

Armed Forces Pension & Compensation Schemes

Main Estimate 2020-21: Estimates Memorandum

1 Overview

1.1 Objectives

The Armed Forces Pension Scheme (AFPS), incorporating the Armed Forces Compensation Scheme (AFCS), is an unfunded defined benefit scheme, in which payments to pensioners are funded by employer contributions, with the shortfall being financed by the Exchequer. The AFPS is free to its members, and therefore, the scheme receives no employee contributions. The AFCS provides compensation for injury, illness and death that are caused by service on or after 6 April 2005.

1.2 Spending controls

The AFPS budgets are not subject to pre-set Departmental Expenditure Limit (DEL) control totals; they sit within a category of spending known as Resource Annually Managed Expenditure (AME), which can be revised and reforecast regularly. This is because net expenditure and cash payments are largely outside the control of the scheme administrators on a day to day basis, instead being affected by factors such as membership numbers; salary levels; mortality rates; the age profile of members, and annual pension increases.

The **Resource AME** sought under the AFPS Estimate is essentially the amount by which liabilities under the pension scheme are estimated to increase during the year, less the contributions paid by employer towards those liabilities.

In addition, the **net cash requirement** represents the estimated net cash required for the year to cover payments of pensions, after taking account of estimated contributions and transfer values paid in. Over time, these amounts are intended to balance, but in a particular year they will not. A negative value means that more is forecast to be received than paid in year.

1.3 Comparison of net spending totals sought

The table below show how the totals sought for the AFPS compares with last year:

Net Spending total Amounts sought this year (Main Estimate 2020-21)		Compared to final budget last year (Supplementary Estimate 2019-20)		Compared to original budget last year (Main Estimate 2019-20)	
		£ m	%	£m	%
Resource AME	£6,682.0m	-£925.9m	-12.2%	+£274.1m	+4.3%

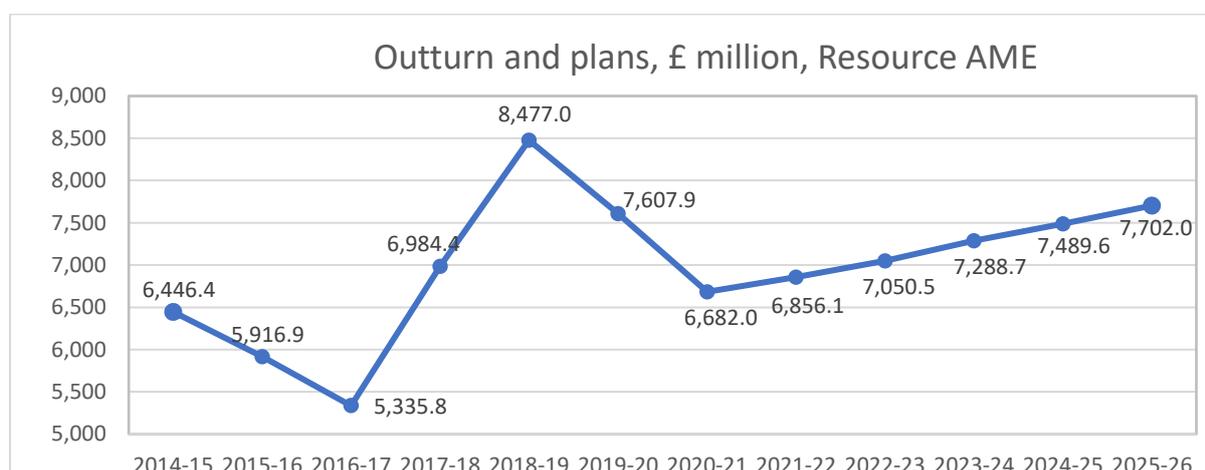
1.4 Key drivers of spending changes since last year

The provision sought under Resource AME is lower than last year's final budget, largely due to the 2019-20 Supplementary Estimate including Past Service Costs of £1bn in relation to Guaranteed Minimum Pension (GMP) indexation and equalisation costs and £110m in relation to potential costs arising from the Langford judgement.

A reduction in the Treasury set discount rate for interest on scheme liabilities, from 2.90% to 1.80% has reduced Resource AME but this has been offset by the impact of an increased Current Service Cost (CSC) percentage from £75.4% to £103.8% to take into account the potential costs of the McCloud judgement.

1.5 Spending trends

The charts below show overall spending trends for the last six years and plans data presented in Estimates for 2020-21.



In general terms, the year on year changes to Resource AME, shown in the above chart, are largely as a result of annual changes to the Treasury set discount rate for long term liabilities, aside from 2018-19 and 2019-20 whereby the total Resource AME is also heavily influenced by Past Service Costs associated with McCloud (£1.9bn in 2018-19) and GMP and the Langford judgement (£1.1bn in 2019-20) as detailed at section 1.4.

1.6 Administration costs and efficiency plans

The costs of the administration of the AFPS are borne by the Ministry of Defence, the employer, and are reflected in the Department's Estimates and Annual Report and Accounts.

2 Spending detail

2.1 Explanations of changes in spending

Subheads	Description	Detail	Resource AME				Over 10% / £10m - See explanation, note/para number
			Main Est 20-21	Supp Est 19-20	Change from Supp Estimate	%	
			£ million			%	
A	Expenditure	- Current service cost	6,277.20	4,605.80	1,671.40	36.29%	1a
		- Past Service cost		1,110.00	-1,110.00	-100.00%	1b
		- Interest on scheme liabilities	4,265.10	5,748.00	-1,482.90	-25.80%	1c
		- Enhancements and transfers in	2.00	1.90	0.10	5.26%	
	Sub Total		10,544.30	11,465.70	-921.40	29.20%	
A	Income	- Employer contributions	-3,860.20	-3,794.20	-66.00	1.74%	
		- Enhancements and transfers in	-2.00	-1.90	-0.10	5.26%	
		- Other Income		-61.80	61.80	-100.00%	1d
	Sub Total		-3,862.20	-3,857.90	-4.30	0.11%	
A	Net total		6,682.00	7,607.90	-925.90	-12.17%	

Note – due to rounding, the totals in the above table may not equal the sum of the parts.

Differences which are above 10% and/or £10 million are explained below:

1.a – An increase in current service cost is due in the main to the reduction in discount rate (real rate in excess of pension increase) from 0.29% to (0.5%). As a result, the Government Actuary's Department (GAD) have calculated the current service cost (calculated as a percentage of pensionable pay) as 103.8% for both Officers and Other Ranks (previously 75.4% for both Officers and Other Ranks). This increase is inclusive of additional (potential) costings in relation to the McCloud judgement.

1.b – The Supplementary Estimate for 2019-20 included a provision for past service costs in relation to GMP indexation and equalisation costs (£1bn) and the Langford judgment (£110m).

1.c – A decrease in interest on scheme liabilities due to a decrease in the interest rate from 2.90% to 1.80%.

1.d – The scheme received additional income in 2019-20 from the Army to cover arrears of pension to a select group of AFPS members.

2.2 Net Cash Requirement

The 2020-21 net cash requirement (NCR) is £1,371m, a marginal change from the 2019-20 requirement of £1,369m.

2.3 Estimated scheme liabilities

The latest valuation of the scheme liabilities for accounting purposes was £195.3 billion, as at 31 March 2019. At the time, there were 305,473 Active member benefits, 520,097 Deferred member benefits, and 436,588 Pensioner benefits.

Details of the latest scheme liabilities can be found within the 2018-19 AFPS accounts, report of the Actuary page 13, at the following link: <https://www.gov.uk/government/publications/armed-forces-pension-scheme-annual-accounts-2018-to-2019>

The next full valuation of the scheme is currently in progress and will be based on detailed member data as at 31 March 2016. The results of this valuation will be reflected in the 2019-20 accounts.