HM Treasury

Public Service Pensions: cost control mechanism consultation

Proposal to reform the mechanism

June 2021

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Chapter 1
Summary

1.1 The cost control mechanism was introduced following the recommendations of the Independent Public Service Pensions Commission (IPSPC) in 2011. The mechanism is designed to ensure a fair balance of risk regarding the cost of providing public service defined benefit (DB) pension schemes between members of those schemes and the Exchequer (and by extension taxpayers).

1.2 The cost control mechanism was first expected to be tested at the 2016 valuations. Provisional results raised the question of whether the cost control mechanism, as currently designed, is too volatile.

1.3 Following this, at HM Treasury's request, the Government Actuary (GA) conducted a review of the cost control mechanism. The review was commissioned amidst concern that the mechanism was not operating in line with its original objectives. The GA has now delivered his final report to HM Treasury containing his findings and recommendations.

1.4 This consultation document sets out HM Treasury's response to the report and proposed changes to the mechanism. The Government proposes making three changes, all of which are recommendations by the GA:

- Moving to a reformed scheme only design: to remove any allowance for legacy schemes in the cost control mechanism, so the mechanism only considers past and future service in the reformed schemes. This ensures consistency between the set of benefits being assessed and the set of benefits potentially being adjusted;
- Widening the corridor: to widen the corridor from 2% to 3% of pensionable pay. This aims to achieve a better balance between stability and responsiveness of the cost control mechanism; and
- Introducing an economic check: currently the mechanism does not include changes in long-term economic assumptions and therefore cannot consider the actual cost to the Government of providing the pension benefits. The Government proposes introducing an economic check so that a breach of the mechanism would only be implemented if it would still have occurred had the long-term economic assumptions been considered.

1.5 The Government believes that these changes will establish a fairer balance of risks between the Exchequer and scheme members, and create a more stable mechanism. The Government is seeking views on these proposed changes from interested parties in this consultation.

Chapter 2

Introduction: the Government Actuary's review of the cost control mechanism

Introduction

2.1 Public service pensions continue to be among the very best available. They are generous, with most enjoying DB schemes where employer contributions are around 20 per cent of earnings – around double the typical contribution rate for large companies in the private sector.

2.2 The cost control mechanism is a mechanism designed to ensure a fair balance of risk with regard to the cost of providing public service DB pension schemes between members of those schemes and the Exchequer (and by extension taxpayers). For each scheme, the mechanism assesses certain aspects of the costs of providing that scheme; if, when the mechanism is tested, those costs have decreased/increased by more than a specified percentage of pensionable pay compared to their original level, then member benefits in the relevant scheme are increased/reduced to bring the cost of that scheme back to target.

2.3 The original objectives of the cost control mechanism can be summarised as follows:

1. To protect the Exchequer (and by extension taxpayers) from unforeseen costs;

2. To maintain the value of a public service DB pension scheme to its members; and

3. To provide stability and certainty on member benefit and contribution levels – the mechanism should only be triggered by 'extraordinary, unpredictable' events.

2.4 In September 2018, the then Chief Secretary to the Treasury (CST) announced that the Government would ask the GA to conduct a review of the cost control mechanism to make sure it is functioning appropriately.[1] On 16 July 2020, the CST announced that this review - which had been put on hold whilst the cost control mechanism was paused - would now proceed.[2]

[1] https://questions-statements.parliament.uk/written-statements/detail/2018-09-06/hcws945

[2] https://questions-statements.parliament.uk/written-statements/detail/2020-07-16/HCWS380

2.5 The decision to commission the review reflected a concern that the cost control mechanism was not operating in line with its original objectives; in particular, the intention that benefit rectification would only be triggered by 'extraordinary, unpredictable events'.

2.6 The GA has now delivered his final report to HM Treasury which has been published.[3] Officials and ministers have considered his findings and recommendations. This consultation document sets out HM Treasury's response to the report and proposed changes to the mechanism. All of the proposals are changes recommended by the GA.

Scope of the review

2.7 HM Treasury and the Government Actuary's Department (GAD) agreed that the objectives for the GA's review of the cost control mechanism were as follows:

1. To assess whether – and to what extent – the mechanism is working in line with original policy objectives for the mechanism.
2. To make recommendations as to any changes to the mechanism that could be made to ensure it is working in line with these original objectives.

2.8 The terms of reference also set out that the review could consider the effect of the mechanism on intergenerational unfairness, and the flexibility within the mechanism to allow the Government to respond to future developments in the public service pensions system, such as changes to the economic and fiscal context in which public service pensions operate and court judgments. Any recommendations on changes that could be made to address such issues might be considered to longer time scales.

2.9 The full terms of reference explain the responsibilities, scope and expected outputs of the review. They are set out in Annex A.

2.10 The GA's review and this consultation apply to all public service schemes covered by the existing cost control legislation in the Public Service Pensions Act 2013 ('the Act'). These schemes are set out in Annex B.

Stakeholder engagement

2.11 As part of his review, the GA held a stakeholder event attended by member and employer representatives from across the public service pension schemes from England, Wales, Scotland and Northern Ireland. At the event, the GA gathered views on the current functioning of the mechanism and whether there should be any changes made to it. The GA considered the stakeholder views in carrying out his review.

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3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/993416/Cost_Control_Mechanism_-_GA_Review_-_Final_Report_-_27_May_2021.pdf

How to respond

2.12 Responses should make clear which questions are being responded to and include all necessary rationale behind their views. Responses should make clear whether they reflect the views of an individual or have been sent on behalf of an organisation.

2.13 This consultation will run for 8 weeks and will close at midnight on 19 August. Responses can be submitted by email to CCMConsultation@HMTreasury.gov.uk

2.14 Alternatively, responses can be sent by post to:

Workforce, Pay and Pensions
HM Treasury
2/Red
1 Horse Guards Road
London SW1A 2HQ

Processing of personal data

2.15 This notice sets out how HM Treasury will use your personal data for the purposes of **Public service pensions: Cost control mechanism consultation** and explains your rights under the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA).

Your data (Data Subject Categories)

2.16 The personal information relates to you as either a member of the public, parliamentarians, and representatives of organisations or companies.

The data we collect (Data Categories)

2.17 Information may include your name, address, email address, job title, and employer of the correspondent, as well as your opinions. It is possible that you will volunteer additional identifying information about yourself or third parties.

Legal basis of processing

2.18 The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental policies or proposals or obtaining opinion data in order to develop good effective Government policies.

Special categories data

2.19 Any of the categories of special category data may be processed if such data is volunteered by the respondent.

Legal basis for processing special category data

2.20 Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a Government department.

2.21 This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

Purpose

2.22 The personal information is processed for the purpose of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest.

Who we share your responses with

2.23 Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).

2.24 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.

2.25 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

2.26 Where someone submits special category personal data or personal data about themselves or third parties, we will endeavour to delete that data before publication takes place.

2.27 Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates, including the Government Actuary's Department. Examples of these public bodies appear at: https://www.gov.uk/Government/organisations

2.28 As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor, NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

2.29 Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.

2.30 Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

Your Rights

- You have the right to request information about how your personal data are processed and to request a copy of that personal data.
- You have the right to request that any inaccuracies in your personal data are rectified without delay.
- You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- You have the right, in certain circumstances (for example, where accuracy is contested), to request that the processing of your personal data is restricted.
- You have the right to object to the processing of your personal data where it is processed for direct marketing purposes.
- You have the right to data portability, which allows your data to be copied or transferred from one IT environment to another.

How to submit a Data Subject Access Request (DSAR)

2.31 To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit
G11 Orange
1 Horse Guards Road
London
SW1A 2HQ
dsar@hmtreasury.gov.uk

Complaints

2.32 If you have any concerns about the use of your personal data, please contact us via this mailbox: privacy@hmtreasury.gov.uk.

2.33 If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, the UK's independent regulator for data protection. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House, Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

2.34 Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

Contact details

2.35 The data controller for any personal data collected as part of this consultation is HM Treasury, the contact details for which are:

HM Treasury
1 Horse Guards Road London
SW1A 2HQ
London
020 7270 5000
public.enquiries@hmtreasury.gov.uk

2.1 The contact details for HM Treasury's Data Protection Officer (DPO) are:

The Data Protection Officer, Corporate Governance and Risk Assurance Team
2/15
1 Horse Guards Road
SW1A 2HQ
London
privacy@hmtreasury.gov.uk

Chapter 3

Background: the cost control mechanism

Establishing the cost control mechanism

3.1 The IPSPC recommended in 2011 that the new public service pension schemes should include an employer cost control mechanism to protect the Exchequer from unforeseen increases in scheme costs. The Government accepted this recommendation and made provisions for the establishment of such a mechanism in the Act. Following consultation with member representatives, the Government set out in a policy paper how the mechanism would operate and made Directions to put this policy into effect. Whilst the Commission recommended a mechanism to protect the Exchequer from increased costs, the final mechanism negotiated between the Government and member representatives is symmetrical and so also maintains the value of pensions to members when costs fall.

3.2 The IPSPC also concluded that the structure of the legacy pension schemes was unfair and unsustainable. Alongside the introduction of the cost control mechanism, the Government therefore introduced reformed schemes based on the IPSPC's recommendations. With career average (CARE) design and increased Normal Pension Ages, the reformed schemes were an important step to protect against unsustainable increases in costs. They nevertheless remain amongst the most generous schemes available in the UK.

3.3 This chapter sets out how the cost control mechanism currently operates and the experience to date.

The operation of the cost control mechanism

3.4 Section 12 of the Act makes provision for an employer cost cap to protect against changes in scheme costs. The employer cost cap (the 'target cost') is a measure of the cost of the schemes expressed as a fixed proportion of pensionable pay. Treasury regulations (made under section 12(5) of the Act) currently specify that there will be a 2-percentage point margin above and below the target cost ('the corridor'). The upper margin forms a 'ceiling', with the lower margin forming a 'floor'.

3.5 Where the cost of the scheme has gone beyond those margins on either side of the target cost (a 'breach'), future pension benefits or member contributions must be adjusted to bring costs back to the target cost. If a breach occurs, the appropriate Secretary of State, or Scottish or Welsh Minister, will then consult the appropriate Scheme Advisory Board, which consists of member and employer representatives in respect of each of the pension schemes, to reach agreement on the steps to be taken to return costs to their target level. Where it is not possible to reach agreement, the scheme regulations typically provide that costs will be returned to target by increasing or decreasing the rate at which pension benefits accrue.

3.6 Section 12(4) of the Act provides for directions to be made by HM Treasury setting out the detail about the costs, or changes in costs, that are to be taken into account for the purposes of measuring changes in the cost of the scheme against the employer cost cap, and how those costs, or changes in costs, are to be taken into account. These are the Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014, as amended (the "Directions").

3.7 Public service pension schemes are subject to an actuarial valuation every four years, to set employer contribution rates and operate the cost control mechanism. The 2012 valuations were the preliminary valuations for the cost control mechanism. They established the level of the employer cost cap in each of the schemes, expressed as a percentage of pensionable pay. These are set out in scheme regulations, together with details of the procedure to be followed if the margins around the target cost are breached. At subsequent valuations, the cost of the scheme is then compared against the employer cost cap. This process measures changes in the value of the scheme to members. Only member costs - broadly, costs which are deemed to affect the value of the scheme to members – are therefore currently taken into account.[1]

3.8 As currently designed, the cost control mechanism assesses costs relating to: (i) active members of the reformed schemes, including any service they have in the legacy schemes; (ii) deferred and pensioner members of the reformed schemes; and (iii) active members of the legacy schemes. Costs associated with pensioners and deferred members of the legacy schemes are excluded.

3.9 The risks of changes in costs associated with those elements excluded from the cost control mechanism are borne wholly by public service employers, who are largely Exchequer funded. Employers, and ultimately the Exchequer, bear the risk associated with changes in costs arising from:

- the SCAPE discount rate (a measure of anticipated GDP growth) used for measuring costs in the unfunded schemes;
- the long-term earnings assumption;
- the actuarial methodology used for calculating scheme costs;
- the price inflation assumptions (based on the Consumer Prices Index).

3.10 The current mechanism is designed to grant members 'technical immunity'. The Directions ensure that, for each scheme, cost control outcomes do not take account of any of the above elements.

[1] Further discussion of what counts as a member cost is set out at https://assets.publishing.service.gov.uk/Government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf.

The 2016 valuations

3.11 The costs of the schemes were expected to be calculated for the first time 'as at' 31 March 2016 ("the 2016 valuations"). Provisional 2016 cost control results indicated a breach of the cost cap floor in all schemes for which results were assessed.

3.12 It was in the context of these provisional results that the Government announced that it was asking the GA to review the cost control mechanism.[2] The key drivers of the indicative floor breaches were a reduction in the assumed level of future pay increases and a reduction in assumed life expectancy. Neither of these reasons necessarily seem to fit the category of 'extraordinary, unpredictable events', raising the question of whether the cost control mechanism, as currently designed, is too volatile.

3.13 Before the provisional results were finalised, the Court of Appeal issued its judgment in the McCloud and Sargeant litigation. The uncertainty around member benefit entitlements arising from the judgment meant that at the time there was not enough certainty to assess the value of benefits to members. Until the Government had set out what the remedy would look like, the value of schemes was impossible to establish. The Government therefore announced a pause to the cost control element of the 2016 valuations in January 2019.[3] Actuarial valuations to set employer contribution rates were completed in Spring 2019 but did not calculate the costs of the schemes for the purposes of the cost control element of the valuations process.[4]

3.14 On 16 July 2020, the Government set out that the cost control mechanism would be resumed as the Government developed its plans to address the court judgments and the associated uncertainties receded. The Government also announced that the costs associated with the increased value of schemes to members as a result of the remedy to address the discrimination identified by the courts (whereby members in scope will be given a choice of benefits in respect of any accruals from 1 April 2015[5] to 31 March 2022) would be taken into account in the completion of the process.[6] The

2 https://questions-statements.parliament.uk/written-statements/detail/2018-09-06/hcws945

3 https://questions-statements.parliament.uk/written-statements/detail/2019-01-30/HCWS1286

4 As part of the 2015 reforms, those within 10 years of retirement remained in their legacy pension schemes. This transitional protection was provided following negotiations with member representatives and was intended to protect and give certainty to people who were close to retirement. The McCloud and Sargeant litigation challenged these transitional arrangements on the basis of age discrimination. In December 2018 the Court of Appeal found that this part of the reforms unlawfully discriminated against younger members of the judicial and firefighters' pension schemes in particular, as transitional protection was only offered to older scheme members.

5 The Local Government Pension Scheme for England and Wales (LGPS) was reformed in 2014 and all members were transferred to the reformed scheme. LGPS members in scope will be protected by an underpin in respect of any accruals from 1 April 2014 to 31 March 2022. This will provide, within the reformed scheme, whichever is the higher: the pension under the reformed scheme or the pension they would have been entitled to under the legacy scheme.

6 When the cost control mechanism was established, it was agreed that it would only consider costs that affect the value of the schemes to members (a 'member cost'). Addressing the discrimination identified in the McCloud and Sargeant judgments – giving members a choice of scheme benefits for the remedy period - involves increasing the value of schemes to members; the costs associated with this therefore fall into the 'member cost' category.

Government explained that taking the McCloud remedy into account would show higher costs than would otherwise be the case.[7]

3.15 In February 2021, the Government announced that, pending the outcome of the GA's review of the mechanism, there would not be reductions to member benefits as a result of completing the 2016 valuations. The Government judged that it would be inappropriate to reduce member benefits based on a mechanism that may not be working as intended. The impact of any ceiling breaches that occur will be waived while any floor breaches will still be honoured, with effect from 1 April 2019.[8] The Government will legislate to give effect to this policy announcement when parliamentary time allows.

3.16 The 2016 valuations will be completed ahead of any changes to the mechanism that come about as a result of this consultation.

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7 https://assets.publishing.service.gov.uk/Government/uploads/system/uploads/attachment_data/file/901141/Update_on_the_Cost_Control_Element_of_the_2016_Valuations.pdf

8 https://www.gov.uk/Government/consultations/public-service-pension-schemes-consultation-changes-to-the-transitional-arrangements-to-the-2015-schemes/outcome/update-on-the-2016-and-2020-valuations

Chapter 4

The Government Actuary's final report

4.1 This chapter summarises the GA's final report on his review of the cost control mechanism. This report has been published in full alongside this consultation.[1]

Assessment of the current mechanism

4.2 The GA assessed the current mechanism by analysing the preliminary results of the 2016 valuations, before the mechanism was paused. The GA noted that:

- **Legacy schemes (i.e. those in place before the 2014/2015 reforms) were the main driver of the breaches** seen in the provisional results of the 2016 valuations. The breaches were caused primarily by a reduction in assumed pay increases and a reduction in life expectancy. The GA considers that these costs relate to risks that have largely been mitigated in the reformed schemes: salary risk is mitigated by the fundamental CARE design of the schemes and several workforces mitigate the longevity risk by the link between Normal Pension Age (NPA) and State Pension age (SPA).[2] Although legacy scheme costs are taken into account, the impact of any breaches can only be delivered through changes to reformed schemes, and the GA comments that "it is not clear to me why these residual risks in the legacy schemes should continue to influence the level of benefits in the reformed schemes".

- It was a **"perverse outcome"** that the 2016 valuation resulted in employer contribution rates increasing, while provisional cost control results found that all schemes breached the floor which would have led to benefit improvements resulting in a further increase to employer contribution rates. The GA finds that this outcome was primarily driven by the fact that the cost control mechanism does not currently account for the change in

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/993416/Cost_Control_Mechanism_-_GA_Review_-_Final_Report_-_27_May_2021.pdf

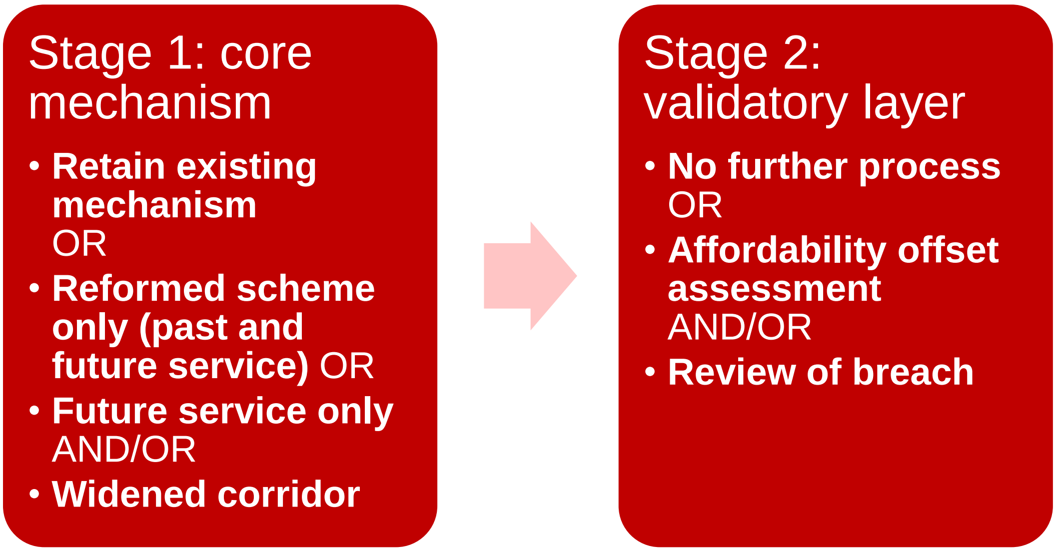
2 Most of the reformed schemes have a Normal Pension Age (NPA) linked to the member's State Pension age (SPA) (the age at which a State Pension can be received). There are exceptions for the armed forces, the police and firefighters, where the NPA is set at 60 for those retiring from active service.

the SCAPE discount rate, which is used to determine employer contribution rates.[3]

- The **current corridor is too narrow** and will lead to excessive volatility in the mechanism. The GA further notes that even under a reformed mechanism, the current corridor would still mean a high likelihood of frequent breaches.

Recommendations

4.3 The GA makes a number of recommendations in his report, set out as part of a two-stage framework: changes that could be made to the core mechanism and elements of validation that could be introduced to moderate the effects of the core mechanism.



4.4 The GA's recommended options to improve the core mechanism are:

- **Reformed scheme only**: to remove any allowance for legacy schemes, so the mechanism solely considers the reformed schemes (both past and future service).

- **Future service only**: to consider only the cost of future service accrual in the reformed schemes.

- **Widened corridor**: to widen the current corridor of +/-2% of pensionable pay for all schemes to reduce the frequency of breaches.

4.5 The recommended options to moderate the effects of the core mechanism are:

- **Affordability offset assessment**: a breach of the mechanism would only be implemented if it would still have occurred had the long-term economic

[3] SCAPE is the methodology used to value unfunded public service pension schemes. It uses a 'SCAPE discount rate' to convert the value of future pension payments into today's terms.

assumptions (such as the SCAPE discount rate) been considered. In practice this would mean that the impact of a change to the long-term economic assumptions would be able to offset any ceiling or floor breaches that would otherwise occur, but in itself it would not be able to cause, or increase the size of, a breach.

- **Review of breach**: allow for reasoned judgement to determine whether benefit changes should be implemented e.g. by the Government or an independent panel.

4.6 The GA also considered longevity, noting that changes in life expectancy can have a significant impact on the cost control mechanism and that longevity risk is already mitigated in some schemes (those with a linkage between NPA and SPA). He sets out two considerations for the Government in the light of this:

- The Government could remove the impact of changing longevity and SPA from the mechanism for the relevant schemes, given they already have mitigation in place;
- Alternatively, the Government could consider smoothing longevity assumptions given their potentially disproportionate impact on the mechanism and the likelihood for such assumptions to fluctuate.

Consistent with the terms of reference, the Government will consider these recommendations on longevity to longer timescales.

4.7 The GA's full rationale, assessment against the objectives and wider considerations for each of these proposals are set out in his report.

Chapter 5

Proposed changes to the cost control mechanism

5.1 The Government has carefully considered the analysis and recommendations contained in the GA's final report. Having reflected on this, the Government proposes making three changes to the cost control mechanism, all of which are in line with the GA's recommendations:

- Moving to a reformed scheme only design (both past and future service);
- Widening the corridor;
- Introducing an economic check.[1]

5.2 This chapter sets out the proposals and reasoning behind them and invites comment on them.

Reformed scheme only design

5.3 At present, the mechanism assesses costs relating to active members in the legacy schemes as well as the reformed schemes.[2] **The Government proposes removing the allowance for legacy schemes** so that, going forward, the mechanism should consider only the reformed schemes (both past and future service).

5.4 A reformed scheme only design would ensure consistency between the set of benefits being assessed and the set of benefits potentially being adjusted. Under the current cost control mechanism, costs relating to active members with service in legacy schemes are assessed, but rectification can only occur in the reformed schemes. A reformed scheme only design would assess and adjust benefits only in the reformed schemes.

5.5 This proposed change would also reduce intergenerational unfairness because certain costs associated with providing pension benefits in the legacy schemes currently influence the benefits received in the reformed schemes (whose membership is comparatively younger). Moving to a reformed scheme only cost control mechanism would mean that comparatively younger members no longer experience changes to their benefits based on the cost of providing benefits to comparatively older members with past service in a legacy scheme.

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[1] Referred to in the GA's report as the "affordability offset assessment".

[2] Further consideration will be given to the detailed implementation of the reformed scheme only design in the Local Government schemes, given the effects of the underpin (see footnote 5 in Chapter 3).

5.6 The GA sets out that moving to a reformed scheme only design would improve the short to medium term stability of the mechanism by significantly reducing the past service component of assessed costs. A reformed scheme only design would mean that the risk of a change in the cost of providing legacy schemes would be borne by the Government rather than members. This risk diminishes over time and could be either beneficial or detrimental to the Government, depending on how the economic picture develops, as well as the nature of any wider demographic changes. The Government believes that in general it is right to transfer this risk to the Exchequer to minimise intergenerational unfairness as the legacy schemes close to future service. It would not seem fair for those who have only ever been members of reformed schemes to bear risks relating to the legacy schemes going forward.

5.7 This is pertinent particularly given that these reformed schemes were introduced in 2014 and 2015 because the IPSPC concluded that the structure of the legacy schemes was unfair and unsustainable. From 1 April 2022, it is intended that there will no longer be any members accruing benefits in the legacy schemes. Removing the allowance for legacy schemes therefore accelerates an existing trend since members with legacy scheme benefits are gradually leaving active membership.

5.8 The GA set out that an alternative to the reformed scheme only design would be to move to a future service only design i.e. a mechanism that only considered the cost of future service accrual in the reformed schemes. While this option would further increase stability and intergenerational fairness, it would further reduce the strength of the cost control, placing all the risks of past service costs (both reformed scheme and legacy scheme) onto the Exchequer. Whilst at first this level of risk is the same as with the reformed scheme only design, it is increasing with this option, rather than diminishing over time. This is because the level of risk associated with the legacy schemes will gradually decrease as membership of those schemes depletes, whereas the level of risk associated with past service as a whole will continue to grow as increasing numbers of members accrue service in the reformed schemes. The Government does not believe that it is right for the Exchequer to take on the risk associated with all past service across the legacy and reformed schemes. The cost control mechanism is intended to share risks between members and the Exchequer and the Government believes that the future service only design would tip the balance too far towards the Exchequer bearing the majority of the risk.

5.9 There are a number of reasons beyond risk sharing that the Government believes make a future service only design undesirable. For example, the GA set out in his report that the real value of member benefits may be preserved less well under this option. This is because any change in value of past service cannot impact the value of any future service a member accrues.

5.10 Moreover, the Government is concerned that a future service only design could restrict the Government's ability to respond to future events. The GA explains in his report that a more narrowly defined mechanism may limit the ability of the Government to reflect relevant developments in the mechanism. In the case of a future service only mechanism which excludes past service, it would be difficult for the Government to respond to changes in overarching pension legislation which impacts past service costs or to respond to court judgements which impact past service, such as McCloud. For example, if a retrospective increase in accrued rights were awarded to members these additional costs could not be captured in a future service only mechanism and so could not be picked up by members, or if there were an unexpected reduction in the value of accrued rights those savings might not benefit members. The Government wishes to retain maximum flexibility to respond to future events.

5.11 Based on the combination of reasons set out above, the Government has opted to only consult on the reformed scheme only option, and to rule out the future service only model. When assessing the balance of risk between the Exchequer and the scheme members, the Government has concluded that it is right for the Exchequer to take on more risk to reduce intergenerational unfairness. However, the Government does not believe that the Exchequer and taxpayers in general should take on all of the risk associated with underestimating the value of past service, as this would move the cost control mechanism away from its original risk sharing intentions.

Question 1: Do you agree that a reformed scheme only design would achieve the right balance of risk between scheme members and the Exchequer (and by extension the taxpayer), and would create a more stable mechanism?

Widening the corridor

5.12 The corridor is currently set at +/-2% of pensionable pay for all schemes. In his final report, the GA asserts that "the 2% corridor could be breached as a result of changes which might not be considered extraordinary or unpredictable under the existing, reformed scheme and future service only mechanisms. There is, therefore, a strong argument for widening the corridor to avoid regular breaches of the mechanism.... Without this widening of the corridor, I expect there to be frequent breaches without any extraordinary, unpredictable events needing to occur."[3]

5.13 **The Government proposes widening the corridor to improve the stability of the mechanism.** The Government has commissioned and reviewed analysis from GAD which estimates the expected frequency of breaches with different corridor sizes. The Government has considered this analysis, alongside the extent to which various corridor sizes retain an appropriate strength of cost control, in reaching the following conclusions.

3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/993416/Cost_Control_Mechanism_-_GA_Review_-_Final_Report_-_27_May_2021.pdf

5.14 The current corridor of +/-2% of pensionable pay, when applied to a reformed scheme only mechanism, might see a breach occur roughly once in every five valuations for each scheme. The Government considers that this is too frequent and undermines the mechanism's stability objective. Moreover, past experience shows that the current corridor can be breached based on circumstances that do not necessarily seem to fit the category of 'extraordinary, unpredictable events'.

5.15 A corridor of +/-3% of pensionable pay, when applied to a reformed scheme only mechanism, might see a breach occur roughly once in every ten valuations for each scheme. The Government considers that this size of corridor is appropriate in that it increases the stability of the mechanism while also continuing to provide effective cost control.

5.16 The Government does not propose introducing an even wider corridor of, for example, +/-4% , as it does not believe that a corridor of this size would effectively control costs. This is due to the fact that, the wider the corridor, the more costs can diverge before being brought back to target. A corridor size of +/-4% would see very low breach frequency: roughly once in every 20 valuations for each scheme (i.e. approximately once every 80 years per scheme). Further detail of expected breach frequencies with different corridor sizes is set out in Table 4.A.

5.17 The GA also mentioned in his report that it would be reasonable to consider wider corridors for schemes with higher costs (i.e. a proportional cost corridor). The Government has considered this option and believes that it would be overly complex and more difficult for members to understand than the current corridor design. It is an advantage that the current corridor, based on a specified percentage of pensionable pay, is consistent across all schemes. The Government is also concerned that wider corridors for schemes with higher costs may benefit members of some schemes over others. The Government is therefore not consulting on a proportional cost corridor.

Table 5.A: Expected breach frequency for a reformed scheme only mechanism[4]

Corridor size	Expected breach frequency for a single scheme
+/-2%	Breaches broadly expected every 5 valuations
+/-3%	Breaches broadly expected every 10 valuations
+/-4%	Breaches broadly expected every 20 valuations
+/-5%	Breaches expected to be rare

Source: Government Actuary's Department

4 The table sets out the expected likelihood of a breach occurring for an individual scheme. The likelihood of at least one scheme breaching at each valuation cycle would be expected to be higher. Conversely, the introduction of an economic check will serve to reduce the likelihood of breaches from those quoted in the table.

Question 2: Do you agree with the Government's intention to widen the corridor? If not, why not?

Question 3: Do you think that a corridor size of +/-3% of pensionable pay is appropriate? If not, why not?

Economic check

5.18 Currently, the mechanism does not consider the wider economic situation when determining whether breaches of the cost control mechanism should result in a change to member benefits.

5.19 As part of his review, the GA concludes that the mechanism cannot protect the taxpayer unless it has some allowance for affordability in relation to the long-term economic outlook. The GA comments that "it does not seem possible for the mechanism to be able to protect taxpayers unless it takes into account more of the factors affecting the actual cost of providing a pension. Furthermore, in the circumstances it might be considered generous for members to be immunised against all the long-term financial downside risks whilst being able to benefit from the upside of other risks."[5]

5.20 Specifically, the GA sets out that the current mechanism fails to protect the taxpayer in that it can lead to what he describes as "perverse outcomes" of employer contributions rising while member benefits are also improved.

5.21 Under the current arrangement, such an outcome can occur when the cost pressures to the Exchequer of providing pensions is moving in the opposite direction to the value of pensions to members. For example, first, employer contributions may increase at a scheme valuation as a result of changes to assumptions that indicate that the cost of providing pensions has increased as a share of the Government's expected future income, such as the result of a reduction to the SCAPE discount rate.[6] Second, the outcome of the cost control mechanism may result in benefit increases for members. For example, under the current mechanism, public sector pay restraint could trigger a correction to the benefit of members at the same time as the cost

5 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/993416/Cost_Control_Mechanism_-_GA_Review_-_Final_Report_-_27_May_2021.pdf

6 The SCAPE discount rate is the discount rate used at scheme valuations to express the cost of pension promises that are being built up as a present-day cost.

of future pension benefits has become relatively more expensive due to a downturn in long-term economic forecasts.

5.22 In order to avoid such "perverse outcomes", the GA recommends introducing a validation layer whereby breaches of the cost control mechanism only lead to a change in benefits where that is in line with the long-term economic outlook. In simple terms, benefits would not be reduced if the country could afford to continue paying the current level of benefits. Similarly, benefits would not be increased if the country could not afford to pay these increases.

5.23 The GA's report emphasises that the economic check can ensure affordability of pensions to the Exchequer, based on past experience of provisional floor breaches. However, the Government notes that the current arrangement could also lead to perverse outcomes to the detriment of members. It is possible to be in a position whereby member benefits are reduced at the same time as employer costs fall. This scenario could occur for example if life expectancy rose and the SCAPE rate increased likewise. This could trigger a correction to the detriment of members at the same time as the cost of future pension benefits has become relatively cheaper due to an upturn in economic forecasts. In this situation, the economic check would work to protect members from perverse outcomes by offsetting potential benefit reductions.

5.24 The Government considers that expected long-term GDP may be an appropriate measure for economic performance since pension promises are funded through the tax base, for which expected long-term GDP is a proxy. In this context, the GA has recommended an economic check linked to the SCAPE discount rate as, under the current methodology, the SCAPE discount rate is set based on expected long-term GDP. Please see Box 5A for further discussion of the SCAPE discount rate.

5.25 Under the GA's recommended design, a breach would only be implemented if the cost of a scheme still resulted in a breach once the impact of any change in the SCAPE discount rate on the cost of the scheme was taken into account. This would mean that if benefits become more expensive under the cost control mechanism, they would not be reduced if the SCAPE discount rate had sufficiently increased such that it offset the extra benefit cost – indicating the economy is forecast to perform better than originally expected and is therefore expected to be able to support the more expensive benefits. Similarly, if the benefits become cheaper under the cost control mechanism, they would not be increased if the SCAPE discount rate had sufficiently decreased such that it offset the reduction in benefit cost – indicating the economy is forecast to perform worse than originally expected and is therefore expected to be unable to support such an increase. In other words, factoring in the SCAPE discount rate could offset a breach, but could not cause or contribute to one. Further explanation of the proposed operation of the economic check is set out in Table 5.B and in Annex C.

5.26 Using the SCAPE discount rate as a measure for the economic check would create a consistent approach to setting employer contribution rates and assessing whether breaches of the cost cap should result in changes to member benefits based on the long-term economic outlook.

5.27 The Treasury is consulting on the SCAPE discount rate methodology in parallel to this consultation.[7] It is possible that the methodology may change depending upon the outcome of that consultation. The GA notes that if the methodology changes then SCAPE may no longer be an appropriate basis for the economic check. In these circumstances, an alternative discount rate would need to be applied to the cost of the scheme for the purposes of an economic check in the cost control mechanism. For example, the GA suggests that, if it is felt that expected long-term GDP still reflects the best assessment of the affordability of changes to member benefits then it would be right to use that rate explicitly in any economic check introduced to the cost control mechanism.

5.28 The consultation on the SCAPE discount methodology is also requesting views on other modifications to the SCAPE discount rate (if it remains linked to long-term GDP), of allowing for short-term GDP projections or actual GDP experience. If such changes were made to the SCAPE discount rate, and SCAPE was used as a measure for the economic check, then it would need to be decided whether the changes were also reflected in the economic check.

Box 5A: The OBR's long-term GDP projections

The existing target costs in the cost control mechanism were set using a discount rate (net of CPI) of 3% a year. This was in line with the SCAPE discount rate in force at that time and hence reflects the expected cost of the benefits when the reformed scheme designs were agreed. If the SCAPE discount rate, or a long-term expected GDP growth discount rate, was used in the economic check, it would then follow that this would be the baseline discount rate which any subsequent changes to the discount rate is assessed against.

The current SCAPE discount rate (2.4% + CPI) was implemented in 2018 and is based on the OBR's long-term GDP projections published in July of that year.

The OBR has since published revised long-term GDP projections, most recently updated in March 2020. These projections forecast a reduction in expected long-term GDP growth relative to the projections published in July 2018.

If the SCAPE discount rate was calculated using the most recent projections, it would result in a rate of 1.8% + CPI. However, the SCAPE discount rate has not been changed to reflect the most recent OBR projections; the SCAPE discount rate of 2.4% + CPI remains in force.

The Government intends to carry out a separate exercise to review the level of the SCAPE discount rate following its consultation on the SCAPE discount rate methodology and will announce any new SCAPE discount rate at a later date.

[7] www.gov.uk/government/consultations/public-service-pensions-consultation-on-the-discount-rate-methodology

5.29 It would also seem appropriate for the economic check to include the impact of any change to the long-term earnings assumption, given this is a long-term economic variable that impacts on employer costs but is currently excluded from the mechanism. Under a reformed scheme only mechanism this would impact those schemes with in-service revaluation set equivalent to the increase in average earnings.

5.30 The Government is aware that the existing mechanism does not include effects caused by changes to the discount rate or the long-term earnings assumptions. However, given the GA's assessment that the mechanism cannot protect the Exchequer without making some allowance for the wider economic situation, the Government judges that it is right to now allow for them, albeit in a limited way, via an economic check. This is a pragmatic approach to avoiding perverse outcomes whilst retaining the limitation that a change in external factors cannot in itself cause a change to member benefits.

5.31 **The Government therefore proposes introducing an 'economic check' to the cost control mechanism.** Depending on the outcome of the review of the SCAPE discount rate methodology, this would be based on the SCAPE discount rate or an alternative measure such as expected long-term GDP, and would also take account of the long-term earnings assumption.

5.32 The Government recognises that there are differences between the Local Government Pension Schemes (LGPS) and other public service schemes, especially in the way in which employer contribution rates are set.[8] Despite these differences, the GA still believes that the design of the economic check would be reasonable for the LGPS. The Government would welcome views on the application of the economic check to the LGPS in particular.

5.33 The GA considered the merits of making full allowance for changes in the SCAPE discount rate in the core mechanism, but judged that this would not be viable as it would likely create significant instability and could be viewed as an overly technical assessment for determining an exact change in member benefits. For further discussion of this point, please see Appendix C of the GA's final report.

5.34 The GA also raised the option of introducing a breach review (or validatory qualitative assessment) to the mechanism. This would mean that a calculation-based assessment would still occur, as now, but the results would be advisory only. The final decision to confirm or waive a breach would be taken in view of the wider context. The GA does not express a view on exactly how this might operate, but notes it could be carried out by, for example, the Government or an independent panel of experts, and would require further work to establish precisely how it would operate. The Government takes the view that it would be preferable to allow the mechanism to continue operating as a purely technical process. Introducing a layer of discretion would lead to a subjective final decision and a reduced

[8] Unlike most other public service pension schemes, the LGPS is 'funded' meaning contributions are held separately from other local authority assets and are invested to pay pensions. Employer contribution rates are calculated locally and the SCAPE discount rate is not used for this purpose. Instead discount rates are set on a prudent basis taking into account expectations of future investment returns.

level of transparency. Moreover, once the envisaged changes have been made it is expected that the mechanism will be significantly more stable than at present and so the need for a further layer in the process will be limited. The Government is therefore not consulting on the breach review option.

Table 5.B: The GA's proposed operation of the economic check

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Initial calculated breach excluding SCAPE	-5% (i.e. 3% outside the -2% corridor)			
SCAPE impact	-1%	+1%	+3.5%	+8%
Initial + SCAPE	-6%	-4%	-1.5%	+3%
Disclosed breach	-5%	-4%	-1.5%	+2%
	SCAPE does not further increase the breach	SCAPE partially offsets the breach	No breach as SCAPE offsets to within the corridor	No breach. SCAPE can only offset and cannot cause a breach in the opposite direction.

To note:

- *the idea is that this will work in both directions, so the economic check could also offset a ceiling breach as well as a floor breach.*
- *these examples have been set out assuming that the economic check uses the SCAPE rate as its baseline discount rate. The Government could also choose to use an alternative discount rate, as set out in the GA's report and above.*

Source: Government Actuary's Department

Question 4: Do you agree with the proposal to introduce an economic check?

Question 5: Do you think that the SCAPE discount rate, as it currently stands, is an appropriate economic measure for the cost control mechanism?

Question 6: If the SCAPE methodology changes, and the Government considers that the SCAPE discount rate is therefore not an appropriate measure for the cost control mechanism, then do you think that a measure

of expected long-term GDP should be used instead? If not, please set out any alternative measures that may be appropriate in this scenario. Please consider in the context of the separate review of the SCAPE methodology currently being undertaken by HM Treasury.

Practical implications of the proposed changes

5.35 The existing target costs determined at the preliminary 2012 valuations and set out in scheme regulations would be consistent with the Government's proposals. In particular, the target costs would be consistent with a reformed scheme only mechanism because the legacy scheme past service element was set to have a net-zero impact at the outset so the target costs wholly related to the reformed scheme. The 2020 valuations will therefore compare costs against the existing target costs including any past service cost pressures arising in the reformed schemes already built up between 2015-20. The GA sets out in his report that there is no need to reset target costs for any of his proposals that the Government has now decided to take forward in this consultation.

5.36 There may need to be some recalculation of other factors in the process. In particular, this applies to the cost cap funds, which are the notional assets in the cost control mechanism, as they currently include notional assets relating to the legacy schemes. The cost cap fund is compared to the cost cap liabilities in each scheme to determine the past service cost element. Therefore, the cost cap funds will need to be adjusted to remove those notional assets relating to the legacy schemes to ensure consistent comparison with the cost cap liabilities where the legacy schemes will also now be excluded.

Equalities impacts

5.37 The Government has considered the equalities impacts of these proposed changes. The changes will apply to all members irrespective of age. Furthermore, the move to a reformed scheme only design will have an overall positive impact on intergenerational fairness, although some age-related consequences remain.

5.38 The protected nature of accrued pension rights and the design of the cost control mechanism are such that it is not possible to exactly align the change in costs that trigger a breach with those who will directly be affected by any related rectification. Currently, the cost control mechanism delivers something of an 'intergenerational transfer': past service costs associated with a group of employees who are, on average, older, affect the pension benefits/contributions of a group of employees who are younger on average – though the latter group will include some of the former group. It is inherent in the design of defined benefit schemes that members in a particular scheme mutually share the risks and benefits, and that there are cross-subsidies between members. Whilst such an 'intergenerational transfer' remains within a reformed scheme only cost control mechanism, it is now with respect to a consistent scheme design. This would appear to be more intergenerationally fair than the current mechanism whereby comparatively younger members experienced changes to their benefits based on the cost of providing benefits to comparatively older members with past service in a legacy scheme that the comparatively younger members never had access to.

5.39 However, whilst improving the overall intergenerational fairness, there is also a possibility that, as a consequence of this change, the value of benefits in the legacy schemes to members reduces with no corresponding increase in reformed scheme benefits which would impact members with significant legacy scheme benefits who are, on average, older.

5.40 The Government does not envisage any positive or negative impact on any other groups with protected characteristics as the reforms apply to all members equally across the relevant schemes. Nevertheless, the Government is seeking views as part of this public consultation as to whether there are equalities concerns it should be aware of.

Question 7: Do you envisage any equalities impacts from the proposals to reform the cost control mechanism that the Government should take account of?

Annex A

The terms of reference for the Government Actuary's review of the cost control mechanism

Context

A.1 In September 2018, the then Chief Secretary to the Treasury (CST) announced that the Government would ask the Government Actuary to conduct a review of the cost control mechanism that was established in the reformed public service pension schemes, following a recommendation of the Independent Public Service Pensions Commission. This reflected a concern that the mechanism was not operating in line with its original objectives; in particular, the intention that it would only be triggered by 'extraordinary, unpredictable events'. On 16 July 2020, the CST confirmed in a Written Ministerial Statement that this review would proceed.

Terms of reference

Purpose

A.2 To undertake a review of the cost control mechanism that was established in the reformed public service pension schemes, following a recommendation of the Independent Public Service Pensions Commission.

Objectives

1. To assess whether – and to what extent - the mechanism is working in line with original policy objectives for the mechanism.

   These objectives are:

- To protect taxpayers from unforeseen costs;
- To maintain the value of pension schemes to the members; and
- To provide stability and certainty to benefit levels – the mechanism should only be triggered by 'extraordinary, unpredictable events'.

2. To make recommendations as to any changes to the mechanism that could be made to ensure it is working in line with these original objectives.

Output

A.3 A final report for HM Treasury that sets out the assessment that has been made of the mechanism, and includes a clear set of recommendations on any changes that could be considered.

A.4 An interim report will also be produced. The parameters of the interim report will be agreed between the review team and HM Treasury at the commencement of the review.

A.5 HM Treasury will publish the final report and respond after the findings and recommendations have been duly considered.

Scope

A.6 The review will consider the operation and effectiveness of the mechanism as it is currently set out in legislation (primary, secondary, and tertiary) governing valuations of public service pension schemes. It should consider the effectiveness of the mechanism at both an aggregate level across all schemes and at an individual scheme level.

A.7 The review will produce a range of recommendations, as appropriate, to be considered by HM Treasury.

1. The review should provide recommendations on potential changes or adjustments to the mechanism as currently established, that could be made ahead of the 2020 scheme valuations, to address any problems with the mechanism that have been identified in the course of the review.
2. The review should provide recommendations on any potential changes or adjustments to the mechanism that would require longer to implement, to address problems that have been identified.
3. The review may also consider broader issues including, but not limited to:

- the effect of the mechanism on intergenerational unfairness; and
- the interaction between the mechanism and the ability of Government to respond to future relevant developments in the public service pensions system, such as changes to the economic and fiscal context and court judgments;

and may make any recommendations on changes that could be made to the cost control mechanism to address such issues; the implementation of which could be considered to longer time scales.

Approach, roles, and responsibilities

A.8 The review will be led by the Government Actuary and supported by actuaries in the Government Actuary's Department. This review team will be responsible for delivery of the work, and the reports to HM Treasury.

A.9 HM Treasury officials will provide support to the review team to facilitate the work as required, but will not play a formal role in delivery of the review.

A.10 Stakeholder engagement will be led by the review team, with HM Treasury support as required.

A.11 The Government Actuary's Department will keep HM Treasury officials up to date on progress in regular meetings. Progress will be shared with senior officials through existing HM Treasury governance arrangements (monthly meetings, and ad hoc engagement as/if required).

Timing

A.12 The review will report in time for recommendations that are accepted to be implemented ahead of the 2020 valuations process.

Annex B

Schemes in scope

B.1 The GA's review and this consultation cover schemes for the following public servants:

- civil servants;
- the judiciary;[1]
- local Government workers for England, Wales and Scotland;
- teachers for England, Wales and Scotland;
- health service workers for England, Wales and Scotland;
- fire and rescue workers for England, Wales and Scotland;
- members of police forces for England, Wales and Scotland;
- the armed forces.

The GA's review also considered the corresponding schemes provided in Northern Ireland. Cost control provision for the equivalent and similarly constituted Northern Ireland public service schemes established under the Public Service pensions Act (NI) 2014 broadly reflects that provided under the Public Service Pensions Act 2013. This consultation welcomes input from interested stakeholders across all of the UK public service schemes.

Other public servants also have pension schemes which mirror the cost control mechanism, although they are not legislatively required to do so.

B.2 The Local Government Pension Scheme (England and Wales) also has a second and separate cost control mechanism operated by its Scheme Advisory Board. The scheme will consider any necessary changes to this second mechanism in the light of the overall changes made across schemes.

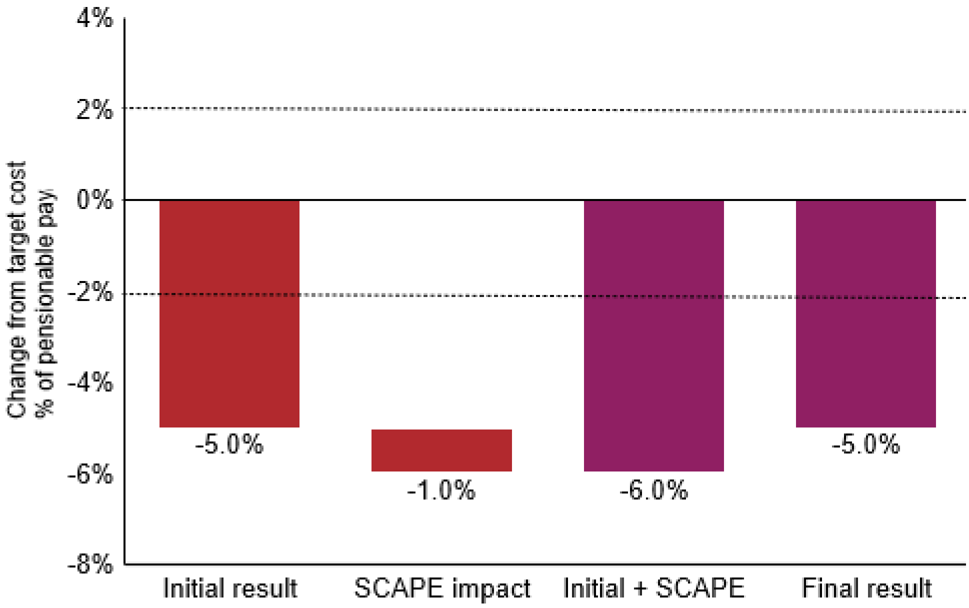
[1] Given there are changes envisaged to the judicial pension scheme, some recommendations may need to be considered in further detail for the judiciary.

Annex C

Economic check illustrations

C.1 The following scenarios illustrate how an economic check would work in practice. They are consistent with the scenarios included in the Government Actuary's report, and therefore consider an economic check linked to a change in SCAPE discount rate and a +/-2% corridor width. As set out in this consultation, an economic check will not necessarily be linked to changes in the SCAPE discount rate and could also include changes in other long-term economic variables such as assumed earnings growth. The Government also proposes to widen the corridor, but such a change has not been included in these illustrations.

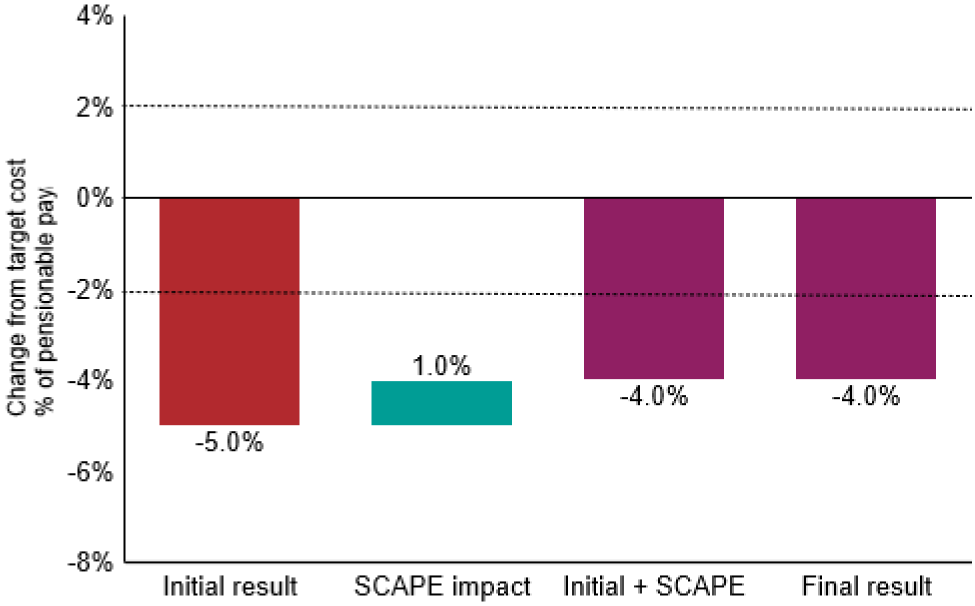
Scenario 1



- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has increased slightly from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would reduce assessed costs by a further 1% of pensionable pay.
- The change in SCAPE discount rate can only offset a breach and cannot cause or contribute to one. Therefore, the final result of the cost control

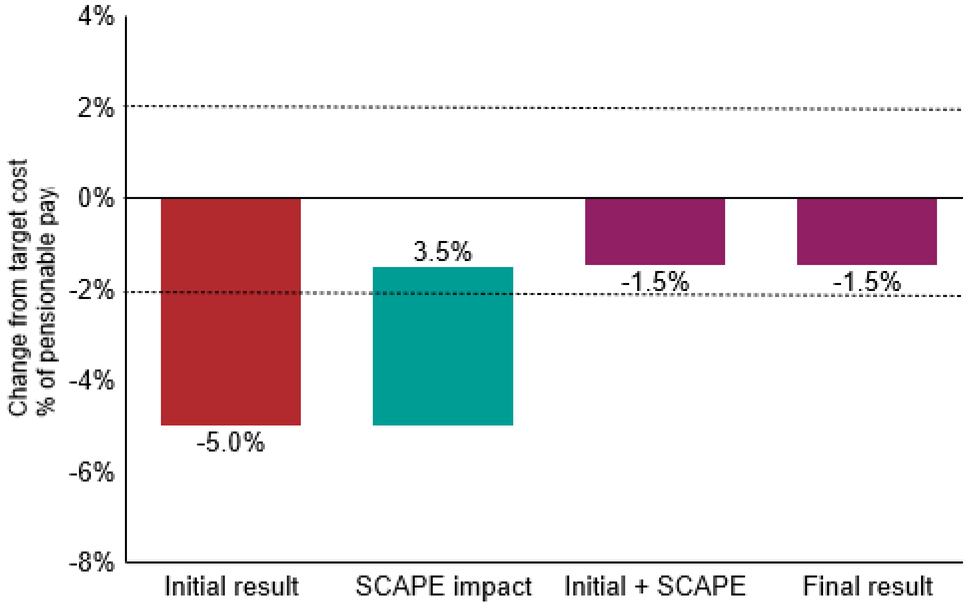
mechanism remains at a reduction of 5% of pensionable pay from the target cost.

Scenario 2



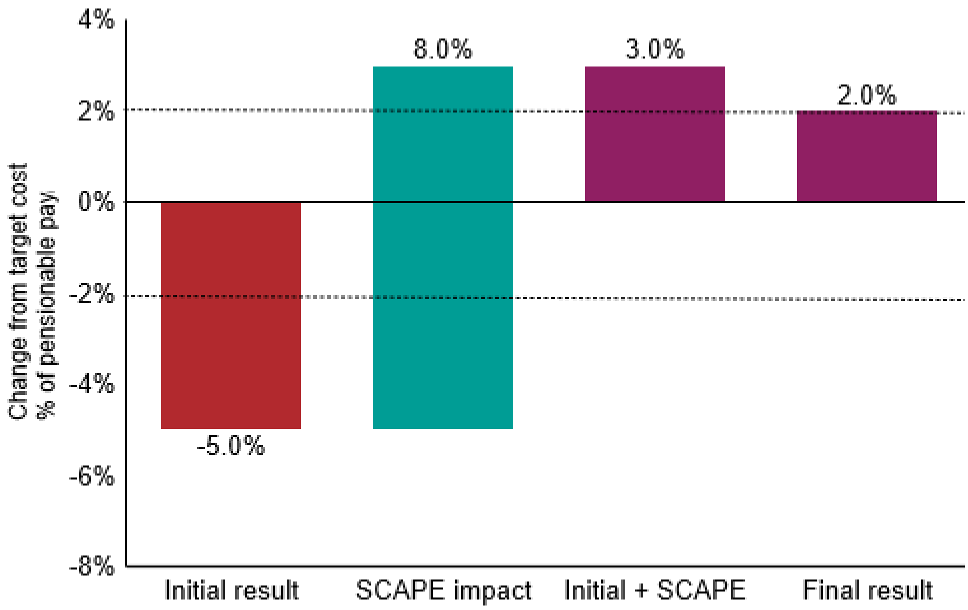
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has decreased slightly from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would increase assessed costs by 1% of pensionable pay in isolation.
- This impact would partially offset the initial breach with the final result of the cost control mechanism being a reduction of 4% of pensionable pay from the target cost.

Scenario 3



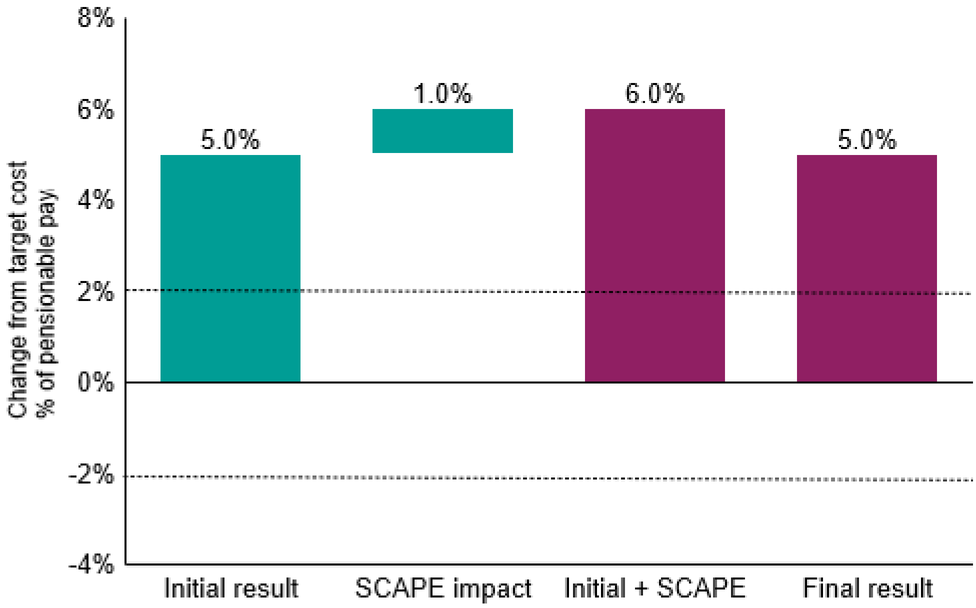
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has decreased from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would increase assessed costs by 3.5% of pensionable pay in isolation.
- This impact would offset the initial breach with the final result of the cost control mechanism being a reduction of 1.5% of pensionable pay from the target cost. In this scenario the final result is back within the corridor and therefore no benefit changes would occur.

Scenario 4



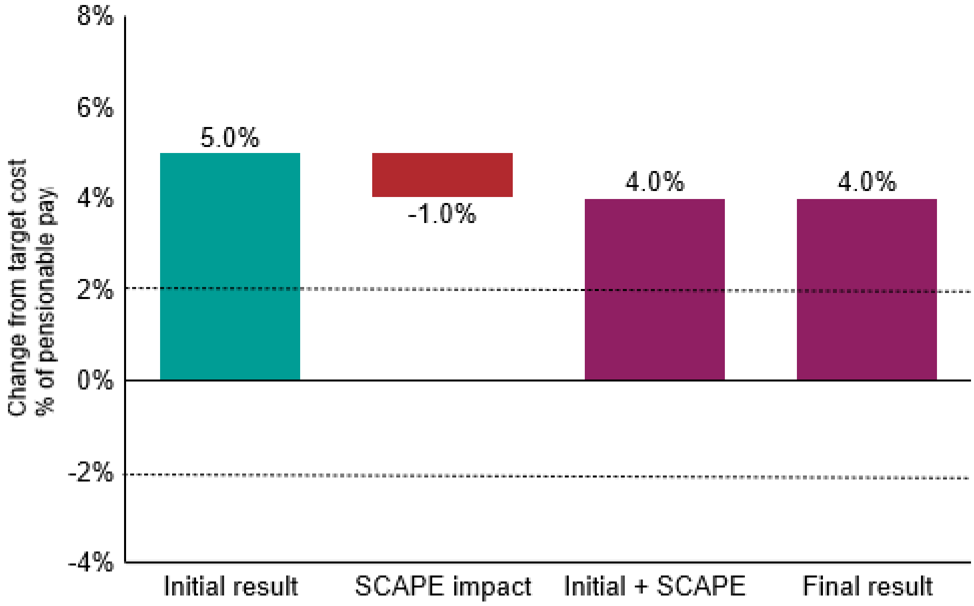
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has significantly decreased from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would increase assessed costs by 8% of pensionable pay in isolation.
- This impact would more than offset the initial floor breach and instead cause a ceiling breach. However the impact of a change in the SCAPE discount rate can only offset a breach and cannot in itself cause one, therefore the final result is capped within the corridor and therefore no benefit changes would occur.

Scenario 5



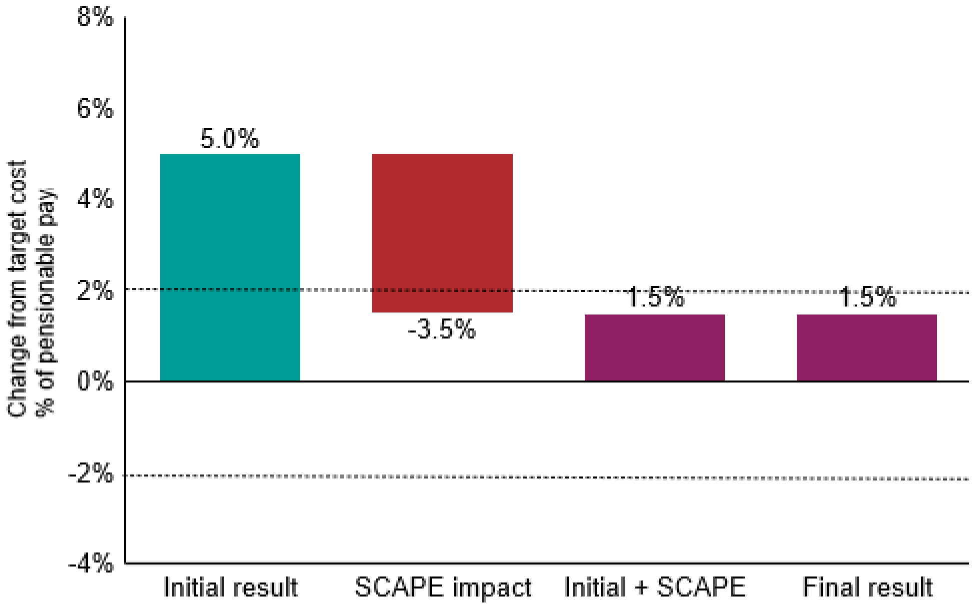
- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has decreased slightly from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would increase assessed costs by a further 1% of pensionable pay.
- The change in SCAPE discount rate can only offset a breach and cannot cause or contribute to one. Therefore, the final result of the cost control mechanism remains at an increase of 5% of pensionable pay from the target cost.

Scenario 6



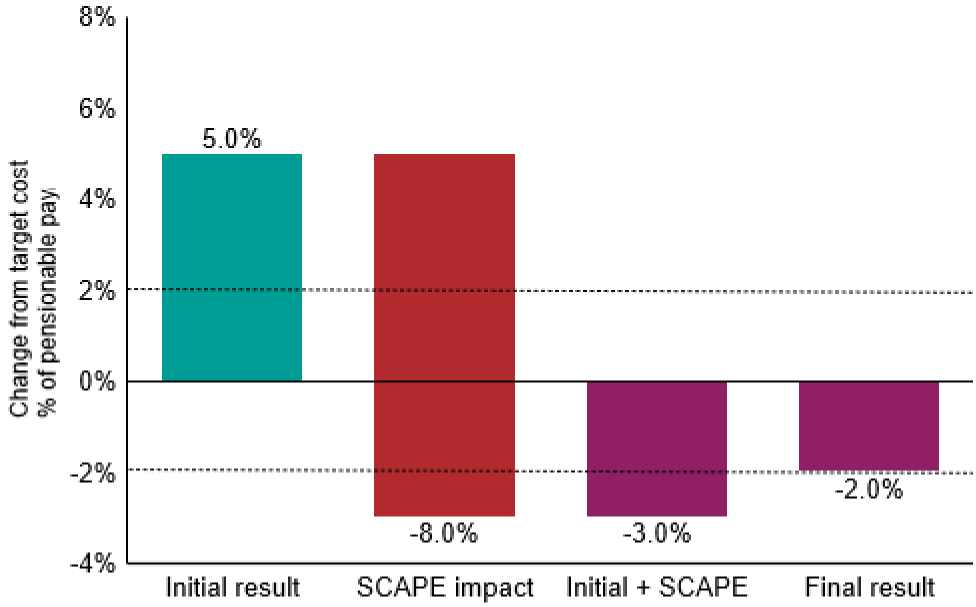
- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has increased slightly from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would decrease assessed costs by 1% of pensionable pay in isolation.
- This impact would partially offset the initial breach with the final result of the cost control mechanism being an increase of 4% of pensionable pay from the target cost.

Scenario 7



- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has increased from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would decrease assessed costs by 3.5% of pensionable pay in isolation.
- This impact would offset the initial breach with the final result of the cost control mechanism being an increase of 1.5% of pensionable pay from the target cost. In this scenario the final result is back within the corridor and therefore no benefit changes would occur.

Scenario 8



- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the target cost.
- The SCAPE discount rate has significantly increased from the 3% a year (net of CPI) rate in force at the time target costs were set. If this were to be recognised in the mechanism it would decrease assessed costs by 8% of pensionable pay in isolation.
- This impact would more than offset the initial ceiling breach and instead cause a floor breach. However the impact of a change in the SCAPE discount rate can only offset a breach and cannot in itself cause one, therefore the final result is capped within the corridor and therefore no benefit changes would occur.

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