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Public service pensions - employer contributions

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Summary

The main public service pension schemes (other than the Local Government Pension Scheme) are unfunded and operate on a pay-as-you-go basis - whereby contributions are paid to the sponsoring government department which meets the cost of pensions in payment, netting off contributions received.

The unfunded schemes are subject to actuarial valuation every four years. The purpose is to assess the value of pension rights being built up, so that total contributions (from employers and employees) can be set at a level to reflect this. The valuations must be undertaken in accordance with Treasury directions which, among other things, specify the 'discount rate' that should be applied in order to assess the present costs of future benefits. (*Public Service Pensions Act 2013,* s11)

Discounting is a technique that takes account of time preference by "discounting" (or reducing) the amount of future payments, to express them in today's terms. In funded schemes, discount rates sometimes reflect the anticipated investment return on a portfolio of assets – so that the discounted value of future payments represents the amount of money that needs to be invested today in order to meet those future payments. For the unfunded public service pension schemes, the Government has developed the SCAPE discount rate (HM Treasury, Consultation on the discount rate etc, December 2010, ch 2).

The Government announced reductions in the SCAPE discount rate in 2016 and 2018:

- In Budget 2016 – it announced a reduction from 3% to 2.8%, with effect from April 2019. It estimated that this would cost £1.97 bn in 2019/20 and £2.005 bn in 2020/21;
- In September 2018 – it proposed a further reduction to 2.4% from April 2019 (HCWS 6 September 2018 c13WS; letter to the TUC).

Keeping all other assumptions unchanged, a lower discount rate would result in higher contribution rates at the next scheme valuations. In September, the Government said that departments and devolved administrations would need to meet the increase in costs from the 2016 Budget announcement in full. It would support them with the increased cost resulting from the 2018 announcement in the 2019/20, but not necessarily beyond that:

> This is because of proposed changes to the discount rate, which is used to assess the current cost of future payments from the schemes, to reflect the Office for Budget Responsibility's long-term growth forecasts. Further details will be known later this year. Some increase in costs was anticipated at Budget 2016, which Departments and the devolved administrations will need to meet in full. The Treasury will be supporting Departments with any unforeseen costs for 2019-20. Further discussions will be taken forward as part of the spending review. (HC Deb 6 September 2018 c13WS)

In Budget 2018, the Government confirmed the reduction to 2.4% and that it would fund government departments with the additional costs deriving from the 2018 announcement for 2019/20 but not necessarily beyond that (except in the case of the NHS, where it had made provision until 2023-24):

> 1.60 The government is supporting departments to ensure that recognition of these costs does not jeopardise the delivery of frontline public services or put undue pressure on public employers. For the NHS, as outlined in the five-year health settlement in England in June 2018, the Treasury has made provision for NHS pension costs until 2023-24. For state schools, the Department of Education are proposing to provide more funding to cover pension costs for the rest of this Spending Review period. To supplement this, the Budget allocates extra DEL to the reserve for 2019-20

> to cover an expected £4.7 billion of additional costs. The Spending Review next year will settle the funding for costs beyond 2019-20 arising from the valuations.

Public sector employers have expressed concern about the impact, particularly in relation to the schemes for police and firefighters. The Home Office announced the support it would provide for police authorities in England and Wales for 2019/20 on 13 December 2018.

In response to its consultation on proposals to support education institutions in April 2019, the Department for Education set out the funding it would provide to support state-funded schools and FE colleges with the additional costs in 2019/20. Decisions beyond that would be taken in the Spending Review. It had decided not to provide additional funding for HE institutions or for independent schools but would consider allowing independent schools to leave the Teachers' Pension Scheme via a phased withdrawal.

Funding for institutions in devolved administrations is a matter for those governments.

The issue of the employer cost cap mechanism which relates to the costs relating to member profiles (e.g. assumptions relating to longevity and earnings growth) is discussed in CBP-6971 Public service pensions – employer cost cap (Feb 2019).

1. Background

The six main public service schemes (other than the local government scheme) i.e. the schemes for teachers, NHS, police, firefighters, armed forces and civil servants – are unfunded. This means that they operate on a pay-as-you-go (PAYG) basis, which means there is no fund of assets which is invested and from which pension benefits are paid. Employer and employee contributions are paid to the sponsoring government department but these contributions are not invested. Instead, the sponsoring government department pays benefits to pensioner members, netting off the contributions received.[1]

The discount rate

A figure used to convert future cash flows into a single figure in today's terms. It is the equivalent of working out how much needs to be invested today in order to pay a promised level of benefits in, say, ten years' time.

Reforms to these schemes were introduced from 2015 under the *Public Service Pensions Act 2013*. Key features of these reforms were that new scheme were introduced providing pension benefits on the basis of Career Average Revalued Earnings rather than final salary and (except in the schemes for the police, firefighters and armed forces) individuals have a pension age linked to their State Pension age. The background to these reforms is discussed in Library Briefing Paper SN-5768 (October 2012).

1.1 Scheme valuations

The unfunded public service pension schemes are subject to regular actuarial valuations (every 4 years) at which the value today of pension benefits that will be paid in the future is assessed. For the unfunded schemes, the purpose of carrying out valuations is to ensure that contributions from employers and employees are set at a level to reflect the future value of benefits being earned. This is so that "the full costs of the scheme are taken into account when financial decisions are made by employers."[2]

Treasury Directions, made under the *Public Service Pensions Act 2013*, provide the legal framework for carrying out these valuations.[3] These directions may specify key details on how valuations should be carried out, including:

- how and when the valuation is to be carried out;
- the time periods over which a valuation will measure a scheme's assets and liabilities;
- the data, methodology and assumptions to be used in valuations;
- the matters that must be covered by the valuations (which may relate to the outputs that must be produced);
- how valuations of new and connected schemes will be combined, where they are to be valued together; and

[1] PPI, an assessment of the Government's reforms to public sector pensions, October 2008, p7
[2] HM Treasury, Public service pensions: actuarial valuations and the employer cost cap mechanism, March 2014
[3] Section 11

- the time period for implementing changes to the employer contribution rate as a result of the outputs of the valuation[4]

HM Treasury is required to consult the Government Actuary before making, revoking or amending directions.[5]

1.2 The SCAPE discount rate

A discount rate is figure used to convert future cash flows into a single figure in today's terms. It is the equivalent of working out how much needs to be invested today in order to pay a promised level of benefits in, say, ten years' time. It is the opposite of compound interest. The interim report of the Independent Public Service Pensions Commission included the following explanation:

> Pensions are long-term commitments. An employee joining a public service pension scheme at age 25 will probably receive pension payments between 40 and 70 years in the future. One method used to understand the cost of pension promises made to date is to calculate the present value of expected pension payments in the future using an appropriate discount rate.
>
> To explain discount rates in more detail, let us assume that a company promises an individual a payment of £100 in 10 years' time. What is the cost of that promise now to the company? The cost to the company could be considered to be the amount of money needed now in order to pay £100 to this individual in 10 year's time. Let us assume that the company decides that it will invest in government bonds and it expects that these will give a return of 4 per cent per year. The cost to the company of providing £100 in 10 year's time is therefore:
>
> £100 ÷ 1.04 = £67.56
>
> Effectively, the 'discount rate' used is 4 per cent, which is equal to the expected return on government bonds.
>
> Alternatively, the company may decide to invest in equities, where it expects a return of 8 per cent per year. The cost of the company of providing £100 in 10 years' time (using a discount rate of 8 per cent) will then be:
>
> £100 ÷ 1.08 = £46.32
>
> So it may appear as though the company should invest in equities. This isn't necessarily the case, because equities are more risky than government bonds and so if the company invests in equities there is an increased chance that the £46.32 they invest now may be less than £100 in 10 years time and they may need to make up the difference.

For funded schemes, discount rates sometimes reflect the anticipated investment return on a portfolio of assets: the discounted value of future payments then represents the amount of money that needs to be invested today in order to meet those future payments.[6]

4 Public Service Pensions Act 2013 – Explanatory Notes, para 74
5 Ibid para 75
6 HM Treasury, Consultation on the discount rate used to set unfunded public service pension contributions, December 2010, para 1.3

Contribution rates for unfunded public service pension schemes are set using the "SCAPE discount rate" - a methodology developed by the Government in the absence of a fund of assets.[7]

The SCAPE rate applies to unfunded public service pension schemes across the UK.[8] It does not apply to the LGPS, which is funded.[9] Valuations of individual LGPS funds are based on assumptions (demographic and financial) agreed between the fund's pension committee and the actuary.[10]

7 HM Treasury, Consultation on the discount rate used to set unfunded public service pension contributions, December 2010., para 1.8-10; SCAPE =Superannuation Contributions Adjusted for Past Experience

8 Ibid, Annex B

9 Ibid, para 1.23

10 LGPS Scheme Advisory Board website – Triennial valuations in the LGPS (England and Wales) in detail

2. 2012 discount rate review

A review of the discount rate used to calculate contributions was one of the recommendations of the interim report of the Independent Public Service Pensions Commission, chaired by Lord Hutton.

> The current discount rate used to set the level of total contributions in schemes was set in the late 1990s. Initial work by the Commission suggests that the current discount rate is at the high end of what is appropriate. The Commission is asking the Government to review this rate, ideally so that the findings can inform the final report. [11]

At that point the discount rate was 3.5% above the Retail Prices Index (RPI). The Commission estimated that a reduction in the discount rate by half a per cent could increase total contribution rate by nearly 3% of pensionable payroll. There was then a question of how this should be split between employers and employees. [12]

2.1 Consultation

In December 2010, the Government launched a consultation on the discount rate used for setting employer contributions in the unfunded public service pension schemes.[13] The discount rates used for setting employer contributions in the funded public service pension schemes – such as the Local Government Pension Scheme – were outside the scope of the consultation. This is because funded schemes set a discount rate appropriate to their circumstances:

> 2.3 For funded pension schemes in the private sector the discount rate used to set contribution rates for pension accrual is normally set equal to the discount rate used to value existing pension liabilities. The discount rate is generally set with reference to the return expected from the assets held by the pension scheme, adjusted to allow for the employer‟s financial strength and long term commitment to the scheme (this is known as the employers covenant). Given its importance, the process used to set the discount rate for technical provisions is governed by funding legislation.[14]

The consultation paper explained that the existing discount rate was set at 3.5% plus RPI inflation, in line with the 'social time preference rate' (STPR). Going forward, the discount rate would be expressed in terms of CPI inflation. The Government asked for views on different approaches to setting the discount rate in future. Its objectives were to have a measure that would:

- Be a fair reflection of costs;
- Reflect future risks to Government income;
- Support plurality of provision of public services;
- Be transparent and simple; and

[11] Independent Public Service Pensions Commission: Interim Report, 7 October 2010, para Ex17

[12] Ibid, para 8.6

[13] HM Treasury, Consultation on the discount rate used to set unfunded pension contributions, December 2010, para 1.39 para 1.23 and Annex B

[14] Ibid

- Provide stability.[15]

Options included:

- a rate consistent with private sector and other funded schemes:
- a rate based on the yield on index-linked gilts;
- a rate in line with expected GDP growth; and
- a Social Time Preference Rate that makes allowances for the particular context of pension provision.[16]

The Government noted that, other things being equal, a lower discount rate would result in higher contribution rates at the next scheme valuations. However, the Government's intention was that departmental budgets set in the Spending Review would not come under additional pressure due to a change in the discount rate:

> A lower discount rate would, in the absence of other changes, result in a higher level of contribution rates being charged. The employers currently in unfunded public service pension schemes are:
>
> - Government departments and other public service employers such as the NHS, state schools and police and fire services;
> - independent providers that either have:
>   - right of access to public service pension schemes, such as General Practitioner businesses, dental practices and independent schools; or
>   - staff who retained access to their public service pension scheme when they transferred into the organisation at its inception, as is the case for some social enterprises.
>
> **Independent providers with access to public service schemes**
>
> 1.30 In the absence of other changes, a lower discount rate would increase the contribution rate at which independent providers have access to public service pension schemes. This would mean increased contributions for such organisations as General Practitioner businesses, social enterprises and independent schools. But as noted above, other changes to public service pensions, such as the change of indexation and the increase in employee contributions will provide offsetting pressure on contribution rates at the next valuations.
>
> **Impact on employers within the public sector**
>
> 1.31 Any change in the discount rate would have an impact on the contributions paid by public service employers, but the Government's intention is that departmental budgets set in the Spending Review will not come under additional pressure due to a change in the discount rate.

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15 HM Treasury, Consultation on the discount rate used to set unfunded pension contributions, December 2010, para 1.39

16 Ibid, para 2.13 and 2.8-3.3

> **Impact on potential new independent providers of public services**
>
> 1.32 The current level of employer contribution rates in the unfunded public service pension schemes is cited as a key barrier to greater plurality of public service provision, potentially reducing efficiencies and innovation in public service delivery from independent providers. A reduction in the discount rate may, in the absence of other changes, reduce the cost advantage of public service providers when bidding against independent sector organisations to provide public services. As explained in paragraph 1.21, consultation on the Fair Deal policy will be taken forward separately.[17]

Responses

In its response to the consultation, the Pensions Policy Institute said GDP growth as a measure:

> The growth in Gross Domestic Product (GDP) is a measure of the growth in the overall economy. This means it may be considered to be a reasonable proxy for the growth in future tax revenues and may therefore be an appropriate approach for the Government to use in setting the discount rate to calculate the contributions needed to pay for the unfunded public sector pension schemes. However, it should be noted that as there is uncertainty about the expected future growth of tax revenues and of GDP, it may also be appropriate for this uncertainty to be reflected in an adjustment to the discount rate.[18]

The Chartered Institute of Public Finance and Accountancy made the point that there were potential tensions between the five key objectives set by the government and that it was important that the correct weight was afforded to each. All of the possible approaches to setting the discount rate had some attractive features but also some drawbacks. It concluded that:

> […] an amended approach to the STPR offers as good a solution to the question "what should the discount rate be" as any of the suggested alternatives, with the added benefit of it being designed to be tailored to the unique circumstances of public sector pensions, their liabilities and their financing.[19]

The Actuarial Profession made the point that no single approach towards setting the discount rate would produce a result that satisfied all of the objectives set by the Government. A decision was needed on what objective was most desirable. This was "essentially a political decision."[20]

In its response in December 2010, the Government said it had decided that in future the discount rate would in future be aligned with GDP growth:

> […] the Government recognises that there are legitimate arguments in favour of the four alternative methodologies put

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[17] Ibid, para 1.29

[18] PPI submission to HM Treasury's consultation on the discount rate used to set unfunded public service pension contributions, 2010-11

[19] CIPFA response to the HM Treasury consultation on the discount rate used to set unfunded public service contributions, March 2011

[20] The Actuarial Profession, Response to HM Treasury's consultation on the discount rate used to set unfunded public service pension contributions, March 2011

> forward by the Commission, but on balance believes GDP growth provides the best alignment with its stated objectives for the discount rate. However, for the purposes of completeness and comparison, this section will also set out the rates which it may have been appropriate to adopt under the alternative methodologies. These are presented as ranges, reflecting the arguments in each case for different actual rates.[21]

It also proposed to review the level of the discount rate every five years and the methodology every ten years.[22]

HM Treasury Directions for scheme valuations therefore included a discount rate of 3% above CPI. The discount rate would next be reviewed in 2016.[23]

2.2 Increase in employee contributions

The December 2010 consultation related to the discount rate to set total contributions to the unfunded schemes. It did not consider the balance of total contributions to be paid by employers and employees.[24]

In October 2010, the Government had announced its intention to:

> […] implement progressive changes to the level of employee contributions equivalent to an average of three percentage points, to be phased in from April 2012. The armed forces will be exempt from this increase.[25]

This was in part a response to the interim report of the Independent Public Service Pensions Commission, chaired by Lord Hutton which had said there was:

> […] a strong case for looking at some increase in pension contributions for public service employees, to better meet the real costs of providing these pensions, the value of which has risen in recent years with most of these extra costs falling to taxpayers.[26]

Further to this, the Coalition Government introduced more fundamental reforms to public service pensions in April 2015. Employee contribution rates for the new schemes are in regulations. The legislation that introduced these reforms included provision restricting changes to 'protected elements', including member contribution rates, within 25 years of April 2015. This was in line with a commitment made when the reforms were being negotiated.[27] It also provided for an employer cost cap" to protect against unforeseen changes and increases in scheme costs. However, this cap applies to increases in "member costs" (i.e.

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[21] HM Treasury, Consultation on the discount rate used to set unfunded pension contributions: summary of responses, April 2011 para 4.3; HC Deb 5 April 2011 c52WS

[22] HM Treasury, Consultation on the discount rate used to set unfunded pension contributions: summary of responses, April 2011 para 4.3

[23] HM Treasury, Public service pensions: actuarial valuations and the employer cost cap mechanism, March 2014, para 2.2.3

[24] Ibid para 1.20

[25] HM Treasury, Spending Review 2010 policy costings, 20 October 2010

[26] Independent Public Service Pensions Commission: interim report, 7 October 2010, foreword

[27] See *Public Service Pensions Act 2013*, section 22 – Explanatory Notes; HC Deb 2 November 2011, c929; and Library Briefing Paper RP 12/57 Public Service Pensions Bill, page 59

costs relating to the profile of members, such as life expectancy, growth in salaries or career paths) not to increases in "employer costs", for example, due to a change in actuarial assumptions used to value benefits (such as the discount rate).[28] For more on the background to these reforms – see Library Briefing Papers SN-06971 Public Service pensions – the employer cost cap (September 2018) and SN-05768 Public service pension reform – 2010 onwards (October 2012).

[28] HM Treasury, Establishing an employer cost cap in public service pension schemes, November 2012

3. Discount rate reductions

3.1 2016 Budget

In Budget 2016, the Chancellor announced that that the Government had reviewed the discount rate, with the result that employer contributions would increase:

> We are also going to keep public sector pensions sustainable. We reformed them in the last Parliament, which will save more than £400 billion in the long term. To ensure that those pensions remain sustainable, we have carried out the regular revaluation of the discount rate, and the public sector employer contributions will rise as a result. This will not affect anyone's pension, and will be affordable within spending plans that are benefiting from the fiscal windfall of lower inflation.[29]

The discount rate would reduce to 2.8%:

> **2.13 Public service pensions SCAPE discount rate** – The government has reviewed the discount rate used to set employer contributions to the unfunded public service pension schemes. The discount rate is being set at 2.8% and employers will pay higher contributions to the schemes from 2019-20 as a result.[30]

This would have the effect of increasing employer contributions from 2019-20 and reducing expenditure on public service pensions:

> This measure is expected to increase the employer contributions made to the unfunded public service pension schemes by £2bn per annum from April 2019. This will produce an increase in Public Service Pension Scheme income from 2019-20. Payments to beneficiaries are unchanged by the measure. The overall impact is therefore a reduction in Public Service Pensions Scheme expenditure, the amount paid (or received in the event of a surplus) by the Exchequer to make up any difference between income and expenditure.[31]

However, final results for employer contribution rates from April 2019 would use scheme data as at March 2016:

> **Costing**
>
> Using analysis completed by the HM Treasury advisory team at the Government Actuary's Department, this measure estimates the impact of the change to the discount rate on employer contributions for the unfunded public service pension schemes. The estimate is produced by applying the new discount rate to the 2012 valuation results of schemes. These calculations involve extrapolating the payroll and past service deficits in the scheme forward from 2012 to 2019. Based on these estimates, this measure is expected to increase employer contributions by £1,970m in 2019-20

Exchequer impact (£m)

	2016-17	2017-18	2018-19	2019-20	2020-21
Exchequer impact	0	0	0	+1,970	+2,005

[29] HC Deb 16 March 2016 c955
[30] HM Treasury, Budget 2016, HC 901, March 2016, para 2.13
[31] HM Treasury, Budget 2016 –policy costings, p74

Areas of uncertainty

> This costing is estimated using the most recent valuations based on scheme data as at March 2012. Final results for employer contribution rates from April 2019 onward will use scheme data as at March 2016.[32]

In its report, the Office for Budget Responsibility said:

> […] the Government has also placed an additional £2.0 billion a year squeeze on departments in that year by raising planned public service pension contributions, in line with a lower discount rate, but not compensating them for the additional costs they will face. This reduces borrowing by displacing other departmental spending within existing expenditure limits, while reducing net spending on public service pensions;[33]

Alongside the Budget, HM Treasury published guidance on the [Basis for setting the discount rates for calculating cash equivalent transfer values payable by public service pension scheme](#) (16 March 2016). This guidance applies to the unfunded public service pension schemes and the Local Government Pension Scheme.

Comment

In its response, the union for senior civil servants, the FDA said:

> It's only three months since departmental budgets were set and yet departments are now expected to deliver an additional £3.5bn of savings in 2019/20 through another efficiency review. But that's not all. By announcing a change to the discount rate on public sector pensions - without any consultation - they are effectively removing a further £2bn from public services and transferring it to the Treasury to give the illusion of a surplus: a political con trick that can only further damage public services.[34]

The Association of Colleges estimated the additional costs that would result for some of the main schemes:

> OBR publishes Information on public sector pensions every time there is a budget or autumn statement. Table 2.22 reports a budget for total employer contributions of £19 billion in 2019-20 of which £4.2 billion is from TPS employers. On the assumption that the Treasury estimates are right and there are no other changes in the valuation, this implies an extra cost for TPS employers (state schools, private schools, colleges and new universities) of about £430 million. Or, to put it another way, the employer contribution rate can be expected to rise from its current level at 16.48% to just over 18%.
>
> On the same basis, the cost for the NHS in 2019-20 will be £665 million and the cost for the cost for the Armed services £300 million. The exact amounts will be different because of the different characteristics, funding levels, age profiles and employee contributions in each scheme. Nevertheless it is important to understand that the saving for the Treasury is a disguised cut to departmental spending.

[32] Ibid
[33] OBR, Economic and fiscal outlook, March 2016, p7
[34] Smoke and mirrors Budget is a political con trick that doesn't match commitment to resources, says FDA, 16 March 2016

> All of this is fairly speculative because the government actuary may make other changes when he/she comes to do the TPS valuation.[35]

The Nuffield Trust came up with a similar figure for the NHS scheme:

> The Treasury has not set out details on how these costs will fall on individual employers. However, health think tank the Nuffield Trust estimated that if it applied to the NHS in proportion to its share of the total unfunded public sector liability, then it could translate into funding pressure for the service up to £650m.[36]

In response to a PQ, the Government said that employer contribution rates would be set following the next round of valuations, taking account of the change in the discount rate:

> **Ministry of Defence: Pensions**
>
> Kevan Jones: To ask the Secretary of State for Defence, by how much he plans that his Department's contribution to public sector pensions will increase in 2019-20 and future years.
>
> Mark Lancaster: The full valuation of the public service pension schemes will commence in April this year. Following that full valuation process, which will take into account the new discount rate set in the Budget, the new employer contribution rates for the Armed Forces and Civil Service Pension Scheme will be set.[37]

3.2 2018 Budget

On 6 September 2018, Chief Secretary to the Treasury Elizabeth Truss said employer contributions would need to increase. The Government was proposing a further reduction in the discount rate (on top of that announced in Budget 2016):

> You will be aware that a change to the SCAPE discount rate, from 3% to 2.8%, was announced at Budget 2016. Having reviewed recent OBR publications and GDP forecasts; the Treasury is proposing that a further change to the SCAPE rate is appropriate. The proposed change is to reduce the SCAPE rate from 2.8% to 2.4%, but this will be confirmed in due course. The draft directions propose that the lower rate will take effect for valuations purposes from 1 April 2019.[38]

The reduction to 2.4% was confirmed in Budget 2018:

> 1.59 The Budget confirms a reduction of the discount rate for calculating employer contributions in unfunded public service pension schemes, to 2.4% plus CPI (in line with established methodology to reflect OBR forecasts for long-term GDP growth). The valuations indicate that there will be additional costs to employers in providing public service pensions over the long-term.[39]

35 AoC, School and college contributions to teacher pensions may rise above 18%, 16 March 2016; See OBR, Economic and fiscal outlook supplementary fiscal tables, March 2016, table 2.22

36 'Budget 2016: Sugar tax and changes to NHS pensions, Health Service Journal', 16 March 2016

37 PQ 31664 22 March 2016

38 Letter to the TUC, 6 September 2018

39 HM Treasury, Budget 2018, HC 1629, October 2018; See also letter from the Chief Secretary to the Treasury to the Treasury Select Committee, 12 November 2018

The Office for Budget Responsibility (OBR) said:

> A.4 Our forecast includes the effect of no fewer than 18 policy decisions that the Treasury has chosen not to present on its scorecard. These are reported in Table A.1. They include:
>
> - **Public service pensions:** changes to employer contribution rates: the Treasury has lowered the discount rate applied when calculating contribution rates for public service pensions from the 2.8 per cent that was set at Budget 2016 to 2.4 per cent. This will increase employer contributions significantly from April 2019 (and September 2019 for teachers). This reduces AME spending by an average of £5.7 billion a year from 2019-20 onwards (as higher contributions reduce net spending on public service pensions). The Treasury has set aside a broadly similar amount in RDEL spending to allow public sector employers to meet these costs.[40]

The Government Actuary's Department has said that reducing the SCAPE rate to 2.4% at this time is:

- In line with the processes for review the Government set out in 2011;
- Consistent with the Government's objectives for the SCAPE rate; and
- Produces a reasonable discount rate to use to determine employer contribution rates for unfunded public service pension schemes.[41]

Treasury support for the additional costs

In September 2018, the Chief Secretary to the Treasury said the Government would support departments with the increased cost resulting from the 2018 announcement in the first year (2019-20), but not necessarily beyond that:

> This is because of proposed changes to the discount rate, which is used to assess the current cost of future payments from the schemes, to reflect the Office for Budget Responsibility's long-term growth forecasts. Further details will be known later this year. Some increase in costs was anticipated at Budget 2016, which Departments and the devolved Administrations will need to meet in full. The Treasury will be supporting Departments with any unforeseen costs for 2019-20. Further discussions will be taken forward as part of the spending review.[42]

Initial responses

Since the announcement in September, employer representatives have expressed concern about the expected increase in employer pension contributions – due in part to the discount rate reductions but also to other factors.[43] The trade union Prospect said:

40 OBR, Budget 2018 policy measures, October 2018; For figures by year see table A.1
41 Letter to HM Treasury, 25 October 2018
42 HC Deb 6 September 2018 c13WS; Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2018
43 'Big Teacher Pension contributions increases in 2019 (8 October update), Association of Colleges, 8 October 2018; Police Chief's Blog: CC Sara Thornton, 11 October 2018; Police pension changes threaten 10,000 officers' jobs, NPCC chief warns,

> While the discount rate does not affect the actual cost of the schemes it does affect how it is accounted for. Public sector employers will have to find additional resources to reflect these changes. As this money is simply paid over to Treasury the most logical source for it is from Treasury. However there is a real danger that Treasury will not recycle this money back to public service providers; that this process will, in effect, be a hidden cut to public services.[44]

In a blog post on 12 October 2018, Chief Constable Sara Thornton expressed concern about the increase in pension costs for police forces:

> Forces are currently pulling together their medium-term forecasts and the Treasury announcement a few weeks ago about changes to employee [sic] pension contributions means that forces in England and Wales may need to find an extra £417 million by 2020/21. This is equivalent to nearly 10,000 officers and grave concern was expressed about further reducing the sustainability of local police forces. This matter has been raised with the Government and discussions are being held.[45]

Budget 2018

In Budget 2018, the Government said it would support departments (to different extents) with the additional costs:

> 1.59 The Budget confirms a reduction of the discount rate for calculating employer contributions in unfunded public service pension schemes, to 2.4% plus CPI (in line with established methodology to reflect OBR forecasts for long-term GDP growth). The valuations indicate that there will be additional costs to employers in providing public service pensions over the long-term.
>
> 1.60 The government is supporting departments to ensure that recognition of these costs does not jeopardise the delivery of frontline public services or put undue pressure on public employers. For the NHS, as outlined in the five-year health settlement in England in June 2018, the Treasury has made provision for NHS pension costs until 2023-24. For state schools, the Department of Education are proposing to provide more funding to cover pension costs for the rest of this Spending Review period. To supplement this, the Budget allocates extra DEL to the reserve for 2019-20 to cover an expected £4.7 billion of additional costs. The Spending Review next year will settle the funding for costs beyond 2019-20 arising from the valuations. [46]

There OBR's Economic and Fiscal Outlook report provided more detail:

> A.4 Our forecast includes the effect of no fewer than 18 policy decisions that the Treasury has chosen not to present on its scorecard. These are reported in Table A.1. They include:
>
> > • **Public service pensions: changes to employer contribution rates**: the Treasury has lowered the discount rate applied when calculating contribution rates for public service pensions from the 2.8 per cent that was set at Budget 2016 to 2.4 per cent. This will increase employer

Pensions Age, 11 October 2018; Firefighters' Pension Schemes Regulations and Guidance - - news – 13 September 2018

[44] Prospect press release, 7 September 2018

[45] Police Chief's Blog: CC Sara Thornton, 11 October 2018' Police pension changes threaten 10,000 officers' jobs, NPCC chief warns, *Pensions Age,* 11 October 2018

[46] HM Treasury, Budget 2018, HC 1629, October 2018

> contributions significantly from April 2019 (and September 2019 for teachers). This reduces AME spending by an average of £5.7 billion a year from 2019-20 onwards (as higher contributions reduce net spending on public service pensions). The Treasury has set aside a broadly similar amount in RDEL spending to allow public sector employers to meet these costs.[47]

In more detail, the OBR said the Government had "decided to fund departments for most of the additional costs, but only to the extent that they exceed those estimated in March 2016 (although the NHS has been compensated in full)":

> 4.142 The largest changes to the forecast come from government decisions, including:
>
> • The direct effect of changes to employer contribution rates. This is in part down to the completion of the scheme valuations process, but the largest effect results from the Government's decision to again reduce the discount rate used in setting employer contribution rates. It had already done this once, in March 2016, when it scored the estimated effect on contributions from 2019-20 onwards. At the time, this increased contributions and reduced AME by around £2 billion a year. Departments were not compensated for this additional DEL cost at the time (although the NHS has subsequently been compensated), so the initial policy reduced borrowing by the amount of the estimated AME saving in our forecast. Before the latest further reduction in the discount rate, the outcome of the scheme valuations process was that employer contribution rates should decrease to reflect both the latest membership and demographic data, as well as changes to address breaches of the Government's employer cost cap mechanism. The effect of further reducing the discount rate has been to offset these effects, increasing employer contribution rates for all schemes. **Abstracting from the paybill effects of higher RDEL spending, this measure on its own would increase employer contributions by amounts rising from £4.7 billion in 2019-20 to £6.3 billion in 2023-24. The Government has decided to fund departments for most of these additional costs, but only to the extent that they exceed those estimated in March 2016 (although the NHS has been compensated in full), so there is a corresponding (but not fully offsetting) increase to RDEL spending**.
>
> • The indirect effect on pension contributions of the Government's decision to increase RDEL spending. We link our forecast for pensionable paybill growth to the path of departmental spending, so the boost to departmental spending plans (excluding the increases that compensate departments for changes in employer contribution rates) has added rising amounts to pension contributions from 2019-20 onwards. By 2023- 24, contributions are £1.7 billion higher than they otherwise would have been thanks to the higher departmental spending. The largest effect is on the NHS scheme, where contributions are estimated to be £1.3 billion higher in 2023-24. [48]

[47] OBR, Economic and fiscal outlook, October 2018, Annex A
[48] Ibid

In evidence to the Treasury Select Committee on 5 November 2018, the Chancellor said departments would be reimbursed for the additional costs of the 2018 change. A Treasury official said this would be ongoing:

> Mr Philip Hammond:[…] The 2016 changes that were made represent about £2 billion of additional pressures for Departments, and Departments were notified in 2016 and told to make provision for those pressures. Subsequently, in 2018, the Government decided that it was necessary to reduce the scope discount rate still further, but on that decision we decided that the Treasury would absorb the additional cost. We have added a sum to the reserve, and Departments will be reimbursed for the additional costs of the 2018 SCAPE change.
>
> Q235 John Mann: Will that be for every year ongoing?
>
> Dan York-Smith: It is actually for every year.[49]

However, in a letter to the Committee, the Chief Secretary to the Treasury said the Spending Review would "settle the funding for costs beyond 2019-20 arising from the valuations."[50] Asked by the Committee whether there was any inconsistency between the two, the Chancellor said there was not:

> The government has committed to covering the additional costs to departments associated with the pension changes impacting in 2019/20 over and above those anticipated in 2016. The path of aggregate departmental resource spending (excluding NHS England) is flat in real terms from a 2019/20 base. The 2019/20 base includes the provision made for pensions changes. Departmental resource budgets in future years (other than NHS England) will be set in the spending review.[51]

3.3 Impact

Although these changes apply across the unfunded public service pension schemes, public comment so far has focussed on the schemes for the police and teachers.

Police Pension Scheme

The National Police Chiefs' Council (NPCC) has expressed its concern about the impact and is reported to have sent a "formal letter to the Treasury saying it will seek a judicial review of the Government's proposals."[52]

In response to an urgent question on 6 November 2018 on liabilities for the police pension schemes, Minister for Policing Nick Hurd said funding arrangements for 2020-21 onwards would be discussed as part of the spending review:

> Budget 2018 confirmed that there will be funding from the reserve to pay for part of the increase in costs for public services,

49 Oral evidence: Budget 2018, HC 1606. Monday 5 November 2018
50 Letter from Chief Secretary to the Treasury to Treasury Select Committee, 12 November 2018
51 Letter from Chancellor to the chair of the Treasury Select Committee, 19 November 2018
52 Police Federation, Back down on £420m pension bill or face legal action, NPCC tells Government, 1 November 2018

> including the police in 2019-20. My officials are in discussions with representatives from the NPCC and the Association of Police and Crime Commissioners to discuss how this additional funding will be distributed. Funding arrangements for 2020-21 onwards will be discussed as part of the spending review.[53]

In response to an adjournment debate on the issue on 14 November 2018, he said:

> I thank the right hon. Member for Wolverhampton South East (Mr McFadden) for securing this long debate, which has had many contributions. In doing so, he has done me a favour by sending another signal to the Treasury about the importance of resolving this issue. I do not want to sound facetious, because we are talking about an extremely important issue that affects one of the most important public services in the country and a service, as the hon. Member for Birmingham, Erdington (Jack Dromey) rightly said, that is the envy of most countries around the world. […] It may surprise the right hon. Gentleman to hear that he and I are in agreement. Neither he, nor I, nor the Home Secretary wants to see any further reduction in police numbers.[54]

He said that "the Treasury has made it clear that it is going to contribute to part of the cost. The rest of the solution will be evident in the police funding settlement."[55]

In its announcement on the police funding settlement for England and Wales for 2019/20, the Government said that it had provided "£153 million specifically to help policing meet increased pensions costs next year – estimated at around £330 million."[56] In more detail:

> Following a revaluation of public sector pensions, police forces are facing increased pensions costs of around £330 million next year.
>
> The Government is allocating £153 million to specifically help the police pay for these increased costs.
>
> Of this, £143 million will go directly to PCCs and £10 million to counter-terrorism police and the National Crime Agency.[57]

The National Police Chiefs Council said the additional funding would help it meet the increased pension costs and avoid making further cuts:

> The Government is right to recognise the serious pressures on policing mean we could not wait for a full spending review and further funding is needed now. The additional funding through the police grant will help forces meet the costs of government pension changes and should allow chief constables and police and crime commissioners to avoid making further cuts.[58]

An answer to a PQ on 25 January 2019 said:

> Home Office and Treasury Ministers have regular discussions covering a number of issues including changes to pension schemes. In his Budget speech, the Chancellor committed to

53 HC Deb 6 November 2016 c1377
54 HC Deb 14 November 2018 c399
55 Cleveland Police, Police funding settlement, 7 December 2018
56 Police to get largest funding increase since 2010, 13 December 2018
57 Home Office, Factsheet: Provisional Police Funding Settlement 2019/20 – funding settlement
58 NPCC, The Government are right to recognise that more money is needed in policing, 13 December 2018

> providing funding to support the police with additional pensions costs.
>
> On 13 December we announced our proposed police funding settlement for 2019/20 which provides up to £970 million of additional investment in the policing system. This includes £153 million of additional pensions funding, £161 million in increased general grants and up to £509 million of additional funding from council tax precept, if Police and Crime Commissioners use the full flexibility provided. This provides enough funding for the police to meet their increased costs, while continuing to recruit and fill capability gaps like the shortage of investigators.[59]

Teachers' Pension Scheme

In November 2019, Schools Minister Sam Gyimah said the Department for Education would run a public consultation to understand the issues better:

> Gordon Marsden: To ask the Secretary of State for Education, what assessment he has made of the potential merits of introducing a phasing in period for higher education Institutions to implement the increased contribution to the teachers' pension scheme.
>
> Sam Gyimah: The department will be running a public consultation regarding the funding of the rise in employer contributions for the Teachers' Pension Scheme and has already agreed to delay the introduction of these changes until September 2019. The department will use the consultation to better understand the impact of the proposed changes on the affected English higher education institutions to decide what, if any, action should be taken.[60]

The Department for Education launched a consultation on 15 January 2019 regarding the impact of the changes in England.[61]

It explained that the valuation had two main purposes:

> to assess the scheme's assets and liabilities and therefore the cost of providing pensions in the long-term; and to recalculate the employer 'cost cap' to determine whether it remains within the settlement reached in 2015.[62]

The employer contribution rate from September 2019 was 23.6%:

> 2.4 The estimated employer contribution rate required for the period from 1 April 2019 to 31 March 2023 is 22.8%. This is based on adjusting the scheme design by changing the rate by which pensions accrue. The Department has agreed, with HM Treasury, that the employer contribution rate for the current valuation will be implemented from 1 September 2019 rather than 1 April 2019. Whilst this gives employers more time to plan for the contribution change, there is an offset in that it will create a small deficit in the first year. In order to recover this deficit an amendment to the contribution rate, to take account of the fact that it will not be paid for the full valuation period, will be made resulting in an employer contribution rate of 23.6% from 1 September 2019 to 31 March 2023.

59 PQ 180819, 25 January 2019; PQ 206438 18 January 2019
60 PQ 191299 19 November 2018
61 DfE, Funding increases to teachers' pensions employer contributions, January 2019
62 Consultation document, para 2.1

The Department estimated that this would increase costs to scheme employers by £1.1bn. It showed how these costs would be distributed across the four sectors:

Education sector	Costs in 2019-20, from 1 Sept implementation (£m)
State-funded schools	830
Independent schools	110
FE	80
HE	80

It asked for views on its proposal for funding support for 2019/20:

> 3.2 This Consultation Document seeks views on the proposal to provide funding to support i) schools (see 4.6 for breakdown) and ii) FE colleges and other public-funded training organisations (see 4.12 for breakdown), to cover the increase in employer contributions, and to better understand the impact on the HE sector and Independent schools, for whom it is proposed that funding support will not be provided.[63]

Funding for institutions in devolved administrations is a matter for those governments.[64]

In its response to the consultation, the Government confirmed its proposed funding for 2019/20 for state-funded schools and FE colleges for 2019/20. The reason was that respondents to the consultation were "strongly positive" and that it was "consistent with the Department's proposal to support institutions most directly funded by Government grant."[65]

Although the judgment was 'finely balanced', it had decided it would not fund HE institutions at this stage:

> The Department has carefully considered the response from the HE sector and noted the additional cost pressures for affected institutions at a time when the sector is facing a number of issues and risks. However, the Department has decisions to make regarding the allocation of available funding across the Education sector. The Department conducted initial analysis on each sector, which suggested that state schools and further education colleges were in high levels of need for additional support. Therefore, the Department has concluded that, while the judgement is finely balanced, the evidence presented by respondents does not sufficiently justify a change in approach. The Department will therefore not fund Universities (and other organisations providing HE) obliged to offer TPS at this stage, or take any mitigating actions against the risks identified in the consultation.[66]

63 Ibid
64 Ibid, para 3.5
65 DfE, Funding increases to teachers' pension employer contributions. Government response to consultation, April 2019
66 Ibid

It had also decided not to fund independent schools, but would consider allowing a phased withdrawal from the TPS:

> We note the cost pressures that the increases in employers' contributions will place on Independent Schools, as well as the desire from Independent Schools to attain greater flexibility over their status in the scheme. The Department also notes the potential effects of this change, particularly redundancies or reduction in specialist provision. As shown above, respondents' main focus was less on the Department providing funding to Independent Schools for these costs, but on Independent Schools' continued membership of the scheme.
>
> **The Department therefore confirms the funding rationale set out in the consultation document and will not fund Independent Schools at this stage. However, by way of a potential mitigation to the risks identified, the Department will begin work to consider allowing Independent Schools to leave the scheme via phased withdrawal.** This potential phased withdrawal approach would enable a school to retain its current teacher members in the scheme but would close the scheme to new entrants. Therefore, a school could remain in the scheme but close the scheme to applications from teachers yet to join the school. This approach would be optional to all Independent Schools who are members of TPS. The Department accepts there is a case for this and will consult with members, employers and other stakeholders at the earliest opportunity. A statutory consultation would be required before any amendments to the scheme regulations are made.
>
> TPS is one of the best pension schemes in the country, continuing to provide valuable retirement benefits for teachers. Teachers enjoy a defined-benefit scheme, giving them a 20 guaranteed, inflation-proof retirement income based on what they earn over their careers. In addition, TPS offers extensive benefits above a pension including insurance for family members, flexible retirement and ill health support.
>
> The Department aims to ensure that teachers can move freely between state and Independent School sectors and believes that continued TPS membership supports that aim. The Department has considered Independent Schools and Universities (and other organisations providing HE) obliged to offer TPS separately from each other, due to the difference in the way they receive funding from Government. For example, Independent Schools possess greater control over their means to raise funding and have the ability to opt out of the scheme, whereas HE institutions do not. They therefore require different approaches when considering mitigations.[67]

Other schemes

The Government has said that for the Firefighters' Pension Schemes, it will:

> […] cover 90% of the additional cost in 2019-20, and following years will be covered by the comprehensive spending review.[68]

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67 Ibid
68 HC Deb 25 Feb 2019 c13

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