Update on the Cost Control Element of the 2016 Valuations

Summary

The government has announced that:

- the pause of the cost control mechanism will be lifted and the cost control element of the 2016 valuations process will be completed
- the costs of addressing the discrimination identified in the McCloud judgment (the proposals for which are set out for public consultation) will be included in this process

Background

The Independent Public Service Pensions Commission recommended in 2011 that the new public service pension schemes should include an employer cost control mechanism to protect the taxpayer from unforeseen increases in scheme costs. The government accepted this recommendation and made provisions for the establishment of such a mechanism in the Public Service Pensions Act 2013 (the Act). Following consultation with member representatives, the government set out in a policy paper how the mechanism would operate[1] and made Directions to put this policy into effect. Whilst the Commission recommended a mechanism to protect the taxpayer from increased costs, the final negotiated mechanism is symmetrical and so also maintains the value of pensions to members when costs fall.

Preliminary valuations of the new schemes established 'employer cost caps' in each of the schemes, expressed as a percentage of pensionable pay. The cost of the scheme would then at future valuations be compared against the employer cost cap. This process measures changes in the value of the scheme to members. Only member costs - broadly, costs which affect the value of the scheme to members – are therefore taken into account.

Treasury regulations (made under section 12(5) of the Act) specify that there will be a 2-percentage point margin above and below the employer cost cap. The upper margin forms a 'ceiling', with the lower margin forming a 'floor'. Where the cost of the scheme has gone beyond those margins on either side of the employer cost cap, pension benefits or member contributions must be adjusted to bring costs back to the target (the employer cost cap).[2]

The impact of the court judgments

The costs of the schemes were expected to be calculated for the first time in the 2016 valuations. However, following the Court of Appeal's judgment in the McCloud and Sargeant cases, the government announced a pause to the cost control element of the 2016 valuations in January 2019, and made amending Directions to achieve that pause in February 2019. Actuarial valuations to set employer contribution rates were completed in Spring 2019 but those valuations did not calculate the costs of the schemes for the purposes of the cost control element of the valuations process.

It was right to pause the mechanism, as the uncertainty around member benefits arising from the court judgments made it impossible to assess the value of the schemes to members with any certainty. If the cost control mechanism had not been paused, the mechanism would

---

[1] Public service pensions: actuarial valuations and the employer cost cap mechanism

[2] Ibid

probably have required schemes to adjust benefits on the basis of incorrect assumptions about benefit entitlements. The Government Actuary (GA) agreed that the policy of pausing the mechanism was reasonable. Further explanation of the necessity of the pause is set out in the statutory consultation between the Director of Public Spending and the GA.[3]

The government has been working to address the unlawful discrimination identified by the courts, both through Employment Tribunals to determine what remedy might be appropriate for claimants, and through proposals for consultation to address the discrimination for claimants and non-claimants, which have now been published.

Over the course of this process, uncertainties about benefit entitlements have receded. Remedy declarations for some claimants have begun to emerge from the Employment Tribunals and HM Treasury, working closely with other government departments and the devolved administrations, has developed detailed proposals to address the discrimination identified by the courts. These proposals have been the subject of technical discussions with employer and member representatives and are now set out in the public consultation published alongside this update.

Un-pausing the cost control mechanism

The government recognises that the pause has been a matter of concern for members and their representatives. Full and regular valuations are an important step in understanding and controlling scheme costs. In light of the developments to address the court judgments, and as the associated uncertainties recede, **the government has announced that the pause should be lifted**.

Accordingly, the government is preparing to complete the cost control element of the 2016 valuations. HM Treasury will follow the established procedure for valuations, working with schemes and member representatives, and plan for the process to be completed by schemes next year. Employer contribution rates will not be changed before the next valuations process.

Completion of the valuations process: treatment of remedy costs

When the cost control mechanism was established, it was agreed that it would only consider costs that affect the value of the schemes to members (a 'member cost'). Addressing the discrimination identified in the McCloud and Sargeant judgments involves increasing the value of schemes to members; the costs associated with this therefore fall into the 'member cost' category. As a 'member cost', this will be considered as part of the cost control element of the valuations process.

HM Treasury will set out in the Directions the technical detail of how these costs should be taken into account in the cost control element of the valuations process. By taking into account the increased value of public service pensions as a result of 'McCloud remedy', scheme cost control valuation outcomes will show greater costs than otherwise would have been expected. The government will consider how best to take forward the cost control mechanism outcomes for each scheme once the detail of these is known.

---

[3] Consultation with the Government Actuary