Government Actuary's Department

Local Government Pension Scheme (England and Wales)

Cost control valuation as at 31 March 2016

Cost cap valuation report

Martin Clarke
Government Actuary
22 June 2022

Michael Scanlon
Fellow of the Institute and Faculty of Actuaries
22 June 2022

Contents

In this report, terms written in ***bold italics*** are defined in the Glossary.

At GAD, we seek to achieve a high standard in all our work. We are accredited under the Institute and Faculty of Actuaries' Quality Assurance Scheme. Our website describes the standards we apply.

1. Summary

Purpose

Addressee and purpose

This report was commissioned by the Department for Levelling Up, Housing and Communities (DLUHC) and is addressed to them. We understand it will be made available to the Scheme Advisory Board.

This ***cost cap valuation report*** sets out the final result of the valuation after the consideration of the remedy of the McCloud discrimination. The separate pre-McCloud ***valuation report*** dated 20 June 2022 reflects that the cost control process was paused following the McCloud judgment. The purpose of the pre-McCloud ***valuation report*** is to set out the ***employer contribution correction cost***, an intermediate value in the cost cap valuation calculations. Both reports have been prepared in accordance with HM Treasury Directions of 7 October 2021.

No changes are required on the basis of this ***cost cap valuation report*** (see "Summary of results").

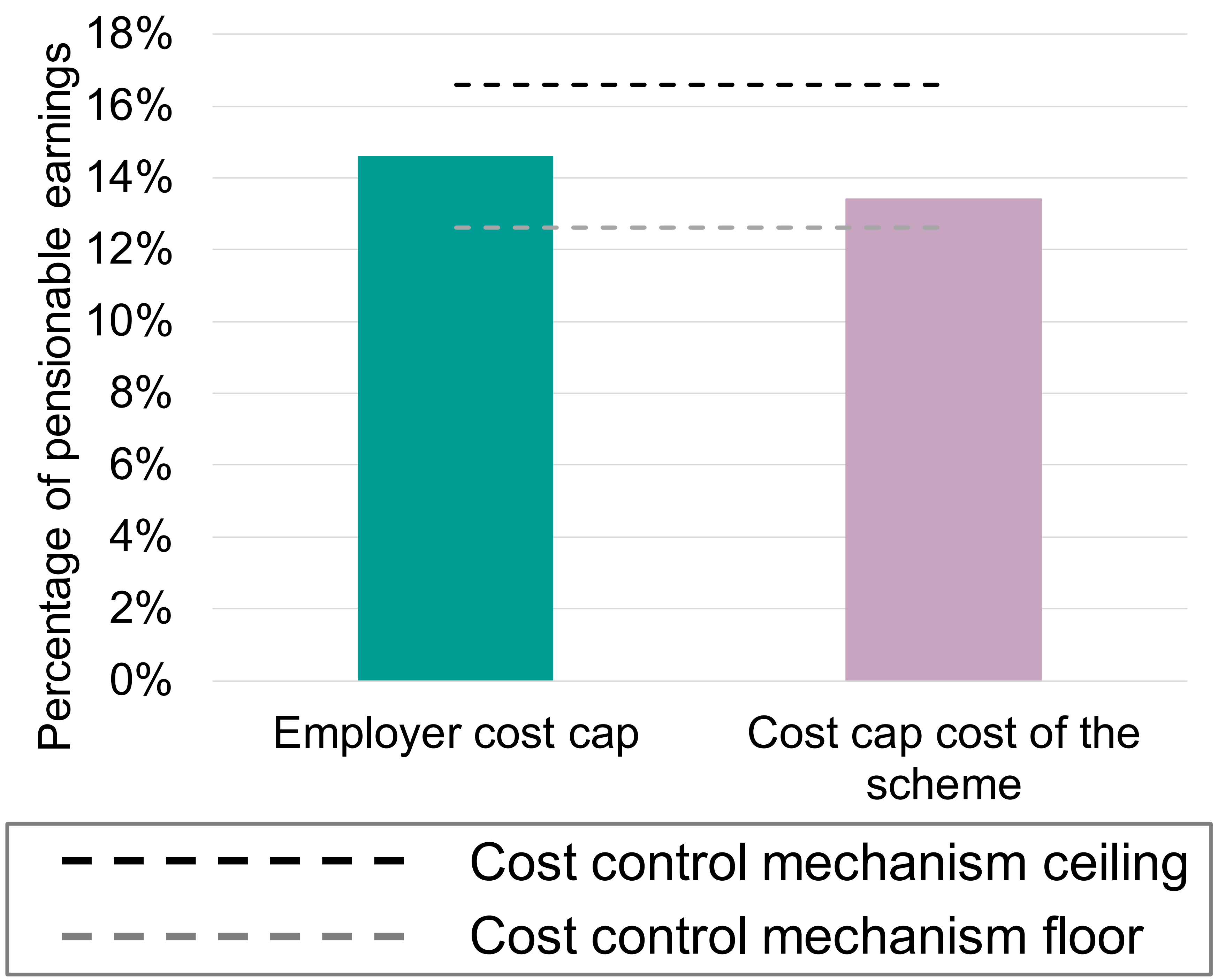
No action is required on the basis of the pre-McCloud ***valuation report***.

Background

Cost control mechanism introduced	• Established to ensure a fair balance of risks between scheme members and the taxpayer • Introduced by section 12 of Public Service Pensions Act 2013 and policy details set out in HM Treasury (HMT) paper of March 2014
2013 valuation: Employer cost cap set at 14.6% of pay	• Set in Regulation 115 of the 2013 Regulations, based on the 2013 valuation • If at subsequent valuations the cost of the scheme is outside a ±2% corridor above / below the employer cost cap, the 2013 Act requires action to be taken to bring costs back to the target cost
2016 valuation: Pause of cost control mechanism	• HMT announcement 30 January 2019: followed the McCloud/Sargeant judgment and was implemented in February 2019 by the ***Directions*** • The ***SAB cost control process*** was also paused from Feb 2019
2016 valuation: Completion of cost control mechanism	• HMT announcement 16 July 2020: the pause would be lifted and the costs of transitional protection remedy would be taken into account • The ***SAB*** completed its own ***SAB cost control process*** and chose not to recommend any scheme changes • HMT Amendment Directions dated 7 October 2021 set the detailed requirements, and further information is available in the Government Actuary's letter of 6 October 2021

Summary of results

This report has been commissioned by, and is addressed to, the Secretary of State for Levelling Up, Housing and Communities and sets out the ***cost control valuation results*** of the Local Government Pension Scheme (England and Wales) as at 31 March 2016 (see Appendix A: Reliance for further details).



The ***employer cost cap*** was determined at the 2013 valuation in accordance with section 12 of the Public Service Pensions Act 2013

The ***cost cap cost of the scheme*** is

-1.2%

below the ***employer cost cap***.

The result lies within the ± 2% corridor specified in the ***HMT regulations***.
This result means that no changes to benefits or member contributions are required.

The results of this cost cap valuation are not used to set the employer contribution rate. Employer contributions are payable in accordance with the rates and adjustments certificates issued as part of the actuarial valuations carried out by actuaries appointed by each of the scheme's 88 local administering authorities.

2. Results

Cost cap cost of the scheme

Data, assumptions and methodology

We have been instructed by the Secretary of State for Levelling Up, Housing and Communities, following consultation with relevant stakeholders, to adopt the best estimate assumptions recommended in our formal advice on the assumptions, methodology and data dated 20 June 2022. A summary of the main assumptions is set out in Appendix F of the 2016 valuation report (before allowance for McCloud – 'pre-McCloud report') dated 20 June 2022.

Calculation of the cost cap cost of the scheme

The ***cost cap cost of the scheme*** has been calculated as follows, in accordance with the ***Directions***:

Cost cap cost of the scheme	=	Employer contribution correction cost	+	Transitional protection remedy cost
13.4%		11.8%		1.6%

The calculation of the transitional protection remedy cost is set out in Appendix B.

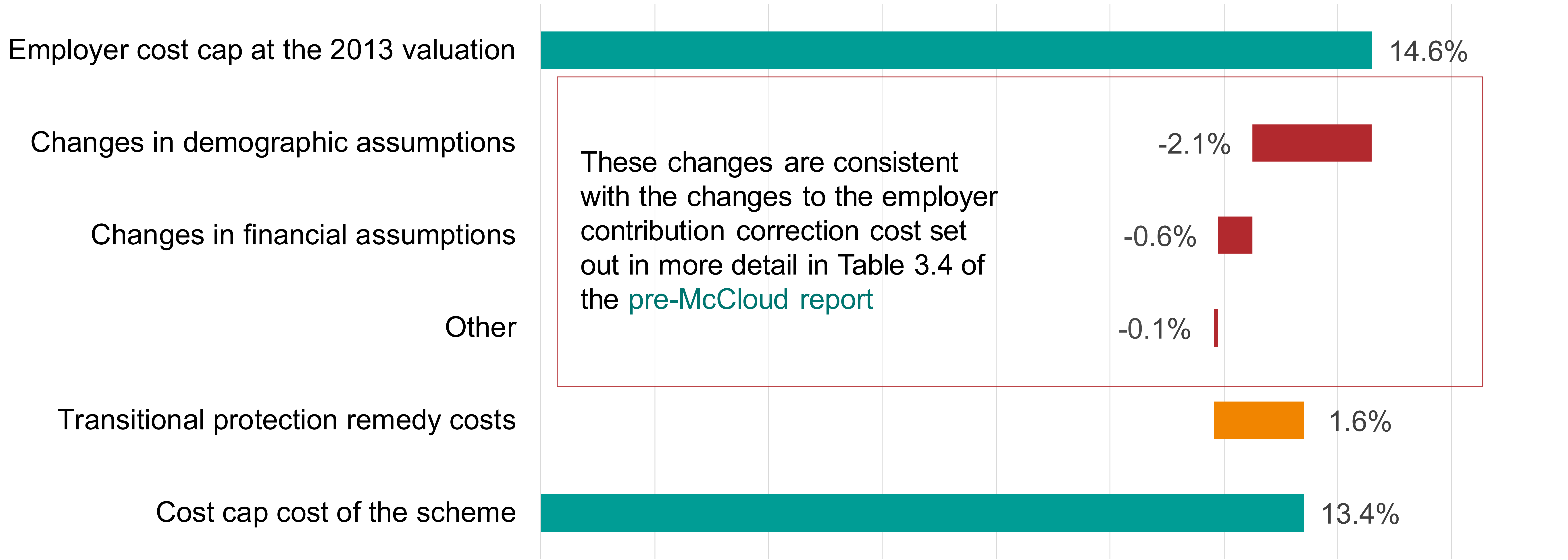
Comparison with employer cost cap

The ***cost cap cost of the scheme*** is 1.2% below the ***employer cost cap***. The ***cost cap cost of the scheme*** is within the ± 2% corridor. This result means that no changes to benefits or member contributions are required.

Cost cap cost of the scheme	13.4%
Employer cost cap	14.6%
Difference	-1.2%

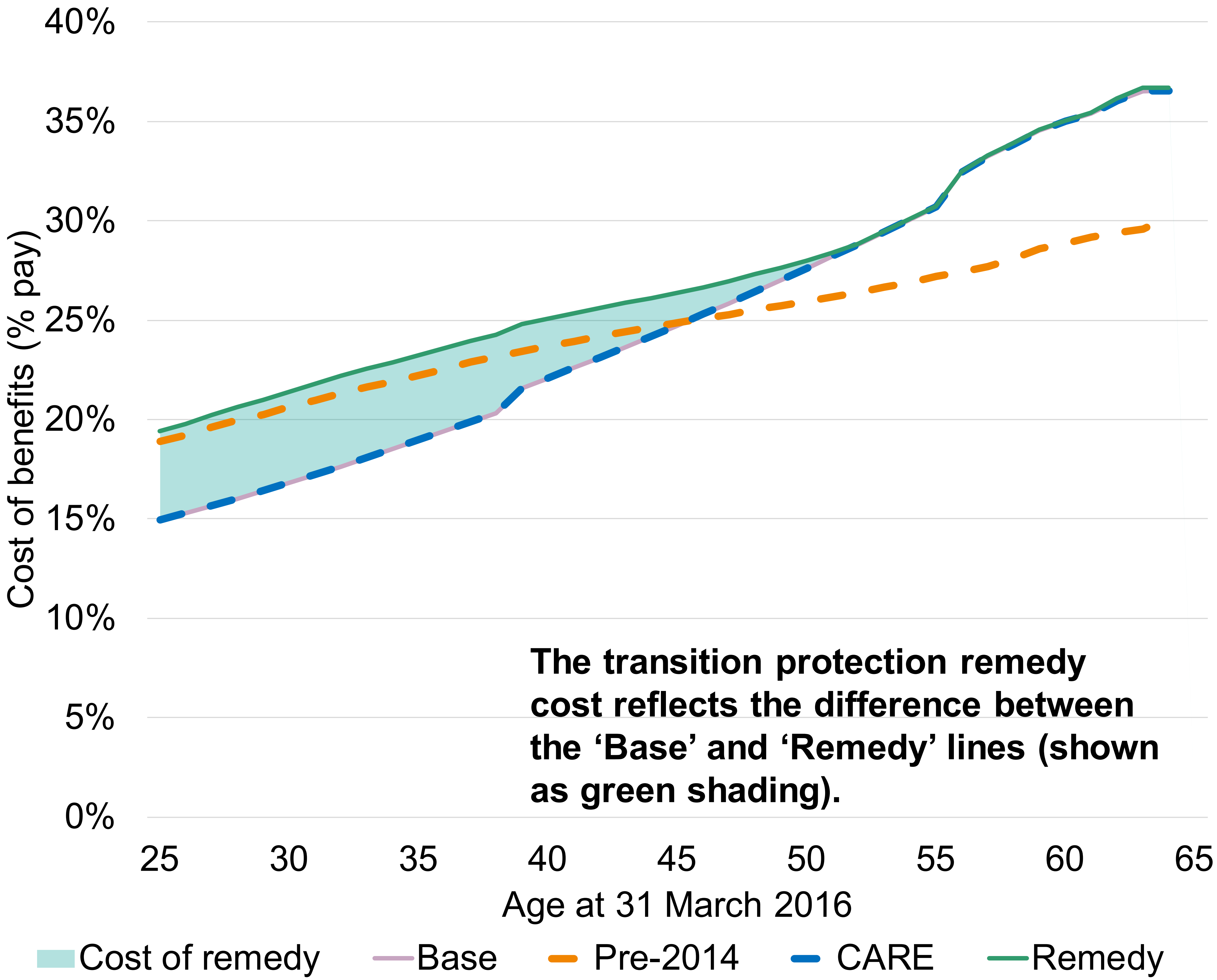
Analysis of change in cost cap cost of the scheme

The chart below shows the key reasons for the difference between the cost cap cost of the scheme and the employer cost cap. Changes in financial and demographic assumptions set by HM Treasury reduce the cost cap cost of the scheme. This is offset by an increase in the cost cap cost of the scheme driven by the transitional protection remedy costs.



Results – Cost by age

This chart shows the cost (as a percentage of pensionable salary) by age of different benefits:



The 'pre-2014' line shows the weighted average cost of the pre-2014 final salary schemes.

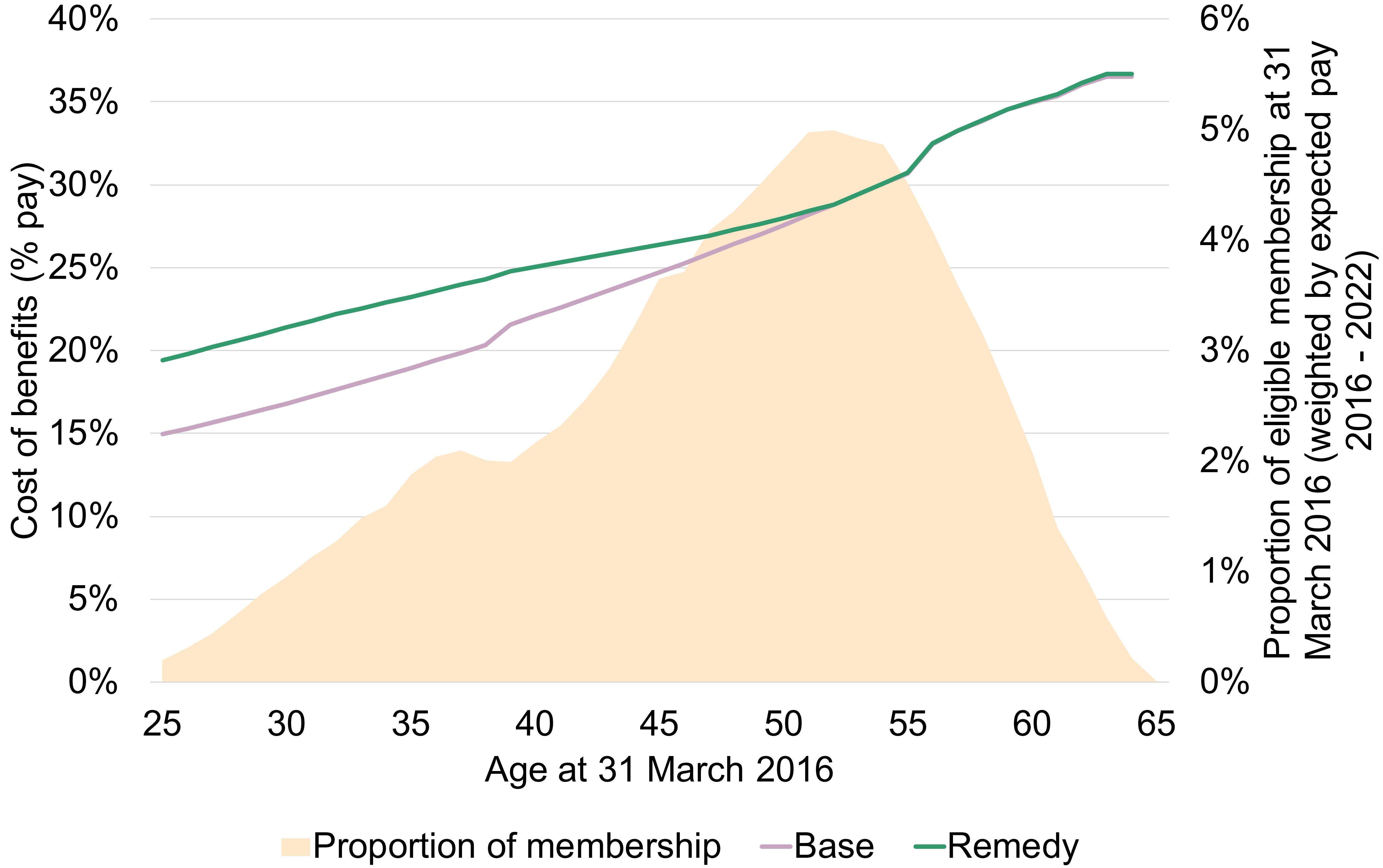
The 'CARE' line shows the cost of the post-2014 scheme – at older ages it is higher than the 'pre-2014 line' due to the higher accrual rate.

The 'Base' line shows the cost of the benefits under the existing statutory underpin. It follows the CARE line (and is partially obscured by it): younger members do not qualify for the existing underpin, benefits for older members are usually higher in the CARE scheme so the underpin does not usually bite.

The 'Remedy' line shows the impact of the LGPS transitional protection remedy: amendments to the statutory underpin. Remedy benefits can be more valuable than CARE and pre-2014, for example if CARE is better for early leavers and final salary is better for long stayers.

Results – Cost by age with membership by age

This chart shows the transitional protection remedy cost (as a percentage of pensionable salary) by age. Alongside this we can see a summary of the distribution of the eligible membership by age at 31 March 2016.



The biggest increases in cost of benefits will be for younger members where the final salary scheme is more valuable.

However, a significant proportion of the membership lies at ages where the increase in the cost of benefits is less.

3. Sensitivities

Key sensitivities

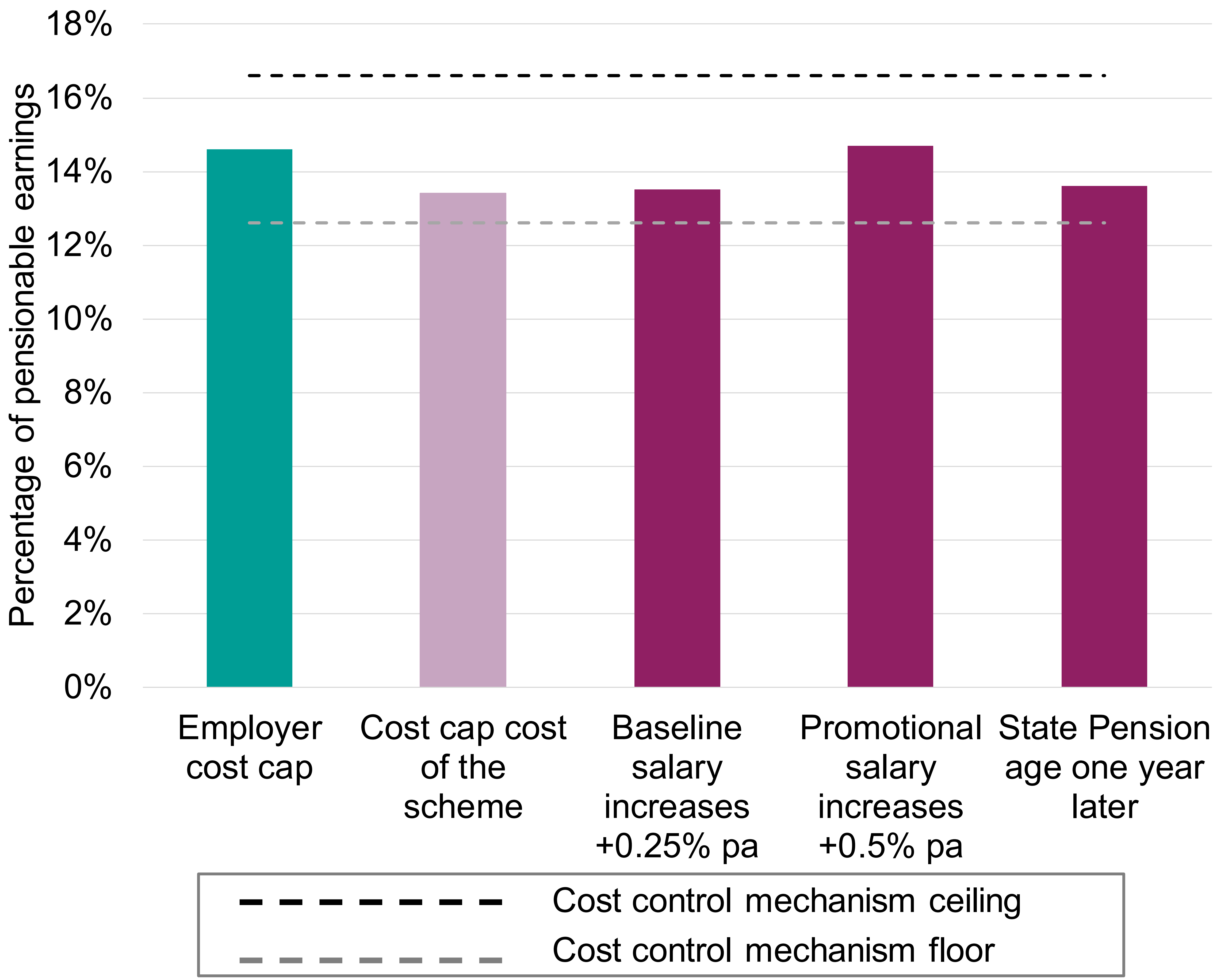
This section illustrates the main sensitivities of the cost control valuation results to the assumptions adopted, to illustrate the range of reasonable outcomes which might have been determined at this valuation had different assumptions been used.

The chart shows the employer cost cap and the cost cap valuation result from this report, then shows what the cost cap valuation result would have been if the following changes were made to the assumptions:

- Baseline salary increases +0.25%
- Promotional salary increases +0.5%
- State Pension age one year later

They are not intended to show the possible range of variation in assumptions which might be considered at future valuations and in light of future experience.

Additional information on sensitivities can be found in Appendix C.



4. Future valuations

Future valuations

Reform of cost control mechanism

- Following a review by the Government Actuary and an HMT consultation, the UK Government intends to reform the cost control mechanism as follows:
  - Move to reformed scheme only
  - Widen the cost control 'corridor' from ±2% to ±3% of pensionable pay
  - Introduce an economic check

2020 valuation

- The UK Government is aiming to implement all three proposals above in time for the 2020 valuations
- Legislation to implement these 'reform scheme only' and the 'economic check' is contained in the Public Service Pensions and Judicial Offices Act 2022; the widening of the 'corridor' will be implemented by regulations

Possible outcomes

- The full impact of the review can only be assessed once the proposals are confirmed, and detailed implementation instructions provided in the ***Directions***
- The following page sets out our high-level view of the key factors which may affect future cost control valuations

Future impact of these results

- The remedy cost calculations are subject to a number of uncertainties, including in relation to eligibility data, future salary increases, and future retirement ages
- Depending on the details of the ***Directions*** for the 2020 valuations, any difference between the actual ***transitional protection remedy cost*** as it emerges and the cost anticipated in this valuation may affect future cost control valuations

Future valuations - outcomes

The table below sets out our high-level view of the key factors which may affect the core cost control mechanism (ie excluding the economic check) at future valuations in the medium term. The table includes an assessment of the size of the impact of these factors, as well as the potential direction of the impact (ie whether it will increase or decrease costs) – further details are provided overleaf. Each item is considered separately; a combination of these items could have a larger impact than is considered likely for any of those items individually. Please see next slide for explanations of each impact.

	Factors potentially affecting results of future valuations	Potential impact on cost cap cost of the scheme, compared with employer cost cap	Direction of impact on costs to the scheme
Expected to occur	Changes allowed for in this 2016 valuation	✓	⇩
	Further anticipated changes to mortality assumptions	✓	⇩
Likely to occur	Legislative and policy changes	✓✓	⇳
	Financial and demographic experience	✓	⇳
Possible but less likely to occur	Unanticipated change in average age of the membership	✓	⇳
	Assumption changes:		
	- long term experience effects	✓	⇳
	- directed assumptions (including any further emerging change to mortality assumptions)	✓	⇳

✓ = impact may be more than 0.5% of pay but, although possible, is quite unlikely to be more than 3% of pay
✓✓ = impact may be more than 3% of pay
⇧ = increase in costs ⇩= decrease in costs ⇳= costs could increase or decrease

Future valuations - outcomes

Factors potentially affecting results of future valuations	Explanation of impact
Changes allowed for in this 2016 valuation	The employer cost cap was set based on the assumptions at the preliminary (2013) valuation. Changes to mortality and other assumptions recognised at this 2016 valuation will continue to result in downward cost pressures at the 2020 valuation (if all else remains equal).
Further anticipated changes to mortality assumptions	The latest 2020-based ONS population projections anticipate further slow downs in improvements to mortality rates, which will result in further downward cost pressures.
Legislative and policy changes	Impacts can vary based on legal challenges and legislative/policy changes.
Financial and demographic experience	If experience is not in line with the assumptions made, a gain or loss will emerge over an inter-valuation period.
Unanticipated change in average age of the membership	The future scheme membership may differ from that projected at this valuation.
Assumption changes:	
- long term experience effects	Assumption changes at future valuations, in light of scheme experience, may have substantial effects on the results.
- directed assumptions (including any further emerging change to mortality assumptions)	Some of the assumptions set in the ***Directions*** are likely to change for each valuation.

Appendices

Appendix A Reliance

This report has been prepared for the use of the Secretary of State for Levelling Up, Housing and Communities in accordance with sections 11 and 12 of the Public Service Pensions Act 2013.

The ***cost cap valuation results*** have been calculated in accordance with the requirements as to data, methodology and assumptions specified by the ***Directions***.

GAD has been appointed as scheme actuary by the Secretary of State for Levelling Up, Housing and Communities to carry out an actuarial valuation of the Local Government Pension Scheme (England and Wales) as at 31 March 2016 (the effective date), as required by Regulation 114 of the ***2013 Regulations***.

The cost cap valuation report required by the ***Directions*** comprises this report, read alongside our advice on assumptions, methodology and data, and the 2016 valuation reporting in the table below.

Area	Document
2013 Act	Sections 11 and 12 of the Public Service Pensions Act 2013
Scheme regulations	Regulations 114 and 115 of the 2013 Regulations
Directions	The Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014, as amended, including in particular amendments made by the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2021 See also the Government Actuary's letter dated 6 October 2021
Transitional protection remedy	DLUHC Consultation dated 16 July 2020
Assumptions, methodology and data	Formal advice on the assumptions, methodology and data dated 20 June 2022
2016 valuation	Published 2016 valuation reports : • Report on membership data dated 8 July 2020 • Advice on assumptions dated 3 October 2019 • Pre-McCloud report dated 20 June 2022

Appendix A Reliance

This work has been carried out 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 report has been prepared for the use of the Secretary of State for Levelling Up, Housing and Communities, to report on cost cap valuation results in accordance with sections 11 and 12 of the Public Service Pensions Act 2013. The information and advice in this report should not be relied upon, or assumed to be appropriate, for any other purpose or by any other person. In particular, this report does not provide any advice on employer contribution rates or funding. The discount rates are set in ***Directions*** and do not relate to the actual assets held. The assumptions do not take account of employer covenant.

We are content for the Secretary of State for Levelling Up, Housing and Communities to release this report to third parties, provided that:

- it is released in full;
- the advice is not quoted selectively or partially;
- GAD is identified as the source of the report, and;
- GAD is notified of such release.

Third parties whose interests may differ from those of Secretary of State for Levelling Up, Housing and Communities should be encouraged to seek their own actuarial advice where appropriate. GAD has no liability to any person or third party for any action taken or for any failure to act, either in whole or in part, on the basis of this report.

GAD is not responsible for any decision taken by Department for Levelling Up, Housing and Communities, except to the extent that the decision has been made in accordance with specific advice provided by GAD. Advice provided by GAD must be taken in context and is intended to be read and used as a whole, not in parts. GAD does not accept responsibility for advice that is altered or used selectively. No significant action should be taken based on oral advice alone. Clarification should be sought if there is any doubt about the intention or scope of advice provided by GAD.

GAD relies on the accuracy of data and information provided by the administering authorities. GAD does not accept responsibility for advice based on wrong or incomplete data or information provided by the administering authorities.

Appendix A Reliance

As required by the ***Directions***, this report is based on data as at 31 March 2016, and the assumptions are the same as those adopted in the 2016 valuation report (the pre-McCloud report). No allowance has been made for any events after 31 March 2016, except for any allowance detailed in the 2016 valuation report. In particular, there is no specific allowance for the impact of the following:

- COVID-19 (or any other pandemics)
- Any changes to benefits and member contributions (save to the extent that those benefits and member contributions are determined in accordance with the ***Directions*** to have changed as a result of the transitional protection remedy), including in particular any changes as a result of the following:
  - GMP equalisation, further to the Lloyds ruling in October 2018, including the GMP indexation changes announced in March 2021
  - Survivor benefit equalisation, relating to survivor benefits for opposite–sex widowers and surviving male civil partners as detailed in a Written Ministerial Statement made by the then Chief Secretary to the Treasury on 20 July 2020
  - Any other legal cases
- Actual public service pension increases / CARE revaluations awarded in April 2019, April 2020 and April 2021
- Development in mortality expectations, including in particular the ONS 2020-based population projections, which assumed lower life expectancy increases than the 2016-based projections

Throughout this report the totals given for summed data may not be exactly the same as the sum of the components shown due to rounding effects.

Appendix B Remedy cost

The ***Directions*** require the ***transitional protection remedy*** cost to be calculated as follows:

	Transitional protection remedy cost component	Value	
		% of pensionable earnings	£ billion
A	Change in liabilities in the remedy period	1.6%	1.8
B	Change in liabilities before the remedy period	0.0%	0
C	Change in liabilities after the remedy period	0.0%	0
D	Change in member contributions in the remedy period	0.0%	0
E	Change in member contributions after the remedy period	0.0%	0
	Transitional protection remedy cost A + B + C – (D + E)	1.6%	1.8

The ***transitional protection remedy cost*** will emerge in the form of increased pension payments over the coming decades as eligible members retire and receive their pensions.

Appendix C Sensitivities

This section illustrates the main sensitivities of the cost control valuation results to the assumptions adopted, including those set out in the ***Directions*** and those set by the Secretary of State for Levelling Up, Housing and Communities.

The table shows the sensitivities relative to the employer contribution correction cost and the transitional protection remedy costs. The ***cost cap cost of the scheme*** is the sum of these two sensitivities, as shown.

The assumptions determined by the Secretary of State for Levelling Up, Housing and Communities are set as best estimate based on available evidence. The sensitivities shown for the Secretary of State for Levelling Up, Housing and Communities determined assumptions are intended to illustrate a range of reasonable outcomes which might have been determined at this valuation had different assumptions been used. They are not intended to show the possible range of variation in assumptions which might be considered at future valuations and in light of future experience.

Directed assumptions	Increase in		
	Employer contribution correction costs	Transitional protection remedy costs	Cost cap cost of the scheme
Discount rate in excess of CPI (-0.25% pa)	-0.2%	0.1%	-0.1%
Pension increases as applicable to pensions in payment and deferred pensions (+0.25% pa)	-0.1%	0.0%	-0.1%
Long term rate of public service earnings growth in excess of CPI (+0.25% pa)	-0.2%	0.3%	0.1%

Appendix C Sensitivities

Directed assumptions	Increase in Employer contribution correction costs	Transitional protection remedy costs	Cost cap cost of the scheme
Short term rate of public service earnings growth (+0.25% pa to each short term rate)	0.2%	0.1%	0.3%
CARE revaluation rate (+0.25% pa to price measure revaluation rates)	-0.1%	-0.3%	-0.4%
Allowance for future mortality improvements (reduction in mortality improvements such that (period) life expectancy lower by around 1.25 years over a period of 75 years)	-0.9%	-0.1%	-1.0%
State Pension age (SPa for 2014 scheme one year later than under current Directions)	-0.8%	0.5%	-0.3%
Allowance for commutation as directed (additional 2% of pension assumed to be commuted for cash)	-0.2%	0.0%	-0.2%
Shortfall spreading period (spreading period increased by 5 years)	0.3%	-0.9%	-0.6%

Appendix C Sensitivities

Assumptions set by Secretary of State for Levelling Up, Housing and Communities	Employer contribution correction costs	Increase in Transitional protection remedy costs	Cost cap cost of the scheme
Membership profile (2 years older on average over implementation period)	1.1%	-0.4%	0.7%
Mortality rates (5%* heavier rates of pensioner mortality)	-0.5%	0.0%	-0.5%
Age retirement rates (Members without underpin assumed to retire one year later)	0.0%	0.2%	0.2%
Commutation, other than as directed (Members commute 2% of pension more than assumed in respect of pre-2008 service, keep 17.5% assumption for post-2008 service)	-0.2%	0.0%	-0.2%
Ill-health retirement (5%* increase to assumed rates)	0.1%	0.0%	0.1%
Ill-health retirement (5%* increase in proportion assumed to receive higher tier benefits)	0.0%	0.0%	0.0%
Proportions partnered (5%* more members assumed to have qualifying partners at death	0.1%	0.0%	0.1%
Resignations and opt outs (5%* higher numbers assumed to leave voluntarily before retirement net of rejoiners)	0.0%	-0.1%	-0.1%
Promotional pay increases (0.5% higher promotional pay increases than assumed)	0.4%	0.9%	1.3%

* All these represent multiplicative increases to rates, i.e. 5% means rates 1.05 times higher

Appendix D Glossary

Many of the terms below are defined by regulations and in such cases this glossary is intended to assist in understanding.

Transitional protection remedy/remedy, also known as the ‘McCloud / Sargeant remedy’ means benefit changes resulting from the Court of Appeal of England and Wales ruling on 20 December 2018 in relation to the McCloud judgment, as set out in Direction 49(2) of the ***Directions***.

The ***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. Apart from the impact of the **transitional protection remedy**, the ***cost cap cost of the scheme*** is set out in more detail in the completed 2016 valuation reporting.

The ***employer cost cap*** is the contribution rate, as determined at the 2013 valuation, to cover the cost of benefits accruing over the implementation period as if all active members were in the Post-2014 scheme and had no pre-2014 scheme service, minus the expected average contribution rate payable by members over the implementation period. This can be thought of as a baseline cost for the scheme under the cost control mechanism.

Pensionable earnings is the part of pay that is included for the purposes of determining contribution requirements and benefit payments.

Appendix D Glossary

The ***2013 Act*** means the Public Service Pensions Act 2013.

The ***2013 Regulations*** means the Local Government Pension Scheme Regulations 2013 (SI 2013 No 2356).

The ***Directions*** means The Public Service Pensions (Valuations and Employer Cost Cap) Directions 2014, as amended, including in particular amendments made by the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2021.

HMT regulations means the Public Service Pensions (Employer Cost Cap) Regulations 2014.

SAB means the Local Government Pension Scheme Advisory Board which advises the Secretary of State for Levelling Up, Housing and Communities on the desirability of making changes to the scheme.

SAB cost control process refers to the process to manage costs in the scheme alongside the process introduced by HM Treasury for all public service schemes, which the ***SAB*** has a duty to maintain under ***2013 Regulations*** regulation 116.