



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ



GOVERNMENT WHIPS' OFFICE
HOUSE OF LORDS
LONDON SW1A 0PW

Lord Ponsonby of Shulbrede, Baroness Janke
House of Lords
London
SW1A 0PW

4th October 2021

Dear Lord Ponsonby and Baroness Janke,

PUBLIC SERVICE PENSIONS: GOVERNMENT RESPONSE TO CONSULTATION ON THE COST CONTROL MECHANISM

Thank you once again for your valuable contributions during the Second Reading debate on the Public Service Pensions and Judicial Offices Bill. We appreciate the cost control mechanism (CCM) consultation is an area of close interest on which we wish to keep you closely informed. As such, we are writing to inform you that the Government has today published its response to the recent consultation on the cost control mechanism, titled 'Public Service Pensions: Proposal to Reform the Cost Control Mechanism'; the link to the response can be found in footnote 1.¹ We hope this will prove helpful in setting out the context and rationale for these reforms, which is of course set out in further detail in the response document, and look forward to the opportunity to discuss this with you.

In 2018 the Government announced it would ask the Government Actuary (GA) to conduct a review of the CCM amidst concerns that it was not operating in line with its objectives. The review proceeded in July 2020, with the GA's final report published on 15 June 2021.² His report set out his findings and made recommendations to improve the operation of the mechanism. After considering the GA's recommendations, the Government ran a public consultation between 24 June and 19 August proposing three key reforms to the mechanism:

- Reformed scheme only design: to remove any allowance for legacy schemes in the mechanism so it only considers past and future service in the reformed schemes;
- Wider corridor: to widen the corridor from 2% to 3% of pensionable pay;
- Economic check: to introduce a check (linked to expected long-term GDP) so that a breach of the mechanism (and therefore benefit changes) would only

¹ <https://www.gov.uk/government/consultations/public-service-pensions-cost-control-mechanism-consultation>

² <https://www.gov.uk/government/publications/cost-control-mechanism-government-actuaries-review-final-report>



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be implemented if it would still have occurred had long-term economic assumptions been considered.

Consultation outcome

Having considered the replies to the consultation, the Government has decided to proceed with all three reforms.

Under the reformed scheme only design, costs associated with legacy schemes will be excluded from the mechanism, and only costs relating to past and future service in the reformed schemes will be considered. Whilst this transfers the risk of legacy scheme payments to the employers (and by extension the Exchequer), it ensures consistency between the set of benefits being assessed and the set of benefits potentially being adjusted. It also will allow the mechanism to better meet its objectives of stability and will reduce intergenerational unfairness.

Widening the cost corridor to 3% of pensionable pay will ensure a more stable mechanism, so that it is more likely that breaches only occur in unforeseen and, unpredictable circumstances, as was intended when the CCM was originally established.

Lastly, the economic check will ensure that any breach of the mechanism would only be implemented if it would still have occurred had the long-term economic assumptions been considered. The economic check will operate in an entirely objective and mechanistic way by tracking the OBR's measure of long-term GDP (possible through the SCAPE discount rate). 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 has taken into consideration points raised about the appropriateness of an economic check linked to expected long-term GDP for the Local Government Pension Schemes (LGPS). Following consideration, the Government are of the view that such an economic check is appropriate for LGPS for the reasons set out in the consultation response. However, the Government also recognises the different, funded nature of LGPS schemes, and will therefore work with LGPS Scheme Advisory Boards (SAB) to agree a process for an LGPS specific discount rate to be used as part of their own SAB cost management process if desired.

Implementation



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It is necessary to implement the reforms in time to apply to the 2020 valuations (they will not apply to the 2016 valuations) and, to achieve this, we believe it is necessary to implement the reformed scheme only design and the economic check through primary legislation, when parliamentary time allows. The wider cost corridor will be implemented to a longer timeline via secondary legislation.

In parallel, the Government also consulted on the methodology used to determine the discount rate for setting employer contribution rates in the unfunded public service schemes (SCAPE discount rate). The Government is considering responses to that consultation and will set out its response in due course.

A copy of this letter is being sent to Lord Davies of Brixton and Baroness Kramer, who raised questions regarding the cost control mechanism during the Second Reading debate of the Bill. A copy is also being sent to the Shadow Chief Secretary to the Treasury and the Chair of the Treasury Select Committee. We have also written separately to the Devolved Administrations, the Chairs of Scheme Advisory Boards for public service pensions, and the Trades Union Congress. A copy of this letter and the consultation response document will be deposited in the Libraries of the Houses.

Yours sincerely,

Simon Clarke MP

Viscount Younger of Leckie