HM TREASURY

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Dear Martin

Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014

Thank you for your letter of 27 November 2014 which set out your views on some proposed amendments to the Treasury's Directions. As you will be aware, the proposed amendments to the Directions were made that day.

2. I have also noted your views on the importance of ensuring that work is done to improve the quality of the data held by the public service pension schemes in advance of the next round of scheme valuations. As you know, I share these views, and the Treasury will work with Departments to consider how work to improve data quality might best be taken forward when the current round of valuations is complete.

3. However, as the current round of valuations nears its conclusion, a further data issue has come to light which necessitates an additional amendment to the Directions.

Amendment to Schedule 2: Notional Assets for First Valuation – Armed Forces pension scheme

4. As I have set out in previous correspondence, the Treasury's approach with regard to the valuations of the public service pension schemes is that these valuations should capture the full costs of providing these schemes. However, it is also the Treasury's view is that it would be inconsistent with our principles if there were to be significant changes to employer contribution rates arising as the result of changes to datasets rather than changes in the underlying costs of providing pension benefits. As initial results of the 2012 valuation of the Armed Forces Pension Scheme (AFPS) have emerged, it has become apparent that a problem with the data used at a previous valuation of that scheme could have a significant impact on the employer contribution rate unless an amendment is made to the Directions.

5. An "as at" 2005 valuation was used to determine the notional asset balance for the Armed Forces Pension Scheme. Since that valuation was completed it has come to light that data relating to a large number of deferred members of that scheme was excluded from that valuation. As such, the liabilities associated with these members was excluded when this notional asset balance was determined. These members have now been included in the 2012 valuation, which has led to a significant increase in the liabilities of the scheme as measured by the 2012 valuation.

6. As these increases in liabilities are not matched by corresponding increases in the notional asset balance, this change will lead to an increased deficit in the scheme. The cost of paying down this deficit over a 15 year spreading period, as specified in the Directions, would require an additional employer contribution of around 4% of pensionable pay.

7. As set out above, it would be inconsistent with the Treasury's approach to the valuations to allow this data issue to lead to a significant increase in the employer contribution rate, given that this does not relate to an increase in the underlying costs of the scheme. As such, we propose to make an adjustment to the notional asset balance listed in Schedule 2 of the Directions to remove this effect.

8. Officials from the Treasury have worked closely with the Ministry of Defence and their respective GAD advisers to ensure that the adjustment to be made is a best estimate of the size of the liabilities that are missing due this data problem. The Treasury is content that further scrutiny of the data or assumptions underlying the proposed adjustment would not significantly increase the likelihood that the adjustment would reflect only the additional liabilities arising from the inclusion of these deferred members.

9. As such, the Treasury proposes to bring forward the amending Directions at Annex A of this letter to adjust the notional asset balance in respect of the AFPS.

10. I would be grateful if you could offer your professional opinion on this revision to the Directions, particularly whether the revised directions will deliver our policy intention. I look forward to receiving your views in respect of this statutory consultation.

Yours sincerely

[redacted]

Julian Kelly

Annex A – Draft amending Directions

HM Treasury

The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2015

The Treasury, in exercise of the powers conferred on them by sections 11(2) and 12(3) of the Public Service Pensions Act 2013(**a**), make the following Directions.

Citation and entry into force

1. These Directions may be cited as the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2015, and come into force on the date that they are signed.

Amendment of the 2014 Directions

2. The Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014 are amended as follows.

3.In the second column of the table in Schedule 2, for the entry in the twelfth row (Armed Forces) substitute "£66,035,000,000".

Signed

Julian Kelly
Director General, Public Spending and Finance
[] February 2015 for Her Majesty's Treasury

(**a**) 2013 c. 25.