Sixth Report of Session 2021–22

HM Treasury

Public Sector Pensions

Introduction from the Committee

Around 25% of pensioners and 16% of the working-age population are members of one of the four largest public service pension schemes (the armed forces, civil service, NHS and teachers' pension schemes). In 2019–20 the four schemes made pension payments of £33.5 billion—funded through around £8.2 billion of employee contributions and around £25.4 billion of taxpayer funding—with scheme members on average receiving around £10,000. HM Treasury has been concerned for some time about the rising cost of public service pensions to the taxpayer and it introduced reforms between 2011 and 2015 aimed at making them more sustainable and affordable. As a result of those reforms, the most recent forecasts show that costs are expected to fall over the long-term from 2.0% of GDP in 2019–20, to around 1.5% of GDP from 2064–65. In December 2018 the Court of Appeal ruled that parts of the reforms were unlawful (the 'McCloud judgment') – as the special protections offered to those closest to retirement were found to be discriminatory on the basis of age.

Based on a report by the National Audit Office, the Committee took evidence on 22 April from HM Treasury and the Government Actuary's Department. The Committee published its report on 11 June. This is the government's response to the Committee's report.

Relevant reports

- NAO report: Public Service Pensions – Session 2019-21 (HC 1242)
- PAC report: Public Sector Pensions – Session 2021-22 (HC 289)

Government response to the Committee

1: PAC conclusion: HM Treasury focuses on affordability to the taxpayer, but this is often at the expense of its other objectives.

1: PAC recommendation: ***HM Treasury should set out explicitly in its Treasury Minute response how it makes trade-offs between its objectives for public service pensions, for example, when evaluating proposals for additional flexibilities in the public service pension system.***

1.1 The government agrees with the Committee's recommendation.

Recommendation implemented

1.2 The government believes that the public service pension reforms introduced in 2015 meet the objectives for public service pensions set out in the 2011 white paper Public service pensions: Good pensions that last and is now focusing on completing implementation of these reforms by transferring remaining members into the reformed schemes from 2022 through the Public Service Pensions and Judicial Offices Bill 2021.

1.3 Departments are responsible for assessing where the reformed public service schemes introduced in 2015 require further changes to meet specific workforce needs. When any changes are proposed to HM Treasury, they are assessed against legal and fiscal implications, including the potential for any consequential impacts on other public service pension schemes.

1.4 For example, additional flexibility in pension savings for public sector workers can create significant upfront costs for the taxpayer. This is because, with the exception of the Local Government Pension Scheme, the main public service pension schemes are unfunded, meaning that flexibilities which reduced member pension contributions with no change to pensions paid out to retired members would increase borrowing in the short-to-medium term.

1.5 Where departments have provided strong evidence that pension arrangements have directly contributed towards recruitment and retention concerns, further flexibilities have been agreed. For example, the government is bringing forward legislation to establish a new judicial pension scheme to tackle recruitment and retention issues among judges. The government has also used other levers as needed to address concerns. For example, at Budget 2020 the Chancellor of the Exchequer announced a package of pension tax measures to address service delivery issues within the NHS.

2: PAC conclusion: It is becoming clear that public service pension policy is affecting the delivery of frontline services in some areas, such as education and health.

2: PAC recommendation: HM Treasury should regularly set out the likely impact on employers' budgets of employer contribution rate changes in advance of their implementation. By giving employers plenty of notice and offering wider support, it can help minimising the impact on frontline services. HM Treasury should also consult widely on the SCAPE discount rate and its methodology, well in advance of any changes.

2.1 The government agrees with the Committee's recommendation.

Recommendation implemented

2.2 Employer contribution rates for public service pension schemes are determined at valuations which are held every four years. Valuations are a complex process which take several years to complete and are carried out by individual departments with scheme advisers from the Government Actuary's Department (GAD), in accordance with Treasury directions. Valuations as at March 2020 are currently underway.

2.3 Throughout the valuation process, HM Treasury, schemes and GAD work together through cross-Government channels to discuss the valuation timetable and any necessary changes to valuation assumptions in a timely manner, and to understand the potential impact of changes to determinants such as the discount rate on employer contribution rates.

2.4 Valuation outcomes depend on several factors and vary by scheme, meaning that any estimate of impacts will remain uncertain until valuations are formally completed at scheme level. This process is typically completed well in advance of new contribution rates being implemented.

2.5 Where factors in the valuation process have changed shortly before valuation outcomes are implemented (such as the change to the Superannuation Contributions Adjusted for Past Experience (SCAPE) discount rate announced in 2018), HM Treasury has provided additional funding to departments to ensure that unforeseen costs do not jeopardise the delivery of front-line services.

2.6 The government is consulting on the methodology used to set the SCAPE discount rate. Following this, the government will carry out a separate exercise to set a new SCAPE discount rate, which will impact new employer contribution rates implemented in April 2024.

2.7 To mitigate the risk of changes to the SCAPE discount rate at a late stage in the valuation cycle, the consultation proposes to align future reviews of the SCAPE discount rate with the valuation cycle.

3: PAC conclusion: HM Treasury has not done enough to ensure people understand the value of their pensions.

3: PAC recommendation: HM Treasury should lead from the centre, and seek to understand members' views regarding their pensions, including the reasons why people may opt out of a scheme and whether this has a long-term impact on other parts of public services and expenditure. It should undertake a review into the take-up and retention of public pensions, particularly amongst young professionals, to help understand the issues employers face when trying to demonstrate the value of pensions. Such a review should identify areas where communication is working well and recommend best practice for employers.

3.1 The government agrees with the Committee's recommendation.

Target implementation date: March 2022

3.2 Participation in the main public service pension schemes are very high. For example, less than 1% of the active Civil Service population has currently opted out of the Civil Service Pension Scheme.

3.3 Data on participation rates in public service pension schemes are collected and held at scheme level and shared with HM Treasury. This is appropriate given that departments are responsible for schemes and controlling membership data. If participation rates change significantly, departments are expected to raise this with HM Treasury and implement appropriate mitigation measures. For example, some departments have implemented exit surveys to understand why employees have opted-out of their pension scheme.

3.4 HM Treasury will commission departments for analysis of latest participation data and will work with departments to standardise data collection, including whether data can be broken down by member characteristics. HM Treasury will also ask departments to provide an update on the measures being taken to improve participation among specific groups, which will be used to inform ongoing work by HM Treasury and departments to promote the value of public service pensions among employees. Departments should also continue to provide HM Treasury with participation data on a regular basis for monitoring purposes.

3.5 Public service pension schemes provide members with generous benefits in retirement. As participation rates in these schemes remain high, HM Treasury does not believe that participation levels will have a significant impact on wider public expenditure. However, HM Treasury will keep this under review.

4: PAC conclusion: ***HM Treasury has done little to identify and manage the stark differences in average pensions between genders and other groups.***

4: PAC recommendation: ***HM Treasury should be proactive in collecting and analysing data to identify where significant gaps in average pensions exist between different groups. This analysis should inform a wider study on the adequacy of public service pensions, and to understand the impact of differences in pay and working patterns.***

4.1 The government disagrees with the Committee's recommendation.

4.2 Differences in public service pensions between different groups are a function of past differences in earnings over members' careers rather than differences in pension provision itself.

4.3 The government agrees on the importance of collecting and analysing data of the drivers of differences in pensions savings between members of different groups. The government has made reporting of the gender pay gap mandatory for all public sector employers, and gender and ethnicity data for respective workforces are included in reports published by independent pay review bodies. Office for National Statistics (ONS) statistics show that the median gender pay gap among full-time employees is lower in the public sector (11.2%) compared to the private sector (14.1%).

4.4 The focus on drivers is supported by practical challenges to collecting data on pensions savings according to other protected characteristics. Data on members' pensions savings are held by scheme administrators for the purpose of paying out pensions and carrying out scheme valuations. Data on protected characteristics, apart from age and gender, are not relevant for these purposes and so are not currently collected by schemes. Schemes may continue to explore options to collect pensions savings data according to other protected characteristics within data regulations.

4.5 Differences in pension savings related to different rates of participation in public service pension schemes are addressed in the response to Recommendation 3.

4.6 As well as providing a better indication of the reasons for differences in pensions savings, the focus on differences in earnings is supported by the fact that these can more readily be addressed by government, for example, through pay gap reporting and targeted career programmes to support equal career opportunities. In contrast, it would not be appropriate for the government to review retrospectively accrued pension rights where these rights were accrued according to the rules of the scheme.

5: PAC conclusion: HM Treasury has had to revisit key elements of the reforms, and these issues may take decades to resolve fully.

5: PAC recommendation: HM Treasury must prioritise work to quickly resolve the challenges presented by the McCloud judgment and cost control mechanism, in order to give certainty to scheme members and employers, and rebuild the trust lost through these issues. The Department should write to us with an update in six months' time.

5.1 The government agrees with the Committee's recommendation.

Target implementation date: February 2022

5.2 The government committed to legislate as soon as practicable to remedy the discrimination identified by the Court of Appeal in the McCloud judgment in its consultation Public service pensions: Changes to the transitional arrangements to the 2015 schemes. Subsequently, the Public Service Pensions and Judicial Offices Bill was introduced in the House of Lords on 19 July 2021.

5.3 For active and deferred members, the Bill introduces the 'deferred choice underpin' as set out in the government's consultation response. Under this approach, members can make their choice over which set of benefits to have earned during the remedy period at retirement, when they will have a greater certainty over which option is most advantageous for them. This means the impact of the McCloud judgment on affected individuals will be resolved as they reach retirement. This approach was strongly supported at consultation.

5.4 HM Treasury is setting out in amending Directions the detail of how the cost control element of the 2016 valuations will be completed. These will be published following engagement with stakeholders before schemes then finalise results. The government announced in February 2021 that any ceiling breaches that occur at the 2016 valuations will be waived, as it would be inappropriate to reduce benefit levels based on a mechanism that is not working as intended. However, any benefit increases due as a result of any floor breaches will be delivered. Once results are finalised, schemes will commence discussions with Scheme Advisory Boards on how to rectify any floor breaches that occur.

5.5 The government has also recently launched a consultation on changes to the cost control mechanism following the Government Actuary's review of the mechanism published in June 2021. Any changes it takes forward following consultation will be implemented ahead of the completion of 2020 valuations.

5.6 The government will write to the Committee with an update on both areas of work in six months.

6: PAC conclusion: HM Treasury has not yet performed an evaluation of its reforms and we are not convinced it is on track to meet its objectives.

6: PAC recommendation: HM Treasury should perform an interim evaluation of its 2011–2015 reforms to ensure it is on track to meet each of its objectives, taking account of whether pensions are working for employers, employees and other taxpayers. It should write to the Committee with an update of this evaluation by the end of the year.

6.1 The government agrees with the Committee's recommendation.

Target implementation date: End 2021

6.2 HM Treasury will write to the Committee with an assessment of how it is meeting its objectives for public service pensions.

6.3 Given the long-term nature of pensions, these are still relatively recent reforms; a significant number of public sector employees continue to accrue benefits under legacy pension schemes and a large proportion of pension payments in the next decade will be for pensions already in payment.

6.4 The government notes that it is still in the course of implementing the 2011-2015 reforms by remedying the discrimination identified by the McCloud and Sargeant judgments and transferring remaining members into reformed schemes. This will be implemented through the Public Service Pensions and Judicial Offices Bill 2021.

6.5 For these reasons, any assessment at this time will necessarily be limited until the reforms have been fully implemented and embedded in the public service pensions system.