HM TREASURY

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[redacted]

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Trevor.Llanwarne@gad.gov.uk
(Via email)

Dear Trevor

Thank you for your letter of 25 February 2013 confirming that you are content for officials to begin preparatory work on draft Treasury Directions on valuations of the public service pension schemes.

As you know, Section 11(2) of the Public Service Pensions Act 2013 enables HM Treasury to make Directions regarding valuations of the public service pension schemes made under that Act, and relevant connected schemes. Section 12(3) of the Act also enables HM Treasury to make Directions setting out how the employer cost caps will be set for schemes made under the Act.

The Government's over-riding objective which these directions seek to achieve is to implement the Government's intended approach to:

- actuarial valuations of public service pension schemes; and
- establishing an employer cost cap in public service pension schemes

set out in the two papers on these two subjects published in November 2012 (attached as Annexes A and B).

Annex C of this letter sets out the principles to which officials have had regard in preparing this first draft of the directions for your consideration.

As part of this preparatory work, a resulting draft set of Directions is attached to this letter as Annex D.

I would be grateful if you could offer your initial professional opinion on the actuarial aspects of these Directions. In particular, I would welcome your views on the extent to which:

- the data, methodology and assumptions proposed in these draft Directions

at Annex D meet the Government's over-riding objectives and principles set out in Annexes A, B and C;
- these draft directions are technically complete and coherent; and
- any practical challenges could arise as a consequence of these draft directions - and any suggestions for how to approach such challenges.

The Treasury will discuss these Directions further with the Departments responsible for the public service pension schemes, and with other interested stakeholders, before the final Directions are issued for use by the public service schemes in conducting their valuations.

For reference I attach in Annexes E and F the covering letter and an FAQ document which we are issuing to other interested stakeholders as part of the process of consulting with them on these draft Directions.

I intend to consult you on a further draft of these Directions, taking account of your response to this letter and stakeholder comments, for final, formal, consultation before these Directions are made.

The Treasury will keep these Directions under review, firstly to ensure that they continue to reflect Treasury policy, and secondly to take account of any developments that are relevant to public service pension scheme cost measurement and control. In particular, the Treasury will review these Directions before each valuation round to ensure that they remain fit for purpose. In line with the Treasury's obligations under the Public Service Pensions Act 2013, the Treasury will consult you (or your successors) before any amendments or additions are made to these directions.

Yours sincerely

[redacted]

Julian Kelly

Enclosures:
- Annex A – "Actuarial valuations of public service pension schemes"
- Annex B – "Establishing an employer cost cap in public service pension schemes"
- Annex C – Principles
- Annex D – Draft Public Service Pensions (Valuations and Employer Cost Cap) Directions 2013 (v3-0)

- Annex E – Stakeholder cover note
- Annex F – Stakeholder FAQ

Annex C - Principles

This Annex sets out the principles which I have asked my officials to have regard to in preparing a first draft of the directions for consultation.

In this Annex "costs" refer to the costs of benefits as they accrue (along with changes in the value of accrued benefits), expressed as a percentage of pensionable pay. For the avoidance of doubt, "costs" do not refer to cash amounts paid from schemes to their members. The IPSPC's final report discussed the use of these two alternative measures of costs for establishing a cost control mechanism and recommended using accruals rather than cash amounts1.

- **Completeness:** The directions should ensure that for each unfunded scheme, taken together, employer and employee contributions reflect the full expected costs of the benefits provided by the scheme. These costs should include any past service effects that have arisen since previous valuations.

- **No bias:** The directions should lead to valuation results which do not contain any bias, as far as is reasonably practicable. No bias means assumptions used to assess costs should be "best estimates" which means that assumptions underlying valuation results should not include any margins for prudence or optimism.

- **Discount rate:** The discount rate will be 3 per cent per annum + CPI. Unless there is a significant change in circumstances before 2016, the level of the discount rate will next be reviewed in 2016. This discount rate and process for review are as per the conclusions of the Government's consultation on the discount rate set out in April 20112.

- **Clarity:** The directions should lead to valuation reports that include sufficient information to allow those who are technically competent to understand how the valuation has been carried out. Valuation reports should provide clear and transparent assessments of schemes' costs and reports should include information that may be helpful to scheme members and stakeholders in understanding the costs of providing benefits.

- **Consistency:** The directions should provide consistency across all valuations for all of the public service pension schemes. The directions should allow for comparisons of the valuation results to be made across schemes, in line with

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[1] Paragraphs 4.24 to 4.35 and recommendation 12 of the IPSPC's final report.

[2] Paragraph 4.20 and paragraph 5.5 of the summary of responses to the Government's consultation on the SCAPE discount rate published in April 2011.

recommendation 6 of the Independent Public Service Pensions Commission3. There should also be consistency over time, to allow for comparisons of scheme costs over time. Where different scheme workforces have different characteristics (e.g. where there are differences between workforces' mortality rates, ill health retirements or any other factors which may affect the valuation), then there should be consistency in the way that these different assumptions are set.

- **Cost Control:** The directions should ensure that, for each scheme, the first and each subsequent valuation report includes valuation results for the purposes of measuring changes in the cost of the scheme against the employer cost cap (as envisaged in Section 12(4)(b) of the Act and required by Section 12(5) of the Act).

- **Sustainability:** The directions should ensure that, for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap (as envisaged in Section 12(4)(b) of the Act and as required by Section 12(5) of the Act) includes effects of scheme experience and future valuation assumptions differing from the assumptions used to determine the employer cost cap.

- **Technical immunity:** The directions should ensure that, for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap excludes effects caused by changes to the discount rate, the long term earnings assumption or changes in the actuarial methodology used in the valuations.

- **Stability:** The directions should ensure that, for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap excludes:
    - costs of the scheme which relate to the payment of benefits to deferred members and pensioner members in existing/connected schemes; and
    - changes in the cost of the scheme which arise due to the effects of members having service in the existing schemes.

[3] Paragraphs 6.33 to 6.39 and recommendation 6 of the IPSPC's final report.

HM TREASURY

The Public Service Pensions (Valuations and Employer Cost Cap) Directions 2013

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.

PART 1: GENERAL

Citation, commencement and entry into force

1. These Directions may be cited as the Public Service Pensions (Valuations and Employer Cost Cap) Directions 2013, and come into force on the date that they are signed.

Interpretation

2. In these Directions:

"analysis of the demographic experience" means an assessment across the scheme membership of changes experienced by scheme members which impact on their expected benefits (such as career breaks, leaving pensionable service, retirement, ill health, and death in service) that can be assessed from data held by the scheme;

"closing date", in relation to an existing scheme, is the date specified in section 18(4) of the 2013 Act;

"continuity of employment" means a period of employment which is determined to be continuous by the provisions of paragraph 3 of Schedule 7 to the 2013 Act;

"cost cap benefits paid" means an amount of money representing benefits debited from the cost cap fund, determined in accordance with direction 46;

"cost cap cost of the scheme" means the contribution rate which is compared against the employer cost cap at the first and each subsequent valuation of a scheme and which reflects the cost of the scheme, determined in accordance with direction 58;

"cost cap fund" means a notional amount of money, used to determine the cost cap cost of the scheme and the cost cap fund contribution rate, determined in accordance with direction 52;

"cost cap fund contribution rate" means the contribution rate determined in accordance with directions 42 and 43;

"cost cap future service cost" means the element of the cost cap cost of the scheme that reflects future service costs determined in accordance with direction 56;

"cost cap income" means an amount of money representing income credited to the cost cap fund, determined in accordance with direction 44;

"cost cap liabilities" means the liabilities of a scheme which are compared against the cost cap fund to determine the cost cap past service cost, determined in accordance with direction 54;

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

"cost cap net leavers liabilities" means liabilities relating to benefits accrued in a connected scheme or schemes by some members who during a stated period have left pensionable service or re-joined pensionable service, determined in accordance with direction 48;

"cost cap notional investment returns" means a notional amount of money added to the cost cap fund of a scheme representing the growth of the cost cap fund over time, determined in accordance with direction 50;

"cost cap past service cost" means the element of the cost cap cost of the scheme that reflects past service costs stemming from the cost cap fund, determined in accordance with direction 57;

"effective date", in respect of a particular valuation, means the date specified in the directions in directions 6 to 8;

"employer contribution rate" means the contribution rate determined in accordance with direction 38;

"employer cost cap" bears the same meaning as in section 12 of the 2013 Act;

"implementation date", in respect of a valuation, means a date assessed in accordance with direction 9;

"implementation period", in respect of a particular valuation, means the period specified in directions 12 and 13;

"inter-valuation period" means:

(a) in respect of a first valuation, the period between the effective date of that valuation and:

   (i) for a scheme which provides benefits to local government workers in Scotland, 31st March 2014;

   (ii) for a scheme which provides benefits to local government workers in England and Wales, 31st March 2013; or

   (iii) in any other case, 31st March 2012.

(b) in respect of a second and subsequent valuation, the period between the effective date of that valuation and the effective date of the previous valuation;

"normal contributions" means contributions that members and employers are required to pay in respect of a member's scheme membership;

"notional assets" means a notional amount of money representing the assets of the scheme used to determine the employer contribution rate;

"notional investment returns" means a notional amount of money added to the notional assets of a scheme representing the growth of the notional assets over time;

"proposed employer cost cap" means the contribution rate calculated in accordance with direction 65;

"SCAPE discount rate" means the Superannuation Contributions Adjusted for Past Experience discount rate used to assess the value of benefits accrued and accruing in a public service pension scheme in order to determine valuation results;

"scheme actuary" means the actuary for the time being appointed in accordance with direction 4;

"the 2013 Act" means the Public Service Pensions Act 2013;

"valuation" means a valuation carried out under section 11 of the 2013 Act, unless otherwise stated;

"valuation report" means the report prepared by the scheme actuary in accordance with directions 28 to 30; and

"valuation results" means the numerical values stated in the valuation report in accordance with directions 29 and 30.

PART 2: VALUATIONS

A “Scheme”

3.—(1) In Part 2 of these Directions, reference to a “scheme” means a scheme made under section 1 of the 2013 Act and any connected scheme or schemes within the meaning of section 4(6) of the 2013 Act, valued together as if they were a single scheme.

(2) For the purposes of a valuation of an existing scheme, scheme regulations may not except schemes listed in Schedule 1 from being connected schemes.

(3) For the purposes of a valuation of a new public body pension scheme carried out in accordance with these Directions:

(a) references in these Directions to “a scheme made under section 1 of the 2013 Act” must be deemed to refer to the new public body pension scheme; and

(b) references to a “scheme” as defined in paragraph (1) are to be construed accordingly.

Scheme Actuary

Scheme Actuary

4.—(1) A scheme actuary must be appointed to carry out a valuation of the scheme.

(2) The scheme actuary must be, in the view of the responsible authority, appropriately qualified to carry out a valuation of the scheme.

5. The scheme actuary must carry out a valuation of the scheme and prepare a valuation report.

Dates and Periods

Timing of valuations: effective date

6. Subject to direction 7, the first valuation must have an effective date of 31st March 2016.

7. A scheme providing benefits:

(a) to local government workers in Scotland must have an effective date for the first valuation of 31st March 2017; and

(b) by way of a new public body pension scheme, must have an effective date for the first valuation which is the date fixed by the responsible authority for that scheme as the effective date of the first valuation of that scheme.

8. The second, and each subsequent, valuation must have an effective date which is:

(a) in the case of scheme providing benefits to local government workers, three years later than the effective date of the first (and subsequent) valuations; and

(b) in all other cases, four years later than the effective date of the first (and subsequent) valuations.

Timing of valuations: implementation date

9.The implementation date must be a date, to be specified by the responsible authority, no more than three years and one day after the effective date.

Period covered by valuations

10. A valuation must consider the demographic experience of the scheme over the inter-valuation period.

11. A valuation may consider the demographic experience of the scheme over a period of time before the effective date of the valuation specified by the responsible authority.

Implementation period

12. The implementation period is the period following a valuation in which the employer contribution rate as assessed by that valuation is assumed to be paid for the purposes of valuing a scheme.

13. The implementation period must:

(a) in the case of a scheme providing benefits to local government workers, be the period of three years from the implementation date; and

(b) in all other cases, be the period of four years from the implementation date.

Data

Membership and other data

14.—(1) The scheme actuary must specify:

(a) in respect of each valuation of the scheme, the scheme membership data and any other data, in relation to the effective date; and

(b) in respect of the first valuation of the scheme, the scheme membership data in relation to the closing date of the connected schemes;

that they require to carry out the valuation (having regard to the data required for the scheme made under section 1 of the 2013 Act and the data required for any connected scheme) and prepare the valuation report.

(2) The responsible authority must designate a person to be responsible for ensuring that the data specified by the scheme actuary in accordance with paragraph (1) is provided to the scheme actuary.

(3) A responsible person within the meaning of paragraph (2) can include the responsible authority, the scheme manager, or any other person or body in a position to ensure that the specified information is provided.

(4) In respect of a scheme established for local government workers in England and Wales, the responsible person shall ensure that the data provided to the scheme actuary is adjusted as if no member has made an election under regulation 10 of the Local Government Pension Scheme Regulations 2013(**a**).

Methodology and assumptions

15. When calculating the valuation results, the scheme actuary must use the methodology and assumptions set out in directions 16 to 26, unless any contrary intention is specified in these Directions.

Projected unit methodology

16.—(1) The scheme actuary must use the projected unit methodology to determine the valuation results.

(2) When using the projected unit methodology, benefits must be attributed to periods of service in accordance with the requirements of International Accounting Standard 19: Employee Benefits.

(**a**) S.I. 2013/2356

Other methodology and assumptions

17. The scheme actuary must calculate contribution yields in accordance with directions 37 and 41 only in respect of members' and employers' normal contributions.

18. The scheme actuary must calculate:

(a) contribution rates in accordance with directions 36(a) and (c); and

(b) the cost cap past service cost in accordance with direction 57;

on the assumption that these contribution rates will be payable for 15 years from the implementation date.

19. Unless specified in directions, the assumptions and data projections used by the scheme actuary will be those set by the responsible authority, having obtained advice from the scheme actuary.

20.—(1) The scheme actuary must use the scheme membership data and other data provided to them to determine the valuation results.

(2) When the scheme actuary calculates contribution yields and contribution rates over a period, the data must be projected to accommodate any expected changes in the scheme membership over that period if:

(a) making such projections would produce a more accurate estimate of the expected scheme membership over that period, and

(b) such projections would have a material impact upon the contribution yields and contribution rates;

and projections must be made consistently in respect of determining both contribution rates and contribution yields over that period.

(3) The data at the effective date must be projected to the implementation date if:

(a) making such projections would produce a more accurate estimate of the valuation results, and

(b) making such projections would have a material impact upon the valuation results;

and any such projections must be made consistently in respect of all valuation results.

21.—(1) When determining the valuation results, the scheme actuary should use the relevant rate of increase awarded in line with the Pension (Increase) Act 1971 where that rate has been set under that Act.

(2) When that rate of increase has not been set, the scheme actuary must assume that the rate is:

(i) 2.9% on 7th April 2014;

(ii) 2.3% on 6th April 2015;

(iii) 2.1% on 11th April 2016; and

(iv) 2% on the first Monday in each tax year subsequently;

22. When determining the valuation results, the scheme actuary should assume that the price measure revaluations of career average re-valued earnings under section 9 of the 2013 Act are the same as the rates of increases awarded in line with the Pension (Increase) Act 1971 as determined under direction 21.

23. When determining the valuation results, the scheme actuary should assume that the earnings measure revaluations of career average re-valued earnings under section 9 of the 2013 Act is:

(a) 3.8% on 11th April 2016;

(b) 4% on 10th April 2017;

(c) 4% on 9th April 2018; and

(d) 4.75% on the first Monday in each tax year subsequently.

24. When determining the valuation results, the scheme actuary should assume that the rate of public service earnings growth is:

(a) 2.2% over the year to 31st March 2014;

(b) 2.5% over the year to 31st March 2015;

(c) 3% over the year to 31st March 2016;

(d) 3% over the year to 31st March 2017;

(e) 3% over the year to 31st March 2018; and

(f) 4.75% each year from 1st April 2018.

25. When determining the valuation results, the scheme actuary must also assume that:

(a) the SCAPE discount rate over each year ending on the 31 March is the assumed rate of increases awarded in line with the Pension (Increase) Act 1971 in the April immediately following each year, compounded with 3%;

(b) the post-retirement mortality rates of scheme members will change in accordance with the changes in mortality rates published by the Office for National Statistics as part of the most recent principal population projections for the United Kingdom;

(c) when the Secretary of State has made a public statement proposing a change to the state pension age, the proposed change to state pension age has already been made; and

(d) that no members of a scheme providing benefits to local government workers in England and Wales ever have, or ever will, make an election under regulation 10 of the Local Government Pension Scheme Regulations 2013.

26. All other assumptions used by the scheme actuary, other than those detailed in directions 16 to 25, must:

(a) be the responsible authority's best estimates and not include margins for prudence or optimism.

(b) be determined with regard to:–

(i) previous valuation assumptions (made in accordance with these Directions or otherwise);

(ii) the analysis of demographic experience prepared in accordance with direction 27;

(iii) relevant data from any other source (including relevant data that becomes available after the effective date);

(iv) any emerging evidence about historic long term trends; and

(v) any emerging evidence that may illustrate long term trends expected in the future.

(c) include, but are not limited to, assumptions about:–

(i) mortality rates;

(ii) age retirement rates;

(iii) commutation

(iv) early and late retirements;

(v) rates and severity of ill health retirements;

(vi) members' dependants;

(vii) resignations;

(viii) members opting out from and re-joining the scheme; and

(ix) promotional earnings increases.

Analysis of the demographic experience

27.—(1) Where the scheme membership data is sufficient for the scheme actuary to carry out a robust analysis of the demographic experience of the scheme, then the valuation report must include a summary of the demographic experience up to the effective date covering the following aspects:

(a) mortality rates;

(b) age retirement rates;

(c) rates of early and late retirements;

(d) rates and severity of ill health retirements;

(e) resignations and opt outs;

(f) rates of re-joining service;

(g) promotional earnings increases;

(h) members dependants;

(i) take up of commutation options; and

(j) any other aspects that the scheme actuary considers to be relevant.

(2) For each aspect listed at paragraph (1), where the scheme membership data is not sufficient for the scheme actuary to carry out a robust analysis of that aspect, then the valuation report must include a statement to this effect.

The valuation report

Contents of the valuation report: information about the scheme and data

28. The valuation report prepared by the scheme actuary must include:

(a) information regarding the scheme membership used to carry out the valuation, including a summary of:–

(i) scheme membership and other data used;

(ii) the checks carried out on the data by the scheme actuary, and the limitations of those checks; and

(iii) any adjustments or projections made to the data by the scheme actuary, the approach used in making them, and the rationale for them;

(b) a statement that the valuation results have been determined in accordance with the requirements as to data, assumptions, and methodology specified by these Directions;

(c) a summary of the regulations, directions, and professional standards relating to the valuation;

(d) a summary of the main provisions of the scheme (with a separate summary for the main provisions of the scheme made under section 1 of the 2013 Act and those of any connected scheme);

(e) an analysis of the demographic experience carried out in accordance with direction 27;

(f) a statement of the assumptions used by the scheme actuary in preparing the report, including:–

(i) a summary of the assumptions adopted for each of the assumptions listed in direction 26(c);

(ii) a statement of how regard has been had to the items of data listed in direction 26(b) when determining the assumptions adopted for each of the assumptions listed in direction 26(c);

(iii) an illustration of the main sensitivities of the valuation results to the assumptions; and

(g) any other matters that the scheme actuary considers to be relevant.

Contents of the valuation report: employer contribution rates

29. The valuation report prepared by the scheme actuary must also include a statement of:

(a) the liabilities of the scheme as at the effective date calculated in accordance with direction 31;

(b) the notional assets of the scheme calculated in accordance with direction 32;

(c) the contribution rates calculated in accordance with direction 36;

(d) the contribution yields calculated in accordance with direction 37; and

(e) the employer contribution rate calculated in accordance with direction 38.

Contents of the valuation report: cost cap

30. The valuation report prepared by the scheme actuary must also include:

(a) a statement of:–

(i) the prior value of the cost cap fund as calculated in accordance with direction 40;

(ii) the cost cap contribution yield calculated in accordance with direction 41;

(iii) the cost cap fund contribution rate calculated in accordance with directions 42 and 43;

(iv) the cost cap income calculated in accordance with direction 44;

(v) the cost cap benefits paid calculated in accordance with direction 46;

(vi) the cost cap net leavers liabilities calculated in accordance with directions 48;

(vii) the cost cap notional investment returns calculated in accordance with direction 50;

(viii) the cost cap fund calculated in accordance with direction 52;

(ix) the change in value of the cost cap fund calculated in accordance with direction 53;

(x) the cost cap liabilities calculated in accordance with direction 54;

(xi) the cost cap future service cost, calculated in accordance with direction 56;

(xii) the cost cap past service cost, calculated in accordance with direction 57;

(xiii) the cost cap cost of the scheme calculated in accordance with direction 58; and

(b) a cost cap analysis carried out in accordance with direction 59.

The valuation report: employer contribution rate

Liabilities as at effective date

31.—(1) The scheme actuary must prepare a statement, from the scheme membership and other data supplied to them, having applied the methodology and assumptions set out in these Directions and made any relevant data projections, of the liabilities of the scheme.

(2) For the purposes of this direction, the liabilities of the scheme must include:

(a) any right or entitlement to present or future benefits that has accrued under the scheme rules to or in respect of a member of the scheme (including a pension credit member);

(b) any right or entitlement to present or future benefits that has accrued under the scheme rules to or in respect of any other person; and

(c) any other liability of the scheme that the responsible authority considers to be relevant.

Notional assets

32. The value of the notional assets at the effective date must be set as equal to:

$$(A + (B - C)) + D$$

where:–

A represents:

(a) for the first valuation of a scheme, the notional assets value set out in Schedule 2 relevant to the scheme;

(b) for the second and subsequent valuation of a scheme, the notional assets as at the effective date of the previous valuation of the scheme;

B represents:

(a) for the first valuation of a scheme, the income received by the scheme from the date set out in Schedule 2 to the effective date;

(b) for the second and subsequent valuation of a scheme, the income received by the scheme over the inter-valuation period;

C represents:

(a) for the first valuation of a scheme, the benefits paid from the scheme from the date set out in Schedule 2 to the effective date;

(b) for the second and subsequent valuation of a scheme, the benefits paid from the scheme over the inter-valuation period;

D represents:

(a) for the first valuation of a scheme, notional investment returns on the notional assets of the scheme from the date set out in Schedule 2 to the effective date; and

(b) for the second and subsequent valuation of a scheme, notional investment returns on the notional assets of the scheme over the inter-valuation period.

33.—(1) The income received by the scheme for the purposes of the calculation at direction 32 must include, but is not limited to, employer contributions, employee contributions and incoming transfer values.

(2) The benefits paid by the scheme for the purposes of the calculation at direction 32 must include, but are not limited to, benefits paid to pensioners and dependants and outgoing transfer values.

(3) The notional investment returns of the scheme for the purposes of the calculation at direction 32 for the first valuation of a scheme must be determined by:

(a) in respect of the period up to 31st March 2011, compounding 3.5% per year with the pension increases awarded under the Pensions (Increase) Act 1971; and

(b) in respect of the period after 31st March 2011, compounding 3% per year with the pension increases awarded under the Pensions (Increase) Act 1971.

(4) The notional investment returns of the scheme for the purposes of the calculation at direction 32 for the second and subsequent valuation of a scheme must be determined by compounding 3% per year with the pension increase awarded under the Pensions (Increase) Act 1971.

(5) For the purposes of paragraphs (3) and (4), for any time when pension increases under the Pensions (Increase) Act 1971 are set to zero as a result of the price inflation index used to calculate increases under that Act being a negative figure, the negative figure of the price inflation index must be used in place of zero.

34. The valuation report must also state the notional assets of the scheme:

(a) for the first valuation of the scheme, as at the date shown in Schedule 2 relevant to the scheme; and

(b) for the second and any subsequent valuation of the scheme, as at the effective date of the previous valuation.

35.—(1) The valuation report must also contain an analysis of any change in the valuation of the notional assets:

(a) for the first valuation of a scheme, between the relevant date in Schedule 2 and the effective date; and

(b) for the second and any subsequent valuation of the scheme, over the inter-valuation period.

(2) That analysis must include (but is not limited to):

(a) income received during that period;

(b) benefits paid during that period; and

(c) notional investment returns during that period.

Contribution rates

36.—(1) The valuation report must state, to the nearest 0.1% of pensionable payroll:

(a) the contribution rate, payable from the implementation date, required to meet the difference between the liabilities of the scheme calculated in accordance with direction 31 and the notional assets calculated in accordance with direction 32;

(b) the contribution rate, payable from the effective date to the implementation date; required to cover the expected costs of benefits accrued and accruing by members between the effective date and the implementation date;

(c) the contribution rate, payable from the implementation date, required to meet the difference between:–

(i) the contributions that would have been received from members and employers had they jointly paid the contribution rate assessed at sub-paragraph (b); and

(ii) the normal contributions expected to be paid by members and employers;

between the effective date and the implementation date; and

(d) the contribution rate required to cover the expected cost of benefits accrued by members over the implementation period.

(2) For the purposes of paragraph (1)(a), when calculating the liabilities and notional assets of a scheme for members of the armed forces, liabilities and notional assets in relation to members of connected schemes who began to draw their benefits before 1st April 2001 must be ignored.

Contribution yields

37. The valuation report must state, to the nearest 0.1% of pensionable payroll, the contribution yield expected from:

(a) member contributions to the scheme between the effective date and the implementation date;

(b) employer contributions to the scheme between the effective date and the implementation date; and

(c) member contributions to the scheme over the implementation period.

Employer contribution rate

38.—(1) The employer contribution rate must be calculated as:—

$$(A+B+C)-D$$

where:–

A represents the contribution rate stated in accordance with direction 36(a);

B represents the contribution rate stated in accordance with direction 36(c);

C represents the contribution rate stated in accordance with direction 36(d); and

D represents the contribution yield stated in accordance with direction 37(c).

(2) Where a scheme makes provision for employers to pay normal contributions at a single rate within that scheme, the responsible authority must confirm whether or not that rate is equal to the employer contribution rate calculated in paragraph (1).

(3) Where a scheme makes provision for employers to pay normal contributions at different rates within that scheme, the responsible authority, having taken advice from the scheme actuary, must confirm whether or not the average of those contributions over the implementation period, expressed to the nearest 0.1% of pensionable pay, is expected to be equal to the employer contribution rate calculated in paragraph (1).

(4) The requirements in paragraphs (2) and (3) do not apply where:

(a) the scheme is a scheme in relation to local government workers; or

(b) the cost cap cost of the scheme identified in the valuation report is outside the margins set around the employer cost cap by Treasury regulations made under section 12(5) of the 2013 Act.

Valuations of a scheme for local government workers

39.—(1) Part 2 of these Directions shall apply to a first valuation of a scheme providing benefits to local government workers as if:

(a) in direction 32, A represents the value of the liabilities as at the effective date, determined in accordance with direction 31;

(b) in direction 32, B, C, and D represent zero;

(c) direction 34(a) does not apply;

(d) direction 35(1)(a) does not apply; and

(e) directions 36(b) and (c) do not apply;

(f) in direction 38, B represents zero.

(2) Part 2 of these Directions shall apply to a second and subsequent valuation of a scheme providing benefits to local government workers as if:

(a) in direction 32, when calculating the income received by the scheme over the inter-valuation period at B, the data is adjusted as if the rate at which all employers had made employer contributions over the inter-valuation period had been at the employer contribution rate disclosed at the previous valuation;

(b) directions 36(b) and (c) do not apply;

(c) in direction 38, B represents zero.

Valuation Report: Cost Cap

Prior value of the cost cap fund

40.—(1) For the first valuation of a scheme, the prior value of the cost cap fund must be a statement of the opening balance of the cost cap fund, calculated as follows:–

(a) the opening balance of the cost cap fund must be set equal to the liabilities of the scheme as at the closing date of the connected scheme or schemes in respect of scheme members in pensionable service at that date;

(b) the liabilities in sub-paragraph (a) must be calculated using:

(i) the methodology set out in these Directions;

(ii) the same assumptions used in a preliminary valuation of the scheme carried out under Part 3 of these Directions to set a cost cap; and

(iii) the membership data as at the closing date of the connected scheme or schemes.

(2) For the second and each subsequent valuation of a scheme, the prior value of the cost cap fund must be the value of the cost cap fund as calculated at the previous valuation.

Cost cap contribution yield

41. The valuation report must state, to the nearest 0.1% of pensionable payroll, the contribution yield expected from member contributions to the scheme over the implementation period.

Cost cap fund contribution rate

42.—(1) For the first valuation of the scheme, the cost cap fund contribution rate must be calculated, to the nearest 0.1% of pensionable payroll, as:

$$A - B$$

where:–

A represents the contribution rate required to cover the expected costs of the benefits accruing to members of the scheme from the closing date of the connected scheme or schemes to the effective date; and

B represents the member contributions to the scheme between the closing date of the connected scheme or schemes and the effective date.

(2) A and B in paragraph (1) must be calculated using:

(a) the methodology set out in these Directions; and

(b) the same data and assumptions used in any preliminary valuation of the connected scheme or schemes that has been used to set the employer cost cap in accordance with Part 3 of these Directions.

43.—(1) For the second and any subsequent valuation of the scheme, the cost cap fund contribution rate will be:

$$(A + B) - C$$

where:–

A represents the contribution rate required to cover the expected costs of the benefits accruing to members of the scheme over the inter-valuation period;

B represents the cost cap past service cost determined in accordance with direction 57 in the previous valuation of the scheme; and

C represents the member contributions to the scheme over the inter-valuation period.

(2) A and C in paragraph (1) must be calculated using the methodology, data and assumptions used in the previous valuation of the scheme.

Cost cap income

44. The cost cap income will be calculated as:

(a) for the first valuation of a scheme, the income received between the closing date of the connected scheme or schemes and the effective date; and

(b) for the second and each subsequent valuations of a scheme, the income received over the inter-valuation period.

45. The income received for the purposes of direction 44:

(a) must include, but is not limited to, employer contributions, employee contributions and incoming transfer values; and

(b) in respect of employer contributions, must be adjusted to the amount that would have been received had all employers contributed at the cost cap fund contribution rate over the relevant period.

Cost cap benefits paid

46. The cost cap benefits paid will be calculated as:

(a) for the first valuation of a scheme, those benefits paid between the closing date of the connected scheme or schemes and the effective date; and

(b) for the second and each subsequent valuation of a scheme, those benefits paid over the inter-valuation period.

47. For the purposes of calculating the cost cap benefits paid in direction 46, the benefits calculated:

(a) must include, but are not limited to, benefits paid to pensioners and dependants and outgoing transfer values; and

(b) must exclude any benefits paid which relate to benefits accrued in the connected scheme or schemes.

Cost cap net leavers liabilities

48. The cost cap net leavers liabilities must be calculated as:—

$$A - B$$

where:–

A represents the value of liabilities relating to benefits accrued in any connected scheme or schemes and relating to:

(a) for the first valuation, members who are in pensionable service at the closing date of the connected scheme, and who have ceased to be in pensionable service between that closing date and the effective date;

(b) for the second and any subsequent valuation, members who are in pensionable service at the start of the inter-valuation period, and who have ceased to be in pensionable service during the inter-valuation period;

B represents the value of liabilities relating to benefits accrued in any connected scheme or schemes and relating to:

(a) for the first valuation, members who are in pensionable service at the effective date, who had re-joined the scheme between the closing date and the effective date and had maintained continuity of employment; and

(b) for the second and any subsequent valuation, members who are in pensionable service at the end of the inter-valuation period, who had re-joined the scheme during the inter-valuation period and had maintained continuity of employment.

49. When calculating the cost cap net leavers liabilities of a scheme in respect of members whose individual liabilities contribute to those net liabilities, the scheme actuary must:

(a) in respect of a member who has ceased pensionable service, measure the liability at the time when pensionable service has ceased and before any benefits have been paid to that member or his dependants;

(b) in respect of a member who has re-joined pensionable service, measure the liability at the point of re-joining, and ignore any benefits that have come into payment in respect of that member; and

(c) in respect of a member who remains in pensionable service but has begun to draw some of their benefits, deem the member to have left pensionable service in respect of that proportion of their benefits that they are drawing.

Cost cap notional investment returns

50. The cost cap notional investment returns must be calculated:

(a) for the first valuation of a scheme, to represent the growth of the cost cap fund between the closing date of the connected scheme or schemes and the effective date; and

(b) for the second and each subsequent valuations of a scheme, to represent the growth of the cost cap fund over the inter-valuation period.

51. For the purposes of direction 50, when calculating notional investment returns over a period:

(a) the notional investment returns over the period must be determined by compounding 3% per year with the pension increase awarded under the Pensions (Increase) Act 1971; and

(b) for any time when pension increases under the Pensions (Increase) Act 1971 are set to zero as a result of the price inflation index used to calculate increases under that Act being a negative figure, the negative figure of the price inflation index must be used in place of zero.

Cost cap fund

52. The value of the cost cap fund as at the effective date must be calculated as:

$$A+(B-(C+D))+E$$

where:–

A represents the prior value of the cost cap fund, calculated in accordance with direction 40:

B represents the cost cap income, calculated in accordance with direction 44;

C represents the cost cap benefits paid, calculated in accordance with direction 46;

D represents the cost cap net leavers liabilities stated in accordance with direction 48; and

E represents the cost cap notional investment returns calculated in accordance with direction 50.

Change in value of the cost cap fund

53.—(1) The valuation report must include an analysis of the change in value of the cost cap fund:

(a) for the first valuation of a scheme, between the closing date of any connected scheme or schemes and the effective date; and

(b) for the second and any subsequent valuation of a scheme, over the inter-valuation period.

(2) That analysis must include, but is not limited to:

(a) the cost cap income;

(b) the cost cap benefits paid;

(c) the cost cap net leavers liabilities; and

(d) the cost cap notional investment returns.

Cost cap liabilities

54. The cost cap liabilities must be calculated as:

$$A+B$$

where:–

A represents the value of liabilities of the scheme as at the effective date which relate to the benefits accrued in any connected scheme or schemes by members who are in pensionable service at the effective date; and

B represents the value of liabilities relating to benefits that have accrued in the relevant scheme made under section 1 of the 2013 Act.

55. The valuation report must also state:

(a) the value of liabilities of the scheme as at the effective date which relate to the benefits accrued in any connected scheme or schemes by members who are in pensionable service at the effective date; and

(b) the value of liabilities relating to benefits that have accrued in the relevant scheme made under section 1 of the 2013 Act.

Cost cap future service cost

56.—(1) The cost cap future service cost must be calculated, to the nearest 0.1% of pensionable payroll, as the contribution rate required to cover the expected cost of benefits accrued by members of the scheme over the implementation period.

(2) For the purpose of calculating the contribution rate in paragraph (1), the data, methodology and assumptions specified in directions 14 to 26 must be adjusted though no members of the scheme;

(a) have any benefits accrued in any connected scheme or schemes; and

(b) have any entitlement to exceptions made under sections 18(5) to (7) of the 2013 Act

Cost cap past service cost

57. The cost cap past service cost must be calculated as:

$$A - B$$

where:–

A represents the cost cap liabilities calculated in accordance with direction 54; and

B represents the cost cap fund calculated in accordance with direction 52;

stated to the nearest 0.1% of pensionable payroll, as a (negative or positive) contribution rate payable from the effective date.

Cost cap cost of the scheme

58. The cost cap cost of the scheme must be calculated as:

$$(A + B) - C$$

where:–

A represents the cost cap future service cost, calculated in accordance with direction 56;

B represents the cost cap past service cost calculated in accordance with direction 57; and

C represents the contribution yield stated in accordance with direction 41.

Cost cap analysis

59. The valuation report must state, to the nearest 0.1% of pensionable payroll:

(a) the difference between the employer cost cap and the cost cap cost of the scheme; and

(b) an analysis of the difference between the employer cost cap and the cost cap cost of the scheme, identifying and quantifying any noticeable differences caused by:–

(i) a change in the average age of members;

(ii) a change in the average normal pension age of members (whether resulting from a change in state pension age or otherwise);

(iii) a change in the expected member contribution yield; and

(iv) scheme experience or a change in assumptions relating to:–

(aa) mortality rates;

(bb) rates of age retirement;

(cc) early and late retirements;

(dd) rates and severity of ill health retirements;

(ee) resignations and opt outs;

(ff) rates of rejoining service;

(gg) general earnings growth until 31st March 2018;

(hh) promotional earnings increases;

(ii) members dependants;

(jj) take up of commutation options; and

(kk) any other relevant reason.

PART 3: EMPLOYER COST CAP

Setting the employer cost cap.

60.—(1) The employer cost cap must be set in regulations made under section 1 of the 2013 Act equal to the proposed employer cost cap calculated in a preliminary valuation of the relevant old scheme, carried out in accordance with directions 62 to 65.

(2) The relevant old scheme in paragraph (1) is :

(a) for a person specified in section 1(2) of the 2013 Act, the existing scheme providing benefits to those persons before the closing date; or

(b) for members of new public service pension scheme, the scheme, schemes, or part of the scheme or schemes that provided benefits to those members prior to the establishment of the new public body pension scheme.

Comparison with the employer cost cap

61.—(1) At the first and each subsequent valuation of a scheme, the scheme actuary must compare the cost cap cost of the scheme identified in the valuation report to the employer cost cap.

(2) Where the cost cap cost of the scheme has gone beyond the margins on either side of the employer cost cap specified in Regulations made under section 12(5) of the 2013 Act, the scheme actuary shall notify the responsible authority.

Preliminary valuation

62. A preliminary valuation for the purposes of these Directions is a valuation which—

(a) is carried out by a person appointed to act as a scheme actuary;

(b) in respect of each group of persons listed in the first column of Schedule 3, is a valuation of the corresponding existing schemes set out in the second column of that Schedule;

(c) assumes that the benefit structures and transitional arrangements set out in the proposals listed in the third column of Schedule 3 for new pension schemes (made under section 1 of the 2013 Act or otherwise) in respect of those persons, will be put into place at the relevant date listed in the fourth column of that Schedule;

(d) is carried out using the data, methodology and assumptions set out in directions 14 to 27;

(e) has a valuation report which includes the information and data set out in direction 28;

(f) has a valuation report which includes the information about employer contribution rates set out in direction 29, calculated in accordance with directions 31 to 38, as if—

(i) the preliminary valuation was the first valuation;

(ii) the effective date was—

(aa) in relation to an existing scheme providing benefits to local government workers in England and Wales, 31st March 2013;

(bb) in relation to an existing scheme providing benefits to local government workers in Scotland, 31st March 2014;

(cc) in all other cases, 31st March 2012;

(iii) the implementation date was—

(aa) in relation to an existing scheme providing benefits to local government workers in England and Wales, 1st April 2016;

(bb) in relation to an existing scheme providing benefits to local government workers in Scotland, 1st April 2017;

(cc) in all other cases, 1st April 2015; and

(iv) the implementation period was calculated according to directions 12 to 13;

(g) has a valuation report which states the proposed employer cost cap in accordance with direction 65.

63. Directions 62(b) and (c) above shall apply to new public body pension schemes as if:

(a) the persons listed in the first column of Schedule 3 were the members or proposed members of the new public body pension scheme;

(b) the existing schemes listed in the second column of Schedule 3 were the schemes (or parts of schemes) that had provided benefits to those persons prior to their becoming active members of the new public body pension scheme;

(c) the benefit structures and transitional arrangements set out in the proposals for the new public body scheme for those persons were listed in the third column of Schedule 3, and

(d) the relevant date listed in the fourth column of Schedule 3 was the date at which it was proposed that those persons became active members of the new public body pension scheme.

64. For the purpose of undertaking the preliminary valuation:

(a) references to a "scheme" in directions 14 to 29, 31 to 38 and 65 must be read as referring to the relevant existing scheme specified in Schedule 3, as modified by direction 63 in the case of a new public body pension scheme, subject to the assumption in direction 62(c); and

(b) references to a "scheme actuary" must be read as referring to the person appointed in accordance with directions 62(a).

Proposed employer cost cap

65.—(1) The valuation report for the preliminary valuation must state, to the nearest 0.1% of pensionable payroll, the proposed employer cost cap, being—

$$A - B$$

where—

A represents the contribution rate required to cover the expected cost of benefits accrued by members of the scheme over the implementation period; and

B represents the contribution yield expected from normal member contributions to the scheme over the implementation period.

(2) For the purpose of calculating A in paragraph (1), the data, methodology and assumptions specified in directions 14 to 26 must be adjusted as if no members of the scheme have any—

(a) benefits accrued in any connected scheme or schemes; and

(b) entitlement to exceptions made under sections 18(5) to (7) of the 2013 Act.

Signed

Name
Name

Date Two of the Lords Commissioners of Her Majesty's Treasury

SCHEDULE 1: CONNECTED SCHEMES

Scheme under section 1 of the 2013 Act in respect of	**Existing schemes which are connected schemes**
Civil servants	The Principal Civil Service Pension Scheme made on 19 November 1974, as amended
The judiciary	Pensions provided for holders of judicial office under: 1. The County Courts Act (Northern Ireland) 1959 2. The Resident Magistrates' Pension Act (Northern Ireland) 1960 3. The Sheriffs' Pensions (Scotland Act 1961 4. The Lands Tribunal and Compensation Act (Northern Ireland) 1964 5. The Superannuation (Miscellaneous Provisions) Act (Northern Ireland) 1969 6. The Rent Act 1977 7. The Judicature (Northern Ireland) Act 1978 8. The Judicial Pensions Act 1981 9. The Judicial Pensions and Retirement Act 1993
Local government workers (England and Wales)	The scheme established in the Local Government Pension Scheme Regulations 2013, in respect of those parts of the Regulations that are not deemed to be a scheme made under section 1 of the 2013 Act by section 28 of that Act
Local government workers (Scotland)	The schemes established by: 1. The Local Government Pension Scheme (Scotland) Regulations 1998, as preserved by the Local Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008. 2. The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008. 3. The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

Teachers (England and Wales)	The scheme established by the Teachers Pensions Regulations 2010
Teachers (Scotland)	The scheme established by the Teachers' Superannuation (Scotland) Regulations 2005
Health service workers (England and Wales)	The scheme established by: 1. The National Health Service Pension Scheme Regulations 1995 2. The National Health Service Pension Scheme Regulations 2008
Health service workers (Scotland)	The scheme established by: 1. The National Health Service Superannuation Scheme (Scotland) Regulations 2011 2. The National Health Service Superannuation Scheme (2008 section) (Scotland) Regulations 2013
Fire and rescue workers (England)	The schemes established by: 1. The Firefighters' Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in England 2. The Firefighters' Pension Scheme (England) Order 2006
Fire and rescue workers (Wales)	The schemes established by: 1. The Firefighters' Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in Wales 2. The Firefighters' Pension Scheme (Wales) Order 2007
Fire and rescue workers (Scotland)	The schemes established by: 1. The Firefighters' Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in Scotland 2. The Firefighters' Pension Scheme (Scotland) Order 2007
Members of police forces (England and Wales)	The schemes established by: 1. The Police Pensions Regulations 1987, insofar as these Regulations apply to members of police forces for England and Wales 2. The Police Pensions Regulations 2006

Members of police forces (Scotland)	The schemes established by: 1. The Police Pensions Regulations 1987, insofar as these Regulations apply to members of police forces for Scotland 2. The Police Pensions (Scotland) Regulations 2007
Members of the armed forces	The schemes established by: 1. The Gurkha Pension Scheme established by Royal Warrant dated 19th December 1949 2. The Gibraltar Regiment Ordinance 1998 3. The Armed Forces Pension Scheme Order 2005 4. The Reserve Forces Pension Scheme Regulations 2005 5. The Armed Forces Early Department Payments Scheme Order 2005 6. The Army Pensions (Armed Forces and Pension Scheme 1975 And Attributable Benefits Scheme) (Amendment) Warrant 2010 7. The Naval And Marine Pensions (Armed Forces Pension Scheme 1975 And Attributable Benefits Scheme) Order 2010 8. The Air Force (Armed Forces Pension Scheme 1975 And Attributable Benefits Scheme) Order 2010 9. The Reserve Forces (Full Time Reserve Service Pension Scheme 1997) Regulations 2010 10. The Reserve Forces Non Regular Staff (Pension and Attributable Benefits Schemes) Regulations 2011

SCHEDULE 2: NOTIONAL ASSETS FOR FIRST VALUATION

Scheme in respect of	**Notional Asset Value**	**Date**
Civil servants	£97,700,000,000	31st March 2007
The judiciary	£1,170,000,000	31st March 2005
Teachers (England and Wales)	£115,782,000,000	31st March 2004
Teachers (Scotland)	£13,030,000,000	31st March 2005
Health service workers (England and Wales)	£123,713,000,000	31st March 2004
Health service workers (Scotland)	£12,405,000,000	31st March 2004
Fire and rescue workers (England)	£13,800,000,000	31st March 2007
Fire and rescue workers (Wales)	TBC	TBC
Fire and rescue workers (Scotland)	TBC	TBC
Members of police forces (England and Wales)	TBC	TBC
Members of police forces (Scotland)	TBC	TBC
Armed Forces	£64,435,000,000	31st March 2005

SCHEDULE 3: PRELIMINARY VALUATION

Valuation in respect of	**Existing schemes**	**Proposed new schemes**	**Relevant date**
Civil servants	The Principal Civil Service Pension Scheme made on 19 November 1974, as amended	The Principal Civil Service Pension Scheme Proposed Final Agreement, 9th March 2012	1st April 2015
The judiciary	Pensions provided for holders of judicial office under: 1. The County Courts Act (Northern Ireland) 1959 2. The Resident Magistrates' Pension Act (Northern Ireland) 1960 3. The Sheriffs' Pensions (Scotland Act 1961 4. The Lands Tribunal and Compensation Act (Northern Ireland) 1964 5. The Superannuation (Miscellaneous Provisions) Act (Northern Ireland) 1969 6. The Rent Act 1977 7. The Judicature (Northern Ireland) Act 1978 8. The Judicial Pensions Act 1981 9. The Judicial Pensions and Retirement Act 1993	The Judicial Pension Reform Written Ministerial Statement, 5th February 2013	1st April 2015
Local government workers (England and Wales)	[The scheme established in the Local Government Pension Scheme Regulations 2013, in respect of those parts of the Regulations that are not deemed to be a scheme made under section 1 of the 2013 Act by section 28 of that Act]	The Local Government Pension Scheme Joint Statement, 31st May 2012 The Local Government Pension Scheme Regulations 2013, insofar as these Regulations are deemed to be a scheme made under section 1 of the 2013 Act by section 28 of that Act	1st April 2014
Local government workers (Scotland)	The schemes established by: 1. The Local Government Pension Scheme (Scotland) Regulations 1998, as preserved by the Local	TBC	1st April 2015

	Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008. 2. The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008. 3. The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.		
Teachers (England and Wales)	The scheme established by the Teachers Pensions Regulations 2010	The Teachers' Pension Scheme Proposed Final Agreement in England and Wales, 9th March 2012	1st April 2015
Teachers (Scotland)	The scheme established by the Teachers' Superannuation (Scotland) Regulations 2005	TBC	1st April 2015
Health service workers (England and Wales)	The scheme established by: 1. The National Health Service Pension Scheme Regulations 1995 2. The National Health Service Pension Scheme Regulations 2008	The NHS Pension Scheme Proposed Final Agreement in England and Wales, 9th March 2012	1st April 2015
Health service workers (Scotland)	The scheme established by: 1. The National Health Service Superannuation Scheme (Scotland) Regulations 2011 2. The National Health Service Superannuation Scheme (2008 section) (Scotland) Regulations 2013	The NHS Scotland Proposed 2015 Pension Scheme Framework Document, 6th August 2013	1st April 2015
Fire and rescue workers (England)	The schemes established by: 1. The Firefighters' Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in England 2. The Firefighters' Pension Scheme (England) Order 2006	The Firefighters' Pension Scheme in England Proposed Final Agreement, 24th May 2012	1st April 2015
Fire and rescue workers (Wales)	The schemes established by: 1. The Firefighters' Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in Wales 2. The Firefighters' Pension Scheme (Wales) Order 2007	TBC	1st April 2015

Fire and rescue workers (Scotland)	The schemes established by: 1. The Firefighters’ Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in Scotland 2. The Firefighters’ Pension Scheme (Scotland) Order 2007	TBC	1st April 2015
Members of police forces (England and Wales)	The schemes established by: 1. The Police Pensions Regulations 1987, insofar as these Regulations apply to members of police forces for England and Wales 2. The Police Pensions Regulations 2006	The Police Reform Design Framework in England and Wales, 4th September 2012	1st April 2015
Members of police forces (Scotland)	The schemes established by: 1. The Police Pensions Regulations 1987, insofar as these Regulations apply to members of police forces for Scotland 2. The Police Pensions (Scotland) Regulations 2007	The Police Pension Scheme Scotland 2015 Framework Document, 5th September 2013	1st April 2015
Members of the armed forces	The schemes established by: 1. The Gurkha Pension Scheme established by Royal Warrant dated 19th December 1949 2. The Gibraltar Regiment Ordinance 1998 3. The Armed Forces Pension Scheme Order 2005 4. The Reserve Forces Pension Scheme Regulations 2005 5. The Armed Forces Early Department Payments Scheme Order 2005 6. The Army Pensions (Armed Forces and Pension Scheme 1975 And Attributable Benefits Scheme) (Amendment) Warrant 2010 7. The Naval And Marine Pensions (Armed Forces Pension Scheme 1975 And Attributable Benefits Scheme) Order 2010 8. The Air Force (Armed Forces	The new Armed Forces Pension Scheme: Final Agreement, 16th October 2012	1st April 2015

	Pension Scheme 1975 And Attributable Benefits Scheme) Order 2010 9. The Reserve Forces (Full Time Reserve Service Pension Scheme 1997) Regulations 2010 10. The Reserve Forces Non Regular Staff (Pension and Attributable Benefits Schemes) Regulations 2011		

HM TREASURY

1 Horse Guards Road
London
SW1A 2HQ

7 October 2013

To:
Trades Union Congress (and for circulation to member unions)
Employer representatives and other interested parties

Comments invited on draft Public Service Pensions (Valuations and Employer Cost Cap) Directions and Public Service Pensions (Employer Cost Cap) Regulations 2013

1. HM Treasury would welcome comments on a further draft of the Public Service Pensions (Valuations and Employer Cost Cap) Directions ('the Directions'), and on a draft of the Public Service Pensions (Employer Cost Cap) Regulations ('the Regulations'). Drafts are attached as Annexes A and B.

2. An FAQ setting out further detail on HM Treasury's proposed approach to the valuations of the public service pensions schemes, and the operation of the employer cost cap in those schemes, is attached as Annex C.

3. HM Treasury would welcome any comments by 8 November 2013.

Background

4. Actuarial valuations of the public service pension schemes are carried out to establish the costs of the public service pension schemes. These valuations are then used to determine the contribution rates to be paid by employers participating in the schemes. While the majority of the public service pension schemes are unfunded, the payment of employer contributions ensures that the full costs of employing and remunerating staff are accounted for by public service employers.

5. In addition, the Independent Public Service Pensions Commission (IPSPC) recommended that the Government establish a mechanism to control future spending on public service pensions, by putting in place an employer cost cap. The IPSPC recommended that this should be expressed a fixed proportion of pensionable pay that public service employers would contribute to the schemes in the long term, and the Government has accepted this recommendation. This employer cost cap will also be derived from an actuarial valuation of the schemes, and scheme costs monitored against the employer cost cap at future valuations.

6. Sections 11 and 12 of the Public Service Pensions Act 2013 ('the Act') confer powers on HM Treasury to make Directions specifying how these valuations will be carried out and how the employer cost cap will be set. Section 12 of the Act also confers powers on HM Treasury to make Regulations specifying the margins within which the costs of the scheme must remain,

and the target cost to which the scheme cost must return if it moves beyond these margins. HM Treasury invites comments on the draft Directions and Regulations to be made under these powers.

Principles

7. The Government's over-riding objective which these Directions seek to achieve is to implement the Government's intended approach to:

    a. actuarial valuations of public service pension schemes; and

    b. establishing an employer cost cap in public service pension schemes

    set out in the two papers on these two subjects published in November 2012 (attached as Annexes D and E).

8. HM Treasury have had regard to the following principles in preparing this draft of Directions for consultation:

    a. Completeness: The Directions should ensure that for each unfunded scheme, taken together, employer and employee contributions reflect the full expected costs of the benefits provided by the scheme. These costs should include any past service effects that have arisen since previous valuations.

    b. No bias: The Directions should lead to valuation results which do not contain any bias, as far as is reasonably practicable. No bias means assumptions used to assess costs should be 'best estimates', which means that assumptions underlying valuation results should not include any margins for prudence or optimism.

    c. Discount rate: The discount rate will be 3 per cent per annum + CPI. Unless there is a significant change in circumstances before 2016, the level of the discount rate will next be reviewed in 2016. This discount rate and process for review are as per the conclusions of the Government's consultation on the discount rate set out in April 2011[1].

    d. Consistency: The Directions should provide consistency across all valuations for all of the public service pension schemes. The Directions should allow for comparisons of the valuation results to be made across schemes, in line with recommendation 6 of the Independent Public Service Pensions Commission[2]. There should also be consistency over time, to allow for comparisons of scheme costs over time. Where different scheme workforces have different characteristics (e.g. where there are differences between workforces' mortality rates, ill health retirements or any other

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[1] Paragraph 4.20 and paragraph 5.5 of the summary of responses to the Government's consultation on the SCAPE discount rate published in April 2011

[2] Paragraphs 6.33 to 6.39 and recommendation 6 of the IPSPC's final report

factors which may affect the valuation), then there should be consistency in the way that these different assumptions are set.

e. Clarity: The Directions should lead to valuation reports that include sufficient information to allow those who are technically competent to understand how the valuation has been carried out. Valuation reports should provide clear and transparent assessments of schemes' costs, and reports should include information that may be helpful to scheme members and stakeholders in understanding the costs of providing benefits.

f. Cost Control: The Directions should ensure that, for each scheme, the first and each subsequent valuation report includes valuation results for the purposes of measuring changes in the cost of the scheme against the employer cost cap (as envisaged in Section 12(4)(b) of the Act and required by Section 12(5) of the Act).

g. Sustainability: The Directions should ensure that, for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap (as envisaged in Section 12(4)(b) of the Act and as required by Section 12(5) of the Act) includes effects of scheme experience and future valuation assumptions differing from the assumptions used to determine the employer cost cap.

h. Technical immunity: The Directions should ensure that, for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap excludes effects caused by changes to the discount rate, the long term earnings assumption or changes in the actuarial methodology used in the valuations.

i. Stability: The Directions should ensure that, for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap excludes:

    i. costs of the scheme which relate to the payment of benefits to deferred members and pensioner members in existing/connected schemes; and

    ii. changes in the cost of the scheme which arise due to the effects of members having service in the existing schemes.

Changes since previous consultation

9. Stakeholders should note that the structure of the Directions have changed since the previous version which we presented and circulated in June 2013. The main changes (which are discussed in more detail below) relate to the structure of the Directions, the setting of the employer cost cap and determining notional asset balances. There are also a variety of more minor changes reflecting other comments we have received as a result of the previous consultation and reflecting ongoing work with our actuarial and legal advisors.

Structure of the Directions

10. Previously, the Directions allowed contribution rates to be determined and the cost cap to be set from the result of a 'first' valuation with an 'as at' date of 31 March 2012[3]. The 'as at' 2016[4] and subsequent valuations were treated as 'second and subsequent valuations', which would be used to reset employer contributions rates, and measure costs against the cost cap. The approach created unnecessary complexity in providing for different ways of dealing with first, second and third valuations, and in determining how to value the new pension schemes before the regulations are for these schemes are in place.

11. This approach has therefore been revised in the current draft of the Directions. In the current draft:

    a. Part 1 of the Directions makes provision about how the Directives are cited, come into force, and set definitions, as before.

    b. Part 2 of the Directions (Valuations) focuses on as at 2016 valuations and beyond. The differences in measuring cost cap cost of the scheme between the old 'second' and 'third' valuations have also been changed to reflect the new position (these have been re-cast as 'first' and 'second').

    c. Part 3 of the Directions (Employer Cost Cap) now sets out how the employer cost cap can be set from an 'as at' 2012[5] valuation of the existing schemes, with an assumption to include the future effects of the planned new schemes into these valuations. This is called the 'preliminary valuation'. It will be used to set the employer cost cap in the same way as the 'first' valuations of earlier iterations of the Directions.

12. The employer contribution rate to be paid in the unfunded schemes from 2015 will be derived from the preliminary valuations, and will be implemented via scheme regulations.

13. The Directions now also make provision for any public body schemes that are made under the Act in future. In particular, Direction 63 provides for a preliminary valuation of a public body scheme to be carried out on the same basis as the preliminary valuations of the other public service schemes.

Setting the employer cost cap

14. The previous iterations of the valuation Directions specified that the cost cap should be set in the 'long term'. This was because we already expect there to be changes in scheme costs in the future. Setting the cost cap based on current assumptions would therefore not take account of these expected changes, and could lead to the cost cap mechanism being

[3] 2013 for LGPS, 2014 for LGPS Scotland
[4] 2017 for LGPS Scotland
[5] 2013 for LGPS, 2014 for LGPS Scotland

triggered by these expected changes.

15. For example, setting the cost cap on the basis of current assumptions would be influenced by the retirement patterns of members with old scheme benefits which are available unreduced before SPA, creating an upward cost pressure as retirement decisions become more driven by new scheme accruals.

16. However, there are difficulties associated with setting the cost cap in the 'long term'. For example, future projections of longevity do not 'flatten out' to reach a steady state and this means that we would need to choose an arbitrary date in the future on which to base assumptions about longevity. In addition, DWP have introduced legislation to Parliament which commits Government to carry out a regular review of State Pension age, with a view that the State Pension age will increase in the future to take into account any increases in longevity, which makes it very difficult to define 'long term' SPA.

17. For these reasons, the Directions suggest an alternative approach. Instead of setting the cap in the 'long term', the Directions state that the employer cost cap should be set to 'exclude the effects of pre-2015 benefits'. This approach still prevents the expected cost changes caused by changing retirement patterns (as people with old scheme benefits leave the workforce) from triggering the cost cap. The remainder of the assumptions on which the cost cap will be calculated will be based on current estimates. This approach:

    a. resolves the problems associated with setting the cap in the 'long term';
    b. does not undermine the ambition to exclude any expected changes in costs from the cost cap mechanism; and
    c. will ensure the cost cap is set at a fair and stable level.

Measuring past service effects for schemes without 'SCAPE' accounts

18. In the absence of a real 'pot' of assets, valuations of the unfunded public service pension schemes use the 'SCAPE' (Superannuation Contributions Adjusted for Past Experience) approach to capture past service effects. This methodology involves creating, and tracking the value of, a 'notional fund' of assets known as the SCAPE fund (defined as the notional asset balance in the Directions).

19. At each valuation, to evaluate whether the scheme is in deficit or surplus in respect of past pension promises, the value of the scheme liabilities is compared with the value of the SCAPE fund. This then feeds through to employer contributions rates as a past service deficit or surplus contribution rate.

20. Some of the public service pension schemes do not have established SCAPE funds. Without these, past service impacts are not well defined, as there is no fixed point in the past from which these effects are measured. This is inconsistent with the principle that employer contributions rates should reflect the full costs of providing pension benefits, including past

service effects, and could lead to inconsistencies between schemes.

21. We plan to address this issue by retrospectively setting the funds equal to schemes' liabilities using old data and/or assumptions from previous valuations. This approach will capture past service effects arising between previous valuations and the 2012 valuations. For some schemes, further actuarial work is underway to derive the 'starting balance' of the SCAPE fund. Once this work is complete, the starting balance will be stated in Schedule 2 of the Directions. The departments responsible for these schemes can provide more information on this process.

Applicability to pension schemes for local government workers

22. With regard to the local government pension schemes, the valuation approach set out in these Directions applies to the scheme at a national level (including the valuation of the model fund, used to provide an aggregate measure of the costs of those schemes). The Directions do not apply to the valuations of individual funds, and therefore do not affect how costs will be measured at the local level or what contribution rates local employers will pay.

References to proposed scheme designs where these have not been finalised

23. Schedule 3 of the draft Directions contains references to the proposed new scheme designs, to allow valuations of the new scheme benefits to be carried out. Where proposed scheme designs have not yet been finalised, these references have not been included. These will be updated before the Directions are finalised.

Consultation question

24. We are seeking views from stakeholders on the extent to which the data, methodology and assumptions proposed in these draft Directions in Annex B meet the Government's over-riding objectives and principles set out in paragraphs 6 and 7 above.

Responses and next steps

25. We are seeking comments from the Trades Union Congress and member unions, other staff representative bodies, employer representatives and other interested parties.

26. Responses to the consultation are requested by 8 November 2013.

27. The Government may engage directly with affected groups or their representatives. Government will carefully consider the responses to this consultation before taking a final decision as to how to proceed. The Government will set out the reasons for its decision and may, unless respondents specifically request that it does not, quote or refer directly to responses received to this consultation.

28. Information provided in response to this consultation, including personal information, 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 1998 (DPA) and the Environmental Information Regulations 2004).

29. 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, amongst other things, with obligations of confidence. 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 binding on HM Treasury.

30. HM Treasury will process your personal data in accordance with the DPW, and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

31. Responses to this consultation should be sent to Sarah Deacon (Sarah.Deacon@hmtreasury.gsi.gov.uk) and Daniel Roff (Daniel.Roff@hmtreasury.gsi.gov.uk) in the Workforce, Pay and Pensions Team HM Treasury. Alternatively, they can be posted to:

Valuations and Employer Cost Cap consultation
Workforce, Pay and Pensions Team
HM Treasury
1 Horse Guards Road London
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Annex C - Valuation Directions and cost cap Regulations - FAQ

Legal

Which parts of the Public Service Pensions Act 2013 are the Treasury Directions and Regulations made under?

- The Directions are made under sections 11 and 12 of the Public Service Pensions Act 2013 ('the Act').
- Section 11 confers a power on the Treasury to make Directions specifying how actuarial valuations of schemes made under the Act are to be carried out. The Treasury must consult the Government Actuary before making the Directions.
- Section 12 confers a power on the Treasury to make Directions specifying how the employer cost cap should be set, how costs and changes in costs are to be taken into account when the cost of the scheme is measured against the cap, and the extent to which connected schemes should be taken into account in the cost cap mechanism.
- Alongside the Directions, Section 12 confers a further power on the Treasury to make Regulations specifying the margins within which the costs of the scheme must remain (the 'ceiling' and 'floor' around the cost cap), and the target cost to which the scheme cost must return if the cost moves beyond the 'ceiling' or 'floor'.

How do the Directions interact with scheme regulations?

- Section 11 of the Act requires schemes to make provisions in their regulations for the actuarial valuation of a scheme made under the Act, and any connected schemes. These valuations will be carried out under existing powers, as these regulations are not yet in place.
- Section 12 of the Act requires scheme regulations to set a cost cap in accordance with Treasury Directions. Section 12 also requires scheme regulations to contain mechanisms by which any deviation in the cost of the scheme from the level of the cost cap can be corrected. There will be a mechanism to secure agreement with stakeholders on a change, and a default mechanism if agreement cannot be reached.
- Schemes will use the results of their preliminary valuation to set the cost cap for the scheme in advance of the introduction of the reformed pension schemes in 2015 (2014 in the Local Government Pension Scheme for England and Wales). That preliminary valuation will take full account of the future effects of the reformed schemes. Scheme regulations will then set out that cost cap, and the mechanisms to correct any change in the cost of the scheme going forward.

Key features of the Directions

What happens at the preliminary valuation? (Directions 62 to 65)

- The Directions which set out how the cost cap is set are made under section 12 of the Act.

- They require the cost cap to be set from a preliminary valuation, carried out in the same way as valuations of the reformed schemes and taking full account of the future effects of the reformed schemes.
- The preliminary valuation of the new schemes will have an effective date of 31 March 2012 (2013 for LGPS England and Wales, and 2014 for LGPS Scotland).
- The Directions specify the data, methodology and assumptions that should be used to set the cost cap from this valuation.
- The preliminary valuation will also be used to set the employer contribution rate for the new schemes). Setting the employer contribution rate does not form part of the Directions. Rather, using an up-to-date valuation to set contribution rates of a scheme going forward is good and usual practice.

What happens at the <u>first</u> valuation, and the subsequent valuations?

- The Directions relating to the first and subsequent valuations are made under section 11 of the Act.
- The first valuation will have an effective date of 31 March 2016 (apart from LGPS Scotland, where this will be 31 March 2017).
- The first and subsequent valuations will:
    - Calculate the employer contribution rate; and
    - Calculate the 'cost cap cost of the scheme', which is to be compared to the employer cost cap to determine if the scheme costs are within the upper and lower margins.

How does the cost cap fund implement the employer cost cap policy?

- The employer cost cap will control the cost risks associated with:
    - Active members of the reformed schemes, including any service they have in the existing schemes;
    - Deferred and pensioner members of the reformed schemes; and
    - Transitionally protected active members of the existing schemes.
- The risks associated with pensioner and deferred members of the old schemes will not count towards the cap.
- The construction of the 'cost cap fund' tracks the assets and liabilities associated specifically with these members, so that only changes in these assets and liabilities can impact on the cost cap mechanism.

Valuation methodology

What actuarial methodology will be used to carry out the valuations?

- The Directions specify that the Project Unit Methodology will be used to carry out the valuations.
- Specifying the actuarial methodology to be used will introduce greater consistency in the way that costs are measured across the different schemes.
- This is also the methodology used when schemes prepare their annual resource accounts, and was the methodology used to inform the scheme design negotiations.

Valuation assumptions

How have the assumptions on rates of increases awarded in line with the Pension (Increase) Act 1971 been derived? (Direction 21)

- The increases awarded in line the Pensions (Increase) Act 1971 will provide for the uprating of pension benefits in payment, and will therefore be determined by the Consumer Prices Index (CPI).
- The Directions use the OBR's estimates for CPI to set these assumptions.

How have the short term earnings assumptions been derived? (Directions 23 and 24)

- The Directions include two variants of short term earnings assumptions which are to be used for two different purposes:
    - changes in public service earnings growth (by which we mean paybill per head); and
    - the earnings measure revaluations of career average re-valued earnings under section 9 of the 2013 Act
- One element of the change in public service earnings growth is the change in paybill per head. We will take a consistent approach to modelling the change this element.
- Paybill per head captures pay settlements – where announced policy is the same across all public service workforces, and pay drift.
- Pay drift is used to capture changes in the overall paybill per head which are not captured by headline pay settlements. For example, if the composition of the workforce changes so people in lower or higher pay bands represent a greater or lesser proportion of the workforce, overall paybill per head will change. Pay drift is inherently uncertain and difficult to forecast on a scheme-specific basis since workforce plans are rarely planned very far in advance.
- Taking a central approach in line with the OBR's estimates for Government employment should therefore provide consistent and fair results across schemes.
- In contrast, the assumptions for earnings measure revaluations of career average re-valued earnings under section 9 of the 2013 Act set out the changes in earnings to be used for revaluing accruals in just the fire and armed forces schemes. They are therefore used for a different purpose to the public service earnings growth assumption.
- These exclude drift, and are based on the Government's preferred measure of earnings growth to be used for indexing benefits – the ONS's Average Weekly Earnings measure, based on the whole economy – which is already in use in State Pension indexation.

How has the long term earnings assumption been derived? (Direction 24(f))

- The long term earnings assumption is derived from the long term GDP forecast. The assumption will be used to estimate earnings growth well after the period for which pay policy has been set, so it makes sense to use the same assumption for all schemes.
- The valuations already contain a long term GDP forecast, since the discount rate – CPI+3% - is equal to GDP growth from the OBR's November 2010 projections when the discount rate was set. So for consistency, it makes sense to use the

same projections for the long term earnings assumption. We are therefore assuming 4.75% long term earnings growth.

- Using the 4.75% rate ensures that the earnings assumption used to project the cost of future payments is consistent with the discount rate used to express those earnings in current terms.
- Using the current figure would create an asymmetry in the methodology.

Do the short and long term earnings assumptions allow for promotion and progression?

- No, the short and long term earnings assumptions do not allow for changes in earnings due to promotion and progression.
- The Directions make separate provision for assumptions about changes in earnings due to promotion and progression. These assumptions are expected to be scheme-specific.

How will assumptions about mortality rates by set?

- Scheme specific assumptions will be used to estimate the 'base' level of mortality for the schemes – the mortality rates currently being experienced by scheme members.
- However, we cannot accurately predict future changes in life expectancy. There is no consensus amongst actuaries or academics about how this may change in the future, and so this cannot be informed by scheme experience.
- Because of this uncertainty, we will use the principal population projections, as calculated by the Office for National Statistics, to estimate future improvements in life expectancy. These are expected to be updated in November 2013 – the preliminary valuations will take these new estimates into account.
- These projections are produced independently and impartially, after consultation with an expert academic group. They are based on data on the whole population and are widely used across Government.

How is 'proposed Government policy' to be defined for the purpose of setting assumption on State Pension Age?

- In order to carry out the valuations, an assumption must be made about what the State Pension age will be in the future.
- The Directions have been redrafted to make it clear that 'when the Secretary of State has made a public statement proposing a change to the state pension age' it is to be assumed that 'the proposed change to state pension age has already been made'.
- It is reasonable to expect that when the Secretary of State has made a public pronouncement of a change to SPA that the change will happen. To then wait for the legislation to catch up to the policy may mean that actuaries are not using the best possible estimate of SPA.
- The Direction allows the valuation to take that reality into account and produce a more accurate estimate of the likely SPA of scheme members.
- Valuations will take place on a regular 4-yearly cycle (3-yearly for LGPS schemes). If the best estimate of what will happen to SPA changes, then the effects of this will feed through into the next valuation.

- In addition to the SPA, scheme actuaries will make other assumptions based on when we expect members to actually retire and draw their benefits. These assumptions will be based on scheme specific data.

What happens if there are changes in the characteristics of the workforce between 2012 and 2015?

- The Directions make provision for data projection where the responsible authority considers this approach would produce a more accurate estimate of the valuation results.

How will all the other assumptions to be used by the valuation be set?

- Scheme specific assumptions will be informed by scheme experience, and will be set by schemes, in consultation with stakeholders.
- Precise arrangements for consulting stakeholders on scheme-specific assumptions will be determined by individual schemes.

Employer cost cap

Why are you excluding the effects of pre-2015 benefits when you set the cost cap?

- The future service costs measured by the preliminary valuation of the new scheme will estimate the cost of providing the new scheme benefits to members between 2015 and 2019.
- However, many of these members will have substantial amounts of service in the old schemes. This may influence their behaviour.
- For example, they may retire earlier, taking their old scheme benefits, but leaving their new scheme benefits in deferment until their SPA.
- This means that the cost of providing the new scheme benefits between 2015 and 2019 could be lower than the cost of providing those benefits once everyone with old scheme service has left, and there is no longer any influence from the old scheme benefits.
- Essentially, we already expect the costs of providing the CARE benefits to drift upwards over time. As this is an expected change, we do not want the cost cap mechanism to be triggered as a result of this. Setting the cost cap excluding the effects of pre-2015 benefits will avoid this problem. The Directions have been drafted to achieve this result.
- This is likely to lead to a higher cost cap than if we took the alternative approach.

How will the effects of changes in 'employer costs' be excluded from the cost cap?

- All the potential costs drivers that have been specified as 'employer costs' – the actuarial methodology, the long term earnings assumption and the discount rate – are specified in the Directions.
- Any necessary adjustment to the cost cap contribution rates and funds will be made when Directions are amended to implement changes in these items.
- This does not change the Government's commitment to excluding these effects from the operation of the cost cap.

How will the effects of employer costs and member costs be disaggregated when these are compounded?

- Any compounding of effects caused by both employer and member costs can only arise if the actuarial methodology, the long term earnings assumption or the discount rate changes. For one of these items to change there would need to be amending Directions. Any necessary additional requirement for direction on the treatment of any compounding of employer costs and member costs would be considered at that time in the light of the specific changes to the actuarial methodology, the long term earnings assumption or the discount rate change taking place.

Cost cap regulations

What will happen if the cost cap is breached? When will changes be required?

- The draft Treasury regulations specify that the cost of the scheme with must remain within upper and lower margins. The regulations specify that these margins should be 2 percentage points above and below the cost cap.
- The Act also specifies that scheme regulations will provide for a procedure for the responsible authority/scheme manager, employers and members to reach agreement on any changes to the schemes if the cost cap is breached. Scheme regulations on this process will also include a time limit for discussions after which a default option for bringing costs back to the level of the cap will be used.

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