Technical Bulletin

1 November 2018

Budget 2018

On 29 October, the Chancellor of the Exchequer presented his Budget 2018, setting out the government's plans for the economy and public finances. This bulletin provides a summary of certain measures announced which relate to areas in which GAD works - focusing on updates regarding HM Treasury's approval regime for contingent liabilities and the public service pension schemes.

Contingent liabilities and the Balance Sheet Review

Contingent liabilities relate to future spending which may arise if certain events happen or if particular conditions are met. As an example, payment under a government-guaranteed loan would only be required if the body covered by the guarantee was unable to repay the loan. In July 2017, HM Treasury (HMT) introduced stricter controls around issuing guarantees and other contingent liabilities which affect the public finances. The contingent liability approval framework was designed in order to ensure that policies giving rise to contingent liabilities are consistent with HMT's objective of safeguarding the sustainability of public finances.

Budget 2018 provides an update on the new approvals regime, which has now been applied to over 60 new contingent liabilities with a total value of £158 billion. Of these, the vast majority of policies were approved after significant modification to reduce exposure and £1 billion of exposure was rejected outright.

The Budget also highlights ongoing work, part of HMT's Balance Sheet Review (BSR), to explore options to improve incentives and secure appropriate compensation for the taxpayer when providing insurance to the private sector. An example of an existing arrangement which does this is Pool Re.

Pool Re - providing insurance to the private sector

Pool Re is a long-standing example of a private sector solution to a public policy objective. Established in 1993 in cooperation with HMT, Pool Re reinsures property damage and business interruption against terrorism in Great Britain. Today, the company is able to draw on over £8 billion before calling on the funding provided by HMT. Pool Re pays a reinsurance premium to HMT for the cover which they provide.

Pool Re was established following a series of terrorism incidents which led to insurers and reinsurers deciding they could no longer provide terrorism cover using traditional methods - particularly given the high potential costs of losses and the lack of any reliable method of estimating what the future loss experience might be. With potentially serious consequences for the economy if areas of business were left unprotected, it became necessary to devise a new mechanism for providing this type of cover, involving both the insurance industry and government.

Managing contingent liabilities forms one strand of the BSR, first announced at Autumn Budget 2017 (see GAD's Technical Bulletin). This review aims to improve the returns on the government's assets and reduce the costs of its liabilities. GAD continues to support the BSR, with a particular focus on contingent liabilities.

The Chancellor confirmed that the government will conduct a full Spending Review next year, to ensure that funding is directed to its priorities for the years ahead. The final conclusions of the BSR will be published at Spending Review 2019 but Budget 2018 provides a progress update on a number of other strands including:

- a commitment not to use Private Finance II (PF2) for new projects and to set up a centre of best practice in the Department of Health and Social Care to improve the management of existing PFI contracts
- detailed forecasts of the government's financial balance sheet by the Office for Budget Responsibility
- a supplementary document setting out details of how the government is looking to get a better financial, economic and social return on intellectual property and other intangible assets

Public Service Pension Schemes

Budget 2018 contained a number of announcements concerning the public service pension schemes. These schemes - such as those providing benefits to teachers, police, armed forces and NHS staff - are subject to an actuarial valuation every four years. GAD has been working with relevant government departments on the latest valuations, which typically have an effective date of 31 March 2016.

- **Benefit improvements:** Budget 2018 states that provisional results from these ongoing valuations indicate that, to maintain their value, public service pension benefits will need to be made more generous from 2019-20. GAD's September 2018 Technical Bulletin provides more information about these valuations and explains why benefit improvements are required to honour the risk-sharing mechanism introduced as part of wider reforms to public service pensions.
- **Changing the discount rate:** In September, the Chief Secretary to the Treasury provided an update to Parliament on these valuations and proposed a change in the discount rate used to assess the current cost of future payments from the schemes. Known as the SCAPE rate, this discount rate is based on the Office for Budget Responsibility's long-term projections of GDP growth and previously stood at 2.8% above the Consumer Prices Index (CPI). Budget 2018 confirms that, as proposed in September, the discount rate is reduced to 2.4% above CPI.
- **Changes to factors:** The SCAPE discount rate can affect various factors used in administering these pension schemes – for example, early retirement factors or cash equivalent transfer values. GAD is working with schemes, where necessary, to update factors in response to the change in discount rate.

Using a lower discount rate increases our assessment of the current cost of future payments. The valuations indicate that there will be additional costs to employers in providing public service pensions over the long-term. The Budget report states that the government is supporting departments to ensure that recognition of these extra costs does not jeopardise the delivery of front-line public services or put undue pressure on public employers. Budget 2018 allocates extra departmental funding to cover an expected £4.7 billion of additional costs in 2019-20. This funding supplements existing commitments in respect of the NHS and state schools.

Spending Review 2019 will settle the funding for costs beyond 2019-20 arising from the valuations. Ahead of that review, the Budget sets out a new path for public spending, with day-to-day departmental spending now growing in real terms.

Pensions policy round-up

The Budget also included a number of announcements relating to pensions policy:

- The government has published its response to DWP's consultation on regulations to implement a ban on pensions cold calling. The government intends to lay draft regulations in Parliament in the autumn and, subject to parliamentary approval, will bring them into force as soon as possible thereafter.
- DWP will consult later this year on the detailed design for Pensions Dashboards, which will allow individuals to see information on their pension pots, including their State Pension, in one place. The Budget provides additional funding of £5 million in 2019-20 to support this work.
- DWP will publish a paper in the winter setting out the government's approach to increasing pension participation and savings persistency among the self-employed.
- Budget 2018 confirmed that the Lifetime Allowance (LTA) for pensions savings for 2019-20 will increase in line with CPI, rising to £1,055,000. The Annual Allowance remains unchanged.

HMT has published a progress report, one year on from its commitment to work with the pensions industry and its regulators to unlock further long-term investment in innovative high growth firms – so-called 'patient capital'. Budget 2018 announced several measures to better enable Defined Contribution pension schemes to invest in patient capital. These include potential regulatory reforms and a commitment from industry leaders to work with the British Business Bank to explore options for pooled investment. The Pensions Regulator recently updated its investment governance guidance for trustees of Defined Contribution pension schemes who are considering investing in patient capital.

HMT's progress report also confirms that a consultation on the consolidation of Defined Benefit pension schemes will be published later in the year.

If you would like to discuss any of these issues in more detail or have any questions please get in touch with your usual GAD contact.

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