Armed Forces Pension & Compensation Schemes

Main Estimate 2023-24: 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 2023-24)**		**Compared to final budget last year** **(Supplementary Estimate 2022-23)**		**Compared to original budget last year** **(Main Estimate 2022-23)**	
		£ m	**%**	**£m**	**%**
Resource AME	£5,078m	-3,543m	-41.8%	-3,443m	-40.41%
Net Cash Requirement	£2,022m	+499m	+32.76%	+499m	+32.76%

1.4 Key drivers of spending changes since last year

The provision sought under Resource AME is £3,543m lower than last year's final budget (Supplementary Estimate 2022-23). This is driven by the net impact of two specific factors:

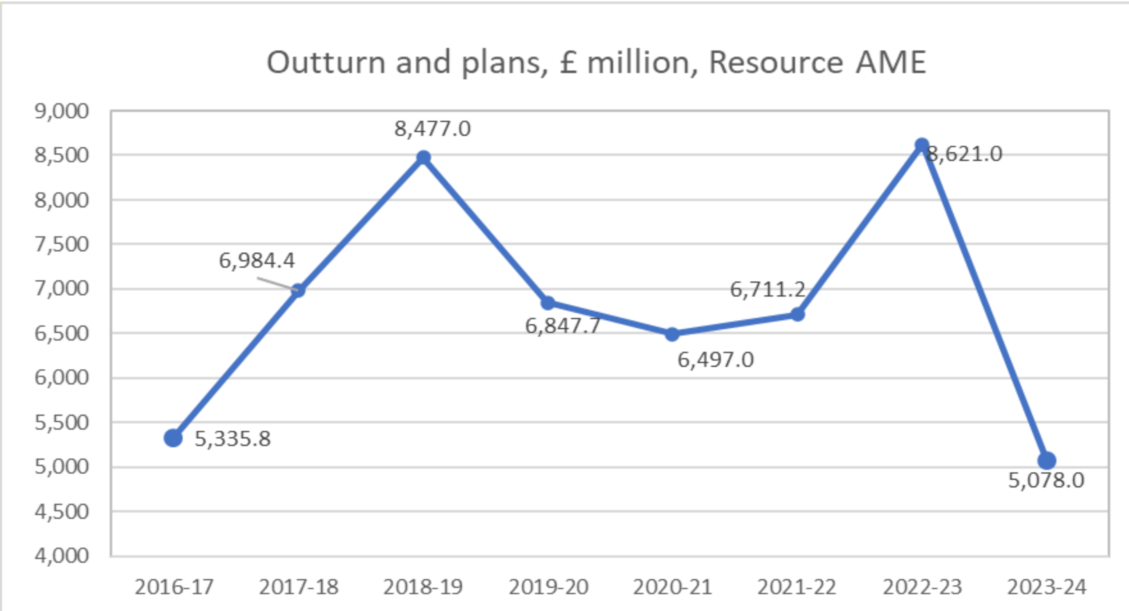
- The increase in the Treasury set **real discount rate** (net of CPI inflation) which is used within the calculation of Current Service Cost. This has increased by 3%, a change from (1.30)% to 1.70%. This has the effect of reducing costs, as in effect less needs to be set aside today in order to achieve the required liability amounts. This results in a decrease in costs of £5,662m.

  Offset by:

- An increase in interest costs of £1,938m due to the increase in the **nominal discount rate** (from 1.55% to 4.15%). The impact of this increased rate has been offset by the significant reduction in the estimated opening liability for 2023-24 (as provided by Government Actuary's Department) which has reduced to £155.1bn (2022-23 opening liability: £279.1bn).

1.5 Spending trends

The charts below show overall spending trends for the last six years and plans data presented in Estimates for 2023-24.



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 specific financial years impacted by material Past Service Costs as detailed below:

- **2018-19** - The total RAME is also heavily influenced by Past Service Costs associated with McCloud (£1.9bn recognised in 2018-19).

- **2019-20** - Past Service Costs of £1bn in relation to GMP equalisation, however this was heavily offset by a negative Past Service Cost of £920m in relation to amendments to the cohort of scheme members impacted by the McCloud judgement.

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				
			Main Est 23-24	***Supp Est 22-23***	**Change from Supp Estimate**		**Over 10% / £10m - See explanation, note/para number**
			£ million			%	
A	Expenditure	*- Current service cost*	2,700.23	8,308.00	-5,607.77	-67.5%	1a
		- Past Service cost	0.00	0.00	0.00	0.0%	
		- Interest on scheme liabilities	6,445.43	4,400.00	2,045.43	46.5%	1b
		- Enhancements and transfers in	2.00	2.00	0.00	0.0%	
	Sub Total		9,147.66	12,710.00	-3,562.34	**29.2%**	
A	Income	*- Employer contributions*	-4,068.00	-4,087.00	19.00	-0.5%	1c
		- Enhancements and transfers in	-2.00	-2.00	0.00	0.0%	
	Sub Total		-4,070.00	-4,089.00	19.00	**-0.5%**	
A	Net total		5,077.66	8,621.00	-3,543.34	**-41.1%**	

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:

1a – A decrease in current service cost is due in the main to the increase in discount rate (real rate in excess of pension increase) from (1.30%) to 1.70%. As a result, the Government Actuary's Department (GAD) have calculated the current service cost (calculated as a percentage of pensionable pay) as 41.4% for both Officers and Other Ranks (previously 128.1% for both Officers and Other Ranks).

1b - An increase in interest on scheme liabilities due to an increase in the interest rate from 1.55% to 4.15%.

1c – The scheme is forecasting a marginal decrease in Employer (SCAPE) contributions as a result of a decrease in the estimated pensionable pay.

2.2 Net Cash Requirement

The 2023-24 net cash requirement (NCR) is £2,022m, a £499m increase (32.8%) from the 2022-23 requirement of £1,523m. This is primarily driven by an increase in forecast pension benefit payments which have increased as a result of the confirmed pensions increase rate for 2023-24 of 10.1%.

2.3 Estimated scheme liabilities

The latest valuation of the scheme liabilities for accounting purposes was AFPS £279.1 billion and AFCS £3.9 billion, as at 31 March 2022. At the time, there were 287,025 Active member benefits, 513,522 Deferred member benefits, and 454,000 Pensioner benefits.

Details of the latest scheme liabilities can be found within the 2021-22 AFPS accounts, report of the Actuary page 16, at the following link: https://www.gov.uk/government/publications/armed-forces-pension-scheme-annual-accounts-2021-to-2022

The next scheme funding valuation of the scheme is currently in progress and will be based on detailed member data as at 31 March 2020. The results of this valuation will be reflected in future accounts.