of any voluntary contributions made to their new scheme.

        iv. compensation payments, including those for tax related refunds that are otherwise in years 'out of scope' such that refunds may not be obtained from HMRC[1].

    2) Payments made from the scheme to the member after the implementation of the remedy, when the member retires, or otherwise leaves the scheme:

[1] HMRC are subject to a statutory 4 year time limit in which they can go back and reopen someone's tax affairs. Any tax refunds that relate to the earlier years, that are out of scope of this 4-year time limit, will be paid as compensation.

i. member contribution refunds – This will apply to the members of the 1987 Police and 1992 Fire pension schemes who ultimately choose new scheme benefits.
   It may also apply to any member who waives the right to a contribution refund at the time of the implementation of the remedy under s18(8) of the Act, and instead receives it at retirement. If such an option is made available to them this will primarily be members of the 2006 Police and Fire pension schemes who did not originally receive full transitional protection, who chose not to receive their refund of excess contributions at implementation and who then elect to receive legacy scheme benefits at retirement.

3) Payments made from the member to the scheme as a result of the implementation of the remedy:

   i. pension and/or retirement lump sum back-payments for pensioner or deceased members should these members make an immediate choice for their alternative scheme design benefits which results in historic payments having been overpaid

   ii. additional member contributions – Affected members will primarily be members of the 1987 Police and 1992 Fire pension schemes who did not originally receive full transitional protection. These members would have originally paid lower contributions to the new scheme than they would have paid to their legacy schemes and are therefore required to pay the difference when moving back to the legacy schemes.

4) payments made from the member to the scheme after the implementation of the remedy, when the member retires, or otherwise leaves the scheme:

   i. additional member contributions – Affected members will primarily be members of the 2006 Police and Fire pension schemes who ultimately choose new scheme benefits. This will include both members who originally received transitional protection and also members who did not originally receive transitional protection but who previously received a refund of contributions when being moved back to their legacy scheme.

Government objectives and rates for interest

11. The Government's objectives for the interest payments are to:

    1) Reflect the position members may have otherwise been in – The determination of interest payment should consider what position the member may have been in had the payments been made on the date they originated from.

    2) Recognise the circumstances of the award – The interest payments should reflect the context as to why the remedy is being implemented and what interest rates are being applied elsewhere as a part of the remedy.

    3) Not unduly burden the taxpayer – Any interest payments should be proportionate and where possible not result in unnecessary costs to the taxpayer.

12. In light of the above objectives, HM Treasury consider that the interest applicable should be:

    1) For payments made from the scheme to the member as a result of the implementation of the remedy - 8% simple per year up to the date 28 days after a Remediable Service

Statement is first issued in relation to the member[2] . Then in line with the interest available on the National Savings & Investments (NS&I) easy access savings account, 'Direct Saver', thereafter. For Judges, the 8% simple per year rate will run up to the date of payment, in light of the different way their remedy operates. For the Local Government Pension Scheme, the periods of interest will be set out in their scheme regulations, to take account of the different way their remedy operates.

Except for payments in relation to tax related compensation which will accrue in line with HMRC's interest rate on tax refunds, which is set as the Bank of England base rate minus 1% with a lower limit of 0.5% p.a.

2) For payments made from the scheme to the member after the implementation of the remedy, when the member retires, or otherwise leaves the scheme – in line with the interest available on the NS&I easy access savings account, 'Direct Saver'[3].

3) For all payments made from the member to the scheme - in line with the interest available on the NS&I easy access savings account, 'Direct Saver'.

13. Where a member has both underpayments and overpayments with respect to different elements of the remedy, the interest will be applied to each set of cashflows separately[4]. The amount collected from the member or paid to the member will reflect the net position of these two sets of cashflows, as opposed to paying the member to correct an underpayment whilst simultaneously requesting payment for an overpayment.

14. A rate of 8% a year simple is in line with the interest awarded to the claimants in the associated employment tribunals. Adopting the same approach for the wider remedy will ensure consistent outcomes with those who were awarded interest payments by the employment tribunal.

15. In line with the Employment Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996; the interest will accrue from day to day and is simple rather than compound. Furthermore, when considering recurring payments the rate will apply to the aggregate of those payments from the mid-point of the period over which the discrimination occurred.

Interest applying to payments due from members to schemes

16. As set out in paragraph A.32 of the response to the Public service pension schemes: changes to the transitional arrangements to the 2015 schemes consultations the Government consider that interest should be applied to money owed by members to aim to achieve fair and equal treatment of all members. Otherwise, members who make payments to the scheme later are in a more favourable position compared to members who paid at the time the payment originated from.

[2] The remedy will come into force for the majority of members on 1 October 2023, unless HM Treasury decides to bring it into force earlier for some members, in accordance with section 131(2) of the Act. However, in relation to those schemes subject to Chapter 1 of Part 1 of the Act ('Chapter 1 schemes'), each member will be informed of their rights in relation to the remedy through their Remediable Service Statement (RSS) which will normally be issued within 18 months of that date. This is expected to be at some point in 2023-2025. HM Treasury consider that, from the date 28 days after their RSS has been issued, it is appropriate for the 8% simple rate to cease since the member will have had their position remedied in law and will have been informed of their rights.

[3] Any member who has waived a previous contribution refund under s18(8) of the Act, as discussed in paragraph 10, will still receive 8% simple per year up to the date 28 days after a RSS is first issued in relation to the member.

[4] Any tax relief adjustment made to a contribution correction will not be considered as a separate cashflow for this purpose.

17. In selecting an appropriate interest rate for payments from members to schemes, we have considered what the member may have done with the money in the additional time they have had access to it. This will vary by member, but we view the two most likely options as using the money to purchase goods and services or saving it in an easy access savings account. This would suggest the use of either an interest rate based on inflation or a savings account interest rate. Recognising that members had no option to make any payment when it was originally due, we view that opting for a savings account rate, which has typically been below inflation since 2015, is most appropriate and in line with the objective to recognise the circumstances of the award.

18. We have considered, and dismissed, the use of a borrowing rate of interest. Whilst it is possible that the prolonged access to money may have resulted in a member needing to borrow less, we do not view this situation as more likely than those set out above. Furthermore charging members interest on such a basis would appear to fit less well with the 'recognise the circumstances of the award' objective.

19. For consistency with the interest rate charged to members, the same savings account interest rate will also be awarded to members from 29 days after the RSS has been first issued for the Chapter 1 schemes[5]. At this point the discrimination has been remedied, members have been informed of their rights, and therefore the use of the 8% tribunal rate is no longer appropriate. Similarly the savings account interest rate will be used for corrective payments that occur after the implementation of the remedy, when the member retires, or otherwise leaves the scheme. The majority of interest awards are expected to be with respect to cashflow corrections arising at the time remedy is implemented.

20. HMRC apply their own rates of interest to tax refunds and additional tax charges, and these will apply as usual for any tax related changes as a consequence of the remedy. These rates of interest are not in scope of the HM Treasury Directions. For consistency with HMRC tax refunds, the Directions provide that any compensation payments for tax related refunds that are in years 'out of scope' of HMRC will attract interest at the same rate as HMRC's interest rate on tax refunds.

21. HM Treasury recognises that it is important to keep the choice of interest rates set out in the Directions under review to ensure that they continue to deliver the Government's objectives. The choice of interest rate will therefore be subject to a review every five years, or in response to unexpected events.

22. I would be grateful if you could offer your professional opinion on the proposed approach to determining interest payments as set out in this letter. In particular, I would welcome your view on the extent to which they meet the Government's objectives.

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[5] A Chapter 1 scheme is a scheme to which chapter 1 of Part 1 of the PSPJOA 2022 applies.