



HM TREASURY

Julian Kelly
Director General, Public Spending and Finance

[REDACTED]
[REDACTED]
[REDACTED]
1 Horse Guards Road
London
SW1A 2HQ
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Trevor Llanwarne
Trevor.Llanwarne@gad.gov.uk
(Via email)

Dear Trevor

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

Thank you for your letter of 21 May which set out your professional opinion on proposed amendments to the Treasury's Directions on valuations and the employer cost cap in the public service pension schemes. I can confirm that the Directions were amended to incorporate these changes on 2 June 2014.

2. As has been noted in our previous correspondence, the Treasury recognises that it is important that these Directions are kept under review in order to ensure that they deliver the Government's policy with regard to the valuations and the employer cost cap. As a result of these review processes, and as further work on specific scheme valuations has progressed, some further technical issues have emerged. These issues necessitate three further groups of amendments to the Directions.

Group A – calculating the employer cost cap for the Judicial Pension Scheme

3. The first set of amendments is required to deliver the Government's policy intention that the employer cost cap mechanism will be triggered only by unexpected changes to scheme costs¹. Average member contribution rates are used to calculate the level of the employer cost cap at the preliminary valuation, and are used in calculations of the "cost cap cost of the scheme" to determine whether the employer cost cap mechanism has been triggered at subsequent valuations. These amendments relate to the way that these average member contribution rates are determined.

¹ Paragraph 2.21 of "Public Service Pensions: actuarial valuations and the employer cost cap mechanism" published in March 2014.

4. Apart from the judiciary, the proposed new scheme designs for all the public service workforces² (where member contributions are paid) specify a fixed average member contribution rate, expressed as a percentage of pensionable payroll. This will ensure that variations in average member contribution rates (either expected or unexpected) cannot trigger the employer cost cap mechanism and so ensures that the Directions meet the Government's policy intention.

5. However the proposed new scheme design for the judiciary does not specify a fixed average member contribution rate³. Moreover, because many members of the existing pension schemes for the judiciary will be entitled to transitional protection⁴ and remain in the existing judicial pension schemes⁵, and because the existing pension schemes for the judiciary have lower member contribution rates than the new judicial pension scheme⁶, the average member contribution rate used in the employer cost cap mechanism for the judiciary is expected to drift upwards as an increasing proportion of the workforce are in the new scheme.

6. Current estimates suggest that by the time the entire workforce is in the new scheme the average member contribution rate will have increased by 1.7% of pensionable pay (all other things being equal). So without these amendments the increasing proportion of the workforce in the new scheme is expected to result in a significant pressure on the employer cost cap mechanism at future valuations. This would be inconsistent with the Government's policy intention i.e. that there should not be a position where there is a clear expectation now that the employer cost cap will come under significant pressure in the future arising out of changing proportions of the workforce that are in the new and old schemes.

7. To ensure that the Directions meet the Government's policy intention, I therefore propose bringing forward amendments to the Directions, as detailed in paragraphs 4 to 6 of the amending Directions, attached as an Annex to this letter. These amendments specify that, for the purpose of calculating the employer cost cap for the judicial scheme at the preliminary valuation and for the purpose of calculating the cost cap cost of the scheme at subsequent valuations, the average contribution rate paid by the members of the judiciary should be calculated as if no members of the judiciary had any entitlement to transitional protection.

2 Set out in the third column of Schedule 3 of the Directions.

3 Instead the average member contribution rates for the judiciary have been determined having regard to the rates in the PCSPS.

4 Those judges who, as of 1 April 2012, had 10 years or less until they reach their Normal Pension Age (NPA) will see no change in when they can retire, or any decrease in the amount of pension they receive at their current NPA, and those who on 1 April 2012 were between 10 and 13.5 years until NPA will receive tapering protection unless they exercise an option to go into the new scheme.

5 In the main, these schemes are established by the Judicial Pensions Act 1981 and the Judicial pensions and Retirement Act 1993. However, there are a number of smaller judicial schemes which will also continue to provide judicial pensions – please see Schedule 5 of the Public service pensions Act 2013 for a full list.

6 To ensure that, once the tax relief on contributions payable to the new scheme is taken into account, members pay similar contribution rates regardless of which scheme they are in (because the existing pension schemes for the judiciary are not registered for tax purposes).



Group B – clarifying the scope of the Directions with regard to the Judicial Pension Scheme

8. As the valuations have progressed, it has come to light that the legislative reference in Schedule 1 of the Directions needs to be amended to clarify the scope of the Directions with regard to the pension arrangements for members of the judiciary.

9. Schedule 1 of the Directions lists those schemes which are to be regarded as connected schemes for the purpose of conducting scheme valuations and includes the Judicial Pensions Act 1981 and the Judicial Pensions and Retirement Act 1993. Under section 11 of the Public Service Pensions Act 2013, the Treasury Directions may only direct how the valuations of defined benefit (DB) schemes are to be carried out, and cannot go so far as to direct the valuations of defined contribution (DC) schemes (notwithstanding that the Public Service Pensions Act 2013 permits scheme regulations to require DC schemes to be valued in line with directions).

10. Members of the judiciary may access DC arrangements within the existing judicial pension schemes alongside the main DB sections of the existing judicial pension schemes. These DC arrangements are established by regulations made under the Judicial Pensions Act 1981 and the Judicial Pensions and Retirement Act 1993. Since both of these Acts, and their subsidiary legislation, are in scope of the valuations, and as such are listed in Schedule 1 of the Directions, this means that, as currently drafted, the Directions would also bring those DC arrangements which are also established by these regulations into the scope of the valuations. However, consistent with the vires of the Direction-making power, it is Treasury's policy intention that only DB schemes are to be treated as connected schemes for the purpose of scheme valuations. This is because DC arrangements within public service pension schemes do not leave the taxpayer with any of the risks which the cost cap mechanism is designed to control.

11. The proposed set of amendments, as detailed in paragraphs 2 and 7 of the amending Directions, is intended to clarify this position by making it explicit that these DC arrangements are not in scope of the Directions or the valuations process. These amendments will ensure that the drafting of the Directions is in line with the Public Service Pensions Act 2013, and deliver the Treasury's policy intention that only DB schemes are to be treated as connected schemes for the purpose of scheme valuations.

12. The need for these amendments only affects the judiciary since none of the other existing schemes listed in the second column of schedule 1 of the Directions include any provisions for DC arrangements.

Group C – amendment to Schedule 3 – Preliminary Valuation – in respect of the Local Government Pension Scheme (England and Wales)



13. Finally, a minor change is required to correct the legislative reference in Schedule 3 which relates to the preliminary valuation of the pension scheme for local government workers in England and Wales.

14. Column 3 of Schedule 3 lists the details of the proposed new pension schemes which are to be valued as part of the preliminary valuation. In relation to local government workers, the schedule includes a reference to the Local Government Pension Scheme Joint Statement of 31 May 2012, and 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. At the time the Directions were drafted, it was intended that all provision for the new scheme would be contained in the 2013 Regulations. However, this has turned out not to be the case.

15. It has now come to light that, additional provision for the new scheme for local government workers has now been made via the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014, in addition to the 2013 Regulations already listed in Schedule 3. The proposed amendments, as detailed in paragraphs 8 and 9 of the amending Directions, therefore inserts a reference to the 2014 Regulations into Schedule 3, and updates the reference more generally.

16. Without these amendments the preliminary valuation of the new scheme for local government workers would only capture part of the benefits which make up the new pension arrangements for local government workers – including these amendments ensures that the entire scheme is taken into account when setting the employer cost cap for the local government workers in England and Wales.

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

Yours sincerely

A solid black rectangular box redacting the signature of Julian Kelly.

Julian Kelly



Annex – Proposed amending Directions

The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) (No. 2) 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.

Citation and entry into force

1. These Directions may be cited as the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) (No. 2) Directions 2014, and come into force on the date that they are signed.

Amendment of the 2014 Directions

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

3. In direction 3 (meaning of “a scheme”), add to the end of paragraph (2) “, unless an exception is indicated in that Schedule”

4. In direction 31, renumber the existing text as paragraph (1) and add as paragraph (2)–

“(2) For the purpose of calculating the contribution yield of paragraph 1 for a scheme providing benefits to members of the judiciary, the contribution yield should be determined as if no members of the scheme have any entitlement to exceptions made under sections 18(5) to (7) of the 2013 Act.”

5. In direction 53(5), substitute “the contribution rate” with “A”.

6. Add as direction 53(7)–

“(7) For the purpose of calculating B in paragraph (1) for a scheme providing benefits to members of the judiciary, the contribution yield expected from normal member contributions to the relevant old scheme during 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.”

7. In the second row of the table in Schedule 1 (the judiciary), add at the end of the entry in second column “*Exception:* The scheme constituted by regulation 1.3 (insofar as that regulation relates to Part II) and Part II of the Judicial Pension (Additional Voluntary Contributions) Regulations 1995”.

8. In the third row of the table in Schedule 1 (local government workers (England and Wales)), substitute the entry in the second column with “The scheme established in the Local Government Pension Scheme Regulations 2013 and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014, insofar as those Regulations are not deemed to be a scheme made under section 1 of the 2013 Act by section 28 of that Act”.

9. In the third row of the table in Schedule 3 (local government workers (England and Wales))–

- (a) substitute the entry in the second column with “The scheme established in the Local Government Pension Scheme Regulations 2013 and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014, insofar as

(a) 2013 c. 25.

those Regulations are not deemed to be a scheme made under section 1 of the 2013 Act by section 28 of that Act”; and

- (b) substitute the entry in the third column with “The scheme established in the Local Government Pension Scheme Regulations 2013 and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014, insofar as those Regulations are deemed to be a scheme made under section 1 of the 2013 Act by section 28 of that Act”.

Signed

[X] August 2014

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