HM TREASURY

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(Via email)

Dear Trevor

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

Thank you for your letter of 17 December 2013 which set out your initial professional opinion on the actuarial aspects of the draft Public Service Pensions (Valuations and Employer Cost Cap) Directions 2013 (v3-0) ("the draft Directions").

The purpose of this letter is to consult you on the updated draft Directions set out in Annex A of this letter (v5-0), in line with our legal obligations under Section 11(4) of the Public Service Pensions Act 2013 ("the Act") when we make the Directions.

Legal background

As you know, Section 11(2) of the Public Service Pensions Act 2013 empowers HM Treasury to make Directions about how actuarial valuations of the public service pension schemes made under that Act, and relevant connected schemes, are to be carried out. Section 11(4) of the Act requires HM Treasury to consult the Government Actuary before making these Directions. Furthermore, section 12(3) of the Act also empowers HM Treasury to make Directions setting out how the employer cost caps are to be set for schemes made under the Act. A Commencement Order (SI 2013/2818) brought all three of these sections of the Act into force on 1 December 2013.

Your letter of 17 December 2013 set out your understanding of the two distinct purposes which the valuations and Directions serve (for each scheme):

- informing the employer contribution rate; and

- setting the "employer cost cap" and "measuring changes in the cost of the scheme against the employer cost cap".

I can confirm your understanding of these purposes. We expect both the employer contribution rate and the employer cost cap to appear in scheme regulations. However there is a different legal relationship between the Directions and the eventual provision in scheme regulations with regard to these two purposes. The Act requires the employer cost cap appearing in scheme regulations to be set in accordance with the Directions, while no such equivalent requirement exists for the employer contribution rate. The Directions have been drafted to reflect these different relationships.

Preliminary preparation

As you are aware, over the course of 2013 we took forward preliminary work in anticipation of this formal consultation and I have noted your view set out in your letter of 17 December 2013 that the draft Directions, in the round, do meet the Government's over-arching objectives and principles to a significant degree and, in the round are technically complete and coherent.

I also note the points you raised in relation to the complexity of actuarial valuations and the uncertainties that are inherent in this kind of analysis - which means that it cannot be guaranteed that the Directions as drafted will cover every eventuality, or that they will continue to deliver the Government's policy objectives when circumstances change. The Treasury recognises this, and agrees that it will be necessary to keep the Directions under review and to revise these periodically. We envisage that such reviews will be needed at least before each subsequent round of scheme valuations but that a need for review could also be triggered by other changes in circumstances - for example if there were changes to other legislation which related to pensions.

In addition to this general point, your letter also raised a number of specific points in relation to the draft Directions and the Government's principles. The Treasury's response on these points is set out below.

Over-riding objective and principles

For the avoidance of doubt, our over-riding objective which these Directions seek to achieve[1], and the principles[2] to which we have had regard to in preparing these Directions, remain as set out in our letter to you of 10 October 2013. It may also be helpful to state explicitly that our intention is for future reviews of these Directions to also be carried out against the same over-riding objectives and

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[1]To implement the Government's intended approach to actuarial valuations of public service pension schemes; and to establish an employer cost cap in public service pension schemes, as set out in the two papers on these two subjects published by HM Treasury in November 2012.

[2] The principles are: no bias, discount rate, consistency, clarity, completeness, cost control, sustainability, technical immunity and stability.

principles.

There is one exception to these principles applying at future reviews of the Directions. That is the discount rate principle - as this simply sets the discount rate - which itself is subject to a separate review process described in the Government's response to the separate consultation on the SCAPE discount rate. For the avoidance of doubt, the Treasury will amend the Directions to reflect any changes to the discount rate arising out of these reviews.

I also note a separate point about the technical immunity principle (which ensures that the measurement of changes in the cost of the scheme against the employer cost cap should exclude certain effects). The Directions as applied to the preliminary valuations will meet this principle automatically because the timing of the valuations (which is mandated the by Directions) mean that the employer cost cap cannot be breached before the next valuations (the "first" valuations under the Directions). The adherence to this principle will therefore only become relevant at subsequent valuations and it will therefore be applied to future reviews of the Directions to ensure that it continues to apply.

Response to points in letter of 17 December 2013

<u>Issue 1: Does consistency or best estimate take precedence</u>

I recognise that there is potentially a tension between the principle that the assumptions used should be "best estimates", and the principle that there should be consistency in the way the valuations calculate the costs of the different pension schemes. I also note your point that, given the potential differences in "best estimate" assumptions that may arise from actuaries exercising their professional judgement, Treasury involvement would be necessary to achieve consistency between the valuations of different schemes in matters which are not explicitly specified in the Directions.

It is the Treasury's view that assumptions should be set centrally where scheme experience data is not sufficient to inform robust assumptions (for example, assumptions in relation to future changes in mortality rates). Where there is sufficient evidence, the Treasury is content for actuaries to exercise their professional judgment in advising responsible authorities on best estimate assumptions. In my view, this is the simplest and most transparent way of proceeding, while ensuring the right balance between consistency and best estimate in the setting of assumptions.

In line with this view, we have reviewed v3-0 of the draft Directions and v5-0 of the Directions includes amendments so that they now reflect this approach. In particular they now mandate central assumptions to be used where there is insufficient scheme evidence to inform assumptions, wherever this is practically possible. In line with this approach, v5-0 of the Directions specify an additional assumption (15%), relating to the proportion of pension income that will be commuted to cash by members retiring from the new schemes. Our GAD advisory team have provided advice which confirms that 15% is a best estimate across the public service schemes.

I note that where assumptions are not specified in the Directions, the Directions include a "catch-all" so that the remainder of the assumptions will be set as responsible authorities' best estimates. I also note that an inevitable consequence of this is that it is possible for circumstances to arise where the precedence of the best estimate principle may lead to inconsistencies.

Issue 2: Inconsistency consequences of timing practicalities

Again, I recognise the tension between the principles of consistency and no bias that may result from the fact that scheme valuations are proceeding to different timescales.

With regard to the key assumptions which are specified in the Directions and the preliminary valuations of the new schemes, the Treasury's view is that the consistency principle should take precedence. This will ensure that scheme costs are calculated on the same basis, and that the schemes' employer cost caps will be set on a consistent basis across all schemes. The Treasury accepts that this means that for schemes which complete their valuations later this may mean that some of the assumptions used may not be able to be described as "best estimate" at the point at which the valuations are completed.

In line with this view, we have reviewed v3-0 of the Directions and v5-0 includes amendments so that they now reflect this approach. In particular, for additional clarity around this point, v5-0 of the Directions now state that the 2012 population projections, published by the Office for National Statistics, should be used as the basis for assumptions about changes in mortality rates. Similarly, v5-0 of the draft Directions now specifies the assumptions to be used about State Pension Age (SPA), based on the announced timetable for SPA changes.

With regard to the assumptions which the Directions require the individual schemes' responsible authorities' to set as best estimates, we are not concerned about inconsistency consequences of timing practicalities because, as discussed in relation to "Issue 1" above, there is already scope for the precedence of the best estimate principle to lead to inconsistencies even if all schemes followed precisely the same timetable for completing their valuations.

Future reviews of the Directions will ensure that these assumptions remain appropriate, and the Directions will be amended when it is necessary to update them.

Issue 3: Instability caused by demographic changes, methodology and assumptions

You letter notes that instability in the cost cap mechanism may arise for reasons other than the effect of old scheme accruals on the future service costs of the new schemes. However, the extent to which these other effects may emerge cannot be anticipated with any degree of accuracy at this stage. The Treasury recognises this and accepts that the employer cost cap will need to be kept under review.

If at a future valuation it can be demonstrated that the cost cap mechanism has been affected by such a change, the Government will need to decide how this should be taken into account in that mechanism. Any decisions of this nature will need to be taken on a case by case basis. In taking any decision to adjust the cost cap or the operation of the mechanism, the Government will need to balance the interests of scheme members against the need to protect the taxpayer and to ensure that the costs to employers remain sustainable.

Given the inevitability that future reviews will need to be carried out and that, as discussed earlier in this letter, we intend future reviews to be carried out against the same over-riding objective and principles which underpin v5-0 of the Directions, we have not made any amendments to the Directions in respect of this issue.

Issue 4: Difference between employer contributions and employer cost cap

The draft Directions set out two key outputs from the preliminary valuation – the rate of employer contributions which, together with member contributions, are needed to meet the full costs of the pension schemes, and the specification of the employer cost cap. Your letter notes the differences between these two outputs, and suggests that, given these differences, the actuarial work needed to produce them could be based on different assumptions and methodologies.

The Treasury has not yet seen any evidence as to why this separation between the employer contribution rate and the employer cost cap may be necessary. Therefore the attached draft of the Directions continues to mandate that the same assumptions are to be used for these two different purposes and we have not made any amendments to the Directions in respect of this issue.

However, the Treasury would consider amending the Directions in future if this does prove to be necessary, and will keep an open mind on this point. I also note that the distinction between the employer contribution rate and the employer cost cap in terms of the legal relationship between the Directions and the eventual provision in scheme regulations (as discussed earlier in this letter) provides some additional and current legislative flexibility around this issue.

Issue 5: Short term assumptions used to set a long term cap

Your letter flags a final point relating to the objective the employer cost cap should provide backstop protection against any unexpected changes in scheme costs. As you note, v3-0 of the Directions did not deliver this objective for those schemes which will use a measure of earnings to revalue the pension benefits for active members (including the Armed Forces and Firefighters' schemes). This was because the Directions specified that the cost cap for these schemes should be set with reference to short term assumptions about changes in earnings, rather than the assumptions for change in the longer term.

The Treasury has noted this point, and v5-0 of the Directions includes amendments so that the employer cost cap for these schemes will be set with reference to the long term forecast for changes in earnings. This will bring the cost caps for those schemes affected into line with those for the other schemes which will revalue with reference to prices, which were already unaffected by differences between short term and longer term price growth assumptions.

Points in Annexes to letter of 17 December 2013

Annex C of your letter discusses the extent to which the data, methodology and assumptions in the Directions meet our over-riding objective and principles. It may also be helpful to set out the Treasury's position in relation to two of the points raised in that Annex C.

Data projections

Your letter notes that the approach to data projections in v3-0 of the Directions could prejudice the "clarity" principle. This is because of the uncertainty about future scheme membership, and the degree of variation between the different data projections that may be adopted (while still being able to be described as "best estimate"). Your letter also notes that the approach could lead to different data projections being used for the purpose of calculating an employer contribution rate and the cost cap, which will be unhelpful in terms of the clarity principle.

The Treasury has noted your points, and the suggested alternative approach of allowing the "best estimate" approach to decision making in relation to assumptions about the likely future membership of the schemes. This is now reflected in v5-0 of the draft Directions, in that they now specifically require the scheme actuary to make an assumptions about the profile of new entrants to the scheme, as well as assumptions about retirements and withdrawals over the relevant period.

Schedule 2 - notional assets for the first valuation

Annex C of your letter notes the potential tension which arises from the specification of the notional asset balances for the unfunded pension schemes (the "SCAPE accounts") in Schedule 2 of the Directions. Your letter notes that while the specification of notional asset balances for these schemes is consistent with the completeness principle, in that it will ensure the valuations capture any past service costs which may have arisen since the previous valuations, there may be a tension with the consistency principle. This is because previous valuations of the schemes have not generally been aligned, and so past service effects are captured from different dates.

The Treasury notes this point. In our view, except in exceptional circumstances, reflecting the general points as discussed earlier in this letter (including under some of the specific issues raised), the completeness principle must take precedence over the consistency principle in relation to setting the notional asset balances which will form the starting point for the valuations. As such, we accept that there will be a degree of inconsistency in the way these notional asset balances have been arrived at. We note your final point that the approach may be regarded as consistent, insofar as the use of previous valuation results has been applied in a consistent way across all of the schemes.

Technical and practical points

Annex B of this letter also sets out our responses to the points made in Annex D (Technical completeness and coherence) and Annex E (Practical challenges) of your letter of 17 December 2013.

Consultation with scheme stakeholders

As explained above v5-0 of the Directions reflects amendments to v3-0 of the Directions which we have made following consideration of the points raised in your letter of 17 December 2013.

Please note that v5-0 of the draft Directions also includes changes made in response to comments received from scheme stakeholders following our two further consultations with stakeholders in addition to other changes. The first of these consultations was in respect of v3-0 (i.e. the same version which you commented on in your letter of 17 December 2013). The second of these consultations was in respect of v4-0 which also reflected the changes we made in response to your letter of 17 December 2013.

Annex C of this letter sets out a summary of the changes made since v3-0 which are a result of comments from stakeholders (excluding typographical changes which stakeholders have identified). Please also note that where you raised comments in your letter of 17 December 2013 and stakeholders made similar comments, these comments are not listed in the table in Annex C.

Draft checking

V5-0 of the Directions is still undergoing legal drafting checks. These will not alter any substantive provisions of the Directions, but may make a few minor changes to the text to align it with wider Government drafting conventions. These will not alter the substance or effect of the Directions.

Request for comments

Thank you for the valuable input that you and your officials have provided during the course of the preliminary work. I look forward to receiving your comments on the attached draft of the Directions in respect of this statutory consultation.

Yours sincerely

[redacted]

Julian Kelly

Enclosures:

- Annex A - Draft Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014 (v5-0)
- Annex B - Technical and practical points
- Annex C - Summary of changes to Directions made in response to stakeholder comments

HM TREASURY

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

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 and entry into force

1. These Directions may be cited as the Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014, 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) that can be assessed from data held by the scheme;

"closing date" means:

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

(b) in relation to a public body pension scheme, the date determined by the public authority responsible for that scheme as the date after which no benefits are to be provided for service after that date, under section 31(2) of the 2013 Act or otherwise;

"cost cap benefits paid" means an amount of money representing benefits debited from the cost cap fund, calculated in accordance with direction 34;

"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, calculated in accordance with direction 42;

"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, calculated in accordance with direction 37;

"cost cap fund contribution rate" means the contribution rate calculated in accordance with direction 32;

"cost cap future service cost" means the element of the cost cap cost of the scheme that reflects future service costs calculated in accordance with direction 40;

"cost cap income" means an amount of money representing income credited to the cost cap fund, calculated in accordance with direction 33;

"cost cap liabilities" means the liabilities of a scheme which are compared against the cost cap fund to calculate the cost cap past service cost, calculated in accordance with direction 39;

(**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, calculated in accordance with direction 35;

"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, calculated in accordance with direction 36;

"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, calculated in accordance with direction 41;

"effective date", in respect of a particular valuation, means the date specified in direction 6;

"employer contribution rate" means the contribution rate calculated in accordance with direction 29;

"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 determined in accordance with direction 7;

"implementation period", in respect of a particular valuation, means 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, determined in accordance with direction 8;

"inter-valuation period" means:

(a) for a scheme which provides benefits to local government workers, the period of three years before the effective date; or

(b) in any other case, the period of four years before the effective date;

"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 calculate 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;

"pension commencement lump sum" has the meaning given by paragraph 1 of Part 1 of Schedule 29 to the Finance Act 2004(**a**);

"proposed employer cost cap" means the contribution rate calculated in accordance with direction 53;

"relevant old scheme" has the meaning given in directions 48 and 52;

"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 calculate 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 21 to 23;

"valuation results" means the numerical values stated in the valuation report in accordance with directions 22 and 23; and

any term in these Directions defined in the 2013 Act has the same meaning as in the 2013 Act.

(**a**) 2004 c.12

PART 2: VALUATIONS

A “Scheme”

Meaning of “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 a scheme made under section 1 of the 2013 Act, scheme regulations may not except schemes listed in Schedule 1 from being connected schemes.

Scheme Actuary

Scheme Actuary

4.—(1) An actuary, referred to in these Directions as the “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

Effective date

6.—(1) The first valuation of a scheme must have an effective date–

(a) in relation to a scheme providing benefits to local government workers in Scotland, of 31st March 2017;

(b) in relation to a new public body pension scheme, which is a date fixed by the public authority responsible for the scheme as the effective date of the first valuation; and

(c) in all other cases, of 31st March 2016.

(2) The second, and each subsequent, valuation of a scheme 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 (or subsequent) valuations; and

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

Implementation date

7. 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.

Implementation period

8. The implementation period must be the period of–

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

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

Data

Membership and other data

9.—(1) The scheme actuary must specify–

(a) before carrying out the first valuation of the scheme, the scheme membership data in relation to the closing date of the connected schemes; and

(b) before carrying out the first and each subsequent valuation of the scheme, the scheme membership data and any other data, in relation to the effective date;

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) The person designated in accordance with paragraph (2) can be the responsible authority, the scheme manager, or any other person or body in a position to ensure that the specified information is provided.

(4) The scheme actuary must use the scheme membership data and other data provided to them to calculate the valuation results.

(5) In respect of a scheme established for local government workers in England and Wales, the responsible person must 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

10. When calculating the valuation results, the scheme actuary must use the methodology and assumptions set out in directions 11 to 19, unless any contrary intention is specified in these Directions.

Projected unit methodology

11.—(1) The scheme actuary must use the projected unit methodology to calculate 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.

Other methodology and assumptions

12. The scheme actuary must calculate contribution yields in accordance with directions 28 and 31 in respect of members' and employers' normal contributions only.

13. The scheme actuary must calculate–

(a) contribution rates in accordance with directions 27(1)(a) and (c); and

(b) the cost cap past service cost in accordance with direction 41;

on the assumption that these contribution rates will be payable for 15 years from the dates indicated in those directions.

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

14.—(1) When calculating the valuation results, the scheme actuary should use the relevant rate of increase awarded by order to official pensions within the meaning of the Pensions (Increase) Act 1971(**a**) where those official pensions have been so increased by order.

(2) When that rate of increase of official pensions has not been set by order, the scheme actuary must assume that the rate is–

(i) 2.7% on 7th April 2014;

(ii) 2.2% on 6th April 2015;

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

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

15. When calculating 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 determined under direction 14.

16. When calculating 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) 3.4% on 11th April 2016;

(b) 3.6% on 10th April 2017;

(c) 3.7% on 9th April 2018;

(d) 3.7% on 8th April 2019; and

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

17. When calculating the valuation results, the scheme actuary should assume that the rate of public service earnings growth is–

(a) 1.8% over the year to 31st March 2013;

(b) 0.5% over the year to 31st March 2014;

(c) 1.5% over the year to 31st March 2015;

(d) 2% over the year to 31st March 2016;

(e) 2.5% over the year to 31st March 2017;

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

(g) 3% over the year to 31st March 2019; and

(h) 4.75% over each year from 1st April 2019.

18. When calculating the valuation results, the scheme actuary must also assume that:

(a) the SCAPE discount rate over each year ending on the 31st March is the assumed rate of increases awarded by order to official pensions within the meaning of the Pensions (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 2012 principal population projections for the United Kingdom;

(c) 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; and

(d) the state pension age–

(i) for a female member will increase to 65 as set out in section 1 of the Pensions Act 2011(**b**);

(**a**) 1971 c.56
(**b**) 2011 c.19

(ii) for male and female members will increase to 66 as set out in section 1 of the Pensions Act 2011;

(iii) for male and female members will increase to 67 as set out in the following table:

Born on	*State pension age*
6 April 1960 – 5 May 1960	66 years and 1 month
6 May 1960 – 5 June 1960	66 years and 2 months
6 June 1960 – 5 July 1960	66 years and 3 months
6 July 1960 – 5 August 1960	66 years and 4 months (1)
6 August 1960 – 5 September 1960	66 years and 5 months
6 September 1960 – 5 October 1960	66 years and 6 months
6 October 1960 – 5 November 1960	66 years and 7 months
6 November 1960 – 5 December 1960	66 years and 8 months
6 December 1960 – 5 January 1961	66 years and 9 months (2)
6 January 1961 – 5 February 1961	66 years and 10 months (3)
6 February 1961 – 5 March 1961	66 years and 11 months
6 March 1961 – 5 April 1977	67
6 April 1977 or later	67

;

(iv) for male and female members will increase to 68 as set out in section 13 and paragraphs (9) and (10) of Schedule 3 to the Pensions Act 2007(**a**);

(e) when a scheme member, in relation to the whole or part of a scheme–

(i) is entitled to choose to surrender pension for a pension commencement lump sum at a rate of £12 of lump sum for every £1 of pension surrendered;

(ii) is not entitled to a pension commencement lump sum the amount of which is fixed by scheme regulations;

the scheme actuary must assume that the member will surrender 15% of their pension for a lump sum, in the whole or any relevant part of the scheme as appropriate; and

(f) when a scheme member is entitled in any part of a scheme to surrender pension for a pension commencement lump sum at a rate other than £12 of lump sum for every £1 of pension surrendered, paragraph (e) of this direction does not apply.

19. All other assumptions used by the scheme actuary, other than those detailed in directions 11 to 18, must–

(a) be determined by the responsible authority, having obtained advice from the scheme actuary;

(b) be determined following such consultation of such persons (or representatives of persons) as the responsible authority considers appropriate;

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

(**a**) 2007 c.22

(d) 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 20;

   (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;

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

(e) include assumptions about–

   (i) new entrant profiles;

   (ii) mortality rates;

   (iii) age retirement rates;

   (iv) to the extent that direction 18(e) does not apply, commutation;

   (v) early and late retirements;

   (vi) rates and severity of ill health retirements;

   (vii) members' dependants;

   (viii) resignations;

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

   (x) promotional earnings increases.

Analysis of the demographic experience

20.—(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 that analysis of the demographic experience up to the effective date covering the following aspects–

(a) new entrant profiles;

(b) mortality rates;

(c) age retirement rates;

(d) rates of early and late retirements;

(e) rates and severity of ill health retirements;

(f) resignations and opt outs;

(g) rates of re-joining service;

(h) promotional earnings increases;

(i) members dependants;

(j) take up of commutation options; and

(k) 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.

(3) When carrying out the analysis, the scheme actuary must consider the demographic experience of the scheme over the inter-valuation period.

(4) When carrying out the analysis, the scheme actuary 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.

The valuation report

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

21. 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 of the average age of the scheme members in pensionable service at the effective date;

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

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

(e) 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);

(f) an analysis of the demographic experience carried out in accordance with direction 20;

(g) 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 determined by the responsible authority under direction 19;

(ii) a statement of how regard has been had to the matters listed in direction 19(d) when determining the assumptions adopted for each of the assumptions determined by the responsible authority under direction 19(e);

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

(h) any other liability of the scheme that the responsible authority has told the scheme actuary that it considers to be relevant; and

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

Contents of the valuation report: employer contribution rates

22. 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 24;

(b) the notional assets of the scheme calculated in accordance with direction 25;

(c) the information about the notional assets of the scheme required by direction 26;

(d) the contribution rates calculated in accordance with direction 27;

(e) the contribution yields calculated in accordance with direction 28; and

(f) the employer contribution rate calculated in accordance with direction 29.

Contents of the valuation report: cost cap

23. 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 30;

(ii) the cost cap contribution yield calculated in accordance with direction 31;

(iii) the cost cap fund contribution rate calculated in accordance with direction 32;

(iv) the cost cap income calculated in accordance with direction 33;

(v) the cost cap benefits paid calculated in accordance with direction 34;

(vi) the cost cap net leavers liabilities calculated in accordance with directions 35;

(vii) the cost cap notional investment returns calculated in accordance with direction 36;

(viii) the cost cap fund calculated in accordance with direction 37;

(ix) the change in value of the cost cap fund required by direction 38;

(x) the cost cap liabilities calculated in accordance with direction 39;

(xi) the cost cap future service cost, calculated in accordance with direction 40;

(xii) the cost cap past service cost, calculated in accordance with direction 41;

(xiii) the cost cap cost of the scheme calculated in accordance with direction 42; and

(b) a cost cap analysis carried out in accordance with direction 43.

The valuation report: employer contribution rate

Liabilities as at effective date

24.—(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, 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

25.—(1) The value of the notional assets at the effective date must be set as equal to:

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

where–

A is–

(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 is–

(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 is–

(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 is–

(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, including notional investment returns on income received less benefits paid 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, including notional investment returns on income received less benefits paid over the inter-valuation period.

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

(3) The benefits paid by the scheme for the purposes of the calculation at paragraph (1) must include, but are not limited to, benefits paid to pensioners and dependants and outgoing transfer values.

(4) The notional investment returns of the scheme for the purposes of the calculation at paragraph (1) must be calculated–

(a) for each year up to and including the year ending on the 31 March 2011, using the rate of increases awarded by order to official pensions within the meaning of the Pensions (Increase) Act 1971 in the April immediately following each year, compounded with 3.5%; and

(b) for each year after the year ending on the 31 March 2011, using the rate of increases awarded by order to official pensions within the meaning of the Pensions (Increase) Act 1971 in the April immediately following each year, compounded with 3%.

(5) For the purposes of paragraphs (3) and (4), for any time when there is no increase awarded by order to official pensions within the meaning of the Pensions (Increase) Act 1971 as a result of the price inflation index used to calculate increases to official pensions being a negative figure, the negative figure of the price inflation index must be used.

Information about the notional assets

26.—(1) 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.

(2) 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.

(3) The analysis in paragraph (2) must include–

(a) income received during that period;

(b) benefits paid during that period; and

(c) notional investment returns during that period.

Contribution rates

27.—(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 24 and the notional assets calculated in accordance with direction 25;

(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

28. 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

29.—(1) The employer contribution rate must be calculated as–

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

where–

A is the contribution rate stated in accordance with direction 27(1)(a);

B is the contribution rate stated in accordance with direction 27(1)(c);

C is the contribution rate stated in accordance with direction 27(1)(d); and

D is the contribution yield expected from member contributions to the scheme stated in accordance with direction 28(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 accordance with paragraph (1).

(3) Where a scheme makes provision for employers to pay normal contributions at different rates, 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 accordance with 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.

The valuation report: cost cap cost of the scheme

Prior value of the cost cap fund

30.—(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 to calculate the employer contribution rate 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

31. 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

32.—(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 is 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 is 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 the methodology, data and assumptions used to calculate the employer contribution rate in a 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.

(3) For the second and any subsequent valuation of the scheme, the cost cap fund contribution rate must be calculated, to the nearest 0.1% of pensionable payroll, as–

$$(A + B) - C$$

where–

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

B is the cost cap past service cost calculated in accordance with direction 41 in the previous valuation of the scheme; and

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

(4) A and C in paragraph (3) must be calculated using the methodology, data and assumptions used to calculate the employer contribution rate in the previous valuation of the scheme.

Cost cap income

33.—(1) 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.

(2) The income received for the purposes of paragraph (1)–

(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

34.—(1) 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.

(2) For the purposes of paragraph (1), the benefits paid–

(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

35.—(1) The cost cap net leavers liabilities must be calculated as–

$$A - B$$

where–

A is 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 is 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.

(2) 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, calculate 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 by leaving pensionable service became entitled to surrender pension for a pension commencement lump sum, calculate the liability assuming the member surrendered the same proportion of pension for pension commencement lump sum as the assumption adopted for such surrender in the valuation;

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

(d) 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.

(3) Paragraph 3 of Schedule 7 to the 2013 Act applies in determining whether a member has retained continuity of employment for the purposes of this direction.

Cost cap notional investment returns

36.—(1) 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.

(2) For the purposes of paragraph (1), when calculating notional investment returns over a period–

(a) the scheme actuary must make allowance for the cost cap income added to the cost cap fund, and for the cost cap benefits and the cost cap net leavers liabilities deducted from the cost cap fund;

(b) for each year ending on the 31st March, the notional investment returns must be calculated by using the rate of increases awarded by order to official pensions within the meaning of the Pensions (Increase) Act 1971 in the April immediately following each year, compounded with 3%; and

(c) for any time when there is no increase awarded by order to official pensions within the meaning of the Pensions (Increase) Act 1971 as a result of the price inflation index used to calculate increases to official pensions being a negative figure, the negative figure of the price inflation index must be used.

Cost cap fund

37. The value of the cost cap fund as at the effective date must be calculated as–

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

where–

A is the prior value of the cost cap fund, calculated in accordance with direction 30:

B is the cost cap income, calculated in accordance with direction 33;

C is the cost cap benefits paid, calculated in accordance with direction 34;

D is the cost cap net leavers liabilities calculated in accordance with direction 35; and

E is the cost cap notional investment returns calculated in accordance with direction 36.

Change in value of the cost cap fund

38.—(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–

(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

39.—(1) The cost cap liabilities must be calculated as–

$$A + B$$

where–

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

(2) 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

40.—(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 assumptions specified in direction 14 must be adjusted so that the assumed rate of increase is 2% on 11th April 2016.

(3) For the purpose of calculating the contribution rate in paragraph (1), the assumptions specified in direction 16 must be adjusted so that the assumed earnings measure revaluations of career average re-valued earnings under section 9 of the 2013 Act is–

(a) 4.75% on 11th April 2016;

(b) 4.75% on 10th April 2017;

(c) 4.75% on 9th April 2018; and

(d) 4.75% on 8th April 2019.

(4) For the purpose of calculating the contribution rate in paragraph (1), the assumptions specified in directions 18(e), 18(f) and 19 must be adjusted as if 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.

(5) For the purpose of calculating the contribution rate in paragraph (1), the expected cost of benefits accrued by members of the scheme over the implementation period should be determined as if no members of the relevant old scheme have any entitlement to exceptions made under sections 18(5) to (7) of the 2013 Act.

Cost cap past service cost

41. The cost cap past service cost must be calculated as–

$$A - B$$

where:–

A is the cost cap liabilities calculated in accordance with direction 39; and

B is the cost cap fund calculated in accordance with direction 37;

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

42. The cost cap cost of the scheme must be calculated as–

$$(A + B) - C$$

where–

A is the cost cap future service cost, calculated in accordance with direction 40;

B is the cost cap past service cost calculated in accordance with direction 41; and

C is the cost cap contribution yield calculated in accordance with direction 31.

Cost cap analysis

43. 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) new entrant profiles;

(bb) mortality rates;

(cc) rates of age retirement;

(dd) early and late retirements;

(ee) rates and severity of ill health retirements;

(ff) resignations and opt outs;

(gg) rates of rejoining service;

(hh) general earnings growth until 31st March 2019;

(ii) promotional earnings increases;

(jj) members dependants;

(kk) take up of commutation options; and

(ll) any other relevant reason.

The valuation report: special applications

Application of Part 2 to local government workers

44.—(1) In relation to a first valuation of a scheme providing benefits to local government workers, Part 2 of these Directions applies with the following modifications–

(a) in direction 25, A is the value of the liabilities as at the effective date, calculated in accordance with direction 24;

(b) in direction 25, B, C, and D are zero;

(c) direction 26(1)(a) does not apply;

(d) direction 26(2)(a) does not apply;

(e) directions 27(1)(b) and (c) do not apply;

(f) directions 28(a) and (b) do not apply; and

(g) in direction 29, B is zero.

(2) In relation to a second and subsequent valuation of a scheme providing benefits to local government workers, Part 2 of these Directions applies with the following modifications–

(a) references to employer contributions assume that 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 27(1)(b) and (c) do not apply;

(c) directions 28(a) and (b) do not apply; and

(d) in direction 29, B is zero.

Application of Part 2 to fire and rescue workers in Scotland

45. In relation to a first valuation of a scheme providing benefits to fire and rescue workers in Scotland, Part 2 of these Directions applies as if in direction 25, B includes notional employer contributions, assumed to be paid between 1 April 2009 and 31 March 2010–

(a) in respect of the existing scheme established by the Firefighters' Pension Scheme Order 1992, insofar as this Order applies to fire and rescue workers in Scotland, at a rate of 27% of pensionable pay; and

(b) in respect of the existing scheme established by the Firefighters' Pension Scheme (Scotland) Order 2007, at a rate of 14.7% of pensionable pay.

Application of Part 2 to members of police forces in Scotland

46. In relation to a first valuation of a scheme providing benefits to members of police forces in Scotland, Part 2 of these Directions applies as if in direction 25, B includes notional employer contributions, assumed to be paid between 1 April 2009 and 31 March 2010–

(a) in respect of the existing scheme established by the Police Pensions Regulations 1987, insofar as these Regulations apply to members of police forces for Scotland, at a rate of 26% of pensionable pay; and

(b) in respect of the existing scheme established by the Police Pensions (Scotland) Regulations 2007, at a rate of 26% of pensionable pay.

Application of Part 2 to new public body pension schemes

47.—(1) In relation to a valuation of a new public body pension scheme, Part 2 of these Directions applies with the following modifications–

(a) references to a “scheme under section 1 of the 2013 Act” refer to the new public body pension scheme (and references to a “scheme” pursuant to direction 3 are construed accordingly);

(b) references to “scheme regulations” refer to the rules of the new public body pension scheme; and

(c) references to a “responsible authority” refer to the public authority which established the new public body pension scheme.

(2) In relation to a first valuation of a new public body pension scheme, Part 2 of these Directions applies with the following modifications–

(a) in direction 25, A is the value of the liabilities as at the effective date, calculated in accordance with direction 24;

(b) in direction 25, B, C and D are zero;

(c) direction 26(1)(a) does not apply;

(d) direction 26(2)(a) does not apply;

(e) directions 27(1)(b) and (c) do not apply

(f) directions 28(a) and (b) do not apply; and

(g) in direction 29, B is zero.

(3) In relation to a second and subsequent valuation of a new public body pension scheme, Part 2 of these Directions applies with the following modifications–

(a) references to employer contributions assume that 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 27(1)(b) and (c) do not apply;

(c) directions 28(a) and (b) do not apply; and

(d) in direction 29, B is zero.

PART 3: EMPLOYER COST CAP

Setting the employer cost cap.

48.—(1) The rate of the employer cost cap set in scheme regulations made under section 1 of the 2013 Act must be equal to the proposed employer cost cap calculated in a preliminary valuation of the relevant old scheme, carried out in accordance with directions 50 to 53.

(2) The relevant old scheme in respect of each group of persons listed in the first column of Schedule 3 is the corresponding existing scheme or schemes set out in the second column of that Schedule.

Comparison with the employer cost cap

49.—(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

50. A preliminary valuation for the purposes of these Directions is a valuation which–

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

(b) is a valuation of the relevant old scheme;

(c) assumes that the benefit structures and transitional arrangements set out in the proposed new scheme listed in the third column of Schedule 3 for new pension schemes (made under section 1 of the 2013 Act or assumed to be so made by operation of section 28 of that Act) 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 9 to 19, so far as they are applicable to directions 24 to 29 and 44 to 46;

(e) has a valuation report which includes the information and data set out in direction 21;

(f) has a valuation report which includes the information about employer contribution rates set out in direction 22, calculated in accordance with directions 24 to 29, and 44 to 46, 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;

(iv) the implementation period was calculated according to direction 8;

(v) directions 29(2), (3) and (4) do not apply; and

(g) has a valuation report which states the proposed employer cost cap in accordance with direction 53.

Preliminary valuation: modification of references

51. For the purpose of undertaking the preliminary valuation, directions 9 to 19, 21 to 22, 24 to 29 and 44 to 46 are to be read as–

(a) references to a "responsible authority" are references to the public authority responsible for the relevant old scheme;

(b) references to a "scheme", "regulations under section 1 of the 2013 Act", and a "connected scheme" are references to the relevant old scheme, subject to the assumption in direction 50(c);

(c) references to a "scheme actuary" are references to the person appointed in accordance with direction 50(a); and

(d) references to a "valuation report" are references to the valuation report prepared in accordance with directions 50(e) to (g).

Preliminary valuation: new public body pension schemes

52.—(1) Direction 48 applies to a new public body pension scheme as if–

(a) in paragraph (1), the reference to regulations made under section 1 of the 2013 Act is a reference to the rules establishing the new public body pension scheme, made under section 31(7) of the 2013 Act or under other powers in compliance with section 30(1)(e) of the 2013 Act; and

(b) in paragraph (2), the relevant old scheme is the connected scheme or schemes, within the meaning of section 4(6) to the 2013 Act, to the new public body pension scheme.

(2) Direction 49(2) applies to the valuation of a new public body pension scheme as if the reference to a responsible authority is a reference to the public authority responsible for the scheme

(3) Directions 50(b) and (c) apply to the valuation of a new public body pension scheme as if–

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

(b) the existing schemes listed in the second column of Schedule 3 are the connected scheme or schemes, within the meaning of section 4(6) to the 2013 Act, to 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 are listed in the third column of Schedule 3, and

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

(4) Directions 50(d) and (f) and direction 51 apply to the valuation of a new public body pension scheme as if the references to directions 44 to 46 are read as a reference to direction 47.

(5) Directions 50(f)(ii) and (iii) apply to the valuation of a new public body pension schemes as if–

(a) the effective date is the date fixed by the public authority responsible for the scheme as the effective date of the valuation; and

(b) the implementation date is a date fixed by the public authority responsible for the scheme as the implementation date of the valuation, which may be a date 3 years and 1 day after the effective date.

(6) The references to a relevant old scheme in direction 53 apply to the valuation of a new public body pension schemes as if paragraphs (1) and (2) of this direction applied.

Proposed employer cost cap

53.—(1) The valuation report for the preliminary valuation produced in accordance with direction 50(g) must state, to the nearest 0.1% of pensionable payroll, the proposed employer cost cap, being–

$$A - B$$

where–

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

B is the contribution yield expected from normal member contributions to the relevant old scheme over the implementation period.

(2) Subject to paragraphs (5) and (6), A and B in paragraph (1) shall be calculated as if the relevant old scheme was subject to the assumption in direction 50(c).

(3) For the purpose of calculating A in paragraph (1), the assumptions specified in direction 14 must be adjusted so that the assumed rate of increase is 2% on 11th April 2016.

(4) For the purpose of calculating A in paragraph (1), the assumptions specified in direction 16 must be adjusted so that the assumed earnings measure revaluations of career average re-valued earnings under section 9 of the 2013 Act is–

(a) 4.75% on 11th April 2016;

(b) 4.75% on 10th April 2017;

(c) 4.75% on 9th April 2018; and

(d) 4.75% on 8th April 2019.

(5) For the purpose of calculating A in paragraph (1), the assumptions determined in directions 18(e), 18(f) and 19 must be adjusted as if no members of the relevant old 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.

(6) For the purpose of calculating A in paragraph (1), the expected cost of benefits accrued by members of the relevant old scheme over the implementation period should be determined as if no members of the relevant old scheme have any entitlement to exceptions made under sections 18(5) to (7) of the 2013 Act.

Signed

Julian Kelly
Director, Public Spending
for Her Majesty’s Treasury

[Date] 2014

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)	£13,500,000,000	31st March 2007
Fire and rescue workers (Wales)	£724,000,000	31st March 2007
Fire and rescue workers (Scotland)	£1,891,000,000	31st March 2009
Members of police forces (England and Wales)	£59,400,000,000	31st March 2008
Members of police forces (Scotland)	£7,130,000,000	31st March 2009
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 Government	The draft Local Government Pension Scheme (Scotland) Regulations 2014, 6th January 2014, insofar as these Regulations are deemed to be a scheme made under section	1st April 2015

	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.	1 of the 2013 Act by section 28 of that Act	
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	The Scottish Teachers Pension Scheme 2015 Framework Document, 20th December 2013	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	The Firefighters' Pension Scheme in England Proposed Final Agreement, 24th May 2012, as if it applied to fire and rescue workers in Wales	1st April 2015

	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	The Scottish Firefighters' Pension Scheme Scotland 2015 Framework Document, 13th November 2013	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	The new Armed Forces Pension Scheme: Final Agreement, 16th October 2012	1st April 2015

	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		

Annex B – Technical and practical points

Section of 17 December 2013 letter	Point of interest	Treasury response (reference in v5-0 Direction)
Annex D		
1	Direction 2 provides a definition of "inter-valuation period". The term "inter-valuation period" appears in Direction 10 but it is not clear if or how this is intended to relate to Direction 27 (analysis of the demographic experience). In addition, for a preliminary valuation, it appears that the inter-valuation period starts and finishes on the same day. You may want to consider what the intention is on these points.	The definition of "inter-valuation period" in Direction 2 has been revised to clarify the policy intention.
2	Direction 2 provides a definition of "valuation report". You may want to consider whether it would be clearer to include in this definition references to all the disclosures required in a valuation report rather than just those specified in Directions 28 to 30 (e.g. Directions 34 and 35 require some disclosures).	Directions 21 to 23 of the Directions now provide full details of the disclosures to be included in the valuation report. These Directions are referenced in Direction 2.
3	Specification of the Projected Unit Methodology - your intention is presumably that allowance should be made (either explicitly or implicitly) for new entrants when using the Projected Unit Methodology but you may want to consider whether this could be made clearer.	Our intention is that allowance should be made for new entrants and Direction 19, 20 and 43 now include explicit references to new entrant assumptions.
4	There are currently (at least) two approaches to attributing periods of service in a career average scheme when using the Projected Unit Methodology which are permitted under International Accounting Standard 19 (the "current salary method" and "average salary method"). There is also room for interpretation over how to attribute periods of service which are granted as "benefit enhancements" (e.g. ill health and death in service). You may wish	The Treasury recognises that there is scope for differing interpretations of this accounting standard. However, we understand all scheme actuaries are currently taking the same approaches in these questions, and therefore have decided not to add further Directions on

	to consider providing further Direction on how scheme actuaries should interpret IAS19.	this point at this stage. The Treasury will keep this under review and make amendments to the Directions in future if this appears necessary to achieve a consistent approach.
5	Direction 18 requires three specific valuation results to be calculated assuming that the rates will be payable for 15 years from the implementation date. However Direction 57 requires one of these specific valuation results to be calculated assuming that the rate will be payable for 15 years from the effective date. To achieve coherence either Direction 57 needs to refer to implementation date or the part of Direction 18 which relates to Direction 57 needs to refer to the effective date. You may want to consider how to take this forward.	The Directions have now been amended to clarify this point and Directions 13 and 41 are now clear that the cost cap past service cost should be calculated as though it is payable from the effective date.
6	Direction 20 requires various data projections to be made under various circumstances. In particular a projection should be made if doing so would lead to a "more accurate" estimate of the future membership and have a "material impact" on the valuation results. As expanded in the discussion of Direction 20 in Annex C above, there is a distinction between "no bias" or "best estimate" and "more accurate" or "material impact". Setting aside the question of new entrant assumptions (see point 8 below), "data projections up to the end of the implementation period" is effectively just another way of describing the various other demographic assumptions listed in Direction 26(c) which relate to active members ceasing active pensionable service as applied up to the end of the implementation period. You may therefore want to consider removing this Direction completely and this possibility is also discussed in Annex C.	We have considered this point and removed this Direction.
7	Direction 21(2)(i) sets an assumption for the April 2014 Pension increase order. Since you wrote, ONS have published the September 2013 CPI figure which usually informs the pension	We have considered this point and updated Direction 14(2)(i).

	increases. The ONS figure is 2.7% not 2.9% (an Office for Budget Responsibility forecast) so you may want to update this.	
8	Directions 26(c) on valuation assumptions, 27(1) on aspects of demographic experience, and 59(b)(iv) on the cost cap analysis do not specifically mention numbers or demographic profiles of new entrants. Many of the valuation results required by the Directions are the costs of benefits (expressed as a percentage of pensionable pay) accruing over a future period. For example at the preliminary valuation, Direction 36(1)(d) requires the costs of benefits accruing over the period from 1 April 2015 to 31 March 2019 to be assessed. When rounded to 0.1% of pensionable pay, these costs are likely to be sensitive to the numbers and profiles of new entrants joining over that period so you may want to consider including new entrants in each of these lists.	Directions 19, 20 and 43 now include explicit references to new entrant assumptions.
9	Direction 32 explains that "D" represents "notional investment returns on the notional assets of the scheme". This Direction is not clear as to whether notional investment returns should also be allowed for on income received net of benefits paid over the relevant period. You may want to consider whether this should be made clearer. An equivalent point applies in respect of Direction 50.	The Directions have now been amended to clarify this point - see the definition of D in Direction 25 and Direction 36(2)(a).
10	Direction 33 (in the part of the Directions below the sub-heading "The valuation report: employer contribution rate") is not explicit on which year's Pension Increase order should be compounded with which discount rate to determine the rate of notional investment returns for a given year. For example to determine the notional investment returns over the year to 31st March 2012 should 3% be compounded with the PI order of 3.1% awarded in April 2011 or the PI order of 5.2% awarded in April 2012. There is a natural read across from Direction 25(a) which determines the discount rate each year (and in this example would suggest the PI order from April 2012). It may be helpful to make this clearer in Direction 33 (and in	The Directions have now been amended to clarify this point - see Direction 25(4) and Direction 36(2)(b).

	Direction 51 which is the corresponding Direction in the employer cost cap part of the Directions).	
11	Direction 38 includes cross-references to Directions 36(a), 36(c) and 36(d). It appears that these should be references to Directions 36(1)(a), 36(1)(c) and 36(1)(d) respectively.	This cross-referencing error has now been corrected.
12	Directions 38(2) and 38(3) will need interpreting for a preliminary valuation but it is not clear how they should be interpreted since the provisions schemes make for the rate at which employers contribute will (as long as new scheme regulations made under Section 3 of the PSPA 2013 are not in place yet) be the provisions, if any, in current scheme regulations not the proposed new employer contribution rates. As the intention is to sign off the Directions before scheme regulations you may want to consider whether this Direction needs amending accordingly.	The Directions have now been amended to clarify this point - see Direction 50(f)(v).
13	Direction 39(2)(a) requires for local government scheme valuations that, in Direction 32, income received by the scheme over the inter-valuation period 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. It is understood that the rates that employers actually pay as set at local fund valuations are not relevant for the notional SCAPE valuation of LGPS required by Part 2. The scope of this Direction is limited to Direction 32 but it may be that this should have a wider application within the Directions (e.g. to Direction 37(b) which is presumably not intended to establish the average employer contribution yield across all the different local fund employer contribution rates). You may therefore want to consider widening the scope of Direction 39(2)(a).	The Directions have now been amended to clarify this point - see Direction 44(2)(a).
14	Direction 40(1)(b)(ii) requires the use of the assumptions used in the preliminary valuation which were used to set the cap when setting the opening balance of the cost cap fund. The opening balance of	The Directions have been amended to reflect this point - see Direction 30(1)(b)(ii), Direction 32(2) and Direction

	the cost cap fund only includes liabilities in respect of service in the existing scheme but the calculations used to set the cap in the preliminary valuation are based on an assumption that the existing schemes do not exist. This appears to suggest the opening balance of the cost cap fund is zero. Presumably this is not intended and so this might suggest that the opening balance of the cost cap fund should be set using the assumptions from the preliminary valuation used to set the employer contribution rate not the employer cost cap. You may want to consider this point. The point applies in an equivalent way to Directions 42(2)(b) and 43(2) in respect of the cost cap fund contribution rate.	32(4).
15	Direction 49(a) requires that the "cost cap net leavers liabilities" are calculated at the point in time when a member leaves pensionable service before any benefits have been paid. Where members have an option to commute pension for lump sum (or any other option) on retirement it is therefore not clear whether the cost cap net leavers liabilities should be calculated using an assumed commutation rate (which will typically be an average figure across the whole membership) or the actual rate that the member chooses. In practice administrative arrangements may vary by scheme and could require commutation decisions to be made either in advance of retirement or after retirement. It may be helpful to make clear in this Direction whether the commutation rate to be used when determining cost cap net leavers liabilities is the valuation assumption or the actual proportion of pension that the member commutes.	An amendment has been made to the Directions to clarify that the valuation assumption should be used - see Direction 35(2)(b).
16	Direction 56(2) (and Direction 65(2)) requires the data, methodology and assumptions in Directions 14 to 26 to be adjusted as though (paraphrasing) "the current schemes do not exist and all members are accruing benefits in the new scheme". The impact of this assumption on each of the data methodology and assumptions	The Directions have now been amended to clarify this point - see Direction 40(4) and Direction 53(5).

	items in Directions 14 to 26 will be more or less clear for each of the Directions. For example it is not clear that the existence or not of the current schemes would have any impact on the discount rate set out in Direction 25(a); but it would be more likely that the existence or not of the current schemes would impact on age retirement rates determined under Direction 26(c)(ii). In Direction 56(2) (and Direction 65(2)) you may want to consider refining which Directions, amongst those in Directions 14 to 26, should be re-considered when assuming the current schemes do not exist.	
17	Direction 62 (and Direction 64) refers to Directions "31 to 38". It is understood these references should extend to Direction 39.	This cross-referencing error has now been corrected.
Annex E		
Communications	The valuations are complex exercises and the dual purpose of the valuations is noted; to set the employer contribution rate and the employer contribution cap may lead to some communication challenges.	The Treasury recognises these challenges. To address these, the Treasury will be publish documentation alongside the formal Directions which will explain the policy implemented by the Directions, and serve as a reference for those seeking to understand the new system. The Treasury will consider what further communications products may be necessary to effectively communicate this policy, especially to non-expert stakeholders.
Implications of the Fair Deal policy	The additional risks associated with the increased participation of non-public sector employers in the pension schemes may mean it is appropriate to charge these employers a different contribution rate. However, it is understood that for pragmatic reasons the same contribution rate will be charged to all employers, and that the Government will use other mechanisms to control the risk associated with the reformed Fair Deal policy.	The Treasury notes the potential risks associated with the reform of the Fair Deal policy. However, for the pragmatic reasons you note, we are content for these risks to be managed via mechanisms other than the charging of differential contribution rates, such as the use of

	In addition, a large influx to the public service pension schemes of readmitted members, as required by the new policy, could lead to instability in the cost cap mechanism.	bonds or indemnities from new employers or contracting authorities, or via provision for exit payments. We also note the potential for instability in the cost cap mechanism to arise a result of previously transferred staff returning to the schemes. Any potential impacts of this nature will be explored via future reviews of the Directions.
Local Government Pension Scheme	The implementation of a parallel cost management process for the Local Government Pension Scheme in England and Wales, as proposed by the Scheme Advisory Board, may have practical implications for the Directions.	The Treasury has noted these points. Any implications for the Directions and the statutory cost control process for the LGPS will be considered with the Department for Communities and Local Government as the relevant LGPS regulations are developed.
Data collection	The Directions may require schemes to supply data beyond which has typically been needed for valuations in the past. This may have implications for schemes' administrative systems.	The Treasury has noted these points. The Treasury has worked closely with the authorities responsible for the pension schemes throughout the development of the Directions, and so they and their administrators will be aware of the additional data that will be required.
Data improvements	Improvements in data which lead to more accurate results could lead to difficult practical challenges with the cost cap, in particular if an improvement in data quality leads to a breach of the margins either side of the employer cost cap.	The Treasury has noted these points. Any potential impact of this nature will be explored via future reviews of the Directions with decisions on any subsequent changes taken on a case by case basis.
Miscellaneous methodological	Direction 26 requires all other assumptions not covered elsewhere in the Directions to be the scheme's responsible authority's	The Treasury has noted these points. Any processes put in place to ensure

assumptions	(generally the relevant Minister's) best estimate. Where processes are put in place to ensure that these assumptions are set in a consistent way, it will be important to ensure that the process comprehensively covers any miscellaneous methodological decisions and data projections schemes make to achieve best estimate results, as well as the demographic assumptions adopted.	assumptions are set in a consistent way will cover miscellaneous methodological decisions and data projections as well as demographic assumptions.
Implications of rounding to 0.1% of pensionable pay	Whenever the Directions require valuation results expressed as a percentage of pensionable pay, they require the relevant valuation result to be rounded to the nearest 0.1% of pensionable pay. This is not an unreasonable degree of rounding and, for a given set of assumptions scheme actuaries will be able to determine the value of valuation results to this degree of rounding. This degree of rounding is also consistent with that shown in recent past valuations - for example the Teachers' Pension Scheme employer contribution rate is currently 14.1%. However, as stated, this is not a statement of the accuracy to which the valuation results can be relied upon as an assessment of the costs which are expected to emerge over many decades but simply a statement of how to present the results of any calculation. It is important to note therefore that this degree of rounding can generate a false sense of security about the accuracy of valuation results and therefore potentially lead to spurious debate about what assumptions should be adopted. However, this should not be taken to mean that an estimate of future costs of e.g. 16.2% will inevitably turn out to be a more accurate estimate than, for example 16.4% or another estimate within reasonable proximity. The true costs of providing the pension benefits being accrued today will not be known for many decades, and the degree of uncertainty therefore attaching to these costs is	The Treasury has noted these points.

	likely to mean that, in the event, costs will be different from estimates today, even when they are based on best estimate assumptions. This inherent uncertainty around assumptions and future costs, combined with a 0.1% rounding threshold could lead to various practical challenges during the assumption setting process. Not losing sight of the genuine uncertainties attaching to the costs of pension provision can help with addressing such challenges. In making these points it is of course recognized that once a best estimate basis has been settled for the preliminary valuations the consistency principle would require subsequent valuations to follow the same such basis (in the absence of compelling evidence for change).	

Annex C – Summary of changes to Directions made in response to stakeholder comments

Comment received	Change made	Direction reference (v5-0)
Questions about how changes in the average age of the scheme membership due to increases in Normal Pension Age might affect the cost cap mechanism.	The Treasury notes that there may be changes in scheme costs in the future which cannot easily be quantified at the preliminary valuation, yet may impact on the cost cap mechanism. The Treasury will therefore keep the cost cap mechanism under review. Any decisions as to whether changes such as this should feed through into the cost cap mechanism will be taken on a case by case basis. The Directions also now contain a requirement for disclosure of information on the average age of the active membership at each valuation.	21(b)
Query about the absence of any requirement for the responsible authority to consult other scheme stakeholders on the assumptions determined the by the responsible authority.	The Directions now contain the requirement that these assumptions must be determined by the responsible authority following such consultation of such persons (or representatives of persons) as the responsible authority considers appropriate.	19(b)
Query over ambiguity on the benefit structure to be valued when determining the employer cost cap.	Additional Directions have now been included to clarify how the employer cost cap should be set. These additional Directions deliver that the policy intention that the cost cap should be set ignoring the impact of transitional protection.	40, 53
Query over the treatment of the SCAPE fund roll up over the year 1 April 2009 to 31 March 2010 for Scottish Police and Scottish Fire schemes, given that employers were only charged contributions from 1	Additional Directions have now been included to allow for notional contributions to be credited to these schemes for the period from 1 April 2009 to 31 March 2010. This will prevent a deficit arising as a consequence of employers not paying contributions over this period.	45, 46

April 2010.		
Comment that the Direction on the implementation date for the preliminary valuation for public body schemes may not align with the dates that schemes reform.	The Directions now allow the relevant public authority more discretion over the timing of the implementation of the preliminary valuation.	52(5)(b)
Ambiguity over how the Direction for the responsible authority to set a commutation assumption should be interpreted given the latest draft specifies 15% in certain circumstances.	The relevant Direction has expanded to clarify how it should be interpreted.	19(e)(iv)