

Public Service Pension Schemes at GAD

Newsletter: December 2018

If you would like to discuss any of the topics in this letter, or if you have any ideas for future topics, just let your usual GAD contact know.

GAD News

Actuarial valuations: We are approaching the finishing line for most of the valuations. We have completed the main calculations, and are now finalising the associated formal reports. As you may be aware, the cost cap mechanism has come into effect in many cases. We are advising departments on the changes they need to make in light of this. See below for a discussion of how revised contribution rates affect departments' finances.

Actuarial factors: Following HM Treasury's change to the SCAPE rate, we are reviewing all scheme actuarial factors used in the calculation of member options such as transfer values, early retirement and purchase of additional pension, to name but a few. We have already issued the most important factors and we will continue to produce updated factors and issue them to the scheme administrators.

Accounting: We have started up our annual project to produce the pension cost and liability figures required for departmental resource accounts and employer accounts. We will soon be in touch with finance colleagues to discuss detailed requirements.

Looking ahead: We will be talking to many of you over the coming weeks about workstreams and budgets for the 2019-20 financial year. At the moment we expect this to be quieter than the current year in relation to 'scheme compliance' work (eg actuarial valuations and factor reviews). With that in mind, some schemes have been discussing more strategic areas of work with us, for example:

- Improving valuation data and more frequent updates on financial position
- Reviewing member contribution structures
- Considering approach to pensions tax issues
- Administration: eg assisting with member communications tools or quality assurance of sample member calculations
- Integrating pensions into the overall reward strategy.
- Considering ways we can use data analytics to aid in policy development and implementation

We will be happy to discuss any of these areas with you.

Hot Topics

GMP equalisation: On 26 October, the High Court issued its judgment in the case of Lloyds Banking Group Pensions Trustees Ltd v Lloyds Bank PLC and others. It found that the Trustees of the Lloyds' Schemes should '*adjust the benefits payable under the Schemes in excess of the GMP in order that the benefits received by male and female members with equivalent age, service and earnings histories are equal*'. HMT has confirmed it is satisfied that the Court's judgement has not called into question the equalisation method used in public service schemes. So we would expect little or no impact on PSPSs provided they had age 60 as the NPA for men and women from 1990 to 1997.

Mortality: The actuarial profession has published an updated set of mortality tables - the 'S3' series. These new tables are an update of the 'S2' tables we referred to in setting mortality assumptions for the current set of valuations. CMI mortality tables are widely used in actuarial work.

If you would like to know more about current thinking on mortality, see our new publication : [Mortality Insights](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/764959/Mortality_insights_late_2018.pdf) (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/764959/Mortality_insights_late_2018.pdf)

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Analysis: How valuation results affect departmental finances

Martin Clarke, Government Actuary

One large difference between funded and unfunded pension schemes is the absence of a real fund of assets to fund future pensions. Instead there is an artificial, notional system to determine the accounting costs at departmental level.

The future pension cash flows at a whole-of-government level depend solely on the scheme benefits and the employee contributions. For an unfunded scheme these cash flows are either positive or negative and contribute (plus or minus as appropriate) to future government borrowing or tax revenue requirements.

An increase in employer contribution costs means that the internal cash flows within government change. The sponsoring department must pay more into the pension scheme, but this extra money does not stay in the scheme as such (there is no fund, remember) but is cycled into Treasury. The actual real cash-flows to and from scheme members are unaffected.

The valuation result may affect departmental spending because of changes to employers' contribution rates, but this is not automatic. It depends how Treasury chooses to treat its extra cash. Treasury could retain the increased pension contributions and put a squeeze on departmental spending as it did during the period of austerity, or it could adjust department budgets appropriately as the Chancellor said in his Autumn Budget he will do this time.

There are, of course, other consequences from the change in public service pension costs not least to those employers participating in public service schemes who do not receive any government funding that might be increased to offset the pensions costs. But, to automatically assume that the consequences of our valuation work is to reduce the number of police on the beat, nurses in hospital wards and teachers in classrooms would be to misunderstand how this system works.

Actuarial made simple – the discount rate (First of an occasional series exploring fundamental actuarial topics.)

To calculate contribution rates we use discounting. A funded scheme holds assets it expects to be enough to pay the benefits after allowing for future investment returns on those assets. The discount rate is then the expected long-term return on those assets. However, unfunded PSPSs do not hold assets, so we need another way to derive a discount rate. We use the SCAPE – 'Superannuation Contributions Adjusted for Past Experience' - rate. It reflects projected long-term growth of UK GDP and so, in the context of government finances, is broadly comparable to the expected long-term asset return for a funded scheme.



The adjacent graph shows how the value of an asset increases over time from £100 now to £412 in 30 years if it earns 5% a year compound. So, if we have a liability of £412 to pay in 30 years and we know we can earn 5% a year, we should invest £100 now to cover that liability. In other words, the discounted value of the £412 is £100. However, unfunded PSPSs do not hold assets, so we need another way to derive a discount rate. We use the SCAPE – 'Superannuation Contributions Adjusted for Past Experience' - rate. It reflects projected long-term growth of UK GDP and so, in the context of government finances, is broadly comparable to the expected long-term asset return for a funded scheme.