Government Actuary's Department

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Dear Colette,

Subject: Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2023

1. Thank you for your letter of 25 September 2023[1], asking for my professional opinion on the draft Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2023 (the "2023 Directions"). In particular, you have asked me to set out my views on the extent to which the 2023 Directions meet the Department of Finance's objectives as stated in your letter and the extent to which they are technically complete and coherent.

2. You asked me to consider those specific areas where these 2023 Directions differ from the Directions made by HM Treasury ("the HM Treasury Directions"). I have therefore limited my response to areas where this set of Directions differ from the HM Treasury Directions and areas where specificities in Northern Ireland may require the consideration of different issues.

Equivalent Process in Great Britain

3. On 31 August 2023, HM Treasury published Directions under the parallel legislative framework which applies to public service pension schemes in Great Britain, together with my letter of 29 August 2023 to HM Treasury, in which I set out my professional opinion on those proposed Directions. In doing so, I had regard to HMT's stated objectives, which are broadly aligned with those of the Department of Finance.

4. **This letter must be read in conjunction with my letter of 29 August 2023 which is referred to in the previous paragraph**. When doing so, references to Great Britain legislation should be read as referring to the corresponding Northern Ireland legislation.

[1] Your letter is set out in the Appendix to this letter.

(although the numbering of the relevant Directions may differ between these 2023 Directions and the HM Treasury Directions).

5. The analysis and conclusions set out in my letter of 29 August 2023 are largely equally relevant to the efficacy of the actuarial valuations and employer cost cap framework specified for public service pension schemes in Northern Ireland (with the exception of the references to the Judicial Pension Scheme[2] and the Civil Service (Other Crown Servants) Pension Scheme). In particular, Appendix B to that letter comments on the impact on valuation outcomes of actuarial assumptions and the material risks arising from unreliable valuation data.

Professional Opinion

6. Actuarial valuations of the public service pension schemes governed by the Public Service Pensions Act (Northern Ireland) 2014, with an effective date of 31 March 2020, are currently being undertaken (the "2020 valuations"). The proposed 2023 Directions, attached to your letter, will set out the framework for these valuations.

7. This letter exchange follows a period of significant change to the landscape of the public service pension schemes. The reforms to the cost control mechanism[3], the implementation of the remedy to the McCloud and Sargeant litigation, and a new scheme for the Judiciary, in total require such substantial changes to the Directions that they have been revoked and replaced by new ones. The structure of the new Directions, however, remains similar and there are large areas of commonality with previous versions of the Directions, particularly the version following the 2018 amendments. Therefore my professional opinion in some areas remains similar to my letter of 10 December 2018.

8. Overall, I consider the 2023 Directions will deliver results which are, in the round, technically complete and coherent. I would note, however, that because this is the first valuation at which the reformed cost control mechanism has been tested and in view of the complex nature of actuarial valuations, it is impossible to be completely certain at a detailed level that the 2023 Directions are fully technically complete and coherent until the valuations they apply to have been completed. Accordingly, it will be appropriate to keep the Directions under review.

9. My overall opinion on the 2023 Directions is that they achieve the eight primary purposes that you have listed in paragraph [8] of your letter and that they will deliver results for the 2020 valuations which largely meet the stated objectives, with some better met than others, and subject to the further comments I make below regarding the valuation objectives set out in paragraph [12] of your letter.

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[2] The Northern Ireland Judicial Pension Scheme closed to future accrual from April 2022. From this date, all scheme members moved to the Judicial Pension Scheme (JPS) 2022. The HM Treasury Directions set out information on the actuarial valuations and employer cost cap framework for JPS 2022. JPS 2022 is excluded from the scope of the Department of Finance's Directions.

[3] Further information on the reforms to the cost control mechanism is provided in my letter of 29 August 2023 to HM Treasury. The NI Assembly agreed a legislative consent motion for two of these reforms – the 'economic check' and the 'reformed scheme only' design - to be applied for devolved pension schemes in NI under the PSPJOA 2022. The third reform – a widening of the cost cap corridor – was introduced in secondary legislation by the Department of Finance during 2022.

10. I have commented in detail on the first ten of these equivalent objectives in my letter of 29 August 2023 to HM Treasury, and the comments are largely equally relevant to the actuarial valuations and employer cost cap framework specified for public service pension schemes in Northern Ireland.

11. However, there are certain practical challenges specific to Northern Ireland that could arise as a consequence of the Directions. I have therefore commented later in this letter on areas where specificities in Northern Ireland require the consideration of different issues in relation to the stated objectives.

12. You have also included a principle of review that recognises that the Directions may need to be amended in the future. HM Treasury have also noted that they will review their Directions if necessary and so, you may need to consider any future reviews in the light of amendments made by HM Treasury.

13. It is important to recognise that there is a high degree of professional judgement involved in the scheme valuation process, particularly around the derivation of best estimate actuarial assumptions.

14. I note that there would be more than one way to reasonably meet the objectives and that another set of Directions and assumptions may do so just as sufficiently.

Assessment against objectives: Northern Ireland specifics

15. As stated earlier, I believe that the Directions do broadly meet your principles and are technically coherent and complete. However, there are areas where specificities in Northern Ireland may require consideration of different issues. I have commented below on these.

Consistency with the HM Treasury Directions

> *Consistency: valuations of all public service schemes made under the 2014 Act and the Westminster Public Service Pensions Act 2013 should be consistent, allowing for comparisons to be made across schemes, including over time.*
>
> *Where different scheme workforces have different characteristics, then there should be consistency in the way that assumptions are set.*
>
> *Included within this principle is the need to ensure that the assumptions explicitly specified in the directions and in particular, those financial assumptions set out in directions 15 to 19(a) are the same as, or consistent with, those set out in the HM Treasury directions[4]. For clarity, this principle applies to both the assumptions that are used to calculate the cost cap and employer contribution rate;*

16. Although these Directions do specify a process that is consistent with that adopted in Great Britain, this does not mean that the assumptions or the outcomes will be the same as those in Great Britain. It is only to be expected that, in applying the same approach to setting assumptions in Northern Ireland, factors specific to Northern Ireland may lead to different assumptions being adopted. It is also likely that different contribution rates will be payable in Northern Ireland when compared to corresponding schemes in Great Britain.

[4] The principle of 'consistency' additionally requires consistency with the directions issued by HM Treasury and applied to schemes in Great Britain.

17. There are some areas where several approaches could be described as being consistent with the HM Treasury Directions. Where, for example, assumptions that are explicitly specified in Directions and set at the same rate as in the HM Treasury Directions, it is possible that, at some future date, there might be more appropriate assumptions that could be adopted specifically in respect of Northern Ireland where circumstances may be different from the rest of the United Kingdom. Such a situation would arise if, for instance, there were Northern Ireland-specific forecasts of future earnings growth available from the Office for Budgetary Responsibility. In the event there are no such forecasts available and, given that the HM Treasury Directions did not specify assumptions that were specific to the countries in which the schemes operated, I am content that your approach achieves both consistency of outcome and consistency of process.

18. There are likely to be some areas where the requirement for consistency of process with Great Britain may be difficult to follow. Given their smaller membership and correspondingly smaller evidence base, there may be a wider range of assumptions from which different actuaries might choose to recommend as "best estimate" for pension schemes in Northern Ireland. This could cause a conflict with the principle of consistency between schemes in Northern Ireland if different approaches are adopted in different schemes. However, I understand that you have established a process to ensure that departments take a consistent approach when setting assumptions according to the Directions.

19. You have listed a number of areas where these Directions have diverged from the HM Treasury Directions and I discuss these in more detail later in this letter.

Sustainability

<u>Sustainability</u> – "for each scheme, the measurement of changes in the cost of the scheme against the employer cost cap (in line with Section 12(4)(b) of the 2014 Act and as required by Section 12(5) of the 2014 Act) includes effects of scheme experience and future valuation assumptions differing from the assumptions used to determine the employer cost cap".

20. The schemes that are covered by these Directions generally have fewer members than those covered by the HM Treasury Directions, and I would expect this to result in greater fluctuations in the cost of the pension scheme when measured at different times. This could impact on both the employer contributions that are paid into the scheme and member contributions / benefits via the employer cost cap. However, since the principle of sustainability set out in your letter primarily covers the cost cap mechanism, I shall focus on this measure.

21. The employer cost caps were calculated at the 2012 valuation, and for many schemes covered by these Directions, there was only limited evidence relating to the recent experience of that scheme. This evidence was insufficient on its own to set the "best estimate" assumptions on which the employer cost cap is based and so evidence from other sources was used to inform the setting of assumptions. There is a danger that if the assumptions, and hence the employer cost cap, are set using evidence (of the past) that is not entirely representative of future experience (that has yet to occur) then this could lead to breaches of the employer cost cap that do not reflect "real" changes in cost.

22. As an example to illustrate this point, there may initially be insufficient experience from a scheme to propose assumptions at the first valuation that differ from those adopted for the equivalent scheme operating in Great Britain (perhaps because of the small size of the

scheme in Northern Ireland limiting the evidence available). In this case, the assumptions adopted to calculate the employer cost cap may well be the same as those for the equivalent scheme operating in England. If, at the next valuation, the additional experience collected, when aggregated with experience that was previously analysed, supported the use of best estimate assumptions for this subsequent valuation that are specific to the Northern Irish scheme, such a change could cause a breach of the employer cost cap (either by itself or combined with other effects). In this circumstance, the breach of the cost cap may not necessarily be because the costs of the scheme have changed; rather that there had been insufficient evidence to forecast the cost of the scheme at the preliminary valuation. Although this is also an issue for schemes in Great Britain, the smaller size of schemes in Northern Ireland increases the risk significantly.

23. The relatively small membership of the schemes in Northern Ireland also means that experience will be subject to larger statistical fluctuations than is the case for schemes for the equivalent and larger workforces in Great Britain, a factor that could increase the likelihood of breaches of the employer cost cap.

24. I am aware that as part of the 2020 valuations process, an historic data error has been discovered in the data supplied for the purpose of setting mortality assumptions at the 2012 and 2016 valuations of the NHS (England and Wales) Pension Scheme. This affects the Health scheme in Northern Ireland too, given it sets mortality assumptions with reference to the experience of the NHS (England and Wales) Pension Scheme. In my letter of 29 August 2023 to HM Treasury, I have set out my views on the treatment of this error in relation to the employer cost cap in the HM Treasury Directions. This treatment has been mirrored in the Department of Finance Directions.

25. You have included a principle of review that recognises that the Directions may need to be amended in the future, so I am content that the issues I have raised do not mean that the Directions fail to meet the principles that you have set out. HM Treasury have also noted that they will review their Directions if necessary and so you may need to consider any future reviews in the light of amendments made by HM Treasury.

Observations on specific differences between the Northern Ireland Directions and HM Treasury Directions

Deficit spreading period

26. One of the areas where you have diverged from HM Treasury Directions is in setting a 25-year period over which any notional deficits or surpluses are spread for the purpose of setting employer contribution rates for schemes providing benefits to health workers and teachers.

27. This approach is not strictly consistent with the process set out in the HM Treasury Directions, but I understand it has been set in this way in order that the outcomes for pension schemes in Northern Ireland are broadly consistent with the equivalent schemes in Great Britain. This is consistent with the approach taken in previous valuations.

28. I consider the length of deficit spreading periods to be a policy matter rather than actuarial issue and so have no significant comments regarding this from an actuarial standpoint.

Local Government Pension Scheme

29. The LGPS is substantially different in Northern Ireland from that in England and Wales or Scotland, as it consists of only one pension fund.

30. The Directions do not require the production of an employer contribution rate for the LGPS in Northern Ireland. This may mean that it is more difficult to make comparisons between the LGPS in Northern Ireland and other schemes across the United Kingdom at a detailed technical level. This is consistent with the approach taken in previous valuations.

Judicial Pension Scheme

31. The Northern Ireland Judicial Pension Scheme closed to future accrual from April 2022. From this date, all scheme members moved to the Judicial Pension Scheme (JPS) 2022. The HM Treasury Directions set out information on the actuarial valuations and employer cost cap framework for JPS 2022. JPS 2022 is accordingly excluded from the scope of the Department of Finance's Directions.

Compliance, limitations, and third-party disclaimer

32. I have not reviewed the 2023 Directions for incorrect cross-references, typographical errors, or the extent to which the language in the Directions is legally well-defined. I have considered how these Directions apply to public service pension schemes in general but have not considered them in relation to any specific public service pension scheme, except for the differences between Northern Ireland and Great Britain relating to specific schemes that you have raised.

33. This letter has been prepared in accordance with the applicable Technical Actuarial Standards: TAS 100 and TAS 300 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK.

34. This letter is addressed to the Department of Finance. The purpose of this letter is to give my professional opinion on the draft Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2023 in accordance with section 11(4) of the Public Service Pensions Act (Northern Ireland) 2014. I understand that the Department of Finance may publish this letter. Other than the Department of Finance, no person or third party is entitled to place any reliance on the contents of this letter. GAD has no liability to any person or third party for any action taken or for any failure to act, either in whole or in part, on the basis of this letter.

Yours sincerely

Martin Clarke CB
Government Actuary