HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

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Congress House
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Dear Frances,

PUBLIC SERVICE PENSION SCHEME VALUATIONS 2016 – DRAFT AMENDING DIRECTIONS

1. As you may be aware, government departments, along with scheme actuaries and HM Treasury officials have been progressing the 2016 public service pension scheme valuations for some time now. I am pleased to be able to share with you Treasury's draft amending valuation directions.

2. The government's overarching objective for the valuations, as expressed when the directions were developed with valuable input from the TUC in 2013-14, remains to provide the most accurate possible measurement of scheme costs for both future accrual and past service, in order to ensure that these costs can be properly reflected in employer contribution rates.

3. The Treasury would welcome the TUC's comments on the proposed amendments to the directions, by close on Friday 28 September. The amendments, and our rationale, are more fully explained in the technical annex.

4. A number of the amendments being made to the directions reflect the passage of time since 2012 and involve updated parameters. These include the directions that specify long-term and short-term earnings growth; as well as pensions increases. The post-retirement mortality assumptions also reflect the most recent Office for National Statistics (ONS) figures, published in October 2017.

5. Some amendments reflect the fact that there are scheme-specific issues that need to be addressed, these are set out further in paragraph 15 below. Others reflect process-related matters that the Government Actuary's Department (GAD) have encountered as they work through the valuations. I hope you would agree that this is understandable the first time the directions are fully tested, not only to value all the public service pension schemes, but also to establish whether or not there have been any breaches of the employer cost cap mechanism. The draft directions include new provisions which set out the process for GAD to follow in the event that the valuation report notifies a cost cap breach.

6. Early indications are that there may be cost cap floor breaches in at least some of the schemes. The scheme valuation reports from GAD, expected later this year once the directions are finalised, will confirm whether there is a breach; and will trigger the process set out in section 12 of the Public Service Pensions Act 2013, as well as HM Treasury and scheme regulations. This process will include consultation with Scheme Advisory Boards, which I know a number of your members actively participate in.

7. As set out in section 5 of HM Treasury's policy paper on public service pension scheme valuations and the employer cost cap mechanism, published in March 2014[1], the Local Government Pension Scheme Advisory Board for England and Wales will follow scheme regulations and run its additional cost control process, before the HM Treasury cost cap mechanism is tested. If the additional cost control process results in a recommendation that changes to the scheme should be made, and the government accepts the Board's recommendations, the statutory employer cost cap mechanism will be adjusted to take the new scheme design into account.

8. When setting the cost cap mechanism up, we explicitly stated that it would need to be kept under review and that we had no reason to believe that it would be triggered unless extraordinary unpredictable events occurred. Given the early indications that it is

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf

likely to be triggered for a number of schemes at its first use, I will therefore be asking the Government Actuary to provide his professional opinion as to whether the mechanism has been implemented in a way that delivers the government's original policy objectives. The scope of the review will be limited to the design of the cost cap mechanism and I have asked the Government Actuary to involve you in the review. The review will conclude in time for the next four-yearly round of valuations. I am committed to implementing the outcome of the current valuations, on the basis of the agreements that the coalition government made. Where the cost cap is breached, steps will be taken to return costs to agreed target levels in respect of employment from 1 April 2019.

9. The technical measures used previously for public sector long-term and short-term earnings growth, issued by the Office for Budget Responsibility's (OBR) at fiscal events, have largely been retained and updated. There is, however, one exception to this and it relates to the public earnings growth figure for 2016/17; which will be inserted into direction 17(a) by amending direction 9(a). This figure is an outturn figure, so is derived from data, rather than being forecast. The OBR's Economic and Fiscal Outlook (EFO) issued in November 2017 cited this figure as 4.4%. The March 2018 EFO revised it to 3.6%. GAD, and some departments, flagged both these figures as being somewhat higher than would be expected in a year where the 1% pay policy continued to apply.

10. GAD advised that an alternative figure could be used, and the figure of 1.2% is proposed instead. This is taken from the published ONS Average Weekly Earnings (AWE) index, and is the 3-month average, as at March 2017, of seasonally-adjusted regular pay for the public sector, excluding financial services.

11. The Treasury intends to continue to centrally direct a number of assumptions, including for commutation in schemes with no automatic lump sum. The draft directions include a provision to increase the relevant assumption from 15% to 17.5%; based upon more recent scheme experience in the period since the last valuations.

12. The assumptions about State Pension Age (SPA) in direction 18(d) have not been amended. You will be aware that, following John Cridland's review of the SPA, the

government announced an intention to conduct a further review, and legislate for changes to the SPA, in the next Parliament. Without a legislative basis, it was not felt appropriate at this point to change the SPA parameters in the current valuation directions.

13. Various amendments are required to implement recent changes to the SCAPE discount rate. You will be aware that a change to the SCAPE discount rate, from 3% to 2.8%, was announced at Budget 2016. Having reviewed recent OBR publications and GDP forecasts; the Treasury is proposing that a further change to the SCAPE rate is appropriate. The proposed change is to reduce the SCAPE rate from 2.8% to 2.4%, but this will be confirmed in due course. The draft directions propose that the lower rate will take effect for valuations purposes from 1 April 2019.

14. Some increase in employer contributions was anticipated as a result of the Budget 2016 SCAPE rate change; which departments and the devolved administrations will need to meet in full. Treasury will be supporting departments with any unforeseen costs for 2019-20. Further discussions will be taken forward as part of the Spending Review.

15. There are a number of amendments which are necessary because of scheme-specific issues. These include amendments relating to the legal case of "Milne" which involved the Fire and Police pension schemes; there are also amendments relating to the Security Services and Civil Service pension schemes, as well as bringing the valuation cycles of the Local Government Pension Scheme into line with other schemes and amendments arising from the implementation of the pension scheme for fee-paid judges. These are all explained in more detail in the technical annex.

RT HON ELIZABETH TRUSS MP