HYBRID MEETING – 17TH JULY 2023

ITEM 6 – PAPER B

COST CONTROL MECHANISMS

HMT Cost Control Mechanism (CCM)

1. The draft HM Treasury Directions were shared confidentially with the Cost Management, Benefit Design and Administration (CMBDA) Committee. Government officials were clear that while views from this Committee (and other public sector scheme SABs) were welcomed, this was not a formal consultation. The Department for Levelling Up, Housing and Communities (DLUHC) had initially requested a response by 23 June 2023 but agreed that the CMBDA could consider the directions at their meeting on 26 June 2023.

2. As per previous announcements, the HM Treasury SCAPE rate (based on long term GDP growth) has been set at CPI plus 1.7% (down from 2.4% for the last set of directions). GAD gave a presentation to the CMBDA Committee on the other key assumptions in the HM Treasury directions, which would be used in their CCM (e.g. around life expectancy and future salary growth, both of which are significant downward pressures on cost across all public sector schemes). GAD also explained how the new economic check will work and their expectation that, due to the very significant change in SCAPE rate, its effect within the economic check removes any chance of a floor breach this time around.

3. The CMBDA Committee did not make any representations on the assumptions in the HMT draft directions but endorsed the suggestion made by the Secretariat that a gender pensions gap analysis and a wider equality assessment should be worked into the standard valuation report and CCM process across all schemes.

4. GAD said that they expected that the final directions would be issued later in the Summer with the results, calculated in accordance with the finalised directions, to be available in Autumn 2023.

SAB Scheme Cost Assessment

5. The SAB's own Scheme Cost Assessment (SCA) process is set out in Regulation 116 of the 2013 LGPS Regulations. The regulations were amended following the recent DLUHC consultation. The SCA process is intended to run prior to the HM Treasury CCM process so that any changes in benefits or costs arising from it are considered within the scheme valuation and CCM.

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6. The key purposes of the SCA are:
   a) To ensure that the costs of the scheme are in line with the target cost (19.5% of earnings using SAB assumptions)
   b) To check that the split of costs between employers and employees is in the ration of 2:1 respectively
   c) To check that the yield of the employee contributions overall is around 6.5%

7. Previously, the SCA assumptions very closely mirrored those of the HM Treasury CCM. That is an option available again for the SCA process, although the context is slightly different. For the 2016 cost control process it did seem, until the implication of the McCloud judgment became clearer, that there was a real prospect of a floor breach leading to some benefit improvements. This meant it was sensible to limit the divergence between the two processes so that they could more easily be considered alongside each other.

8. For this year's process, it seems very unlikely either that the HM Treasury CCM will result in a floor beach (due to the operation of the economic check) or that DLUHC ministers would agree any improvements to member benefits, if the SCA shows a floor breach.

9. As with the HM Treasury process, the key assumptions that the Board will need to set are around:
   a) The discount rate
   b) Changes in life expectancy
   c) Future salary increases (less relevant in a CARE scheme).

10. The key variable the Board may wish to consider moving is the discount rate. The LGPS is a funded scheme, so return on investment, rather than GDP is the main driver. In the past, these figures have been fairly similar, but an early analysis of fund-level discount rates suggest a growing divergence. The scheme-level valuation report, which should be published shortly, also shows that while total employer contributions (expressed as a %age of salary) have fallen, the primary contribution rates have risen further. The difference is due to the offsetting reduction in secondary contribution rates with so many funds now being in surplus.

11. The secretariat would like to commission the Board's GAD adviser to do the necessary work and collate a paper on the assumptions in due course. Given the next CMBDA meeting is on 30th October 2023, the Committee will consider the recommendations and make a proposal to the Board by correspondence. As the Board does not meet again until December 2023, it is similarly proposed that the Board agrees to approve the recommendations of the CMBDA Committee by correspondence.

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Recommendation – that the Board agrees to commission GAD to provide advice on assumption setting in the SCA and for this matter to be dealt with by correspondence

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