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Dame Meg Hillier MP

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Chair, Public Accounts Committee
House of Commons London
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Dear Dame Meg Hillier,

Follow up to the Whole of Government Accounts (WGA) 2020-21 PAC Hearing

I am writing to provide a response to a question raised by a Committee member, Sir Geoffrey Clifton-Brown, at the recent PAC hearing. Sir Geoffrey asked why local authorities can set their own discount rates for valuing local government pension scheme liabilities, rather than there being a single discount rate that is consistent across the local authority sector.

I will differentiate here between discount rates used for the purpose of actuarial funding valuations which determine employer contribution rates, and those used for accounting purposes.

Local Government Pension Scheme (LGPS) funds and other funded public sector schemes carry out periodic actuarial valuations to determine employer contribution rates and funding levels. The discount rates used for these valuations reflect the specific expected investment returns on the actual assets held by the particular fund or scheme, as this is an accurate reflection of how the scheme will finance its pension obligations i.e. through investment returns on top of actual contributions. The Government Actuary's Department (GAD) is appointed by DLUHC to provide a report under section 13 of the PSPA 2013 following each round of LGPS actuarial funding valuations. This report considers the aggregate funding position of the LGPS, and how the various actuarial funding valuations compare to each other with regards to compliance, consistency, solvency, and long-term cost-efficiency.

This is a different approach from the unfunded public service pension schemes for which a single discount rate known as the SCAPE (Superannuation Contributions Adjusted for Past Experience) discount rate is consistently used to determine employer contributions. This is based on the OBR's forecast of long-term GDP growth, as a proxy for the growth in the future tax base, as these schemes do not have actual ringfenced assets for the financing of pension obligations – current benefits are funded through employee and employer contributions, with any shortfall or surplus being funded by or passed to HM Treasury.

The difference in discount rates used for actuarial funding valuations reflects their funded and unfunded arrangements, in order to provide the most appropriate measure of costs and liabilities for each, which can then be used for comparison across the public sector.

Turning to the discount rate for accounting purposes, HM Treasury annually updates the Government Financial Reporting Manual (FReM) which sets out guidance for preparing accounts for central government including the required departures from International Accounting Standards for unfunded pension schemes.

HM Treasury sets discount rates on an annual basis for all reporting entities that apply the FReM, which are primarily central government bodies. The FReM does not apply to local government, who instead operate under the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance and the Code of Practice on Local Authority Accounting. As a result, local government are independent of central government when determining discount rates.

The rules they follow mean that the discount rates for Local Government Pension Scheme (LGPS) investment funds, and for the unfunded and locally administered police and firefighters' pension schemes, are set for each LGPS fund and police or fire pension authority on the basis of advice from their actuaries. Differences in the discount rates used are a reflection of the following features:

- i. The timing of when assumptions are derived – HMT updates the discount rate used for pension accounting disclosures in the Public Expenditure System (PES) annually as at 30 November, but most funded schemes including LGPS funds base their assumptions on conditions as at 31 March coinciding with their scheme financial year.
- ii. Funded schemes tend to reflect scheme liability and membership profile and duration (i.e. when benefits are due to be paid from the scheme on average) when setting their assumptions. A scheme with shorter duration (benefits due to be paid sooner on average) could end up with a different discount rate to one with longer duration based on expected variations in short-dated and long-dated bond yields.
- iii. Funded schemes tend to have different advisors and the firms may have different methodologies for deriving the corporate bond yield curve or determining an appropriate assumption.

The timing difference at point (i) is the greatest potential source of variation. However, it is important the PES process takes place in advance of year ends, allowing schemes to provide accurate Supplementary Estimates by the required deadline. The bespoke method at point (ii) can also lead to variation but is designed to provide a measure which reflects the specific liability and membership profile of the schemes.

Taken together, there are valid reasons for local government pension scheme funds to take individual approaches to discount rates, both with respect to actuarial funding valuation and accounting treatment. These are necessary to reflect their particular funding arrangements and accounting standards and do not prevent comparisons being drawn across the local authority sector, and indeed the wider public sector.

We would also like to take this opportunity to propose minor corrections to the transcript. These relate to matters of fact which do not materially alter the general sense of answers given.

Question	Current wording in transcript	Proposed correction
1	<i>[HMT response] this set of accounts took us about 14 months to produce...</i>	This should be updated to 13 months
5	<i>[HMT response] Under the £500 million threshold, my understanding for previous years is that 251 bodies...</i>	This should be updated to 258 bodies

18	<i>[HMT response]</i> <i>We aim to get draft accounts to the NAO for</i> November	This should be updated to December
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We would appreciate if the Committee can consider whether these minor corrections can be made to the transcript.

As ever the Treasury is grateful to the Committee for its continued support for the Whole of Government Accounts and greatly values your feedback.

Yours sincerely,



Conrad Smewing