HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Public Sector Pensions, HC 947

Thursday 22 April 2021

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Watch the meeting

Members present: Meg Hillier (Chair); Shaun Bailey; Olivia Blake; Dan Carden; Sir Geoffrey Clifton-Brown; Barry Gardiner; Peter Grant; Nick Smith.

Gareth Davies, Comptroller and Auditor General; Simon Reason, National Audit Office; and David Fairbrother, Treasury Officer of Accounts, were also in attendance.

Questions 1 - 92

Witnesses

I: Sir Tom Scholar, Permanent Secretary, Her Majesty's Treasury; Cat Little, Director General, Public Spending and Head of Government Finance Function, Her Majesty's Treasury; and Martin Clarke, Government Actuary, Government Actuary's Department.

Report by the Comptroller and Auditor General

Public service pensions (HC 1242)

Examination of witnesses

Witnesses: Sir Tom Scholar, Cat Little and Martin Clarke.

Chair: Welcome back to the Public Accounts Committee on Thursday, 22 April 2021. We are now moving on to our session on public sector pensions. I thank the National Audit Office for their excellent Report.

We have as our witnesses Sir Tom Scholar, who is permanent secretary at the Treasury; Cat Little, the director general for public spending at the Treasury and also, crucially probably for this session, head of the Government finance function, because there are obviously implications for pensions across the piece; and Martin Clarke, who is the Government Actuary from the Government Actuary's Department. He is a first-time visitor to this Committee, so welcome, Mr Clarke.

I should say at the outset that a number of members of the Committee either have pensions or have family members who are members of the four main public sector pension schemes we are looking at today: teachers; the civil service; armed forces; and the NHS. We take that as a blanket declaration. Indeed, our witnesses are no doubt members, in many cases, of the civil service pension scheme. As with tax, we are all involved in some way or another.

I invite Nick Smith MP to kick off.

Q1 **Nick Smith:** Thank you, Chair. This really is a big-ticket issue. It affects many families across the country, and it is a big item of Government expenditure. At present, it costs approximately 2% of GDP. This Committee and lots of families across the country will be interested in the discussion on it. Thanks to the NAO and the Treasury for producing this good and important Report.

My first question is to Sir Tom. What specific outcomes are you trying to achieve with your public service pension reforms?

Sir Tom Scholar: The purpose of the reforms was to create a system of public sector pensions that will be sustainable and that will be able to balance three important objectives: providing a decent income in retirement to public sector workers; acting as part of the overall remuneration of public sector workers in order to ensure good recruitment and retention of high-quality workers; and to do all that within a framework that is affordable for the taxpayer. That is the intention of the reforms.

Q2 **Nick Smith:** They are all important priorities, but all very different. There are lots of conflicts and pressures among them. How do you prioritise them?

Sir Tom Scholar: That was a hugely difficult task that was undertaken, starting in 2010 with the Hutton review. The Government of the day took the conclusions of that and tried to balance everything off in the way I suggested. Obviously, we then keep all of that under review. These are inherently difficult judgments and trade-offs to make and, of course, judgments for Ministers. Our job is to provide the best possible analysis that we can of the effects of different proposals, and of long-term sustainability, where we draw very much on the work of the OBR and the Government Actuary's Department, who provide the expert analysis on this.

Q3 **Nick Smith:** Do you think the trade-offs are working, or do you have any glitches that you need to tell us about?

Sir Tom Scholar: Let me say something about the big picture, and then I will turn to Cat and to Martin on some of the operational parts.

In the big picture, as you say, public sector pensions today are over 2% of GDP. I think they are peaking at something like 2.2%, and they have been on a rising trend for two decades or more. That was expected at the time of the reforms. The purpose of the reforms was to level that off and bring it down. The intention is to bring down the pension bill to something like 1.5% of GDP over the next 50 years.

Obviously, this kind of reform takes a long time to feed through. We are just at the very early stages of it, but the best assessment we have is that it is on track to achieve that. That is the overall long-term sustainability. Within that, there is a whole series of other more specific decisions that come along. Perhaps I can turn to Cat for that.

Cat Little: Going back to your question about prioritisation, I would argue that the most important aspect of the reforms is being able to deliver sustainable and affordable pensions. Without that, we simply will not be able to offer the overall remuneration that drives effective recruitment and retention. Neither would we be able to guarantee a good level of retirement income. We place an emphasis on affordability being a priority.

I am not sure that I would quite agree that there are significant trade-offs. If we have been able to demonstrate the affordability of pensions in the very long term—of course it is a very long-term assessment that we are trying to drive—it is over to employers and to schemes, to make sure that members understand the benefit of those schemes in the long term, and that we actively monitor and consider how total remuneration is considered as part of recruitment and retention issues. I do not quite see it as a binary trade-off, because there are short-term versus long-term considerations.

Q4 **Nick Smith:** Except that one of the trade-offs is that other people, or the public service providers, are having to pay more. That is certainly one of the trends. How fair is it that public service employees, who are earning less now than they did 10 years ago in real terms, are now paying their highest pension contributions ever?

Cat Little: If we go back to the commission's report in 2011, one of the reasons why it recommended member costs and employee contributions be increased was the conclusion that, overall, the taxpayer was paying a larger proportion of the overall costs. Following the reforms, we implemented a phased approach to increasing the employee contributions that were made by members. That was phased in, with an average of about 3%, over a period of time.

At the same time, while in real terms wages had reduced, the very latest assessment of the public sector earnings premium shows that the public sector overall has a premium of around 7%. When you are looking at the total remuneration and the fair balance of who should pay for public sector pensions between the taxpayer and members, what we have strived to do is to achieve a fair balance overall.

Q5 **Nick Smith:** Let us look at that term "fair balance". There are some question marks over it, aren't there? Sir Tom, despite differences in pay over working lifetimes, is it right for there to be a 45% gap between the average pensions of male and female scheme members?

Sir Tom Scholar: As you say, there is a gender gap. That itself is determined by the pay history. What you see there is that, over the working life of the people we are talking to, pay was higher for men than for women. That is something I think we all know about. It is a different question, but we are taking all the steps we can to close the gender pay gap and to avoid that situation. What you see in the pension data is a reflection of decisions or systems going back many decades.

Q6 **Nick Smith:** Sure. We understand that pension policy goes back a long way and that women take career breaks for childcare. Cat Little, how are the Government seeking to address that pay gap? What are they positively doing to make things better, particularly for women and others who suffer this?

Cat Little: As Sir Tom said, for pensions it merely reflects the historical inequalities in pay over many decades in the past. The main thing that we can do is to make sure that the policy response is to close the pay gap in future. Of course, we are seeing evidence that the pay gap is closing. In the public sector, it is much lower than in the private sector, but we have to continue on that path to make sure that we continue to put a focus on closing the pay gap overall in the public sector.

Q7 **Nick Smith:** Let me pursue this a bit more. Mr Clarke, to what extent are there likely to be similar pay and pension gaps for other groups—for those identifying as black, Asian or minority ethnic? What is the scale of that issue?

Martin Clarke: Thank you, and good morning. As has been explained, this is largely a reflection of the mix of the workforces, the relative equality of pay and indeed the working history of the various protected groups that we are talking about, whether it is gender or ethnicity.

One would expect very similar effects to be occurring with this, in so far as pension outcomes reflect the composition of the workforce for 10 or 20 years previously. I have not seen data on other protected groups, other than the gender ones that are in the NAO Report. My expectation would be that, for ethnicity, BAME would be a very similar kind of experience, simply because of the nature of the disparities in earnings that have led to the pension outcomes.

On some of the changes that have come through the reforms, many of the schemes have contribution rates for employees that vary according to the size of salary. There are ways in which some of the equalities or inequalities can be balanced out in the pension system. There is also the switch from final salary to a CARE scheme, where career averaged earnings form your pension. That means the real disparities, particularly in senior levels of various groups, are reduced as far as pensions are concerned. I think some things are moving in the right direction, but I do not have any specific data on ethnicity.

Q8 **Nick Smith:** Thank you. Sir Tom, the difficulty with that is that what we are really being told is, "You get what you get." What I am troubled about is, are you, as policymakers, going to come forward with suggestions that address the inequalities that make a difference to people who may have been short-changed?

Sir Tom Scholar: A right to a pension in whatever job you are doing is part of your terms and conditions of employment, a contractual entitlement. Clearly, there are rules that govern what your pension will be, depending on contributions.

You have raised the much broader question of fairness, which is really a political question for Ministers, and ultimately Parliament. It is not a question I think I can answer. It is true, as you say, that the data shows that there are disparities, but those reflect people's contractual entitlements, depending on their employment history. The question of what should be done about that is a broader policy question.

Q9 **Nick Smith:** Let's go on to the wider issues of who else is paying more, particularly public bodies and employers. What have the increased contributions meant for frontline services in schools and hospitals? Have extra pension contributions for employers meant that there has had to be a cutback in frontline services?

Sir Tom Scholar: We allocated £4.7 billion last year to try to avoid that. Cat may have further particulars.

Cat Little: Whenever there are unforeseen costs resulting from pension changes, particularly the changes in the discount rate, the Treasury has provided funding. As Sir Tom said, we provided £4.7 billion to employers last year.

If I can speak from personal experience, when I was responsible for the impact of costs in the Ministry of Defence, my response was to ring-fence the on-costs from those changes and to make sure that they did not have an impact on the balance of investment choices that we were working through with Ministers at the time. I fully expect that other employers and Departments took a similar approach.

Q10 **Nick Smith:** What trade-offs have employers had to make in order to fund these big increases in their contributions, would you say?

Cat Little: As I said, the vast majority have been funded directly by the Treasury in order to limit trade-offs, certainly with frontline services and other activities, but of course there are always pressures that Departments manage in the normal course of their budgets.

Q11 **Nick Smith:** Mr Clarke, how many employers have withdrawn from public service pension schemes since 2019-20 and the rise in employer contributions?

Martin Clarke: I am afraid I do not know the answer to that question at all. I am not aware that that data has been collected.

Q12 **Nick Smith:** There was an issue in the materials around the Report that some private schools are now withdrawing from the education—

Chair: Private schools are threatening to withdraw. I do not think they have finally decided that.

Q13 **Nick Smith:** Do we know if that has actually come to anything? Mr Clarke, are these warning noises, and will it make a difference? Will that undermine the wider scheme?

Martin Clarke: In the wider scheme, the Department for Education has a scheme manager who is facilitating arrangements to protect teachers who are in independent schools, or who may be choosing to withdraw from the scheme, to make sure that arrangements can be put in place to secure the pensions of teachers who are already in service.

The evidence I have seen is anecdotal at the moment. Obviously, there was something recently about a particular independent school where the teachers are threatening strike action.

These cost increases are not unique to public service pension schemes. Pension costs are a phenomenon that is increasing all round. To not account for those cost increases in a proper way would be to deny ourselves visibility of that within the public sector. I think this is a consequence of something that affects pension schemes in the private and the public sector.

Q14 **Chair:** Can we go to Cat Little on that?

Cat Little: Obviously, where a private sector employer chooses to opt in to a public sector pension scheme, we expect them to make exactly the same contributions because their members get the same benefits. When we provided additional funding last year to cover the unforeseen costs of changes in the employer contribution rates, it was up to Government to think about where we needed to target that money most in order to guarantee delivery and to make sure that we made the most of the funding available. In the case of the Department for Education, I think about £900 million went to state schools and to FE colleges.

Obviously, we try to make sure that the parts of the public sector that are dependent on Government and have no other means of raising income are the people who get support from Government to cover the costs of rising employer contributions. As Martin said, in the case of the 200-odd schools that are looking to withdraw from the scheme, the Department for Education has worked very closely with the Teachers' Pension Scheme to make sure that current teachers can stay within the current TPS and new arrangements put in place going forward.

There are protections. We monitor it very carefully, but I think it is right that we target Government funding and taxpayers' funding on the organisations that need it most to cover rising employment contributions.

Q15 **Nick Smith:** I want to consider for a while the issue of global economic turmoil that we are going through at the moment, the affordability of public service pensions and the impact of that turmoil on overall affordability. Mr Clarke, and maybe Cat Little, have your assumptions on future pension costs changed since those 2018 forecasts, given the economic turmoil through Covid-19 and EU exit, which will have had a big impact too, I imagine?

Martin Clarke: I will start on this and then pass over to Cat. Sir Tom mentioned the aspiration and the expectation that the reforms themselves will reduce the burden of public service pensions from just over 2% GDP in the long term to 1.5% or thereabouts. Obviously, if the circumstances that you have referred to, Mr Smith, have shrunk the economy in some shape or form over that long period, it might make the attainment of those goals a little bit more difficult. If the economy is, for example, 5% smaller than it would otherwise have been, that 1.5% target might effectively become 1.6%.

A lot depends on how future growth works out over what is a very long period of time. We are talking about 40 or 50 years. The figures that Sir Tom was quoting were from the Office for Budget Responsibility. I think they will next be looking at these kinds of lengthy projections in 2022, when obviously they will be looking at what the prospects for economic growth in this post-Covid, post-Brexit era are like. They will also be taking the forecasts of the cash flows from the pension schemes themselves, which is the area that my Department would assist with. Again, they are dependent on the circumstances at the time and a lot of factors about the size of workforce and how long people are living. There has been an easing up in the growth in life expectancy in recent times. The prospects for salary and wage growth also impact the cost. Clearly, a weakly performing economy over a long period is likely to be associated with a weak experience of wage inflation. A lot of factors need to go into that assessment, and they will be brought together by the Office for Budget Responsibility in 2022.

Sir Tom Scholar: As Martin says, affordability is defined. We look at it by looking at pensions as a share of GDP, and we look at it over a 50-year timeframe. Covid, of course, has had a devastating short-term economic impact, but I do not think there is any reason to believe that it would have an impact on the size of the economy in 2064, so we do not need to rush into any judgment on it now. What we need to do is to see how the economy comes out of Covid, and then what are the best expectations of long-term growth beyond that. If, as we all expect, this turns out to have been an extremely serious but temporary and short-term episode, it would not have any impact on long-term pension affordability.

Cat Little: I do not have much to add, other than on the very short-term impacts of Covid in particular—rising public sector employment and increased short-term mortality rates. They all get taken into account in the very short-term OBR forecasts and considerations of cash-flow forecasts. We see those effects more immediately, and we certainly continue to monitor that.

Q16 **Sir Geoffrey Clifton-Brown:** Ms Little, in the old type of pension schemes you were able to draw a lump sum payment when you retired, sometimes three times salary or whatever. It seems that, as scheme participants are dying off, those lump sum payments are likely to reduce over time.

If that is the case, and lump sum payments generally in public sector pensions are likely to reduce, is that not an impediment to encouraging public sector employees to stay in their jobs until retirement? Isn’t it more likely that they would want to go off and find other jobs?

Cat Little: We do not have any evidence of that being the case. It really does depend on the scheme. The most important thing is that we work closely to make sure that current members understand how their pension benefits accrue over time and what they can expect, so that they can make informed choices about how they might move between different bits of the public sector or between the public and the private sector.

I am certainly not aware of any evidence that suggests directly that it would change someone’s individual career choices. Ultimately, most people in public service pension schemes now are certainly not entitled to final salary lump sum benefits. The vast majority are on the new schemes.

Q17 **Sir Geoffrey Clifton-Brown:** Do you accept that lump sum payments are likely to become a thing of the past?

Cat Little: Yes, because of the new schemes and the reforms that are being implemented, inherently there will be, over a long period of time, less incidence of those lump sums being made.

Q18 **Sir Geoffrey Clifton-Brown:** Given that the whole thrust from the Treasury point of view of these public sector pensions is to make them more affordable—one of your main aims—how does that chime with recruitment and retention of public sector employees? Do you have a policy? Prior to 2012, it used to be one of the aims of pensions, but it is not now. Have you any plans to revise that in the future?

Cat Little: As you say, it was one of the main aims in 2011, and the Treasury still sees pensions as a really important part of the overall remuneration package, which obviously is one of the big drivers in recruitment and retention in the public sector. We continue to monitor and look at overall remuneration, mainly through the work that independent pay review boards undertake for us in providing advice to Government. We also look at a range of workforce data. Of course, there are examples where we take action to consider specific workforces where we think a pension lever is helpful.

For example, in the Government Commercial Organisation, the terms and conditions for employees for commercial skills deviate from standard civil service terms. We offer a higher base salary and a lower defined contribution pension rate. That is deemed to be better suited to the sort of people we are trying to attract into the commercial skillset in Government. The sorts of things that people moving from the private sector will consider are the trade-offs between immediate salary and overall pension. They are used to much lower and much less generous schemes in the private sector. There are examples of it, and we think it is an important tool overall.

Q19 **Sir Geoffrey Clifton-Brown:** Time and time again across a range of hearings in this Committee, we hear of shortages of certain skills in the public sector, and those skills are more likely to be pinched by the private sector. What tends to happen is that people leave school and work in the public sector. They get trained up in IT, for example, and then, when they are well skilled in the public sector, they get poached by the private sector.

Is there any way we could use the total package of remuneration and pensions to try to retain those people who, after all, have been given vital skills by the public sector?

Cat Little: Absolutely. It goes back to my point about making sure that people understand the full value of their total remuneration package. As part of recruitment, we are trying to do some work with the Cabinet Office to agree some standardised wording in all our recruitment adverts to set out, as a proportion of pensionable pay, what you can expect as an employer contribution, and to make it clear that these are much more generous overall than the sorts of equivalent schemes you would expect to be part of in the private sector setting. A lot of it comes down to communication and engagement, explaining how individual schemes affect individuals. That is obviously mainly undertaken by employers and the individual schemes themselves.

Q20 **Sir Geoffrey Clifton-Brown:** I anticipated that answer. Before I came here this morning, I asked one of my very capable young assistants, when she and her friends are thinking about going for a job, what is more important: the remuneration or rate of pay; or an above-average pension. She said, without hesitating, "The rate of pay."

Clearly, young people in particular are not thinking as much about their pensions. Is this a question of education, and ought we to be educating them more in thinking about their future? If you and I go back to our first jobs, probably the last thing we were thinking about was pensions. Retirement seemed an awful long time off. As we get older, it seems to be less time off. Is this not something we ought to be addressing in the education system?

Cat Little: As an accountant, and someone who is passionate about making sure that people understand their pensions, I can only agree with you. I think it is only natural for people starting out in work probably to put more weight on the short-term and immediate benefit of the cash they get through their salary than on something that feels quite remote and further on in life. A lot of it comes down to education, and making sure that people understand how pensions work.

Q21 **Sir Geoffrey Clifton-Brown:** Sir Tom, what are you doing to make pensions more flexible for employers and employees? I am thinking particularly about participation of the low-paid group, and the bigger of the four pension schemes, the national health, and some of the lower-paid people in the national health service. If they opt out of these pension schemes, ultimately the state will be liable through the benefits system for helping them in their older age.

Sir Tom Scholar: I will pass that question to Cat.

Cat Little: For all the four main schemes, participation is quite high and opt-out rates are relatively low. The same is true of the NHS. Over time, across all the "Agenda for Change" grades in particular, we have seen a much steadier level of participation. We are not seeing a difference there for more junior or younger people necessarily.

What we try to do in our pay policy is to protect lower earners. As we announced as part of the SR last year, for the pay pause, lower earners, and the vast majority of lower earners below the median wage, will get a pay rise. We do that so that they recognise that in the overall remuneration there is an important weighting towards pay.

Q22 **Sir Geoffrey Clifton-Brown:** Is there any thought about making those schemes more flexible, to encourage employment in the public sector—for example, by allowing flexibility on the accrual rates?

Cat Little: Changing the accrual rate is obviously a big lever for affordability. To your previous question to me, I am not sure that most people understand how accrual rates operate. It is not the easiest to explain to people. Most pension schemes have a standardised accrual rate. There are very few exceptions; for example, in the civil service pension scheme, I think it accrues at about one sixtieth of your average pensionable pay.[1] I am not sure it is the easiest thing to explain to people. I am not sure that pensions would be the first thing that you would turn to as a flexible lever to aid recruitment and retention. I would go to other things first. As you say, pay tends to have a more immediate impact.

Q23 **Sir Geoffrey Clifton-Brown:** At the mid-career point, going back to my previous question, when people are likely to be poached by the private sector because they have desirable skills, if you offered a flexibility of accrual rate at that point, it would be long enough for them to boost their pension, and it would be an attraction for them to stay on in the public sector.

Cat Little: Obviously, individual circumstances and individual choices about a future career are very difficult to reflect fairly across large member schemes that are quite complex. It is a fair point, Sir Geoffrey, but I am not sure it would be the first thing that we would turn to. Increasingly, what we are seeing is that people in the middle of their careers value public service, the impact that we have on service delivery, and obviously job security. There are lots of different factors that we would turn to before we turned to pensions.

Q24 **Sir Geoffrey Clifton-Brown:** You have already referred to the really important figure 11 on page 32, showing pensions as a proportion of GDP dropping over time as a cost to the public sector. Have you done any work on what I call the pensions time bomb—the second post-war baby boom who are likely to retire in the late 2020s and early 2030s? It is going to add a huge number of pensioners. Does that graph take that into account?

Cat Little: I believe it does, but I will turn to Martin if that is okay.

Martin Clarke: Thank you, Cat. Those projections take into account the expectation of life of all the workers and the profile of the workforce stretching out into the future. All that underlying demography will be taken into account in compiling the cash flows for those forecasts. Therefore, the feature you refer to will be included among those.

Q25 **Sir Geoffrey Clifton-Brown:** One final question for Cat Little. Going back to the education point, does the Treasury, in combination with DFE, have an education policy about pensions?

Cat Little: I am afraid I do not know the answer to that; not one that I am aware that the Treasury actively sponsors and works on with the DFE. I will take that away, but given the answer to my previous question, it is obviously something I would personally endorse. I will come back to you.

Chair: I think we would all agree that good education is vitally important in this.

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[1] The witness has clarified that the accrual rate in this scheme is 2.32%, or approximately one forty-third of pensionable pay.

Q26 **Peter Grant:** Sir Tom, you gave some forceful explanations earlier for the 45% gap in average pensions between male and female former employees. Some of those historical reasons have subsequently been found to be unlawful. A number of local authorities, for example, have been faced with some very expensive equal pay claims for historical discrepancies in the rates of pay between male and female employees.

How confident are you that the 40% pension gap between male and female former employees is lawful and that there is not a risk of a very expensive claim on behalf of female pensioners that they have been illegally denied the same pension as their male counterparts?

Sir Tom Scholar: Let me try to answer that. First of all, where that has been found to be the case, it will have consequences for the pensions of those people too, because they will need to be recalculated to reflect whatever remedial action has been taken on pay. If there are other examples where there is a legal risk to historical pay cases, clearly there would be the same risk to pensions.

The third possibility, which may be a more theoretical possibility, is that, beyond pay, there was something inherent in the design of the pension scheme, or the pension entitlement methodology itself, which, leaving the pay question to one side, resulted in discrimination. I am not aware of any such case, but you can certainly imagine it. That would be another alternative source of potential legal risk and potential risk of discrimination. I do not know whether we have any data on that, but that is analytically how I would think about it.

Q27 **Peter Grant:** Thank you. Mr Clarke, I appreciate that you may not want to get into too much detail in case you compromise any future action, but as part of the analysis that you do in assessing the potential future demands on the scheme, do you take account of anything that may be a sizeable legal claim involving a number of individuals that could present the pension scheme with a significant financial liability in the future? Is that something that is routinely part of your analysis?

Martin Clarke: One would have to say that we only deal with known and predictable events. All the costings that we do in valuation work are on what are called best estimate bases. If there is something that we do not know about, it would obviously not form part of the best estimate. We tend to deal with known expectations and predictions and assumptions about the future, but we do not routinely make assumptions about things we do not have any indication or warning of.

As soon as a potential issue arose of a known event that would cause us to factor those events into the expectations, then, yes, that would be the case. Carrying provisions for unknown events, or events that we assume might happen but we do not know how they are going to happen, would not normally form part of a best estimate projection.

Q28 **Peter Grant:** Sir Tom Scholar, to follow up on another comment you made in relation to the same question, you and Ms Little went through some of the reasons why you would expect the pay gap in the public service to be narrowing year on year. At what point in the future can we expect the 45% pension gap between men and women to finally disappear? Do you have a target date in mind for that?

Sir Tom Scholar: I do not think the Government have a target for that. Again, analytically, you would expect the pension pay gap to be eliminated some decades, on average, after the pay gap itself had been eliminated, since the pension gap is a consequence of the pay gap. I do not think the Government have a target for it, but regrettably I think it can be expected to be some way into the future.

Q29 **Peter Grant:** Given that the gender pay gap has not been eliminated for people who are coming into public service now, does that mean that some of those people will still face a gender pension gap when they finally retire in possibly 40 or 45 years' time? Is that the kind of timescale we could be talking about, before women get the same pension as men who have done the same work?

Sir Tom Scholar: Of course, we have equal pay legislation. I cannot speak for every public authority, but I can certainly give you an assurance that in the Treasury, as an employer, we go to great lengths to ensure that we are both meeting our responsibilities there and closing the gender pay gap. I am sure other employers are doing the same. I cannot say the timescale over which it will happen.

Q30 **Peter Grant:** I want to look at the longer-term implications of people choosing to opt out of the employer schemes. Sir Tom, what information do you collect on employees who choose to opt out? For example, are you able to identify whether particular age groups, salary levels or racial or ethnic groups are more or less likely to opt out of the scheme? Is that information that you collect?

Sir Tom Scholar: I am not sure what level of detail we have on that. Perhaps Martin or Cat might have more information.

Cat Little: We do not as standard collect detailed opt-out rates in the Treasury, but the schemes do. The schemes provide quite detailed assessment of opt-out rates, where they have the evidence, as part of the information they provide to the public pay review bodies. We obviously take a very close interest in that.

Q31 **Chair:** When you say you take a close interest, do you see breakdowns of who is opting out?

Cat Little: Yes, we can access breakdowns where they are available. I should say that they are not always available. The Teachers' Pension Scheme has done an estimate of overall participation. There are lots of imperfections and issues with opt-out data, especially since autoenrolment. Opt-out data in itself is not something we would look at in isolation.

We also look at wider membership data, such as numbers of members and contribution yields. We look at broader workforce data as a means of building up a picture about how participation is flowing. Wherever possible, we look at segregated and cohort data. As I said, it is not widely available, but certainly at scheme level they have much more information than we do as standard.

Q32 **Peter Grant:** The NAO has found evidence to suggest that younger employees, and employees generally on lower salary levels, are more likely to opt out of pension schemes. Is that something that the Treasury is aware of? Is it something that would give the Treasury, or the Government more widely, cause for concern?

Cat Little: Anecdotally, yes, although, as I said in my previous response to Sir Geoffrey, the data is quite mixed. I refer back to the point about education. Anecdotally, our hypothesis would be that younger people probably do not value the long-term pension benefits that accrue, which will feel very remote to them when compared with the immediate cash benefit of their salary. You can see why, if presented with a choice, it might be appealing. It all comes back to education, and making sure that when individual members make those choices they have the full facts and understand the trade-off that they are making between short-term cash benefit versus longer-term pension benefit.

Q33 **Peter Grant:** A number of young people will be looking at the news every day and seeing both public and private sector employers pension schemes that are often unilaterally reducing retirement benefits for their employees below the levels that employees thought they were signing up to when they entered the scheme. We have clearly seen what happened to the WASPI women in particular with the state pension scheme. A lot of women are now being told that they will not get the pension they were promised when they originally signed up to it.

Have you done any investigation as to whether those kinds of stories are damaging the trust that young people in particular put in their pension scheme? Is there an issue that they do not join the scheme because they just do not believe that the promises they are given now will still be in place when they come to retire in 40 years' time?

Cat Little: We have not done any specific investigation, but of course public sector pension schemes, by their nature, are backed by Government. They are not defined contribution schemes, so they are inherently different in risk from quite a lot of the private sector schemes that tend to cause the headlines. It is not something that we have looked into specifically.

Q34 **Peter Grant:** But would you accept that the state pension is a Government-backed scheme, and that did not help the WASPI women to get a fair deal from the changes that were made to their pensions? As a civil servant, you maybe cannot comment on the fairness of it, but you would accept the fact that the state pension, which is a Government backed scheme, did not prevent the state pension rules from being changed to the detriment of a significant number of women born at particular times in the 1950s.

Cat Little: Yes, I agree with your point.

Q35 **Peter Grant:** Do you have a concern that, if people are opting out of their employer's scheme, they may become easier prey for other schemes that are less reliable? They may in fact be getting into the next Equitable Life, the next London Capital & Finance, or whatever the next pension scandal is. Is that something that the Government or the Treasury take into account—that if you change the rules in such a way that it discourages people from signing up to their employer's scheme, it makes them more likely to fall victim to pension scams that they won't know about until the scheme collapses in 30 years' time?

Cat Little: Generally, on the subject of pension scams, it is something that the Government are very acutely aware of overall and have taken quite considerable action on over several years. For example, Project Bloom was established across Government, led by The Pensions Regulator, to make sure that lessons are learnt and that we are actively doing everything we can to prevent people taking on schemes where we are clear that there are scams involved. That is part of wider Government efforts.

Once an employer or an employee withdraws or opts out from a public sector pension scheme, I do not think we actively trace what happens after the point at which they opt out. We certainly do not collect data.

Q36 **Peter Grant:** When you are assessing the impact of potential changes to a public sector scheme, what assessment do you make of any likely longerterm impact on other aspects of public spending, such as the benefits system?

Chair: You were a little bit unclear in the room, Mr Grant. Could you repeat that, please?

Peter Grant: I beg your pardon. When you are assessing the impact of potential changes to public service pension schemes, what assessment do you make of the consequential impact elsewhere on the public purse—for example, an increase in demand for benefits in the future?

Cat Little: Pension costs are a very large part of public spending. It is up to Ministers to decide what proportion of public expenditure they want to focus on all parts of the public sector, including pensions. It is certainly something that we consider as part of spending reviews, and in particular for pensions at the point at which we have implemented reforms. That was clearly part of the considerations that were undertaken back in 2011.

Q37 **Peter Grant:** In 2011, this Committee reported that, if you make pension schemes more expensive to employees, more employees opt out and subsequently more of those former employees have to rely on meanstested state benefits. The report went on to say that important implications of this kind need to be evaluated and understood.

What has the Treasury done in the 10 years since that report to make sure that you now understand the implications for the benefits system, for example, of making changes to the pension schemes?

Cat Little: First, if I can refer back to my previous answer on participation and opt-out rates, at the moment opt-out rates are very low, certainly in proportion both to total participation and to private sector schemes.

We have not specifically done any evaluation of the impact ultimately on individuals, and whether they are more likely or less likely to need to access benefits. We are still in the process of implementing the reforms from 2011 to 2015, so there will come a point when we need to undertake much more detailed evaluation. Our main focus at the moment is on implementing the major reforms as envisaged nearly 10 years ago.

Q38 **Peter Grant:** The point of the recommendation in the report in 2011 was that before you decided on what changes you were going to make—before you decided on the changes that you are now implementing—you had to make sure that you understood their overall impact on the public finances. From what you are saying now, it appears to me that you are implementing changes that were decided before you had a full assessment of their impact on the number of people who would rely on benefits in the future. Is that correct?

Cat Little: Back in the period 2011 to 2015, we undertook quite an extensive evaluation of what we thought the forecast impact would be in a whole range of different circumstances. What I am saying is that we have not repeated that exercise as a post-implementation evaluation because we have not finished the implementation. I am sorry if I misunderstood your question, Mr Grant.

Q39 **Peter Grant:** In 2012, the Government produced an impact assessment for the Public Service Pensions Bill. Did that impact assessment include the likely impact on the number of people who would have to rely on state benefits because their employee pension would not be enough?

Cat Little: I do not know directly off the top of my head. I apologise. I do not know if Mr Clarke knows.

Martin Clarke: I am sorry, I am not aware whether that was included or not.

Q40 **Chair:** Is that something the Government Actuary's Department could do an analysis of, to work out if a pension is lower and, for example, people cannot afford their rent so they claim housing benefit, and all those knockon effects? Is that something you could model?

Martin Clarke: It is possible. There are lots of variables in that, but with a fair amount of thought, it is perhaps something we could put our minds to if that is what our Government clients want us to do.

Q41 **Peter Grant:** I have one final question to end this section. It is probably for the permanent secretary to answer. Sir Tom, we have been saying that, if we make the wrong changes to a public sector pension scheme now, the consequence in the future can be, effectively, that more public servants retire into poverty. They retire on a pension that is not enough to get by on and have to rely on state-funded benefits, income-related benefits. Is that in itself something that the Government consider an undesirable consequence of changes to the schemes?

Sir Tom Scholar: If I can go back to my first answer, the policy objective of the reforms 10 years ago, set out at the time, was certainly to put the public sector pension system on a sustainable basis of affordability. It was also to ensure, within that, a decent income for retirement and an attractive overall package of remuneration for the public sector, to attract and retain public sector workers. It is already inherent in the design of the reforms and in the objective of the policy.

Q42 **Peter Grant:** If, as has been indicated in the NAO Report, younger and low-paid employees in particular do not think the pension scheme is for them, doesn't that suggest that that key objective and the reforms have not worked?

Sir Tom Scholar: As Cat said, we are in the very early stages of the reforms. These things play out over several decades. The indication is that opt-out rates are quite low.

Q43 **Chair:** When you say "indication", Sir Tom, the National Audit Office asked questions of your officials about this, and there was no data available to the Treasury to provide to the National Audit Office.

Sir Tom Scholar: Cat has some information that might be helpful.

Cat Little: If we go down the main schemes, the TPS is 92% to 93% participation, obviously with the converse being the opt-out rate. The civil service is less than 1% opt-out. The NHS is around 90% active membership. I do not have the armed forces data off the top of my head, but again—

Q44 **Chair:** But you have that data.

Cat Little: Absolutely.

Q45 **Chair:** Can we make sure they are supplied to the National Audit Office?

Cat Little: I think in our conversations with the National Audit Office we entirely agreed with its sentiment that we have to pay very close attention to opt-out rates. The Treasury does not itself directly collect that data, but we monitor it. That is the distinction I would make. Certainly, the schemes are collecting, analysing and sharing that information, where possible, but most notably through the pay review body process, which takes into account overall remuneration.

Q46 **Chair:** I am sorry, Sir Tom, I cut you off part-way through your answer. Do you want to continue with your response?

Sir Tom Scholar: I think I had mostly finished it, but clearly any future changes that are considered would have to take into account the kind of effect that you are referring to, Mr Grant.

Peter Grant: As well as the percentage figures that were quoted, it would be helpful if we could get information about the actual number of people opting out. What can look like a small percentage of the total number of teachers in England and Wales, for example, could translate into a lot of individual people who may not be adequately provided for in their retirement. It would be quite interesting if we could see the numbers of people, as well as the percentages. I have no more questions, thank you.

Q47 **Shaun Bailey:** I want to drill down a bit more into the armed forces offering. Ms Little, could you confirm how we can ensure that the pension offering for people who want to join the armed forces means we are still able to recruit and retain the best?

Cat Little: I would think of the pensions offer as part of total remuneration. That is something that the Armed Forces Pay Review Body considers independently and then provides the recommendation to Government. That is just to reiterate the process.

The armed forces pension scheme is very generous. From memory, it has a 42% employer contribution rate, one of the highest of the four main schemes.[2] One of the challenges, certainly during my time at the MOD, that we were working on was making sure that everybody understood the benefit of that 42% contribution. At the time I left the MOD, we were looking at how we could denote on the payslips of individual members of the armed forces a bit more specific information on the line that says "employee/employer contribution" and to spell it out in plain English, so that as they received their payslip there was a really clear explanation of the value of that line. It is an ongoing challenge and, as I said earlier, we have to completely commit to doing as much as we can to educate and communicate the value of pensions overall.

Q48 **Shaun Bailey:** I am very conscious that the armed forces pension in particular is in a very unique place. Quite often, it is relied on by people who are, effectively, trying to set themselves up in a second civilian life after they have served. Working with the Armed Forces Pay Review Body, how is the Treasury trying to ensure that, in this particular instance, members of the armed forces who have done their 22 years can rely on that in order to settle in their civilian life? This is certainly something that I have heard from armed forces organisations that they are very concerned about.

Cat Little: Generally, there are differences for uniformed public service workers across the board. We recognise that the physical requirements of the role for firefighters and members of the armed forces is very different. Of course, it is not just the armed forces; we are very conscious of the need to ensure that pensions are fit for purpose and reflect the overall requirements of employers. Ultimately, as I said at the start, Mr Bailey, the process for making sure that we provide the right overall remuneration and that we monitor it is through the pay review body process, which is undertaken annually.

Q49 **Shaun Bailey:** I absolutely understand that. I get the pay review body process; I completely understand that is not your job, but you feed into that. My point was: are you confident that someone who has joined the Army or the armed forces at 18 and leaves at 40 will have enough of a

[2] The witness has clarified that the total employer contribution rate in this scheme is 63.5%. The employer contribution rate relating to future service only is 42.6%.

basis to set up a new civilian life? That is the pushback that I have received from armed forces organisations. They are concerned that that might not be the case.

To ask again, are you confident that someone could set up a second life on the basis of that offering?

Cat Little: It is quite a subjective judgment, isn't it? It will depend on individuals, but what I can say is that the main schemes are significantly more generous than equivalent private sector schemes, and the armed forces scheme has the highest level of employer contribution rate. Of course, it is designed with some of the circumstances that you mentioned in mind. It will be much more generous than any other scheme that an individual could access in the public sector or the private sector.

Q50 **Shaun Bailey:** Surely there is a counterargument when a member of uniformed personnel is putting their life on the line. I see what you are saying on the generosity point, but is there not a counterbalance with the fact that that person is putting their life on the line? We have had pushback from armed forces charities around the point about employer contributions, and I would be keen to understand again how you are balancing those risks, particularly the dangerous nature of the roles, with the offer that is there. Is that part of the rationale behind the increased employee contributions?

Cat Little: Obviously, the armed forces play a unique role in protecting society and this country, and that is reflected in the total remuneration that the armed forces receive. I do not think it is really for me to judge whether I am confident that that will, in all circumstances, be the right level, if I am frank, but that is what the pay review body is designed to reflect in its consideration of how adequate total remuneration is for the armed forces as a whole.

Q51 **Shaun Bailey:** Okay, but just to take a step back, there must be some form of data or analysis that you have done across the board to ensure that that offering is adequate in terms of the risks that people are putting themselves through, and the potential knock-on as a result of those risks. As we have discussed previously, given the base level required for an individual at, say, 40, who has to restart, surely, in conjunction with the pay review body, some sort of analysis must have been done on this.

Cat Little: I am not aware specifically, off the top of my head, but I am happy to take that away and come back to you.

Q52 **Shaun Bailey:** I would be grateful for that. One final question from me. Given the changing nature and the evolving risks for personnel, do you think that the current annual information that personnel receive is enough? Do you think that perhaps it needs to be more frequent in order that more informed choices can be made around pension offerings and choices?

Cat Little: Is that for all schemes, or for the armed forces in particular?

Shaun Bailey: Specifically for the armed forces, but you can expand it to other schemes as well.

Cat Little: I know that the armed forces pension scheme provides a range of different communications to help members understand the value of pensions. It is not just the annual membership statement that they get; there are frequent online communications, newsletters and other forms of engagement so that people understand exactly how their benefits and pension rights affect them. I am confident that the armed forces pension scheme takes that very seriously.

Shaun Bailey: I will leave it there. Thank you.

Q53 **Chair:** We have touched on other sectors, and we know that other sectors outside the public sector are changing the way they do schemes because of the affordability issue, particularly for the employer. Is it really sensible, Ms Little, for the Government to keep swimming against that tide? Are they swimming against a tide of change where other sectors recognise that there is a big challenge about how to fund pensions in this way?

Cat Little: The 2011 reforms were put in place precisely because of the rising issue of affordability. Obviously, in the private sector it is more acute, especially where you have funded schemes.

Q54 **Chair:** We know about the history, but the point is that employer contributions have gone up incredibly, up to 25%. The armed forces are slightly different, for all the reasons of the pay review that takes place there. If public sector services are paying out that much money for their employees, it affects the services that they can deliver. It is very costly to them. Basically, can the nation continue to afford public sector pension schemes in the way they are funded, even under the reforms?

Cat Little: Overall, our view is that we want to make sure that affordability is sustained over a long period of time. As Sir Tom said, that ultimate measure is over a 50-year period. Our view at the moment is—

Q55 **Chair:** But the employer contributions are now: that is the bit that has gone up significantly—

Cat Little: I suppose—apologies, Chair—the cost control mechanism, which was one of the recommendations from the 2011 report, was partly to make sure that, over time, there was a symmetrical way of making sure that member costs and employer costs were more fairly balanced. We might come on to this, but that was one of the mechanisms that allowed us to say, depending on whether there is a floor or a breach, that will be able to adjust, and ensure that there is a fair proportion of costs between employers and members.

Q56 **Chair:** I will come to Mr Clarke in a moment, particularly on the cost control mechanism. We have talked about private schools coming out, and the DFE has been looking into that. The British Medical Association submitted evidence to us some months ago, and particularly for this inquiry as well, about the impact on consultants, something that was raised in this

Committee in 2012 with the then permanent secretary at Health about senior doctors coming out, so it is not unknown. Higher education has written to us, because they inherited public sector pension schemes, but they are now private bodies.

We have a lot of challenges. If these individuals or groups push to pull out, or to be treated differently, how sustainable is it to maintain even the changes that were made in 2011-12?

Cat Little: On the schemes that you mentioned, as you say, the USS has nothing to do with Government, because its members' employers are private bodies. Ultimately, the thrust of your question is probably getting at overall responsibility for some of the pension risks that we are seeing more broadly.

We want to make sure that we understand and monitor how other private sector bodies are dealing with, managing and reforming their schemes. Fundamentally, that is for them as non-Government bodies and independent employers to manage, not for central Government itself.

Q57 **Chair:** We are stacking up a big challenge for the future. As colleagues have touched on, you have opt-out rates, and we do not know what will happen in the future, as it is more expensive. You have a whole generation that is not a property-owning generation, because that is not affordable for a lot of people with interest-only mortgages and potentially not opting into the pension scheme.

I asked Mr Clarke earlier about whether they can do any actuarial evaluation of the potential impact of that sort of activity on future costs to the Exchequer. Is that something that is in your mind? Have you done, or are you planning to do, any work to look at what will happen if people do not sign up to their pensions in the wider context of their economic situation, compared with, say, what my kids would call the boomers?

Cat Little: We do not currently have any active evaluation being undertaken, but it is certainly in our mind. As I said earlier, once we have got through the immediate implementation of the 2011 reforms, we want to make sure that we have continuing monitoring and evaluation. It is certainly something that we will come to.

Sir Tom Scholar: As Cat said earlier, in conversation with Mr Grant, we monitor the opt-out data. If that starts to show a trend, it might be a trend just at the younger end of the workforce, which might not seem to pick up what Mr Grant was saying earlier about percentages; it might not be a big percentage, but it might be concentrated, for example, in the younger end or the least well-paid end of the workforce. That is one of the things that we would hope to pick up. If we see that beginning to develop, it clearly raises the question that you have put.

Q58 **Chair:** We touched earlier on the breakdown of other groups that might not be taking up their pension, perhaps because they are in low-paid jobs, and that might be more concentrated in certain groups of people and perhaps certain ethnicities. Is it in your mind to evaluate the equality impact of that? If you had, say, a group of people who were opting out because of immediate affordability issues, as they saw it, that could stack up problems and cause them longer-term problems in their retirement. Is that something that is at all in the Treasury's sights?

Sir Tom Scholar: The—I am hesitating because I am not sure about the detailed breakdown of the information that we have. Clearly, in order to answer that we'd have—

Q59 **Chair:** Should you not be curious about it, even if you do not have the detailed breakdown? We have heard that the schemes have information. I do not know if even they break it down like that. Whether they do or not, do you not think that would be a sensible approach? We could see really big inequalities stacking up that we do not even realise at this moment. All it takes is the right data to develop it. I am sure that Mr Clarke will have some views, but Sir Tom first.

Sir Tom Scholar: We should look at that.

Q60 **Chair:** What about the actuarial point of view, Mr Clarke? Is there anything you can do with the data that is available that could shine a light on some of the potential challenges for certain groups?

Martin Clarke: Not specifically from data I have seen. What would have to happen would be that the various workforces' equality data on ethnicity, for example, would have to be matched to their pension data to fuse those together. I am not aware at this moment whether any of the schemes have actually done that.

It is subject to all the data restrictions; however, it is theoretically possible to do that and to form some sort of emerging view. It will depend, of course, on the quality of the breakdown of workforce composition data as to the validity of some of it, as there are obviously issues elsewhere about people reporting their ethnicity, for example. It is theoretically possible. It depends on the quality of the data and the willingness to share it across various sectors, from workforce data into pensions data, but it is theoretically possible.

Q61 **Chair:** It is quite straightforward male-female, because of the volume of people; half the population is female.

It sounds like there is work to be done there, potentially. Can I check, Sir Tom, for the record, that the Treasury's position, or the Government's position, is still that there should be no more major changes to pension systems for the next 25 years?

Sir Tom Scholar: I am not sure that the phrase was the next 25 years, but—

Q62 **Chair:** We have had that a lot in evidence, with people wanting that guarantee or that confirmation. What is your timeframe for changes—for how long you would want to stick with what we have at the moment? I am going to touch on McCloud, which might throw some light on it. Ms Little?

Sir Tom Scholar: Is there a formal Government policy on that? I am not sure that there is.

Cat Little: No. Ultimately, the priority at the moment is to implement the last set of reforms.

Q63 **Chair:** How long is the steady-as-she-goes period after that?

Cat Little: Exactly. Ultimately, we need to make sure that we implement them and evaluate them. There are no intentions for any crossGovernment reform, but it is something that we continue to monitor.

Q64 **Chair:** That brings me on to McCloud. The changes came in. We had the Hutton review and cross-party consensus that things needed to be done. We have auto-enrolment in the private sector, and lots of exciting potential things happening to get people to save for their future. Then the McCloud remedy came along. How did we get into this mess, Sir Tom?

Sir Tom Scholar: It is all well-trodden—

Chair: You do not need to go through the court case.

Sir Tom Scholar: It is well-trodden ground. The court case looked at the policy that had been introduced. The policy itself had been introduced following quite widespread consultation, including with employers and trade unions. A strong feeling was expressed in the consultation that there was a need for protection for people closer to retirement date, which is why that was incorporated into the system. That was upheld by judgments in some courts, but was ultimately overturned by the Court of Appeal. It was a policy that came out of a long consultation process.

Q65 **Chair:** But you had legal advice, at the point when you implemented the changes, that there could be a challenge under the Equality Act.

Sir Tom Scholar: I do not know what legal advice we had at the time, but I am sure that the legal advice would have looked at the possibilities for challenge. It always does.

Q66 **Chair:** I was wondering what the probability of that challenge was when the decision was made.

Sir Tom Scholar: I do not know.

Q67 **Chair:** Okay. If you could dig that out and write to us, that would be very helpful.

McCloud is a very complex issue. The restitution means that many schemes will be operating two parallel systems, the old scheme and the new scheme, and people can have a choice under many schemes, although it depends on the scheme, of course. They could decide at retirement, which means that pension schemes will have to run two parallel schemes. That is quite costly, potentially. Is the Treasury looking into supporting employers and schemes? Cat Little, you nodded.

Cat Little: Yes. As you alluded to, in February we announced the remedy and the deferred choice underpin. It was only really in the last couple of months that schemes were able to start to assess the estimated costs. We are working very closely with schemes, and I would expect that, as soon as we have that information available, it will be factored into the spending review and into departmental budget considerations.

Q68 **Chair:** There is no in-principle decision by the Treasury at this point to fund the cost of that part of dealing with the outcome of McCloud.

Cat Little: No, we are asking schemes to tell us what they think the estimated costs are.

Q69 **Chair:** So far, if we are reading it right, it seems that the general thrust of Government is that this cost should be shared between the Exchequer and other bits of the pension system. Where pension contributions went up, the Exchequer gave some money, but not enough, so employers had to cover some of that. Is that the general principle or general rule of thumb for what you are thinking about with McCloud as well?

Cat Little: We have not yet developed any sort of principles; we are just waiting for schemes to tell us.

Q70 **Chair:** The one does not necessarily mean that that is the thinking for—

Cat Little: Yes. It is not necessarily the precedent that we would apply.

Q71 **Chair:** That is perhaps a crumb of comfort for some of the pension funds.

Overall, who is going to pay for the £17 billion mistake that McCloud has thrown up?

Sir Tom Scholar: It is public sector pensions so, ultimately, it is the public sector.

Q72 **Chair:** Will the Treasury support schemes and restitution costs?

Sir Tom Scholar: I do not think that this has been—

Cat Little: Ultimately—this is where it gets a bit complicated—the impact of the McCloud remedy will be included in the 2016 valuation and will be borne by member costs going up. We then have to apply the cost control mechanism to the 2016 valuation. The reason why we announced that we would, in effect, waive ceilings where target costs are exceeded is that we do not want members to be put in a worse position than they would have been prior to the McCloud remedy being implemented.

Ultimately, the costs will be borne by members, but the cost control mechanism will manage that cost. The ultimate logic from that is: who pays for the costs of the waiver? That will need to be considered as part of the valuation process, which then sets the employment contribution rate.

Q73 **Chair:** This all goes back into when there will be other changes. It is going to take so long to deal with McCloud, and the outfall of that, that it would be helpful, as soon as the Treasury has a position—I suppose it is a policy decision—to know how long there will be a guarantee on no more changes. Is it possible to make that guarantee about no further changes? Pete mentioned private schools possibly opting out of the teachers' pension. If you saw more of that, it could make some of these pensions far less sustainable in the long term. There is nothing to stop those groups leaving, is there?

Cat Little: That is obviously for Ministers. As I said, we just need to make sure that we implement these reforms and understand their impact.

Q74 **Chair:** It seems to me that we need to see this in the round, as I was saying about the wider impact. I am concerned about the seeming lack of evaluation of trends in different generations. Those who are already well into a pension scheme are in one group, and those who have retired are in another, but it is about the young people coming through with a very different economic outlook.

Anyone who bought a house in the 1970s, first, would have been able to buy it and, secondly, it would have gone up as an appreciable asset, which is then part of a retirement pot, in effect, even if it was not intended for that purpose. That is not going to be the case for most of my constituents. About a third of my constituents are under the age of 35, or even younger than that, under 34 or something. They are not homeowners, and they will not have that cushion.

It will have a huge economic impact for the nation, if those people are going to need support for their housing and living costs, because they may have opted out of their public sector pension and have their state pension alone to live on. Is this something that anybody is looking at or thinking about in your purview?

Cat Little: As Sir Tom said, it is clearly something we need to look at. As you alluded to, if we do further evaluation, we obviously have time to consider it and to work that through into future policy development. As Sir Tom said, we will take that away.

Q75 **Chair:** I hope you will. Pensions are what we call slow politics, and most Ministers are not in a job long enough to see the impact, as Mr Osborne should remember, of their decisions on this issue. It is, I hope, down to a long-standing civil service to make sure that pins are put on Ministers' seats so that people think about it. I just make that plea.

Mr Clarke, I want to talk to you about the cost control mechanism. I believe that there were issues about introducing it and that the Government Actuary's Department raised some concerns. For the sake of people who may be watching this, could you give a simple explanation of what the cost control mechanism is and then tell us how you think it has been working?

Martin Clarke: This is a product of the reforms. The cost control mechanism is a way of baselining costs within the schemes and measuring at future valuations whether the costs have moved sufficiently far from that baseline to justify some correction to the benefits.

What was put in place was a mechanism that had a margin around the baseline of two percentage points of the payroll. When, at subsequent valuations, the measured costs had moved outside that corridor, the mechanism was intended to force scheme managers to apply some remedy, which would be either to reduce the benefits or to increase them, depending on which way it went, corresponding with the contributions. That was introduced as part of the reforms.

The valuations that were being done in 2016 were the first full iteration of that evaluation. The purposes of the cost cap mechanism, or the Government's objectives, are to maintain or control costs from the taxpayer's point of view, to maintain value from members' point of view and to achieve stability, and only to make the changes that I referred to in terms of benefits due to unexpected or unforeseen events.

In 2016, the emerging news from the valuation, based on provisional results, was that, for a couple of reasons, the schemes had all breached that corridor by virtue of the fact that the costs were more than 2% lower than the baseline. That was at the first time of asking, as it were, and it coincided with the McCloud issue that we have just been speaking about. The Government did not run through the full process, and those valuations were paused while the McCloud issue began to be tended to.

It was also announced that I would be commissioned to review the whole process of the cost cap mechanism, which is an ongoing piece of work that we are doing, to look more closely at what was happening in the first iteration to see whether those three or four objectives of Government in the cost cap mechanism were being maintained through the actual experience.

Q76 **Chair:** That is quite a challenge, isn't it? As an actuary, a professional in this area, and as an adviser to Government on it, what would you want to see changed? It is currently Government policy to have the cost control mechanism, and you are doing your review. Can you give us a hint about what might need to be changed, or what you would like to see changed, to make it more manageable and effective for the pension funds and the pensioners?

Martin Clarke: The mechanism obviously performed as it was designed to. The question is whether it properly meets the objectives. In high-level terms, what I have concluded, looking at the experience was, first, that the expectation would be that corridor breaches would be very frequent. Given the way the mechanism was designed, my expectation is that this would not be a one-off occurrence but would be a very frequent occurrence in future, which would appear to undermine the objective of stability.

The cost reductions arose from people's expectations of life being slightly less optimistic, shall we say, nowadays, and because expectations of salary growth had not been quite as originally assumed. That would imply, if it was followed through, that benefits would be improved or contributions reduced. At the same time, as we have already been hearing this morning, employer contribution rates were already set to rise. To a certain extent, it seems counterintuitive to have both those forces going at the same time and would appear not to meet the demands of keeping taxpayers' costs under control.

I have analysed that experience and have drawn some conclusions along those lines, and made some suggestions about possible changes that might be made to it. We will await the iterations and discussions involving myself and the Treasury about what they want to do with the kinds of suggestions that are being made and on which they will be consulting.

Q77 **Chair:** You have sort of asked my question for me. What is the Treasury going to do about the cost control mechanism?

Cat Little: I look forward to receiving Martin's report.

Chair: We love people who do numbers, Mr Clarke.

Cat Little: It depends on the specific recommendations. If we can clearly see that changes are required, the most important thing is that we need to consult very widely, and we will formally and fully consult on any proposals. In terms of timing, I expect to formally receive that report fairly shortly.

Q78 **Chair:** Okay. We have the cost control mechanism and the outfall of McCloud. Because of the changes in 2011, employer contributions are still very high. There are an awful lot of still-moving parts in the pension system; it has still not solidified. What else is the Treasury planning to do to make sure that this is sustainable and affordable to employers, employees and the Exchequer? We have talked about not having major change, but just in dealing with those issues quite a lot of change is still in play.

Cat Little: Yes. Our focus now is on implementing the McCloud remedy and considering the recommendations from the Government Actuary on the cost control mechanism. We have to implement the 2016 valuations. We are also due to receive the normal cyclical review of the SCAPE discount rate. Then we need to move on to the 2020 valuation. As you say, there is quite a lot that we need to get done.

These are very long-term impact reforms. Overall, we are still expecting the impact of those reforms to be delivered over 50 years, even with the changes that we are making for McCloud. You can imagine that our absolute focus is on the next four years and getting to the full implementation.

Q79 **Chair:** To cut to the crux on this before I go to Sir Geoffrey, the Treasury's focus has been affordability to the Treasury—to the Exchequer and to the taxpayer—which, on one level, is fine, but the costs to the employer are very high. We have had representations from most of the bodies that we deal with in these schemes about the sudden cost to schools of the increase in pensions there. When roughly 75% of your expenditure as a school is on staff, or perhaps even higher, that is a huge cost to them. That means on the ground, in real life, employing one or two members of staff fewer than you would otherwise.

Is the Treasury going to stay wedded to this Exchequer cost without thinking about the cost shunting—basically, shunting that cost on to a public service that will end up reducing services as a result? Do you look at it at all in the round? If you don't, who does?

Cat Little: The precise reason why the Exchequer funded quite a lot of those employer costs—

Chair: But not all of them.

Cat Little: Not quite all of them but, for foreseen costs, where Departments could plan, and as part of our normal discussions about overall pressures and how best to use total public resources, we did our absolute best to make sure that there was no impact on frontline services. Fundamentally, in the very short term, we are going to have a spending review this year, and we will need to work with Departments to make sure that we have clear assumptions about employer contributions for whatever period the spending review covers.

We are very mindful of it. It is very real, and it is very tangible. It is part of the everyday conversations that we are having with Departments.

Q80 **Chair:** It certainly is very real for the frontline public service providers who have really struggled. The Exchequer paid some.

Finally, I go back to the point about opting out. How does the Treasury engage, for example, with the NHS pension scheme if consultants want to opt out? The BMA says they get a change to their approach because of the annual and, in particular, the lifetime allowance, which is causing them to leave the job. Is that something that you factor into discussions about this as well?

Cat Little: Specifically on senior clinicians, as you know, last year in the Budget—

Chair: Yes; there was a change.

Cat Little: We made the changes.

Q81 **Chair:** But they are asking to be like the judges, aren't they, so that it is not—

Cat Little: I am aware of that. The judicial pension scheme and the challenges facing recruitment and retention of judges are very different from the challenges that the NHS is facing for the recruitment and retention of senior clinicians. The judicial pension scheme is in many ways unique, because of those recruitment challenges. We have very well-paid lawyers who are, in effect, giving up their private sector work and their earnings as a professional to join the judiciary, with a retirement age that is enforced on them. There are very different factors that we are considering.

As part of the SSRB recommendations for the judiciary in 2018, we were asked to make sure that we had taken all of that into account as part of recruitment and retention overall, which is what we are doing. I would not compare and contrast those two workforces; they are very different.

Q82 **Chair:** Equally, senior consultants could do private work exclusively and opt out of the NHS pension scheme, and they would then be lost to the NHS.

Cat Little: They can, and—

Chair: They do.

Cat Little: They can make an informed choice about that, but, ultimately, they do not have a set retirement age. Of course, people tend to join the judiciary later in their career.

Chair: I would love to talk about this more, but that on its own could be a whole inquiry. I throw it open to Sir Geoffrey Clifton-Brown.

Q83 **Sir Geoffrey Clifton-Brown:** Sir Tom, in relation to McCloud, from 2022 onwards, as the NAO Report makes clear, about 3 million pensioners or potential future pensioners will have to make very complex decisions as to whether to go for a career average or whether to go back for a final pension scheme. Although you have stated that in most pension schemes there will be a deferred option, these will nevertheless be complex decisions. Will the Treasury be setting guidelines to public sector pension schemes on the information that they must provide to these pensioners to help them make that very complex decision?

Sir Tom Scholar: The answer to that is yes, but Cat might want to give the details.

Cat Little: Yes. One of the specific things that will be part of the actual implementation that will happen in 2024 is that we will be requiring all pension schemes to set out, as part of their annual membership statements, the equivalent information for the legacy scheme as well as the new scheme so that, throughout the remaining period of an individual's career, they can see how the two schemes change on an annual basis, as they would for the current scheme they are members of.

The deferred choice underpin means that, at the point at which an individual seeks to retire, they can face the full facts. Hopefully, they would have had a period of time to familiarise themselves. Obviously, that is not true of everybody. For the McCloud remedy, the deferred choice underpin, we are working with all the pension schemes to make sure that they have dedicated McCloud communications. For example, in the civil service, we have pensions awareness week, with tens of thousands of people actively engaged in that. There are McCloud-dedicated sessions. We have Civil Service Live, which has dedicated sessions on McCloud. We are working very much in partnership with those schemes to make sure that people understand the implications.

Q84 **Sir Geoffrey Clifton-Brown:** That is good to hear. Turning to the cost control mechanism, it says that certain large events will defer the implementation of the cost control mechanism. Does Covid interact with that?

Cat Little: No. It is a function partly of the pause, partly of the review and partly of the fact that there is so much going on. For the cost control mechanism, the SCAPE review and the 2016 valuation, as you might be aware, we have moved back the deadline for implementation by a year. That is very much in response to feedback from schemes, which have a very complicated administrative task to manage. There is a delay, but we think it is important that we get the balance right in implementing it quickly and effectively, but giving schemes time to implement it with the resources they have.

Q85 **Sir Geoffrey Clifton-Brown:** We are on to the Chair's spinning plates. You have mentioned SCAPE. When the Government first introduced the discount rate in 2011, they said that the rate would be reviewed every five years and the methodology every 10 years. It looks as though the methodology review will be due this year. Is that correct?

Cat Little: That is correct. We have both the five-year discount rate review and the methodology review this year.

Q86 **Sir Geoffrey Clifton-Brown:** Even though there was an out-of-sync announcement in the Budget in 2018 that the rate would be reduced.

Cat Little: Yes.

Q87 **Sir Geoffrey Clifton-Brown:** It still means you are going to review it this year, does it?

Cat Little: Yes. The Bill provides for us to make out-of-cycle specific requests to review the discount rate if there are reasons to do so. Back in 2018, the OBR made significant adjustments to its long-term forecast of GDP, which prompted the Treasury to ask the Government Actuary specifically to review the discount rate at that time. It provides for cyclical, regular review, but also specific interventions where the Treasury thinks that there might be a reason to do so.

Q88 **Sir Geoffrey Clifton-Brown:** Will we get a separate result on this? Normally, these discount rates are set at the Budget. We have had the Budget; when are we likely to get the results of the review, not only of the rate but of the methodology?

Cat Little: On the SCAPE discount rate and the methodology, I think we are due to receive a report later this year. It will then take a bit of time for us to go through the consequences of that. Ultimately, it will not be implemented until 2024, so there is quite a bit to do before then, and I do not think we have yet agreed which fiscal event, or how it will be communicated, to be frank. I do not think there is an assumption about that.

As I said, for the spending review, because that discount rate has an impact on employer contribution rates, we will have to make a set of assumptions if the spending review covers the period after which we implement the new discount rate.

Q89 **Sir Geoffrey Clifton-Brown:** Talking about catastrophic events, I do not know how Mr Clarke makes his predictions 50 or 60 years out, but one of the consequences of Covid—although we do not know whether it will be or not—is inflation. Given that paragraph 2.22, on page 31, says that "a 0.5% annual increase in the earnings growth assumption would increase pension costs by £14.9 billion in 2067-68," I come back to what the Chair was asking earlier: how can you realistically say that this pensions policy is likely to subsist for 25 years without major changes? You do not really know. Mr Clarke, I am sure, will do assumptions on inflation, but you really do not know, 50 years hence, what the inflation rate is going to be.

Cat Little: That is true, but I go back to the point that short-term events such as Covid and EU exit do not necessarily guarantee that there will be an equivalent long-term impact on GDP, which is ultimately the denominator that we would use in calculating our views of affordability over the very long term.

Sir Tom Scholar: Similarly, a rise in the inflation rate does not, by itself, make public sector pensions less affordable. We are hedged on inflation, because a rise in the inflation rate also raises nominal wages and salaries, which increases the tax take.

Q90 **Sir Geoffrey Clifton-Brown:** I thought you were going to say that, Sir Tom, but past experience actually shows that wages do not generally totally keep up with inflation, do they? What actually happens in high inflation is that public sector wages get squeezed, so there would be a concern, would there not, if wages were being squeezed because they were having to make increased pension contributions?

Sir Tom Scholar: I did not mean to say—I was not trying to predict what will happen if inflation rises in 50 years' time, but simply to say that it acts on both sides of the account.

Q91 **Sir Geoffrey Clifton-Brown:** Yes, but maybe not totally, as I have just demonstrated. Public sector wages generally do not totally keep pace with inflation. They are not index-linked, for example, which would ensure that they did. If we had a period of sharply increased inflation, the bit that I have just quoted to you would indicate that pensions were likely to cost more, which is likely to put a bigger burden on the pension payers—the employees. If wages were not keeping up with inflation, yet pensions were costing more, there could come a situation where public sector employees would be squeezed considerably.

Sir Tom Scholar: But it is not simply a question of public sector wages and salaries—

Sir Geoffrey Clifton-Brown: Well, everyone.

Sir Tom Scholar: It is all nominal quantities. A rise in the inflation rate that leaves everything else the same in terms of shares of GDP would not, by and of itself, point to direct affordability conclusions. Clearly, as we are looking at long-term affordability, we have to try to take everything into account, but long-term trends in inflation are, essentially, impossible to predict.

Q92 **Chair:** The NAO highlights this on page 27 in part two, paragraph 2.12: average pay in 2009-10 was £36,000, compared with £31,000 in 2019-20, so average pay for employees fell by 12% in real terms. To highlight what Sir Geoffrey was saying, it is worth getting that on the record.

Sir Tom Scholar: Yes and, over the same time, inflation expectations, inflation and outcomes have been much lower than—

Chair: We don't want to get into an economics argument, but I thought it was worth highlighting that, backing up what Sir Geoffrey was saying. Is there anything else, Sir Geoffrey?

Sir Geoffrey Clifton-Brown: No, that is fine, thank you, Chair.

Chair: I thank our witnesses very much indeed for their time and for their patience with the technical problems earlier. Our transcript of this and the other two sessions will be up on the website in the next couple of days, uncorrected, so please keep an eye out for that. This will be long-term work for us, but our immediate report on the issue will be out at some point, probably during May. With Prorogation and so on, we are not quite sure of the timetable.