



# HM TREASURY

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13 February 2019

Martin Clarke  
Government Actuary  
Via email

Dear Martin

## Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2019

1. I am writing following the Chief Secretary to the Treasury's written statement of 30 January concerning public service pensions. The Chief Secretary announced that the cost cap element of the public service pension scheme valuations is to be paused in light of the potentially significant but uncertain impact of the Court of Appeal judgment concerning the transitional protection arrangements in the schemes.
2. A mechanism for assessing the value of pensions (the cost control mechanism) was introduced as part of the 2015 reforms to public service pensions. As set out in the Chief Secretary's statement of September last year, provisional results indicated that the cost control mechanism would be engaged, triggering automatic changes to member benefits.
3. The cost control mechanism is concerned with the value of the past and future benefits of all active employees. However, given the Court of Appeal judgment, it is not now possible to assess the value of the current public service pension arrangements with any certainty. It is therefore prudent to pause this part of the valuations until there is certainty about the value of pensions to employees from April 2015 onwards. Ministers consider that the public interest is best served by pausing until that uncertainty is removed.
4. HM Treasury officials have considered how best to implement a pause of the cost control mechanism. Sections 11 and 12 of the Public Service Pensions Act 2013 (the Act) enable HM Treasury to make Directions regarding valuations of the public service pension schemes made under that Act, and relevant connected schemes. We have concluded that amendments to the Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014 (the

directions) are necessary to ensure that the cost control mechanism element of the valuations is paused.

5. The effect of the directions is to remove requirements requiring notification of movements in the cost control mechanism. So, for example, the amending directions remove the requirement for valuation reports to calculate and disclose the cost cap cost of the scheme. The proposed amending directions are at Annex A of this letter. Annex B of this letter includes a technical explanation of the proposed amending directions.
6. The Government continues to believe that the transitional protection elements of the public service pension reforms were appropriate, justified and lawful, and is seeking permission to appeal the Court of Appeal's decision. If the Government is successful, we will reinstate the cost control mechanism and require schemes to implement steps necessary to rectify any consequent cost cap breaches.
7. The Chief Secretary confirmed that, in order to ensure employers are meeting the increased costs of providing pensions, the part of the valuations of the unfunded schemes which sets employer contributions will continue. The proposed directions therefore also provide for employer contribution rates to continue to be calculated on the basis of meeting those increased costs.
8. The Government's reasons for proceeding to implement employer contribution rates including an amount to reflect assumed changes in costs arising from the rectification of provisional cost control mechanism breaches are threefold:
  - a. whether or not Government are ultimately successful in the ongoing litigation, the generosity of the benefits provided in the public service pensions is expected to increase;
  - b. if we do not implement this element of the increase to the employer contribution rate, we estimate that significant deficits would build up in the schemes over the next valuation period; and
  - c. Government has already set aside £4.7bn for the financial year 2019/20 to support departments to manage the unforeseen additional pension costs arising from the valuations (in addition to £1.25bn already allocated to the NHS).
9. The changes to the directions will therefore require employer contribution rates to be calculated on the assumption that steps to remedy any provisional movement in the cost control mechanism are implemented with effect from April 2019. Whilst we recognise that these calculations will be based on assumed benefits the Government's view is that ignoring the fact that employers' pension costs will increase one way or another would be imprudent.
10. I am grateful to your team for the many months of work that have already gone into the valuations. I recognise that these changes will require steps to revise the final draft valuation reports and that departments responsible for the schemes need that work to be completed urgently so they, and other employers



that participate in the schemes, can finalise their contribution rates payable from April 2019. I would be grateful for your support in ensuring that changes can be made as expediently as possible. For our part, we will ensure that the directions are in place as soon as possible to allow this important work to conclude.

11. I would therefore be grateful if you could offer your professional opinion on the proposed amending directions. In particular, I would welcome your views on the policy approach set out above and whether the directions are technically complete and coherent.
12. When considering the proposed directions it may be helpful to note that our over-arching policy, principles and objectives for valuations, which we have discussed in our previous correspondence on the directions, remain unchanged. The purpose of these amending directions is to ensure that valuation reports can support proposals for employer contribution rates from April 2019 whilst not triggering the cost control mechanism while there is uncertainty over benefit levels.
13. It would be helpful if you were able to let me have your professional opinion by 14 February.

Yours sincerely



**Conrad Smewing**





## The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment and Savings) Directions 2019

The Treasury make the following Directions in exercise of the powers conferred on them by sections 11(2) and 12(3) of the Public Service Pensions Act 2013<sup>(a)</sup>.

### Citation and entry into force

1. These Directions may be cited as the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment and Savings) Directions 2019, and come into force the day after the day on which they are made.

### Amendment of the 2014 Directions

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

### Amendment of Part 1

3. In direction 2 (interpretation)—

(a) at the appropriate places insert—

““corrected employer contribution rate” means the contribution rate calculated in accordance with direction 43A;”

““employer contribution correction cost” means the contribution rate calculated in accordance with direction 42;”

““preliminary valuation” means a valuation carried out in accordance with Part 3 of these Directions as they were in force prior to 14 February 2019;”

““uncorrected employer contribution rate” means the contribution rate calculated in accordance with direction 29;”;

(b) omit the definition of “cost cap cost of the scheme”;

(c) in the definition of “cost cap fund”, omit the words from “, used to determine” to “contribution rate.”;

(d) in the definition of “cost cap future service cost”, for “cost cap cost of the scheme” substitute “employer contribution correction cost”;

(e) in the definition of “cost cap past service cost”, for “cost cap cost of the scheme” substitute “employer contribution correction cost”;

(f) omit the definition of “employer contribution rate”;

(g) omit the definition of “employer cost cap”;

(h) in the definition of “implementation period”, before “employer contribution” insert “uncorrected”;

(i) in the definition of “notional assets”, before “employer contribution” insert “uncorrected”;

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(a) 2013 c. 25.

- (j) in the definition of “proposed employer cost cap”, for “direction 53” substitute “a preliminary valuation”;
- (k) omit the definition of “relevant old scheme”;
- (l) in the definition of “valuation report”, for “23” substitute “22”;
- (m) in the definition of “valuation results”, for “directions 22 and 23; and” substitute “direction 22;”.

## **Amendment of Part 2**

- 4. In direction 3 (meaning of “a scheme”), omit paragraph (2).
- 5.—(1) In direction 22(f) (contents of the valuation report: employer contribution rates), before “employer contribution” insert “uncorrected”.
  - (2) After direction 22(f), insert—
    - “(g) the corrected employer contribution rate calculated in accordance with direction 43A.”.
- 6. Omit direction 23 (contents of the valuation report: cost cap).
- 7. In direction 25 (notional assets)—
  - (a) in the definition of “A”, omit paragraph (b);
  - (b) in the definition of “B”, omit paragraph (b);
  - (c) in the definition of “C”, omit paragraph (b);
  - (d) in the definition of “D”, omit paragraph (b).
- 8. In direction 26 (information about the notional assets)—
  - (a) omit sub-paragraph (1)(b);
  - (b) omit sub-paragraph (2)(b).
- 9.—(1) In the heading to direction 29 (employer contribution rate), for “Employer” substitute “Uncorrected employer”.
  - (2) In direction 29(1), before “employer” insert “uncorrected”.
  - (3) Omit directions 29(2) to (4).
- 10.—(1) In the section heading before direction 30 (prior value of the cost cap fund), for “cost cap of the scheme” substitute “employer contribution rate correction”.
  - (2) In direction 30(1)(b)(ii), omit the words “of the scheme” to “cost cap”.
  - (3) Omit direction 30(2).
- 11. For direction 31(1) (cost cap contribution yield), substitute—
  - “31.—(1) For the first valuation of the scheme the cost cap contribution yield must be calculated, to the nearest 0.1% of pensionable pay, as the contribution yield expected from member contributions to the scheme during the implementation period.”.
- 12.—(1) In direction 32(2) (cost cap fund contribution rate)—
  - (a) before “employer cost cap” insert “proposed”;
  - (b) omit the words “in accordance with Part 3 of these Directions”.
  - (2) Omit directions 32(3) and (4).
- 13. In direction 33(1) (cost cap income), omit sub-paragraph (b).
- 14. In direction 34(1) (cost cap benefits paid), omit sub-paragraph (b).

15. In direction 35 (cost cap net leavers liabilities)—
- (a) in the definition of “A”, omit paragraph (b);
  - (b) in the definition of “B”, omit paragraph (b);
  - (c) omit direction 35(2)(f); and
  - (d) omit direction 35(3).
16. In direction 36(1) (cost cap notional investment returns), omit sub-paragraph (b).
17. Omit direction 38 (change in value of the cost cap fund).
18. In direction 39 (cost cap liabilities), omit paragraph (2).
19. In direction 40(4) (cost cap future service cost), for “relevant old scheme” substitute “relevant existing scheme”.
- 20.—(1) For the heading to direction 42 (cost cap of the scheme), substitute “Employer contribution correction cost”.
- (2) In direction 42, for “cost cap cost of the scheme” substitute “employer contribution correction cost”.
21. In direction 42A (cost cap difference), omit “in accordance with direction 53”.
22. Omit direction 43 (cost cap analysis).
23. After direction 43, insert—
- “Corrected employer contribution rate**
- 43A.** The corrected employer contribution rate must be calculated in accordance with direction 29, except that the calculation should assume that the accrual rate set in scheme regulations made under section 1 of the 2013 Act has been adjusted from 1 April 2019 to the extent necessary for the employer contribution correction cost to be equal to the target cost of that scheme.”
24. In direction 44 (application of part 2 to local government workers), omit paragraph (2).
25. In direction 47 (application of part 2 to new public body pension schemes)—
- (a) omit direction 47(3);
  - (b) in direction 47(4)(f), for “cost cap of the scheme” substitute “employer contribution correction cost”.

### **Amendment of Part 3**

26. Part 3 (employer cost cap) is omitted.

### **Amendment of Schedules**

27. Schedule 1 (connected schemes) is omitted.
28. Schedule 3 (preliminary valuation) is omitted.

### **Savings**

29.—(1) Notwithstanding the amendments made by these Directions, the Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014 continue to apply to the same effect as they had on 1 February 2019—

- (a) in relation to a preliminary valuation of a scheme providing benefits to—
  - (i) members of the judiciary;

(ii) employees of the Secret Intelligence Service or the Security Service; or

(iii) members of the National Assembly for Wales; and

(b) to the extent necessary to carry out any calculations in accordance with Part 2 of those Directions as amended.

(2) In this Direction, a ‘preliminary valuation of a scheme’ means a valuation carried out in accordance with Part 3 of the Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014 as they had effect on 14 February 2019.

Signed

14 February 2019

*Conrad Smewing*  
Director, Public Spending  
for Her Majesty’s Treasury

The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment and Savings)  
Directions 2019 – Technical Annex

Amending Directions 6 and 26

- These amendments remove the requirement for GAD to report on issues connected with the cost cap cost of the scheme, including a comparison with the employer cost cap.

Amending Direction 23

- This amendment introduces a new requirement for GAD to calculate a corrected employer contribution rate on the basis that the accrual rate in reformed CARE schemes has been adjusted from 1 April 2019, assuming a hypothetical cost cap breach.

Amending Directions 3, 5, 9, 10(1) and (2), 11, 12(1), 17 – 22, 25(b) and 28

- These amendments update the directions to reflect the change in reporting requirements required by other amendments, in particular to reflect the fact that GAD are now reporting on a corrected employer contribution rate, rather than the cost cap cost of the scheme.
- There are also necessary amendments to cross references.

Amending directions 4 and 27

- These amendments remove unnecessary provisions relating to “connected schemes” (a term defined in the Public Service Pensions Act 2013, and covered in scheme regulations).

Amending directions 7, 8, 10(3), 12(2), 13 – 16, 24 and 25(a)

- These amendments delete references to second and subsequent valuations (valuations due to take place from 2020 onwards). This reflects the fact that these amendments are intended to provide for a pause, rather than permanent changes. Further amendments to the directions will be necessary before second and subsequent valuations can be carried out.

Amending direction 29

- This amendment inserts a “saving” provision to ensure that schemes still needing to carry out (or re-run) a preliminary valuation are able to, despite these amendments omitting the relevant sections of the directions.





Government  
Actuary's  
Department

Conrad Smewing  
Director, Public Spending  
HM Treasury

*by email only*

14 February 2019

Dear Conrad

**Public Service Pensions (Valuations and Employer Cost Cap) (Amendment)  
Directions 2019**

Thank you for your letter of 13 February 2019 proposing some amending directions.

**Background and context**

In my letter to you of 22 November 2018, I set out the background to the Directions and amendments to the Directions that you proposed at that time and which were subsequently made. Since then, the Court of Appeal has handed down a judgment which could have implications for the benefits provided across the public service pension schemes. The Government then responded to that judgment in a Written Ministerial Statement (WMS).

Your letter confirms the policy approach set out in the WMS: To pause the operation of the cost control mechanisms and to implement employer contribution rates from 1 April 2019 as if the cost control mechanisms had not been paused. Your letter provides the rationale for that policy approach and explains that the proposed amending directions are intended to implement the policy approach. You ask for my views on the policy approach, my professional opinion on the amending directions and assurance that they are technically complete and coherent. I set these out below:

**1. Views on the policy approach**

In my view the policy approach to pause the operation of the cost control mechanisms is reasonable. When the reformed schemes were introduced (for most schemes in 2015) the transitional protections determined which members remained in the unreformed schemes (generally older members) and which joined the reformed schemes (generally younger members). My understanding is that the judgment finds the transitional protections, included as part of the reforms amount to unlawful discrimination. One implication of the judgment is therefore that there is significant uncertainty over which benefits have accrued to members since the reforms were introduced. In the circumstances it is reasonable to pause the cost control process (which itself can lead to benefit changes) until such time as there is clarity on the benefits which the cost control mechanisms assess.



From the Government Actuary

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The other component of the policy approach is to implement employer contribution rates from 1 April 2019 as if the cost control mechanisms had not been paused. You give three reasons in paragraph 8 of your letter that the planned employer contribution rates will better reflect employers' costs, and I agree with these. I note that the deficits mentioned in paragraph 8b would be significant as they include deficits relating to the reduction in the discount rate (around £10bn per annum - see my letter to you of 25 October 2018). Given the uncertainty around benefit levels, the planned employer contribution rates are unlikely to reflect actual employer's costs should government ultimately lose the ongoing litigation. However these rates do include an allowance for some benefit improvements and it is not unreasonable for the Government to take the view that these should be implemented from 1<sup>st</sup> April 2019. Moreover, if the Government is ultimately successful in the ongoing litigation these employer rates will reflect exactly that outcome (assuming cost cap breach rectifications are achieved by default accrual rate changes).

## **2: Professional opinion on the proposed amending directions**

In my professional opinion the proposed amending directions will enable the calculation of employer contribution rates which meet your policy objectives from a technical actuarial perspective. The question of whether the amending directions do deliver the policy approach is, of course, ultimately a legal matter.

## **3: Assurance that the Directions will be technically complete and coherent**

I have reviewed the proposed directions and have concluded that the amended Directions will be, in the round, technically complete and coherent.

I note that Direction 19 requires responsible authorities to make some valuation assumptions that are best estimates without margins for prudence or optimism. The uncertainty around the ultimate outcome of the litigation means that responsible authorities will need to satisfy themselves that the existing assumptions remain appropriate to implement revised employer contribution rates from 1 April 2019. In my view not directing an outcome and leaving responsible authorities to set these assumptions is reasonable.

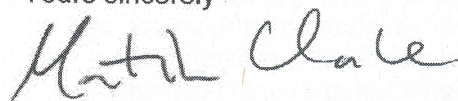
## **Next steps - valuation reports supporting employer contribution rate changes**

I agree that concluding work on the valuations is now urgent and am pleased that the Directions will soon be in place. The schemes' responsible authorities need valuation reports to ensure that their decisions on setting employer contribution rates are properly understood based on transparent, documented, actuarial advice. There are many stakeholders involved in the process to determine the employer contribution rates and GAD actuaries will work as quickly as possible with your team and departments to achieve this.

## **Compliance and third party disclaimer**

This letter has been prepared in accordance with the applicable Technical Actuarial Standards: TAS 100 and TAS 300 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK. This letter is addressed to HMT. The purpose of this letter is to give my professional opinion on the proposed amending directions. I understand that HMT intend to publish this letter. Other than HMT, no person or third party is entitled to rely on the contents of this letter, and GAD has no liability to any person or third party for any act or failure to act based on this letter.

Yours sincerely



**Martin Clarke**  
Government Actuary