HM Treasury

Public Service Pensions: cost control mechanism consultation

Government response to the consultation

October 2021

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Executive summary

The cost control mechanism was introduced following the recommendations of the Independent Public Service Pensions Commission (IPSPC) in 2011. It is a mechanism designed to ensure a fair balance of risk between members of public service Defined Benefit (DB) pension schemes and the Exchequer (and by extension taxpayers).

The cost control mechanism was first tested at the 2016 valuations. Provisional results raised the question of whether the cost control mechanism, as currently designed, is too volatile. Following this, at HM Treasury's request, the Government Actuary (GA) conducted a review of the cost control mechanism. The review was commissioned amidst concern that the mechanism was not operating in line with its original objectives. The GA's final report to HM Treasury containing his findings and recommendations was published on 15 June 2021.

Having considered the GA's report, the Government held a consultation between 24 June 2021 and 19 August 2021 to seek views on three key proposals to reform the mechanism, all of which were recommendations by the GA:

- **Moving to a 'reformed scheme only' design** so that the mechanism only considers past and future service in the reformed schemes, and costs related to legacy schemes are excluded. This ensures consistency between the set of benefits being assessed and the set of benefits potentially being adjusted;
- **Widening the corridor from 2% to 3% of pensionable pay.** This aims to achieve a better balance between stability and responsiveness of the cost control mechanism; and
- **Introducing an economic check.** The GA's report noted that "It does not seem possible for the mechanism to be able to protect taxpayers unless it considers more of the factors affecting the actual cost of providing a pension." Currently the mechanism does not include changes in long-term economic assumptions and therefore cannot consider the actual cost to the Government of providing pension benefits. The Government proposes introducing an economic check so that a breach of the mechanism would only be implemented if it would still have occurred had any changes in the long-term economic assumptions have been considered.

HM Treasury received 61 responses in total from a broad range of respondents. These have been considered in detail.

Changes to the core mechanism

Reformed scheme only design

The majority of respondents supported the Government's proposal to move to a reformed scheme only design and agreed that it did not seem fair for the costs of legacy schemes to impact the benefits received by relatively younger members in the reformed schemes. They agreed that as the mechanism can only adjust benefits in the reformed schemes, it seems fair to exclude the impact of legacy schemes.

A small minority felt that the current approach was preferable, as many members have service in both the legacy and reformed schemes, and so the mechanism should account for all these costs.

Others felt that a future service only design, (whereby the mechanism would only account for the costs of future service in reformed schemes) would be even fairer for relatively younger members in the reformed schemes, as they would not be affected by the impact of any past service costs of relatively older members, the impact of which will increase over time.

In line with the majority of respondents, the Government believes that a reformed scheme only design is necessary to ensure the right balance of risks between members and the Exchequer and to improve stability. A reformed scheme only design will mean that the risk of costs associated with legacy schemes will be transferred to the Exchequer, but the Government believes it is right for the Exchequer to bear this risk in order to reduce intergenerational unfairness.

Wider corridor

A majority of respondents agreed with the proposal to widen the corridor, and a slight majority agreed that the corridor should be set at +/-3% of pensionable pay. They welcomed the fact that widening the corridor would lead to a more stable mechanism by minimising the frequency of breaches, which will lead to fewer changes in benefits or member contributions. They felt that a corridor size of +/-3% was appropriate, and will strike the right balance between stability and effective cost control.

However, some favoured retaining a +/-2% corridor on the basis that a wider corridor, while providing more stability, would also diminish the cost control provided by the mechanism. Many respondents raised concerns that a wider corridor would exacerbate the "cliff-edge" nature of the mechanism which means larger changes in costs can occur without remedial action. Many argued that a proportional cost corridor, where the size of the corridor would vary depending on the size and costs of that scheme, would be more appropriate.

The Government considers that a +/-3% corridor would strike the right balance between providing effective cost control and a stable mechanism. A corridor size larger than this would not be appropriate as it would allow costs to diverge by too much before being brought back to target. The Government considers that while the "cliff-edge" risk exists, a wider corridor is necessary to ensure a more stable mechanism. The Government believes that a consistent corridor design for all schemes is preferable to a proportional cost corridor. A consistent corridor size limits the absolute change in costs that can occur across all schemes before a breach is triggered. The Government does not consider that just because a scheme is more expensive from the outset, it should be allowed to let costs change by a greater absolute amount. Furthermore, the Government considers that a proportional cost corridor would be overly complex and more difficult for members to understand than the current consistent corridor design, potentially eroding transparency and trust in the mechanism.

Economic check

Responses on the proposal for an economic check were mixed; similar numbers of respondents supported and opposed the proposal. Some argued that it would lead to a more stable mechanism and also help avoid benefit reductions if the wider economic outlook improved but individual scheme costs rose. Many raised concerns that this proposal may be a breach of the 25-year guarantee, and that it had been agreed when the mechanism was set up that changes in the SCAPE discount rate would not impact member benefits. Many also raised concerns that the economic check would not be transparent or objective and would make the mechanism subject to government interference.

Respondents with links to the Local Government Pension Scheme (LGPS) were consistently of the view that if an economic check was adopted, linking it to expected long-term GDP would not be appropriate for the LGPS. The LGPS, as a funded scheme, looks to achieve investment returns to ensure a minimum call on future local taxpayers by maintaining a pension fund able to meet all future liabilities. They argued that this is a fundamentally different situation to the unfunded schemes, where taxpayers are directly responsible for paying the cost of public service pensions.

The Government has considered all responses and maintains the view that an economic check should be introduced for all schemes, with further consideration required for potential allowances for the LGPS. The economic check will operate in line with the GA’s recommended design and will be linked to the OBR’s independent and objective measure of expected long-term GDP growth and the long-term earnings assumption. The economic check may potentially be linked to the SCAPE discount rate if the methodology remains linked to expected long-term GDP growth. The SCAPE consultation response will be published in due course; the Government has considered any relevant points raised as part of that consultation here.

In the Government’s view, the main purpose of the economic check is to ensure consistency between benefit changes and changes to the long-term economic outlook. This approach ensures that there will be a higher bar for benefit increases to be awarded if the country’s long-term economic outlook has worsened. This will equally apply to benefit cuts if the long-term economic outlook has improved. The Government can confirm that the economic check will apply symmetrically, operating in the exact same way in relation to floor breaches as it would to ceiling breaches. It will operate purely mechanically and transparently, with no scope for interference from individuals or groups, either from within the Government, or outside.

The Government has taken into consideration the concerns raised by LGPS stakeholders that an economic check linked to expected long-term GDP growth is not appropriate for the funded LGPS. The Government recognises the different nature of the LGPS. However, on balance, the Government still believes that the economic check as a whole is an appropriate proposal for LGPS.

As noted by respondents, the purpose of LGPS investments is to minimise the cost pressures facing LGPS employers who will meet the balance of costs. If the cost of benefits goes up the responsibility will fall on local authorities, who are funded to a significant extent by local taxpayers and other LGPS employers. Similar to the reason for the economic check for the unfunded schemes, the purpose of an economic check in the LGPS is to ensure consistency between benefit changes and changes in the wider economic outlook. Whilst the financial health of individual local authorities is not directly linked to expected long-term GDP growth, the Government would still expect a link between the economic performance of the UK and the financial health of local authorities.

HM Treasury will work with the Department for Levelling up, Housing and Communities and LGPS stakeholders to consider whether it is desirable for the England and Wales Scheme Advisory Board (SAB) process to be adapted in line with the principles of the economic check. The Government also acknowledges that the SABs in Scotland and Northern Ireland may wish to consider introducing a similar process to the England and Wales SAB, and will work with colleagues in the Devolved Administrations if they feel it would be desirable to do so.

Next steps

The Government is aiming to implement all three proposals in time for the 2020 valuations. It is necessary to implement the reformed scheme only design and the economic check through expanded powers in primary legislation, when parliamentary time allows, and then by making Treasury Directions under those powers in due course. The wider cost corridor will be implemented to a longer timeline via secondary legislation.

Chapter 1
Introduction

Background

The establishment of the cost control mechanism

1.1 The cost control mechanism (CCM) is a mechanism designed to ensure a fair balance of risk with regard to the cost of providing public service Defined Benefit (DB) pension schemes between members of those schemes and the Exchequer (and by extension taxpayers). It was introduced following the recommendations of the Independent Public Service Pensions Commission (IPSPC) in 2011. Whilst the IPSPC recommended a mechanism to protect the Exchequer from increased costs, the final mechanism negotiated between the Government and member representatives is symmetrical and so also maintains the value of pensions to members when costs fall.

1.2 The original objectives of the CCM can be summarised as follows:

1. To protect the Exchequer (and by extension taxpayers) from unforeseen costs;
2. To maintain the value of a public service DB pension scheme to its members; and
3. To provide stability and certainty on member benefit and contribution levels – the mechanism should only be triggered by 'extraordinary, unpredictable' events.

1.3 For each scheme, the mechanism assesses certain aspects of the costs of providing that scheme compared to a base level ("the employer cost cap"); if, when the mechanism is tested, those costs have decreased/increased by more than a specified percentage of pensionable pay compared to the employer cost cap, then member benefits in the relevant scheme are increased/reduced to bring the cost of that scheme back to target. The target cost is the same as the employer cost cap. So, there is effectively a corridor either side of the target cost, with a margin representing the 'ceiling' and 'floor'. If costs fall below the lower margin (a "floor breach"), then benefits must be increased to bring costs back to target. If costs increase above the upper margin (a "ceiling breach"), then benefits must be reduced.

1.4 The Government made provision to establish the CCM in the Public Service Pensions Act 2013 ('the Act'). Following consultation with member representatives, the Government set out in a policy paper[1] how the mechanism would operate and the Treasury made directions to put this policy into effect.

The 2016 valuations

1.5 The first test of the mechanism was at the 'as at' 31 March 2016 valuations ("the 2016 valuations"). Provisional results indicated floor breaches across all schemes for which results were assessed. It was in the context of these provisional results that the Government announced that it was asking the Government Actuary (GA) to review the cost control mechanism.[2] The Government's intention is that the cost control mechanism is only triggered by 'extraordinary, unpredictable events'. The key drivers of the indicative floor breaches were a reduction in assumed future pay increases (caused by short term pay restraint) and a reduction in assumed life expectancy. The Government did not consider that either short term pay restraint or a change in future projections of life expectancy fit the category of 'extraordinary, unpredictable events', raising the question of whether the cost control mechanism, as currently designed, is too volatile. Meanwhile, employer contribution rates increased by up to 9% of pensionable pay before the impact of the CCM. But the preliminary results of the CCM for all schemes showed a floor breach which would have further increased employer contribution rates and costs to the taxpayer.

1.6 The cost control element of the 2016 valuations was paused due to the uncertainty arising over the value of member benefits following the judgments in the McCloud and Sargeant litigation, and with it so was the GA's review of the CCM. On 16 July 2020, alongside the publication of the Government's consultation on addressing the discrimination identified in the McCloud and Sargeant judgments, the Government announced that the pause of the cost control element of the 2016 valuations process would be lifted and the GA's review of the CCM would proceed.[3] In addition, the Government announced that the costs associated with addressing the discrimination would be considered when completing the cost control element of the 2016 valuations.[4]

1.7 Whilst amending directions instructing schemes on how to complete the cost control element of the 2016 valuations are yet to be finalised, and will be published in due course, early estimates indicate that some ceiling breaches are likely. If normal statutory procedure were followed, any ceiling breaches would lead to a reduction in member benefits in order to bring costs back to target. The Government decided that there should not be reductions to member benefits as a result of completing the cost control element of 2016 valuations, particularly based on a mechanism that may not be working as originally intended. The Government has therefore announced that, should results identify ceiling breaches once finalised, the impact of these will be waived. This means that the benefit reductions that would be

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1 https://www.gov.uk/government/publications/public-service-pensions-actuarial-valuations-and-the-employer-cost-cap-mechanism

2 https://questions-statements.parliament.uk/written-statements/detail/2018-09-06/hcws945

3 https://questions-statements.parliament.uk/written-statements/detail/2020-07-16/HCWS380

4 Policy note - cost cap unpause and McCloud costs.docx (publishing.service.gov.uk)

expected following such ceiling breaches will not be implemented. As a result, where results show that costs in a scheme fall within the corridor or above the ceiling, benefit levels will not be changed as a result of the 2016 valuations.

1.8 The Government has, however, committed to delivering the impact of any floor breaches that occur. This means that when results have been finalised and implemented, any benefit improvements that are due will be delivered via increases in benefit accrual and/or reductions in member contributions in respect of service from 1 April 2019. The Government has introduced legislation to waive ceiling breaches in the Public Service Pensions and Judicial Offices Bill, which is currently before Parliament having been introduced into the House of Lords on 19 July 2021.

Government Actuary's Review and Consultation

1.9 The GA concluded his review in May 2021 and his final report was published on 15 June 2021.[5] The GA noted that:

- **Legacy schemes (i.e. those in place before the 2014/2015 reforms) were the main driver of the floor breaches** seen in the provisional results of the 2016 valuations. The breaches were caused primarily by a reduction in assumed pay increases and a reduction in the rate of increase of life expectancy. The GA considers that these costs relate to risks that have largely been mitigated in the reformed schemes: salary risk is mitigated by the career average (CARE) design of the schemes and most workforces mitigate the longevity risk by the link between Normal Pension Age (NPA) and State Pension age (SPA).[6] Although the mechanism assesses costs in both the legacy and reformed schemes, the impact of any breaches can only be delivered through changes to reformed schemes. The GA comments that "it is not clear to me why these residual risks in the legacy schemes should continue to influence the level of benefits in the reformed schemes".

- It was a **"perverse outcome"** that the 2016 valuations resulted in employer contribution rates increasing, whilst provisional cost control results found that all schemes breached the floor. If they had been confirmed, floor breaches would have led to benefit improvements, resulting in a further increase to employer contribution rates. The GA finds that this outcome was primarily driven by the fact that the cost control mechanism does not currently account for the change in the SCAPE discount rate, which is used to determine employer contribution rates.[7]

- **The current corridor is too narrow** and will lead to excessive volatility in the mechanism. The GA notes that even under a reformed mechanism,

5 https://www.gov.uk/government/publications/cost-control-mechanism-government-actuarys-review-final-report

6 Most of the reformed schemes have a Normal Pension Age (NPA) linked to the member's State Pension age (SPA) (the age at which a State Pension can be received). There are exceptions for the armed forces, the police and firefighters, where the NPA is set at 60 for those retiring from active service.

7 Superannuation Contributions Adjusted for Past Experience (SCAPE) is the methodology used to value unfunded public service pension schemes. It uses a 'SCAPE discount rate' to convert the value of future pension payments into today's terms.

the current corridor would still mean a high likelihood of frequent breaches.

1.10 In the context of these findings, the GA made a series of recommendations on how the CCM could be reformed to bring it more in line with its objectives.

1.11 Between 24 June 2021 and 19 August 2021, the Government sought views on proposals to reform the cost control mechanism. The consultation document set out the Government's response to the GA's report and proposed changes to the mechanism. The Government proposed three changes to the mechanism in the consultation, all of which were recommended by the GA:

- **Moving to a 'reformed scheme only' design** so that the mechanism only considers past and future service in the reformed schemes, and costs related to legacy schemes are excluded. This ensures consistency between the set of benefits being assessed and the set of benefits potentially being adjusted;
- **Widening the corridor from 2% to 3% of pensionable pay.** This aims to achieve a better balance between stability and responsiveness of the cost control mechanism; and
- **Introducing an economic check.** The GA's report noted that "It does not seem possible for the mechanism to be able to protect taxpayers unless it considers more of the factors affecting the actual cost of providing a pension." Currently the mechanism does not consider the wider economic situation when determining whether breaches of the mechanism should result in a change to member benefits. The Government proposes introducing an economic check so that a breach of the mechanism would only be implemented if it would still have occurred had any changes to long-term economic assumptions been considered.

1.12 The Government believed these proposed changes would establish a fairer balance of risks between the Exchequer and scheme members and create a more stable mechanism. The Government sought views on these proposed changes in its consultation.

1.13 The GA's review and the consultation applied to all public service schemes covered by the CCM. These schemes are set out in Annex A.

1.14 In parallel to this consultation, the Government also held a separate consultation on the methodology used to determine the discount rate for setting employer contribution rates in the unfunded public service schemes (the SCAPE discount rate). The Government is considering responses to that consultation separately and will set out its response in due course; the Government has considered any relevant points to the CCM raised as part of that consultation here.

Stakeholder engagement

1.15 As part of his review, the GA held a stakeholder event attended by member and employer representatives from across the public service pension schemes from England, Wales, Scotland and Northern Ireland. At the event, the GA gathered views on the current functioning of the mechanism and whether there should be any changes made to it. The GA considered stakeholders' views in carrying out his review.

1.16 Following publication of his final report, the GA chaired a webinar which discussed his assessment of the current mechanism and recommendations on possible changes to the mechanism, followed by a Q&A. Speakers also included members of the team that assisted the GA with his review, and an introduction from HM Treasury officials.

1.17 Following publication of its consultation on proposed changes to the cost control mechanism, HM Treasury ran a number of engagement sessions in July and August 2021 to ensure stakeholders were given the opportunity to express their views directly to the Government. Meetings were held with members of Scheme Advisory Boards (SABs)[8] from across the UK relating to each public service workforce, which are made up of member, employer, and administrator representatives. These sessions also allowed stakeholders to seek clarification on any of the proposals. Most stakeholders followed up with formal written responses and the feedback received during the stakeholder sessions and in formal written responses has been considered in deciding the final policy proposals.

1.18 HM Treasury also held a further engagement session with the Local Government Pension Scheme (LGPS) England and Wales SAB in August 2021 to discuss the proposals in more detail, given the difference in the way the LGPS is funded.

1.19 In addition, the Chief Secretary to the Treasury (CST) met with the General Secretary of the Trades Union Congress (TUC) and a delegation of other Trade Union leaders. This allowed the TUC to share their views with the CST on behalf of their member organisations, which stretch across the public sector and are affected by the consultation.

1.20 Stakeholder engagement will remain important as the Government looks to implement changes to the cost control mechanism. HM Treasury will continue to engage with stakeholders directly where necessary, and through relevant government departments responsible for the different public service pension schemes.

[8] Statutory bodies, created by the Public Service Pensions Act 2013, that advise responsible secretaries of state on potential changes to public service pension schemes and advise on the administration and management of the relevant schemes. The SABs usually consist of representatives of the relevant employers, employees and administrators.

Responses to the consultation

1.21 Consultees were asked to respond to a total of 7 questions. Responses to each question were considered in making final policy decisions, and in the drafting of this response.

1.22 Responses to the consultation were received in email form and presented in different formats. Each answered all, some or none of the questions asked in the consultation document. While some responses did not necessarily address the specific questions posed in the consultation document, all responses have been considered appropriately.

1.23 The Government has undertaken quantitative and qualitative analysis of the responses, and the common themes and views are summarised within this document. Whilst trade unions and other representative bodies represent a large portion of public service workers, it should be noted that the Government recognises that the number of responses received does not accurately represent all public service pension scheme members. Therefore, any quantitative data has its limitations and has been handled with caution during the decision-making process. Where we have supplied data in this document, it is to simplify and summarise responses and provide the reader with a sense of trends – the Government did not treat respondents' answers in a binary way (agree or disagree) when forming its final policy.

1.24 HM Treasury received 61 responses from a broad range of respondents. These included trade unions and other member representative bodies, Scheme Advisory Boards (SABs), government agencies, actuarial and pensions specialists and pension scheme administrators. A wide range of trade unions and other member representative bodies, including but not limited to the Trades Union Congress (TUC), Prospect, the Public and Commercial Services Union (PCS), the British Medical Association, the National Education Union (NEU), the Scottish Police Federation and the Defence Police Federation, responded to the consultation, representing over 3.5 million public service workers.

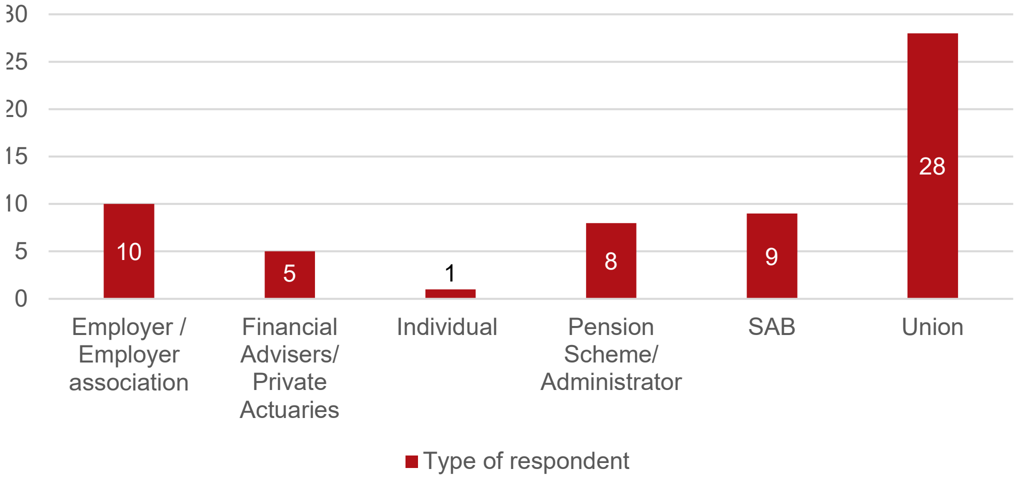
1.25 The 61 responses came from the following stakeholders:

- 9 SABs, representing the NHS (England & Wales), NHS (Scotland), Teachers (Scotland), Police (England & Wales), Police (Scotland), Local Government (England & Wales), Firefighters (England), and Firefighters (Scotland) Schemes.
- 28 trade unions and member representative bodies.
  - Of these, 10 predominantly represent members in schemes for teachers, 4 in schemes for police, 2 in schemes for firefighters, 2 in the scheme for civil servants, 1 in NHS schemes, 1 in schemes for local government, 1 in the scheme for the armed forces, and 7 across multiple schemes.
- 10 employers and employer associations.
  - Of these, 5 predominantly employer members in schemes for teachers, 2 in schemes for local government, 1 in schemes for firefighters, 1 in the scheme for the armed forces, and 1 in multiple schemes.

- 8 pension schemes and administrators.
  - Of these, 7 administer Local Government pension funds and 1 administers multiple schemes.
- 5 financial advisors and consulting actuaries.
- 1 individual.

1.26 A broad range of responses were received, as shown in Chart 1.A, which have been used to identify views and issues from members and bodies in relation to all the main pension schemes. The responses have usefully informed our assessment of the equalities impacts of the policy options, and in line with the Government's duty to have regard to the need to eliminate discrimination, advance equality of opportunity, and foster good relations in formulating its response.

Chart 1.A: Chart



Chapter 2
Changes to the core mechanism

Reformed scheme only design

Proposal

2.1 At present, the cost control mechanism assesses costs relating to active members in the legacy schemes as well as all members in the reformed schemes. The mechanism does not assess costs relating to deferred and pensioner members in the legacy schemes. In its consultation, the Government proposed excluding costs related to the legacy schemes so that, going forward, the mechanism would only consider costs associated with members in the reformed schemes (both past and future service).

2.2 A reformed scheme only design would ensure consistency between the set of benefits being assessed and the set of benefits potentially being adjusted. Under the current cost control mechanism, costs relating to active members with service in legacy schemes are assessed, but rectification can only occur in the reformed schemes. A reformed scheme only design would only assess and adjust benefits in the reformed schemes.

2.3 The consultation also set out that this proposal would reduce intergenerational unfairness as it would mean that comparatively younger members no longer experience changes to their benefits based on the cost of providing benefits to comparatively older members with past service in a legacy scheme.

2.4 Question 1 in the consultation asked whether respondents agree that a reformed scheme only design would achieve the right balance of risk between scheme members and the Exchequer (and by extension the taxpayer) and would create a more stable mechanism.

Responses

2.5 In total 60 stakeholders responded to Question 1. A high majority of respondents agreed with the proposal to move to a reformed scheme only design.

2.6 Many respondents noted that only benefits from the reformed scheme can be adjusted by the mechanism and therefore it is reasonable for the mechanism to only assess the costs of the reformed scheme.

"By reducing the size of the past service component, this would lead to a more stable mechanism, which could potentially increase confidence in the system for both members and employers. It seems reasonable to ensure that only those benefits that can be adjusted by the mechanism are considered in the assessment of cost."

Trades Union Congress (TUC)

2.7 Many respondents also agreed that this proposal would reduce intergenerational unfairness, as it seems unfair that relatively younger members in the reformed schemes should bear the risks relating to the final salary legacy schemes. They agreed that the reformed scheme only design would create a more stable mechanism over the short-medium term. Some respondents noted that stability is a key consideration of the mechanism, because frequent changes to benefits and/or contributions add more complexity to schemes and can create confusion among members.

"The NEU believes a reformed scheme only design is fairer on intergenerational grounds. This is especially the case for those members who join after April 2022 (the current proposed date to move all active members into the career average schemes). It seems unfair to make these members in particular bear risks relating to the previous final salary schemes."

National Education Union (NEU)

2.8 Some respondents noted that creating the "right" balance of risks between scheme members and the Exchequer is a different objective to that of creating a more stable mechanism, although the proposal to include both past and future service from reformed schemes in the mechanism represents a reasonable compromise between these aims.

2.9 Some respondents favoured the current design of the mechanism which takes account of costs in both the legacy and reformed schemes, and noted that a reformed scheme only design does not reflect that many members will have service in both the legacy and reformed schemes. They felt that changes in the value of final salary benefits should be taken into account when determining whether reformed scheme benefits should change, and that a cost control mechanism should cover all liabilities, not just those of the reformed schemes or future benefits.

2.10 Alternatively, a small minority of respondents argued for a future service only mechanism. They felt that the mechanism is designed to rectify any future service benefits and therefore an approach that only accounts for the revised costs of future benefits may be more appropriate. They argued that past service benefits in the reformed schemes will inevitably increase over time, and that where the impact of past service is included, but only future benefits are changed, intergenerational unfairness occurs. Therefore, they felt that a future service only design will preserve fairness for future joiners to schemes. Additionally, they felt that a reformed scheme only design will only have a short-term impact on intergenerational fairness as the value/cost of past service will build up over time. Some respondents were also concerned that one of the justifications the Government provided for rejecting a future service only design in its consultation was that it would make it *"difficult for the Government to respond to changes in overarching pension legislation which impacts past service costs or to respond to court judgements which impact past service, such as McCloud."* They felt it was not appropriate that a decision on reforming the cost control mechanism should be influenced by what they claimed was the Government's desire to avoid any future costs arising from any future wrongdoing.

"The proposed inclusion of both past and future service reformed scheme benefits seeks to address the competing objectives of maintaining the value of a public service defined benefit pension scheme to members, and protecting the exchequer from unforeseen costs. Stability will be important for confidence on both issues and member benefit and contribution rates are of importance to members. The SPF however is less persuaded this approach will have as stark an impact as is suggested on intergenerational unfairness. Although we consider this is a likely short-term outcome, we feel it is important to observe that past service benefits will inevitably increase in value over time. The potential impact of this on the cost cap and the weighting this will add to potential floor or ceiling breaches appear obvious. The very nature of cost cap reviews could see breaches that were essentially driven by past service experience (and by default, usually by the oldest members) being addressed by changes (either in contribution rates and/or benefits) being borne by younger scheme members."

Scottish Police Federation

2.11 A small number of respondents also raised questions about the potential interaction between the McCloud remedy cost and cost sharing under a reformed scheme-only design, and what impact this would have on the 2020 valuations.

2.12 Several respondents with an interest in the Local Government Pension Scheme (LGPS) noted that a reformed scheme only design may be more difficult to achieve for LGPS given the effect of the underpin1, and it was not made clear in the consultation how the underpin will be treated under this design. They also noted that unlike for the unfunded schemes, where the risk of legacy benefits would be borne by the Government, for the funded LGPS the risk of legacy benefits would fall entirely on LGPS employers.

[1] The Local Government Pension Scheme for England and Wales (LGPS) was reformed in 2014 and all members were transferred to the reformed scheme. LGPS members in scope will be protected by an underpin in respect of any accruals from 1 April 2014 to 31 March 2022. This will provide, within the reformed scheme, whichever is the higher: the pension under the reformed scheme or the pension they would have been entitled to under the legacy scheme.

Government response

2.13 The Government has considered the responses received and remains of the view that a reformed scheme only design achieves the right balance of risks between members and the Exchequer, improves stability of the mechanism and reduces intergenerational unfairness. As set out above, this view was shared by the majority of respondents. The Government recognises that creating the right balance of risks between scheme members and the Exchequer and creating a more stable mechanism are not the same aim. However, the Government feels that a reformed scheme only design will allow the mechanism to better meet both aims. Although it means that the risk associated with legacy scheme costs will be transferred to the Exchequer, the Government believes this is the right approach to take in order to reduce intergenerational unfairness and ensure the mechanism is fairer to younger members who did not previously have access, or had access for a shorter time, to the legacy schemes.

2.14 It is acknowledged that many members will have service in both the legacy and reformed schemes. However, from 1 April 2022, it is intended there will be no members accruing benefits in the legacy schemes, and members with legacy scheme benefits will gradually leave active membership over the coming decades. The GA found that a key cause of the floor breaches seen in the provisional results of the 2016 valuations was the impact of the legacy schemes. The Government believes it is right that as the mechanism can only adjust the benefits of the reformed schemes, it should only account for the costs associated with the reformed schemes. This is emphasised by the fact that the IPSPC concluded that the structure of the legacy schemes was unfair and unsustainable, so it would not seem appropriate for these schemes to continue to influence the level of benefits in the reformed schemes.

2.15 The Government also recognises that the past service component of the reformed schemes will increase over time, and that a future service only design would therefore further reduce intergenerational unfairness and increase stability. However, the Government does not believe that the Exchequer should bear the entire risk of costs associated with past service in the reformed schemes. The mechanism was designed to protect both taxpayers and members, and the Government believes that a future service only design would not adequately protect taxpayers from unforeseen increases in costs. Additionally, the Government remains of the view that a future service only mechanism would restrict its ability to respond to future developments, such as changes in overarching legislation or court cases which may impact the value of past service benefits, such as McCloud. If a future development were to retrospectively impact the value of past service in the reformed schemes for members (for example following a legal judgment), and therefore increase the value of schemes to members, then it would be accounted for in the cost control mechanism, in line with the pre-determined framework for assessing costs. It should also be noted that under this approach, if the value of the past service component of the reformed schemes falls, the CCM would take account of this.

2.16 The Government will provide further details on how the reformed scheme-only design will be implemented at the 2020 valuations and beyond, and the extent to which there will be any interaction with the McCloud remedy at future valuations, in due course.

2.17 In relation to LGPS, the Government notes that removing the impact of legacy schemes means that these risks sit with employers. The Government acknowledges that the arrangements for budgeting for and funding LGPS employer contributions are different from the unfunded schemes. It is also acknowledged that the implementation of the reform scheme only design may be different for the LGPS given the presence of the underpin within the reformed schemes. However, the Government still believes that a reformed scheme only design is appropriate for LGPS, and that it is still fair and appropriate to remove the impact of the legacy schemes from LGPS for the same reasons as set out above, including to reduce intergenerational unfairness. The Government will work with LGPS stakeholders to consider the most appropriate way to implement this proposal for LGPS at the 2020 and subsequent valuations, including the treatment of the underpin, and provide further details in due course.

Wider corridor

Proposal

2.18 The corridor is currently set at +/-2% of pensionable pay for all schemes. In its consultation, the Government proposed widening the corridor to improve the stability of the mechanism. The Government set out that it considered a corridor of +/-3% of pensionable pay to be appropriate when applied to a reformed scheme only mechanism, which will increase the stability of the mechanism while also continuing to provide effective cost control.

2.19 Question 2 in the consultation asked for views on the Government's intention to widen the corridor. Question 3 asked for views on whether the proposed corridor size of +/-3% is appropriate.

Responses

2.20 Both questions 2 and 3 were responded to by 59 stakeholders each. A majority of respondents agreed with the proposal to widen the corridor, and a slight majority agreed that the corridor should be set at +/-3% of pensionable pay. That majority welcomed the fact that widening the corridor would lead to a more stable mechanism by minimising the frequency of breaches, which will lead to fewer changes in benefits or member contributions. They felt that a corridor size of +/- 3% was appropriate, and will strike the right balance between stability and effective cost control. However, their view was that +/-3% should be the absolute maximum size of the corridor.

2.21 A key concern amongst those who favoured retaining a +/-2% corridor was that although a wider corridor would increase stability, it would mean that changes would be too infrequent which would diminish cost control. They did not consider the estimated breach frequency of every 5 valuations[2]

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2 based on modelling provided by the Government Actuary's Department

(therefore every 20 years) expected under the current corridor to be too frequent.

"SLS agrees with the proposal to widen the corridor to develop a more stable cost control mechanism, as per the Government's stated intention. A wider corridor will reduce volatility, leading to fewer changes in benefits or member contributions. However, it is possible that any subsequent changes will, by their definition, be greater in exacerbating the "cliff edge" nature of the cost control mechanism."

School Leaders Scotland (SLS)

2.22 A majority of respondents, including many of those who agreed with the proposal for a widened corridor and supported the corridor size of +/-3%, as well as those who disagreed, raised concerns that widening the corridor exacerbates the 'cliff edge' nature of the mechanism. This is because under a wider corridor, larger changes in costs can occur without any remedial action. They noted that this would mean changes in costs between +/-2 to 3% could go unaddressed for long periods of time and argued this could cause problems to go undetected. They argue that this would increase the scale of rectification necessary when a breach does occur, which would mean significant benefit changes for members once the mechanism was triggered. A proposal put forward to mitigate the risk of dramatic changes in benefits was that when a breach occurs, the mechanism could allow schemes to bring costs back to a level within the corridor to rectify the breach, rather than back to the employer cost cap.

2.23 An alternative suggestion to manage the cliff edge risk was that schemes could be provided with discretionary powers to adjust benefits if costs moved within the corridor e.g. that schemes would have the option, but not the obligation, to adjust benefits if costs moved between +/-2% and +/-3%. They argued that providing schemes with this type of flexibility would allow for earlier and milder interventions.

2.24 Many respondents expressed concerns that a +/-3% corridor would still not lead to stability for certain schemes. They argued that a proportional cost corridor, where the size of the corridor would vary depending on the size and costs of that scheme, would be more appropriate. They felt that schemes have different overall pension costs, so a +/- 3% corridor may be proportionally narrower or wider for certain schemes versus others. They argued that while an average scheme is estimated to expect a breach frequency once every 10 valuations under a reformed scheme design with a +/-3% corridor (based on modelling from the Government Actuary's Department), schemes with higher costs could expect a breach more frequently. On this point, respondents argued that different public services have different characteristics and different workforce challenges to deal with, so sector-specific approaches may be more appropriate.

"As a scheme with a higher total long-term cost than most other public service pension schemes, we are concerned that, even with a widening of the corridor to +/-3% of pensionable pay, we may still be more likely to suffer breaches as a result of events that are not out of the ordinary, due to the fact that the cost corridor is proportionately narrower for the FPS than other public service pension schemes. For example, a 3% corridor would require a 15% increase in long-term costs for the Teachers' Pension Scheme but only a 10% increase for the FPS, for the cost cap to be breached. Therefore, while the "average" scheme might expect a breach only once every 40 years, the Fire schemes might expect a breach more frequently than this. If instead the 40 years breach was set consistently between schemes, this could be achieved by setting the corridor as equal to the 15%, say, of the cost of the scheme. Thus, if the corridor was set at +/-3%, say, for the Teachers' Pension Scheme (which had a 2012 long-term cost of 20.5%), then the proportionate corridor for the FPS, would be +/-4.4%."

Firefighters' Pensions (England) SAB

2.25 The Police Pension SAB argued that in absence of proportional cost corridor, a consistent +/-4% corridor for all schemes may be more appropriate to improve stability for those schemes with higher costs too. Some suggested that the Government should ask the GA to provide modelling specifically for each individual scheme, rather than base a decision on modelling for an average scheme. A small minority expressed concerns on whether the estimates of expected breach frequencies could be relied upon.

2.26 Some respondents felt that widening the corridor did not seem necessary if the proposal for an economic check was put in place. Similarly, a small number of respondents felt that a wider corridor would be unnecessary if a reformed scheme only design is adopted, and only supported implementing one or the other.

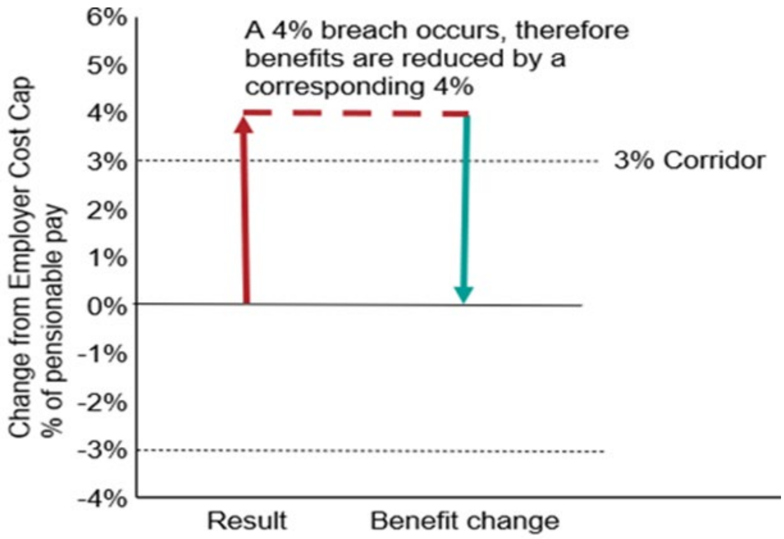
Government response

2.27 The Government recognises that a wider corridor increases the cliff edge nature of the mechanism, and that this means larger changes in costs can occur without any remedial action. This was highlighted in the GA's report and the Government considered this risk carefully as part of the consultation process. To clarify, a wider corridor will not mean that different action would need to be taken if a breach beyond +/- 3% was observed. For example, a breach of +/-4% would still require the same changes in benefits under either a +/-2% or +/-3% corridor. This is illustrated in the diagram below.

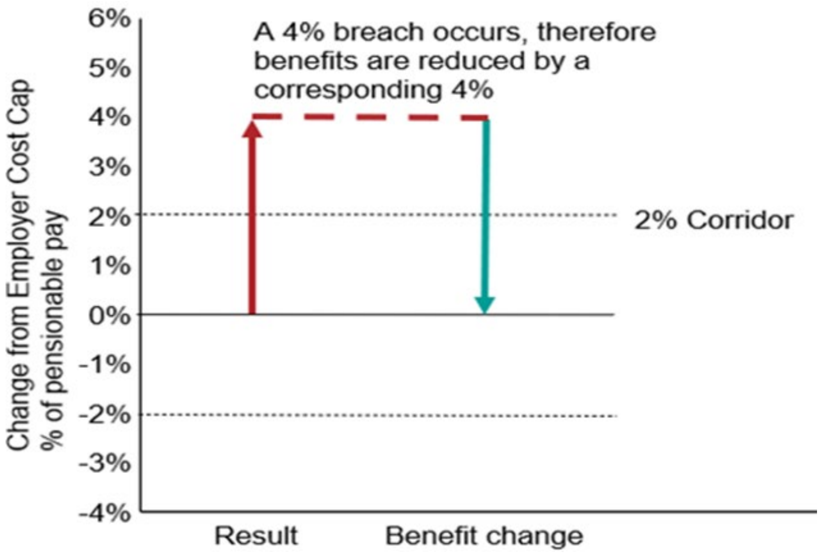
Box 2.A: Corridor width illustrations

Scenario: the costs increase by 4% of pensionable pay from the employer cost cap in a single valuation. Regardless of whether the corridor is +/-2% or +/-3%, the same level of benefit change will occur.

3% corridor



2% corridor



Illustrations provided by the Government Actuary's Department

2.28 However, a +/-3% corridor will mean that cost changes between +/-2-3% will not trigger a breach and require rectification, which could lead to a larger than otherwise breach occurring at subsequent valuations. For example, if at one valuation the results were +/-2.5% and then at the next were +/-3.5%. The Government considers that, although this risk exists, a wider corridor is necessary to ensure a more stable mechanism and limit the frequency of benefit changes. The Government considers that a +/-3% corridor would strike the right balance between providing effective cost control and a stable mechanism. A corridor size larger than this would not be appropriate as it would allow costs to diverge by too much before being brought back to target.

2.29 It is also not correct to assume that if a scheme shows cost changes between 2-3% at one valuation, then that automatically means that costs would either stay at that level or move further in the same direction at subsequent valuations and therefore result in a breach that would be larger than under a smaller corridor. Multiple factors affect the cost of a scheme. It is perfectly possible that a scheme may see a small increase in costs at one valuation, and then a reduction in costs at the next due to a change in factors. A wider corridor of +/-3% may prevent confusion and disruption for schemes and members by reducing the likelihood that smaller, temporary fluctuations in costs within the corridor will lead to benefit changes, which may then be reversed at subsequent valuations.

2.30 In response to the proposal to mitigate large benefit changes when breaches occur by allowing schemes to bring costs back to a level within the corridor rather than back to the target of the employer cost cap, the Government does not believe such an approach would provide effective cost control. Bringing costs back to the level of the cap once the +/-3% corridor is breached ensures that costs are brought back to the original level. If costs are only brought back to the edge of the corridor or to within e.g.1% of the employer cost cap, then that means the mechanism would not be maintaining value to members or fully protecting taxpayers (because as soon as costs have increased by more than 3% they will always be higher than their original level). That might result in more frequent breaches and reduce stability. Furthermore, if the approach was to allow either the Government or scheme to determine the appropriate level to bring costs back to, depending on the size of the breach, this would introduce a level of subjective decision making into the process, contrary to the transparent and mechanical process which the Government believes it is very important to maintain.

2.31 In relation to a proportional cost corridor, the GA mentioned in his report that it would be reasonable to consider this. However, the GA did not recommend this approach over a consistent corridor as a percentage of pensionable pay. The Government has considered this option and does not believe that it would be a better approach. A consistent corridor size limits the absolute change in costs that can occur across all schemes before a breach is triggered. The Government does not consider that just because a scheme is more expensive from the outset, it should be allowed to let costs change by a greater absolute amount. Furthermore, the Government considers that a proportional cost corridor would be overly complex and more difficult for members to understand than the current consistent corridor design, potentially eroding transparency and trust in the mechanism. It is important that members understand the mechanism operates consistently and transparently across all the public service pension schemes. Therefore, the Government chose not to consult on this option, and maintains the view that it is preferable to have a consistent size corridor, based on a specified percentage of pensionable pay, across all schemes. A proportional corridor could also raise concerns of fairness, as wider corridors for schemes with higher costs may appear to benefit members of some schemes over others. It could lead to a position where there is the same change in costs in two different schemes with different cost corridors (but that represent a consistent proportional cost); the scheme with a narrower cost corridor could see benefits or contribution rates adjusted whereas a scheme with a relatively wider proportional cost corridor would not. The Government acknowledges that a +/-3% corridor may result in greater stability for some schemes compared to others. However, the Government maintains that on balance, the same size corridor applied uniformly to all schemes is the fairer solution.

2.32 Similarly, the Government does not believe it would be beneficial to provide schemes with a discretionary power to adjust benefits if costs changes are observed within the +/-3% corridor. Such a discretionary power would rely on schemes reaching agreement between employers and members on whether to adjust benefits if e.g. a movement in costs between 2-3% was observed. The Government believes it is important to maintain the mechanical and objective nature of the CCM, whereas this approach would introduce an element of subjective decision making which the Government believes would increase complexity, erode transparency and reduce trust in the process. Furthermore, a key advantage of the +/-3% corridor is that it will reduce the frequency of breaches and lead to increased stability and certainty over benefit levels, which this approach will not provide to the same degree. Additionally, the lack of a consistent approach across all schemes may raise issues of fairness, as it could lead to cases where two schemes experience the same change in costs, but one agrees to adjust benefits and the other does not. The Government believes it is important to ensure that all schemes are subject to the same general rules, and that rectification action is only taken when breaches occur outside of the +/-3% corridor.

2.33 Some respondents felt that implementing a wider corridor alongside the reformed scheme only design was unnecessary. However, modelling from the Government Actuary's Department suggests that a +/-2% corridor under a reformed scheme only design would still result in expected breaches on average every 5 valuations (every 20 years), which the Government believes would be too frequent and not in line with the aim of a stable mechanism that is only triggered by unforeseen and unpredictable events. The Government believes that an estimated breach frequency of every 10 valuations (every 40 years) provides the right balance between stability and effective cost control.[3]

3 Please note that these estimated breach frequencies are provided as a high-level indication only. They are of course just estimates based on a certain set of parameters, the actual frequency at which breaches occur is unknown and may well differ from these estimates. Furthermore, if the estimated breach frequency is for example "once every 5 valuations" for an individual scheme that does not mean it is expected to happen exactly every 5 valuations. It may mean that a scheme still breaches either the floor or ceiling at the next scheme valuation, whereas another scheme may breach after another 2, 3 or 4 valuations. Although in practice there will be a strong degree of correlation between the outcomes for different schemes.

Chapter 3
Economic check

Proposal

3.1 Currently, the cost control mechanism does not consider the long-term economic outlook (such as changes in expected long-term GDP or the long-term earnings assumption) when determining whether breaches should result in a change to member benefits. The GA recommended introducing an objective and symmetrical technical validation layer, which would only allow a breach to be implemented if it would still have occurred had the long-term economic assumptions been considered. In its consultation, the Government proposed introducing an 'economic check' to the cost control mechanism, in line with the GA's recommended design.

3.2 Under the GA's recommended design, a breach would only be implemented if the cost of a scheme still results in a breach once the impact of any change in the SCAPE discount rate on the cost of the scheme is taken into account. The consultation set out that, depending on the outcome of the review of the SCAPE discount rate methodology, the economic check would be based on objective forecasts of expected long-term GDP growth from the OBR (potentially through the SCAPE discount rate) and would also take account of changes in the long-term earnings assumption. Examples of how the economic check would work in practise are set out at Annex C.

3.3 Question 4 of the consultation asked for views on whether stakeholders agreed with the proposal to introduce an economic check. Question 5 asked for views on whether the SCAPE discount rate, which under its current methodology is linked to expected long-term GDP growth, is an appropriate economic measure for the economic check. Question 6 asked for views on whether, in the case where the SCAPE discount rate methodology changes, expected long term GDP is an appropriate measure, and if not, what other appropriate measures may be.

Responses

3.4 In total, we received 60 responses to question 4, 54 responses to question 5, and 52 responses to question 6.

3.5 In response to question 4, similar numbers of respondents agreed with the proposal to introduce an economic check as disagreed with the proposal. Some respondents were ambivalent, and noted that an economic check may be beneficial, but expressed a number of reservations.

3.6 Respondents who supported the proposals noted that it could help avoid 'perverse outcomes' such as those seen at the 2016 valuations and identified in the GA's final report, where no factors linked to the change in economic growth were considered and help improve stability. They felt it was important that a symmetrical check would also maintain scheme benefits in the event of increased scheme costs but an improved economic outlook.

> "Yes, an economic check makes sense and will help avoid perverse results such as those seen in the preliminary 2016 results where no factors linked to the change in economic growth were considered."
>
> Essex Pension Funds

> "Although the proposals fundamentally alter the cost control mechanism, some form of economic check seems appropriate since it should help to improve the stability of public sector pension schemes and avoid perverse outcomes such as that experienced with 2016 scheme valuations. Stability and affordability for government, employers and scheme members has to be sought to maintain the long-term viability of public pensions."
>
> Fire Officers' Association

3.7 Many respondents expressed concerns this proposal may be a breach of the 25-year guarantee. They argued that the economic check is a significant departure from the process for the cost control mechanism originally agreed between Trade Unions and the Government and that, during discussions at the time, it was strongly suggested by the Government that the originally agreed cost control processes were covered by the guarantee. A related concern was that the Government has previously made explicit promises that employers would meet any costs arising from changes to the SCAPE discount rate, and that such impacts would be excluded from the cost control mechanism as they were not member costs. Relatedly, some also questioned the concept of 'perverse outcomes' presented in the GA's report and noted that the exclusion of SCAPE from the CCM was an intentional decision and so there was no expectation that employer rates and the results from the CCM would move in the same direction.

> "ASCL's view is that the exclusion of the SCAPE discount rate from the cost control mechanism is a fundamental part of its design. So, whilst the discount rate currently has no impact on member's benefits, the proposal introduces a risk of to both members' benefits and contributions being affected by changes in the discount rate."
>
> Association of School and College Leaders (ASCL)

3.8 Many respondents expressed concerns that the check could easily be subject to Government or political interference, and they would need significant assurances that it would operate objectively and transparently. Some felt that the proposed design essentially amounts to a qualitative review and would lead to arbitrary decisions by Government on whether or not to apply the results of a cost control valuation. In contrast to this, others noted that a qualitative breach review, instead of or alongside an economic check, may actually be more appropriate and preferable. They recognised the need to consider the reasons behind a breach if it occurs and consider the appropriateness of any corrective actions. The NHS Scheme Advisory Board (SAB) proposed a form of qualitative breach review where the SAB would provide advice to the Secretary of State if a breach occurs. This would include an assessment of why the breach has occurred, a recommendation of whether any rectification is necessary and, if so, the extent of any such rectification. They argued that this *"places emphasis on qualitative collaboration rather than running more numbers and would be a more open and transparent process."* The SAB urged Government to give serious consideration and directly respond to this alternative proposal.

> "The cost control mechanism needs to operate independently from politics and all stakeholders and scheme members need to feel reassured that the sole purpose is to objectively measure costs without results being subject to wider political issues. Ultimately, UNISON remains unconvinced by the economic check methodology proposed in the consultation and considerable reassurance is needed from HM Treasury to ensure that any economic check is fair, transparent, and free from government manipulation. We also wish to register our concerns as to whether these proposed changes to the cost control mechanism contradict the Government's 25-year Guarantee for not making further scheme reforms and undermine the Proposed Final Agreements struck with schemes."
>
> UNISON

3.9 In relation to what measure of economic growth is appropriate, many expressed a strong view that the discount rate used in the economic check should match the rate used to set employer contribution rates, to avoid perverse outcomes in future. They argued that assumptions used to set employer contribution rates should be consistent with those used in the mechanism and the economic check. They felt that if a methodology based on the Social Time Preference Rate (STPR) was adopted for setting the SCAPE discount rate then the economic check should also be based on STPR. Others argued for the merits of using STPR on its own terms regardless of the SCAPE discount rate methodology. As STPR is a measure used to assess other government investments, they argued that it is also appropriate to assess pension costs, as public service pensions are also a form of government investment.

3.10 Some respondents highlighted that the adoption of a methodology based on expected long term GDP growth to set the SCAPE discount rate in 2011 had contributed towards increased volatility in employer contribution rates over the last 10 years. They argued that if the SCAPE methodology had remained based on STPR, employer contribution rates may not have increased at the 2016 valuations and the 'perverse outcomes' identified by the GA at the 2016 valuation provisional results would not have occurred. They therefore argued that adopting a SCAPE discount rate methodology based on STPR could negate the need for an economic check. They felt that trying to address problems caused by the SCAPE discount rate methodology through the cost control mechanism was inappropriate.

3.11 Some felt that an economic check was an unnecessary addition to the reformed scheme only and wider corridor proposals. Others supported the proposal, but only if applied to a future service only mechanism. Concerns were also expressed by some respondents that an economic check would mean that results which showed a breach may be hidden, and that SABs may not be told about the results of the mechanism before the long-term economic outlook is taken into account.

LGPS responses

3.12 Respondents with links to the LGPS were consistently of the view that if an economic check was adopted, linking it to expected long-term GDP would not be appropriate for the LGPS. They felt that unlike with the unfunded schemes, the SCAPE rate does not directly drive employer costs, which are determined by locally set discount rates, taking advice from fund actuaries as part of the triennial fund valuation process. These locally determined discount rates are designed to track the returns of each LGPS fund's investment strategy, risk appetite and globally diversified asset allocations. The LGPS, as a funded scheme, looks to achieve investment returns to ensure a minimum call on future local taxpayers by maintaining a pension fund able to meet all future liabilities. They argue that this is a fundamentally different situation to the unfunded schemes, where taxpayers are directly responsible for paying the cost of public service pensions.

3.13 Respondents proposed alternative approaches for the economic check. One key alternative was to use an LGPS specific discount rate for the economic check in relation to its application to LGPS. Such a rate could take into account factors that influence the actual discount rates in operation across the LGPS to reflect both future and past investment returns.

> "..the SCAPE rate is divorced from the drivers of actual employer contributions in the scheme. These contributions, which are determined locally, use discount rates designed to track the returns of each LGPS fund's investment strategy, risk appetite and globally diversified asset allocations. A discount rate based on the OBR's long-term forecast of UK GDP is entirely appropriate for assessing the future affordability of the unfunded schemes against the projected tax base. The purpose being to ensure the costs of the scheme remain affordable to future taxpayers who will be responsible for meeting those costs. The LGPS, as a funded scheme, looks to set a discount rate for a different purpose. That purpose being to ensure a minimum call on future local taxpayers by maintaining a pension fund able to meet all future liabilities. As such the rate must be able to reflect changes in global asset values given the global nature of the scheme's investments. We would therefore propose that – should the economic check be introduced – it would, for the LGPS, use the changes in an 'LGPS discount rate' rather than SCAPE. Such a rate would take into account the factors which influence the actual discount rates in operation across the LGPS (reflecting both future and past investment returns) and would therefore be much more closely aligned with movements in employer contributions."
>
> LGPS (England and Wales) SAB

3.14 Another alternative was based around the separate but subordinate cost management process that is operated by the LGPS (England and Wales) SAB, and was set up given the key differences between LGPS and the unfunded schemes. The current SAB process operates within and is subject to the CCM. It is broadly similar but can use different assumptions around employee cost elements. It was argued that this SAB process could act as the economic check for LGPS, and would be required to reflect movements in an LGPS specific discount rate as proposed above. It would operate in the same way as the economic check, in that it could not cause or extend a breach – only provide a check on a breach (either way). In operational terms, a breach of the HMT corridor would only result in mandatory recommendations for a change to benefits/contributions if the LGPS SAB process also resulted in a breach.

3.15 The Scottish LGPS SAB also proposed an alternative for a continuous review process rather than the current cost control process which always takes place at one point in time. The SAB suggested that such an approach could be based on a combination of the England and Wales SAB model and work undertaken by GAD, but crucially would be on a continuous basis. This would not however mean that breaches or non-breaches would be measured or that changes would need to be applied more frequently, as any decision to change could come at an agreed point in time.

Government response

3.16 The Government has considered all responses and maintains the view that an economic check should be introduced for all schemes, with further consideration required for potential allowances for the LGPS. The economic check will operate in line with the GA's recommended design and will be linked to the OBR's independent and objective measure of expected long-term GDP growth and the long-term earnings assumption. The economic check may potentially be linked to the SCAPE discount rate if the methodology remains linked to expected long-term GDP growth. The SCAPE consultation response will be published in due course.

3.17 In his report, the GA concluded that the mechanism cannot protect the taxpayer unless it has some allowance for changes in the long-term economic outlook. Ultimately, future taxpayers will pay the costs of any pension benefits accrued now. In the Government's view, the main purpose of the economic check is to ensure consistency between benefit changes and changes to the wider economic outlook. This approach ensures that there will be a higher bar for benefit increases to be awarded if the country's long-term economic outlook has worsened. This will equally apply to benefit cuts if the long-term economic outlook has improved. The Government believes that using an independent and objective measure of expected long-term GDP growth best serves this purpose. For the unfunded schemes, pensions are paid out of general taxation, so the Government feels it is appropriate to introduce an economic check to ensure the mechanism is better able to protect the taxpayer. However, the Government also feels it is equally important to honour the objective to protect the value of schemes to members, and therefore the economic check will operate symmetrically to also protect the value of schemes to members.

3.18 The Government agrees that it is of the utmost importance that an economic check should be implemented in a transparent way, and that the process will be mechanistic and objective. The Government can confirm that the economic check will apply symmetrically, operating in the exact same way in relation to floor breaches as it would to ceiling breaches. It will operate purely mechanically, with no scope for interference from individuals or groups, either from within the Government, or outside.

3.19 The costs of the schemes would be assessed excluding any changes to the long-term economic variables, as they are now, to see if a breach has occurred. If a breach has occurred, in either direction, then the calculation would be repeated with the measure of the wider economic situation – changes in expected long-term GDP and changes in the long-term earnings assumption - taken into account. If a breach had still occurred in the same direction following this second calculation, only then would it be implemented, with the smaller of the two breaches being implemented. In this way, the economic check could offset a breach of either the floor or the ceiling, but it could never cause a breach or increase the size of a breach. The economic check would apply to initial breaches in either direction, so would operate symmetrically.

3.20 The Government does not currently see the value in implementing a subjective breach review, either instead of or alongside the economic check.

The Government believes that a key advantage of the economic check is that it will be mechanistic and transparent, and apply consistently across all schemes. The Government believes it would be difficult to ensure that a subjective breach review could operate in the same way so that members felt that their benefits were being decided in a transparent way.

3.21 In response to the alternative suggestion from the NHS SAB, the Government feels this again raises the same issues as a discretionary power to take action when costs move within the corridor. Such an approach would introduce a level of subjective decision making into the process and not be in line with the Government's intention to maintain an objective, technical and mechanical CCM, and the views of many respondents who wanted reassurance that the check would not be subjective. Such an approach would also not be in line with the main objective of the economic check, to ensure consistency between benefit changes and changes to the wider economic outlook. It is difficult to determine how an individual, group or SAB could make such a judgement without considering long-term GDP projections in any case.

3.22 The Government will shortly respond to its consultation on the methodology used to set the discount rate for setting employer contribution rates in the unfunded public service schemes. The Government invited respondents to provide views what it believes are the two most appropriate possible methodology options for setting the SCAPE discount rate: a methodology based on expected long-term GDP growth and a methodology based on STPR. Respondents were also able to suggest alternative methodologies. In reaching a decision on the SCAPE discount rate methodology, the Government will have regard to the distinct objectives for the SCAPE discount rate, which differ to the cost control mechanism, and points raised by stakeholders in support of consistency between the discount rate and the economic check.

3.23 The Government does not believe that the STPR would be an appropriate measure for the economic check. The STPR is set by HM Treasury as an estimation of society's preference for consumption sooner rather than later and is used by the Government to appraise the value for money of projects which involve short-term public expenditure to deliver future welfare benefits. The STPR is not intended to provide an estimate of the long-term economic outlook.[1] As a result, it does not fulfil the purpose of the economic check: to ensure consistency between benefit changes and changes in the wider economic outlook. Therefore, the measure of long-term economic outlook applied to the economic check will be linked to expected long-term GDP growth for the reasons set out above. The economic check may potentially be linked to the SCAPE discount rate if the methodology remains linked to expected long-term GDP growth.

3.24 The Government recognises that the addition of the economic check is introducing a new step into the process, and that political statements were

[1] For further details on the Social Time Preference Rate please see Annex 6 of the Green Book. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/938046/The_Green_Book_2020.pdf

made to the effect that the 25-year guarantee would mean that there should be no changes to scheme design, benefits or contribution rates outside of the processes agreed for the CCM. However, the Government does not believe that the proposal for the economic check necessarily breaches the 25-year guarantee. The elements protected by the 25-year guarantee in law are set out in section 22 of the Public Service Pensions Act 2013 and include i) the CARE nature of schemes, ii) member contribution rates and iii) benefit accrual rates. The cost control mechanism is not one of the protected elements. Furthermore, the Government is proposing this change following a thorough and independent review of the mechanism by the GA. As the GA's report makes clear, the CCM processes are not operating properly to serve its objective to sufficiently protect taxpayers. The Government is now seeking to implement the economic check to improve the CCM process and ensure the mechanism is better able to meet this objective, while also ensuring that the mechanism equally continues to protect members.

3.25 Furthermore, the introduction of the economic check will reduce the likelihood that member benefits can be reduced or increased in future, in line with the principles of the 25-year guarantee to provide greater stability and confidence to members on benefit levels. It is right that Government is able to review policy and make changes if it is felt that a key element of a reform is not operating as designed, after following a proper process of review and an open and transparent consultation. The Government is not proposing to make changes to the objectives of the mechanism themselves. However, the Government believes that even if the introduction of the economic check were to contradict previous statements made, it would in any event be justified and proportionate to depart from those statements in the circumstances. The economic check will maintain the technical and symmetrical nature of CCM processes and will never be able to cause benefit reductions, or benefit improvements, only prevent or reduce benefit changes.

3.26 The Government recognises that when the mechanism was set-up, the intention was that changes in the SCAPE discount rate, and by extension changes in expected long-term GDP growth, would be excluded and would not impact on member benefits. However, in line with the GA's recommendations and for the reasons set out above, the Government believes it is now justified and appropriate to introduce the impact of changes in expected long-term GDP growth to the mechanism, albeit in a limited way, through the economic check.

3.27 While some respondents felt that the economic check would be unnecessary under a reformed scheme only design and a 3% corridor, the Government believes all three proposals should be implemented in tandem. Without the economic check, the mechanism will not be able to ensure consistency between benefit changes and changes in the wider economic context. In relation to suggestions that the economic check should only be implemented under a future service only design, the Government does not believe a future service only design would be appropriate for the reasons provided in chapter 2.

3.28 In response to concerns around whether schemes will be notified at future valuations of how schemes costs have changed prior to the application of the economic check, and to ensure transparency, the Government would expect valuation reports to publish results both before and after the impact of the economic check.

Government response for the LGPS

3.29 The Government has taken into consideration the concerns raised by LGPS stakeholders that an economic check linked to expected long-term GDP growth is not appropriate for the funded LGPS. The Government recognises the different nature of the LGPS, which is funded and where money is invested in a diverse range of global assets, and acknowledges that different considerations apply to LGPS. In particular, expected long-term GDP growth is not used to set employer contribution rates for LGPS. However, on balance, the Government still believes that the economic check as a whole is an appropriate proposal for LGPS.

3.30 Firstly, while it is correct that the discount rate used to set employer contribution rates in LGPS will be based on expected investment returns, expected long-term GDP growth should act as a broad proxy for this and therefore the use of the economic check as envisaged would still appear to be relevant. Furthermore, as noted by respondents, the purpose of LGPS investments is to minimise the cost pressures facing LGPS employers who will meet the balance of costs. If the cost of benefits go up the responsibility will fall on local authorities, who are funded to a significant extent by local taxpayers, and other LGPS employers. Similar to the reason for the economic check for the unfunded schemes, the purpose is to ensure consistency between benefit changes and changes in the wider economic outlook. Whilst the financial health of individual local authorities is not directly linked to the expected long-term GDP growth, the Government would still expect a link between the economic performance of the UK and the financial health of local authorities. It is also important to note that the IPSPC reforms were intended to provide some commonality of design and value across the public service pension schemes, particularly for the non-uniformed services, which also requires similarities of approach in valuing and amending schemes. A consistent approach also means that public service workers will not be treated differently in unfunded and funded schemes. Therefore, having considered the alternatives, the Government remain of the view that an economic check linked to expected long-term GDP is appropriate for the LGPS.

3.31 In relation to the 2 alternative proposals, the Government does not consider they would be appropriate to include in the mechanism. An LGPS specific rate based on a best estimate of expected returns would introduce a level of subjectivity into the mechanism, as any discount rate based on future investment returns would be subjective, and there will be a huge range of views on how any particular asset may be expected to perform. As noted above, the Government does not currently believe that introducing a level of subjectivity into the mechanism is desirable, as it may erode transparency and trust in the process. The Government also does not believe there should be a change to the current dynamic between the England and Wales LGPS

SAB process and the cost control mechanism. The Government believes that the current interaction between the 2 separate but linked processes should be maintained. Given the different nature of the LGPS, the Government acknowledges the value of the SAB process in that it can take account of LGPS specific assumptions to provide a recommendation to the Government as part of the cost control valuations.

3.32 HM Treasury will work with the Department for Levelling up, Housing and Communities and LGPS stakeholders to consider whether it is desirable for the England and Wales SAB process to be adapted in line with the principles of the economic check. The Government also acknowledges that the Scottish and Northern Irish SABs may wish to consider introducing a similar process to the England and Wales SAB and will work with colleagues in the Devolved Administrations if they feel it would be desirable to do so.

3.33 In relation to the alternative proposal from the Scottish LGPS SAB, the Government believes this proposal is to effectively replace the cost control mechanism entirely, rather than just reform it. The Government does not wish to fundamentally replace the cost control mechanism with an alternative cost management approach, but to improve its operation.

Other issues raised

3.34 Some respondents raised other issues not directly related to the questions posed in the consultations, which the Government has sought to address below.

3.35 Some respondents noted that they did not believe an 8-week timeline for consultation was long enough to adequately respond to the consultation, especially given the complexity of the topic area and that the consultation was held over the summer period. The Government also received requests from a small number of respondents for a short extension to the consultation deadline towards the end of the consultation period. The Government carefully considered the appropriate period for consultation in advance of launching the consultation, and revisited its justification in light of later requests for an extension. The Government believes that 8 weeks was a sufficient period of time to allow the full range of stakeholders to provide a considered response to the questions raised. However, to ensure that key stakeholders were as informed as possible, and to mitigate concerns about the consultation period, HM Treasury decided to supplement the consultation document by holding several official-led consultation events with employer and member representative groups over the consultation period. The Chief Secretary to the Treasury also met with the TUC to discuss issues raised in the consultation. Additionally, an important consideration was ensuring that the consultation was concluded in time to ensure any changes to the CCM could be implemented in time for the 2020 valuations. As the GA has found, the mechanism is not operating in line with its objectives, and the Government believes it is crucial that the changes outlined above are in place for the next scheme valuations. In light of this, the Government believes that the correct balance has been struck between providing sufficient time for informed and intelligent responses, and the need to implement the reforms in time for the 2020 valuations.

3.36 Some respondents noted that the baseline assumptions and estimates used to set the employer cost caps at the 2012 valuations may be flawed and the Government should consider whether these remain appropriate for the purposes of the CCM or whether they need to be reset. The Government does not believe that the employer cost caps need to be reset based on a new set of assumptions. The Government believes it is normal and expected that actuarial assumptions are updated at each valuation as further experience comes to light and views of the future change. Revised assumptions, such as those seen at the 2016 valuations, are therefore not a reason to reset the employer cost caps. The employer cost caps were set using best estimate assumptions of the costs at the time the reformed schemes were introduced and this policy decision made at the time is not being revisited. This was also not a recommendation made by the GA.

3.37 Many respondents also raised the fact that the 2016 valuation process has not yet been completed, and the Government's decision to include the cost of McCloud remedy within the mechanism at the 2016 valuations. The Government has previously set out the rationale for the decision to reflect the McCloud remedy in completing the cost control element of the 2016 valuations.[2] The Government will finalise the Directions to complete the 2016 process in due course.

3.38 Some respondents noted that changes in life expectancy have an impact on pensions, but the impact of longevity is largely mitigated by the link to the State Pension Age in some of the reformed schemes. The consultation noted that the GA had also considered this issue and set out two considerations for Government in light of this: i) the Government could remove the impact of changing longevity and SPA from the mechanism for the relevant schemes, given they already have mitigation in place; or ii) alternatively, the Government could consider smoothing longevity assumptions given their potentially disproportionate impact on the mechanism and the likelihood for such assumptions to fluctuate. One respondent noted their opposition to these two proposals. However, the Government did not consult on these proposals. As noted in the consultation, the Government will consider these recommendations on longevity to a longer timescale.

Next steps

3.39 The Government is aiming to implement all three reforms to the CCM in time for the 2020 valuations, through the appropriate legislative vehicle. It is necessary to implement the reformed scheme only design and the economic check through expanded powers in primary legislation, when parliamentary time allows, and then by making Treasury Directions under those powers in due course. The wider cost corridor will be implemented to a longer timeline via secondary legislation.

[2] https://www.gov.uk/government/consultations/public-service-pension-schemes-consultation-changes-to-the-transitional-arrangements-to-the-2015-schemes/outcome/update-on-the-2016-and-2020-valuations

Annex A
Schemes in scope

A.1 The consultation covered schemes for the following public servants:

- Civil servants;
- The judiciary;
- Local government workers for England, Wales and Scotland;
- Teachers for England, Wales and Scotland;
- Health service workers for England, Wales and Scotland;
- Fire and rescue workers for England, Wales and Scotland;
- Members of police forces for England, Wales and Scotland;
- The Armed Forces.

A.2 The GA's review also considered the corresponding schemes provided in Northern Ireland. Cost control provision for the equivalent and similarly constituted Northern Ireland public service schemes established under the Public Service Pensions Act (NI) 2014 broadly reflects that provided under the Public Service Pensions Act 2013. The consultation welcomed input from interested stakeholders across all of the UK public service schemes.

A.3 Other public servants also have pension schemes which mirror the cost control mechanism, although they are not legislatively required to do so.

A.4 The Local Government Pension Scheme (England and Wales) also has a second and separate cost control mechanism operated by its Scheme Advisory Board. The scheme will consider any necessary changes to this second mechanism in the light of the overall changes made across schemes.

Annex B
Equality impact assessment

B.1 The Government has considered the equalities impacts of these proposed changes. This section records the equalities analysis undertaken in relation to all three reforms to the cost control mechanism, to enable Ministers to fulfil the requirements placed on them by the Public Sector Equality Duty (PSED) as set out in section 149 of the Equality Act 2010.

B.2 Question 7 in the consultation asked for views on any equalities impacts envisaged from the proposals to reform the mechanism which the Government should take account of. The analysis in this section builds on, and updates, the equalities impact analysis undertaken by HM Treasury set out in the consultation document, in light of the responses received to question 7.

B.3 When formulating policy, the government is required to comply with the PSED. The duty requires public bodies to have due regard to the need to eliminate discrimination, advance equality of opportunity and foster good relations between people with different protected characteristics when carrying out their activities. This section includes the assessment of the impacts of the three policies outlined above (reformed scheme only design, +/-3% corridor and economic check), by reference to the protected characteristics identified in the Equality Act 2010 of: sex, age, disability, race, religion or belief, gender reassignment, pregnancy and maternity, sexual orientation and marital or civil partnership status.

B.4 In total, 54 responses to question 7 were received. A majority of respondents believe that these proposals will have an equalities impact, with the impact on age and intergenerational unfairness being the key consideration. However, some respondents also raised equalities impacts in response to questions 1-6, and those comments have also been considered as part of the analysis in this section.

Age

B.5 The Government acknowledges that the policies set out in the consultation response may have different impacts on people depending on their age. It has considered whether those potential impacts are proportionate and justified and has concluded that they are, as set out below.

B.6 Some respondents raised the impact on intergenerational unfairness of the Government's decision to account for the costs of McCloud remedy as part of completing the cost control element of the 2016 valuation process. As the consultation focussed on the three proposed reforms to the mechanism, with the aim of implementing them in time for the 2020 valuations, the

Government has only sought to analyse the impacts of these three reforms in this section. The Government has not sought to address any equalities impacts in relation to decisions relating to the 2016 valuations in this document.

Reformed scheme only design

B.7 Respondents generally felt that a reformed scheme only design would have positive consequences for younger members of the scheme and reduce intergenerational unfairness. They felt that moving to a reformed scheme only design would mean that comparatively younger members will not experience changes to their benefits based on costs associated with relatively older members in the legacy final salary schemes.

B.8 In contrast, some respondents noted that younger members would benefit if reformed scheme benefits were improved if the impact of including legacy scheme costs led to a floor breach. They argued that excluding the impact of legacy service would therefore not necessarily benefit younger members or those with mixed service.

B.9 The move to a reformed scheme only design will have an overall positive impact on intergenerational fairness, although some age-related consequences remain.

B.10 The protected nature of accrued pension rights and the design of the cost control mechanism are such that it is not possible to exactly align the change in costs that trigger a breach with those who will directly be affected by any related rectification. Currently, the cost control mechanism delivers something of an 'intergenerational transfer': past service costs associated with a group of employees who are, on average, older, affect the pension benefits/contributions of a group of employees who are younger on average – though the latter group will include some of the former group. It is inherent in the design of defined benefit schemes that members in a particular scheme mutually share the risks and benefits, and that there are cross-subsidies between members. Whilst such an 'intergenerational transfer' remains within a reformed scheme only cost control mechanism, it is now with respect to a consistent scheme design. This would appear to be more intergenerationally fair than the current mechanism whereby comparatively younger members experienced changes to their benefits based on the cost of providing benefits to comparatively older members with past service in a legacy scheme that the comparatively younger members never had access to.

B.11 However, whilst improving overall intergenerational fairness, a consequence of this change is that if the value of benefits in the legacy schemes to members reduces, there would be no corresponding increase in reformed scheme benefits, which would impact members with significant legacy scheme benefits who are, on average, older.

B.12 On balance, the Government considers that removing the impact of legacy scheme costs from the mechanism will have an overall positive impact on intergenerational fairness, for the reasons set out in chapter 2 above, which most respondents supported. The Government recognises that younger members would also benefit if legacy impacts led to floor breaches, however, if legacy impacts led to ceiling breaches in future, this would mean that younger members would see their benefits reduced as a result of costs relating to the legacy schemes. The Government therefore considers that a reformed scheme only design is fair and proportionate.

Wider corridor

B.13 Some respondents noted that widening the corridor to +/-3% may also have an impact on intergenerational unfairness. They argued that there may be a greater intergenerational impact if the wider corridor led to less frequent benefit adjustments, since those in service following the breach will have their benefits adjusted, whereas relatively older members who will have retired or be closer to retirement would be unaffected or less affected. They argued that more frequent benefit adjustments may be fairer across the age range, because the impact of breaches would be felt more frequently by members across their service.

B.14 The Government recognises agrees that a wider corridor should lead to fewer breaches of the mechanism and fewer benefit adjustments, which may have an impact on intergenerational fairness, depending on the underlying causes of the breach when it does occur. However, a wider corridor may also insulate relatively younger members from smaller and temporary changes in costs related to the past service of relatively older members. The Government maintains the view that the benefits provided by a wider corridor in terms of increased stability and certainty of benefit levels for members make it a justified and proportionate measure to introduce.

Economic check

B.15 Respondents did not raise any particular points on the impact of the economic check on intergenerational fairness.

B.16 The Government considers that the economic check will make it less likely that breaches of the floor and ceiling are implemented through benefit increases or benefit reductions. As the economic check is expected to lead to fewer benefit adjustments, this may have an impact on intergenerational unfairness in the same way as a wider corridor, depending on the underlying causes of the breach when it does occur. However, it may also insulate relatively younger members from benefit changes based on smaller and temporary changes in costs. Furthermore, due to its symmetrical design, it will insulate younger members in relation to both benefit increases and reductions. The Government maintains the view that the benefits provided by a wider corridor in terms of increased stability and certainty of benefit levels for members make it a justified and proportionate measure to introduce. The Government has also set out that it believes the economic check is necessary to protect taxpayers by ensuring consistency between benefit changes and changes in the wider economic outlook whilst also maintaining the value of schemes to members.

Sex

B.17 Some respondents noted that these proposals may have an indirect impact on women, as women are generally overrepresented across the public sector and are more likely to be part-time workers, particularly in certain public sector workforces such as local government.

B.18 The policies outlined apply regardless of sex and to all members regardless of full-time or part-time status. The Government, therefore, does not expect there to be a direct impact on women from these proposals.

B.19 However, the government acknowledges there may be an indirect impact insofar that women have entered the workforce in greater numbers as time has progressed, meaning that they account for a greater proportion of younger cohorts than they do of older cohorts. Therefore, women may be disproportionately affected by proposals which also have a differential impact by age.

B.20 For instance, as women in the workforce in the workforce are more likely to be younger, they might be more affected by the fact that, under a reformed scheme only design, members will not experience changes to their benefits based on costs associated with relatively older members in the legacy final salary schemes. This will disproportionately advantage women where legacy scheme costs would otherwise result in a reduction in benefits.

B.21 Women may be relatively less disadvantaged in the scenario that the value of benefits in the legacy schemes reduces and there is no corresponding increase in reformed scheme benefits, as this would impact members with significant legacy scheme benefits who are, on average, older and so more likely to be male. In contrast, where younger members with no or little legacy scheme benefits, who are more likely to be women, would have previously seen an increase in their benefits in this scenario despite the change in value relating to benefits of earlier cohorts, they will no longer be disproportionately advantaged.

B.22 As set out above, the Government considers that a reformed scheme only design is fair and proportionate. This is particularly so as a reformed scheme only design means more women will be insulated from benefit changes based on changes in costs associated with legacy schemes of which they are relatively less likely to be members, and those legacy scheme costs could otherwise lead to both ceiling and floor breaches.

B.23 Women may also be disproportionately impacted by changes which are expected to reduce the frequency of breaches - the economic check and widened corridor - depending on the underlying causes of the breach when it does occur and whether they are associated with costs for older members, who are more likely to be men. However, women may also be relatively more insulated from smaller and temporary changes in costs related to the past service of relatively older members who are more likely to be men.

B.24 As set out above, the Government believes that the benefits provided by a wider corridor and economic check, in terms of increased stability and certainty of benefit levels for members, make them justified and proportionate measures to introduce. The Government believes these reforms strike an appropriate balance between the the need to protect taxpayers while preserving the value of schemes to members, and the duty to do so in a way that does not unnecessarily disadvantage women. This is evidenced by the fact that women may be either net beneficiaries or net losers of the policy depending on prevailing economic and financial factors unrelated to sex.

Other protected characteristics

B.25 As the policy proposals outlined apply equally to public service pension scheme members, the Government does not consider it likely that there will be direct impacts from these proposals on those with other protected characteristics, such as race or disability.

B.26 However, the Government recognises there may be indirect impacts in relation to race and other protected characteristics. This is because a higher proportion of younger members are likely to have protected characteristics such as disability, sexual orientation or being from an ethnic minority compared to older members. This is through a combination of demographic changes, because members of these groups have entered the workforce in greater numbers over time and because several employers have made efforts to increase diversity among their workforce.

B.27 Consequently, the same analysis set out above in relation to women is also expected to hold in relation to these groups. As members of these groups in the workforce are more likely to be younger, they might be more affected by the fact that, under a reformed scheme only design, members will not experience changes to their benefits based on costs associated with relatively older members in the legacy final salary schemes, who are more likely to be white, heterosexual, and to not disclose a disability. This will disproportionately advantage these groups where legacy scheme costs would otherwise result in a reduction in benefits.

B.28 These groups will also be relatively less disadvantaged in the scenario that the value of benefits in the legacy schemes reduces and there is no corresponding increase in reformed scheme benefits, as this would impact members with significant legacy scheme benefits who are less likely to hold these characteristics. In contrast, where younger members with no or little legacy scheme benefits, of which these groups are more likely to be part of, would have previously seen an increase in their benefits in this scenario despite the change in value relating to benefits of earlier cohorts, they will no longer be disproportionately advantaged.

B.29 The Government considers that a reformed scheme only design is fair and proportionate way of achieving its policy aims. This is particularly so as a reformed scheme only design means later cohorts with less service in legacy schemes, and which are more likely to include members with protected characteristics, will be insulated from benefit changes based on changes in costs associated with legacy schemes of which they are relatively less likely to be part of, which could otherwise lead to either ceiling or floor breaches.

B.30 Members with protected characteristics of race, sexual orientation or disability may also be disproportionately impacted by changes which are expected to reduce the frequency of breaches - the economic check and widened corridor - depending on the underlying causes of the breach when it does occur and whether they are associated with costs for older members, who are less likely to hold these protected characteristics. However, by reducing the frequency of breaches, these measures may insulate members with these protected characteristics from smaller and temporary changes in costs which are related to the past service of earlier cohorts which they are less likely to be part of.

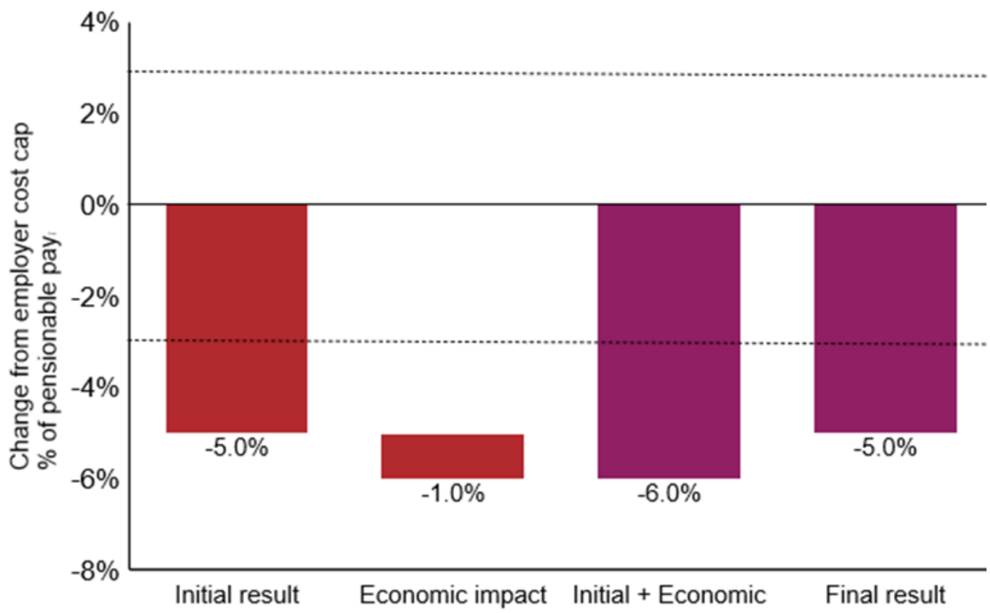
B.31 Again, the Government believes that the benefits provided by a wider corridor and economic check, in terms of increased stability and certainty of benefit levels for members, make them justified and proportionate measures to introduce. The Government believes these reforms strike an appropriate balance between the need to protect taxpayers while preserving the value of schemes to members, and the duty to do so in a way that does not unnecessarily disadvantage members with protected characteristics. This is supported by the fact that members with protected characteristics may be either net beneficiaries or net losers of the policy depending on prevailing factors unrelated to these characteristics.

B.32 The Government does not have sufficient evidence to consider the impacts on other protected characteristics not mentioned here. Collecting this data would not have been proportionate as it would have required public service pension schemes to collect and hold new data on its members that it does not currently hold. In making this assessment Government has considered the burden on members and the presumption that public bodies should not hold data on individuals that it does not require to fulfil its core purposes.

Annex C
Economic check illustrations

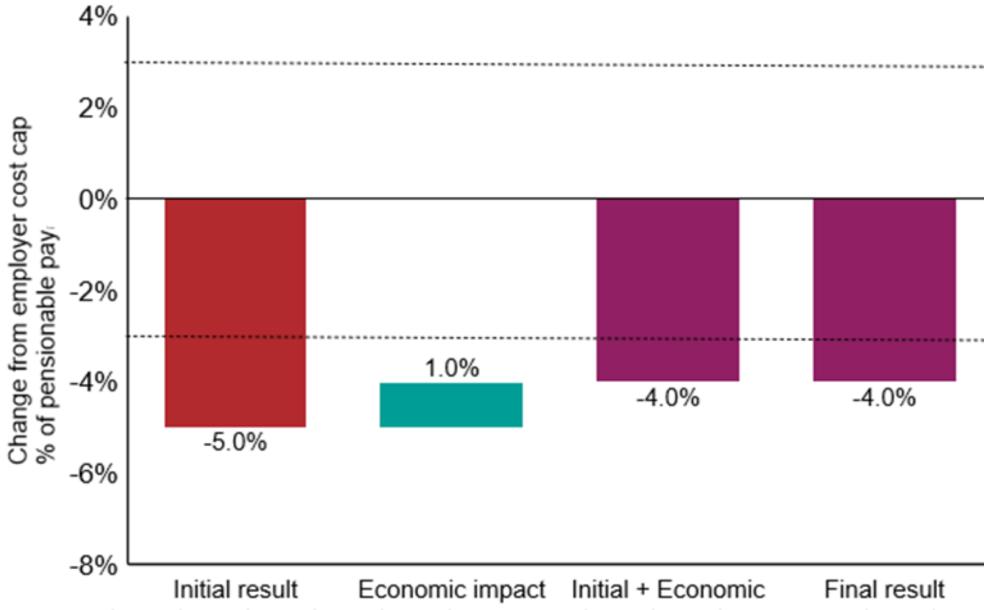
C.1 The following scenarios illustrate how the economic check will work in practice. They are similar to the scenarios included in the consultation document and the Government Actuary's report, but have been updated to consider a +/-3% corridor width.

Box C.1: Scenario 1



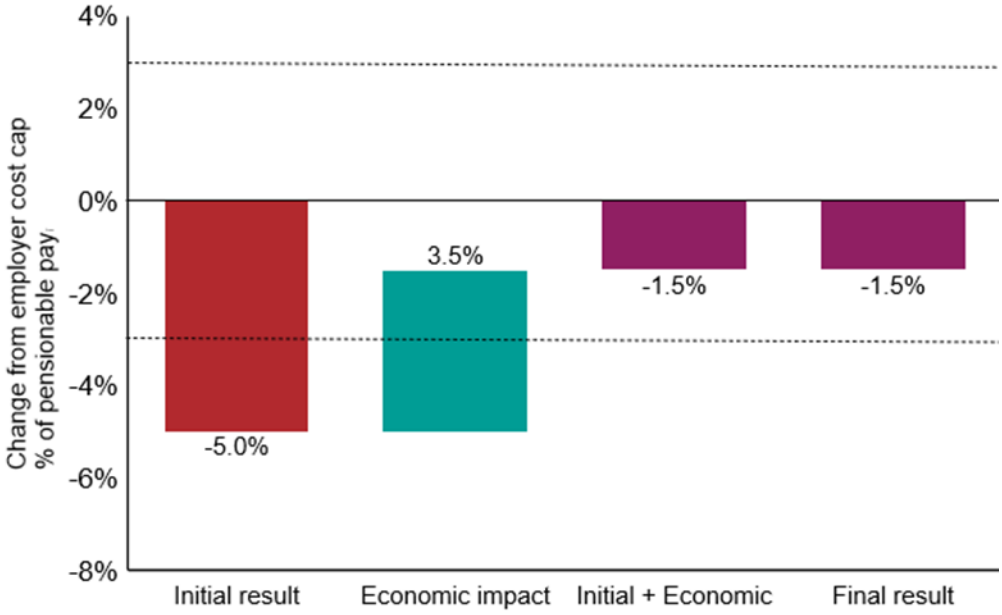
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the employer cost cap
- The discount rate has increased slightly from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would reduce assessed costs by a further 1% of pensionable pay
- The change in discount rate can only offset a breach and cannot cause or contribute to one. Therefore, the final result of the cost control mechanism remains at a reduction of 5% of pensionable pay from the employer cost cap

Box C.2: Scenario 2



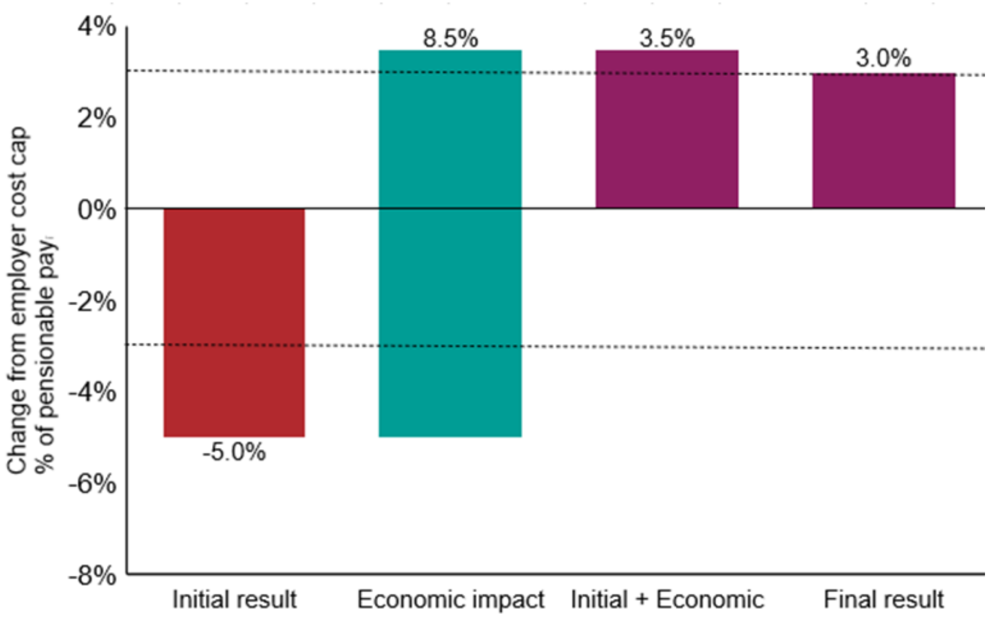
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the employer cost cap
- The discount rate has decreased slightly from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would increase assessed costs by 1% of pensionable pay in isolation
- This impact would partially offset the initial breach with the final result of the cost control mechanism being a reduction of 4% of pensionable pay from the employer cost cap

Box C.3: Scenario 3



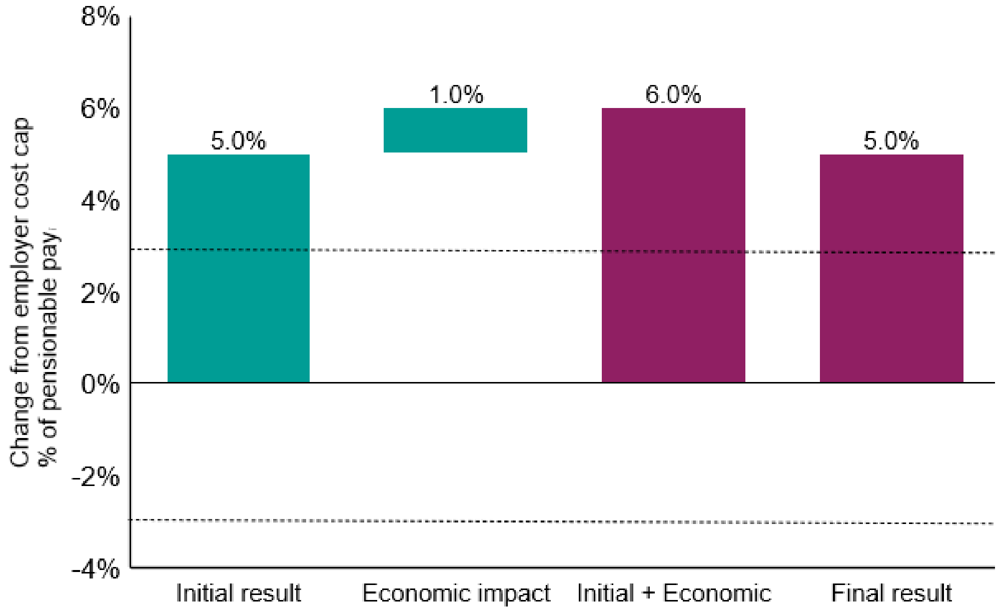
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the employer cost cap
- The discount rate has decreased from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would increase assessed costs by 3.5% of pensionable pay in isolation
- This impact would offset the initial breach with the final result of the cost control mechanism being a reduction of 1.5% of pensionable pay from the employer cost cap. In this scenario the final result is back within the corridor and therefore no benefit changes would occur

Box C.4: Scenario 4



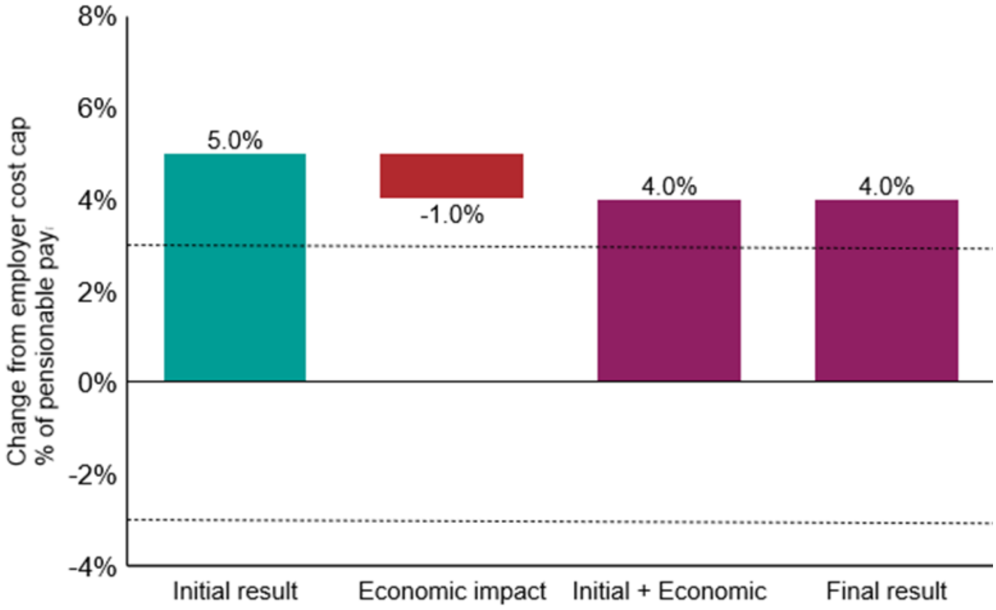
- The initial result of the cost control mechanism is that costs have reduced by 5% of pensionable pay from the employer cost cap
- The discount rate has significantly decreased from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would increase assessed costs by 8.5% of pensionable pay in isolation
- This impact would more than offset the initial floor breach and instead cause a ceiling breach. However the impact of a change in the discount rate can only offset a breach and cannot in itself cause one, therefore no benefit changes would occur
- Note that for illustration purposes the final result is depicted at the edge of the opposite corridor to the initial breach. A decision on what exactly the quoted final result would be in this situation has yet to be made, however the important point is that the final result would be treated as being within the corridor and no breach would occur

Box C.5: Scenario 5



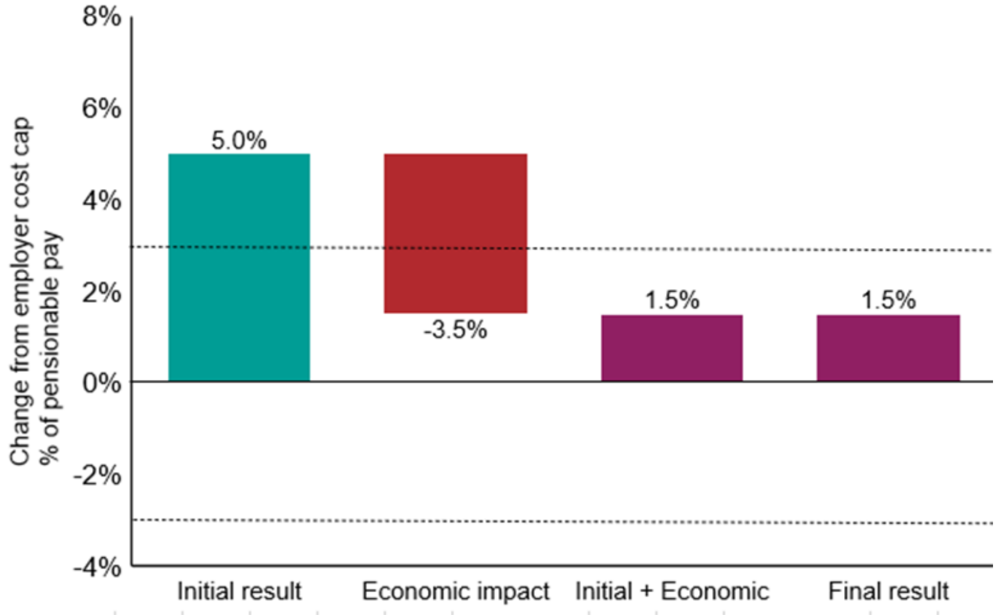
- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the employer cost cap
- The discount rate has decreased slightly from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would increase assessed costs by a further 1% of pensionable pay
- The change in discount rate can only offset a breach and cannot cause or contribute to one. Therefore, the final result of the cost control mechanism remains at an increase of 5% of pensionable pay from the employer cost cap

Box C.6: Scenario 6



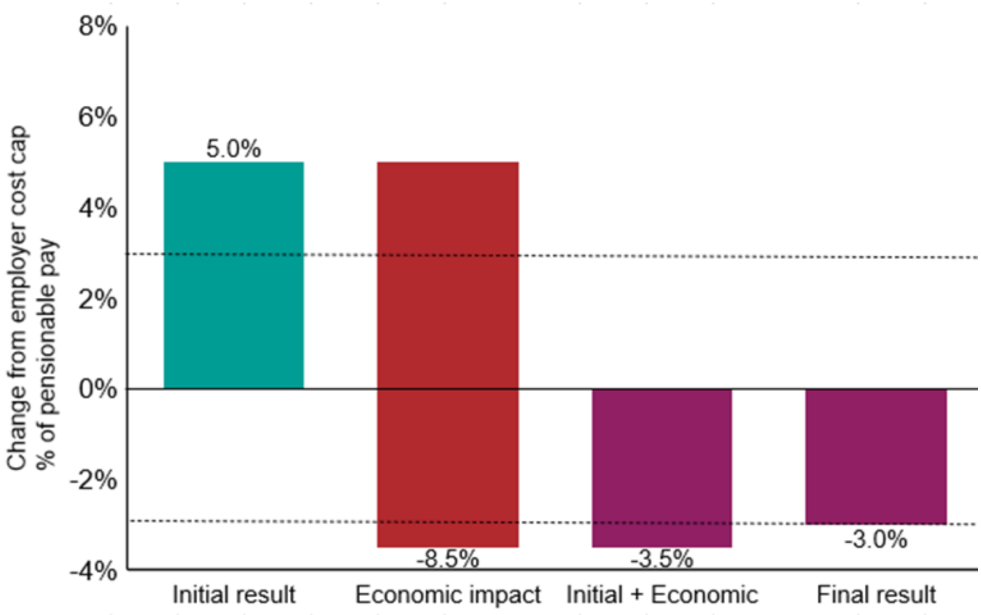
- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the employer cost cap
- The discount rate has increased slightly from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would decrease assessed costs by 1% of pensionable pay in isolation
- This impact would partially offset the initial breach with the final result of the cost control mechanism being an increase of 4% of pensionable pay from the employer cost cap

Box C.7: Scenario 7



- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the employer cost cap
- The discount rate has increased from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would decrease assessed costs by 3.5% of pensionable pay in isolation
- This impact would offset the initial breach with the final result of the cost control mechanism being an increase of 1.5% of pensionable pay from the employer cost cap. In this scenario the final result is back within the corridor and therefore no benefit changes would occur

Box C.8: Scenario 8



- The initial result of the cost control mechanism is that costs have increased by 5% of pensionable pay from the employer cost cap
- The discount rate has significantly increased from the 3% a year (net of CPI) rate in force at the time employer cost caps were set. If this were to be recognised in the mechanism it would decrease assessed costs by 8.5% of pensionable pay in isolation
- This impact would more than offset the initial ceiling breach and instead cause a floor breach. However the impact of a change in the discount rate can only offset a breach and cannot in itself cause one, therefore no benefit changes would occur
- Note that for illustration purposes the final result is depicted at the edge of the opposite corridor to the initial breach. A decision on what exactly the quoted final result would be in this situation has yet to be made, however the important point is that the final result would be treated as being within the corridor and no breach would occur

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