NICSHR ADSTÉ

Department of Finance
An Roinn Airgeadais
www.finance-ni.gov.uk

Director of Pensions Division
NICSHR, DoF
Waterside House
75 Duke Street
Derry
BT47 1FP

☎ 028 71321227 (87227)
email: colette.heaney@finance-ni.gov.uk

25 May 2023

CCWG Employer Representatives

Dear Employer Representative,

THE PUBLIC SERVICE PENSIONS (VALUATIONS & EMPLOYER COST CAP) DIRECTIONS (NORTHERN IRELAND) 2023

Purpose

1. The Department of Finance has commenced the consultation process on the above directions with TUS and other such persons (or representatives of such persons) as appear to the Department that may be affected by the directions. A copy of the directions are attached separately at **Annex A**.

Background

2. Under PSPA(NI) 2014 public service pension schemes must periodically complete an actuarial valuation. The valuation is an analysis, performed by the scheme actuary, of the pension scheme's financial position, to ensure that the contributions paid into a scheme are sufficient to meet the benefits being paid from it.

3. DoF directions made under sections 11 and 12 of PSPA(NI) provide instruction to the NI Departments with responsibility for the devolved public service pensions schemes on processes and assumptions to be used when completing these actuarial valuations.

4. Valuation and cost cap directions were first introduced in 2014 following the making of PSPA(NI) 2014. There have been further amendment directions made since in 2015, 2018, 2019 and 2021, all of which will be consolidated by this new set of directions for NI Departments. In addition to consolidating previous iterations, the directions also make some additional technical amendments in line with recent changes to the cost cap mechanism and other policy developments.

The Public Service Pensions (Valuations & Employer Cost Cap) Directions (NI) 2023

5. The 2023 directions make technical changes required to fully implement cost cap reforms introduced in the Public Service Pensions and Judicial Offices Act 2022 (PSPJOA 2022), i.e. the:

- ‘reformed scheme only’ design: to remove any allowance for legacy (pre-2015) schemes in the CCM so it only considers past and future service in the reformed schemes (post-2015), and the

- ‘economic check’: linked to expected long-term GDP and used to validate any breach of the mechanism so that this would only be implemented if the breach would still have occurred had long-term economic assumptions been considered.

6. The 2023 Directions will also now operate within the context of the change to the cost cap corridor previously made in the Public Service Pensions (Employer Cost Cap and Specified Restricted Scheme) Regulations (Northern Ireland) 2022 to increase the margin of normally acceptable movement in costs, before a breach is deemed to have occurred, from 2% to 3%.

7. These 3 changes have been discussed at previous CCWG meetings. The policy changes carried in the PSPJOA 2022 were subject to a central Treasury consultation in 2022 and subsequently agreed by the Assembly by legislative consent motion. The Department also previously formally consulted with TUS on the wider cost cap corridor from June 2022 to August 2022.

8. Other main changes introduced by the 2023 directions include:

- The assumption for the SCAPE discount rate is updated from 2.4% to 1.7%;

- References to the NI Judicial Pension Scheme, which became non-devolved in 2022, have been removed;

- Economic assumptions for CPI, CARE revaluation and earnings growth are updated;

- Technical changes are made for treatment of some McCloud remedy provisions;

- Directions on commutation assumptions are revised; and

- Minor changes are made to how scheme specific provisions in the LGPS(NI) are accounted for.

Position in GB

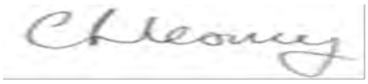
9. These directions reflect comparable directions, “The Public Service Pensions (Valuations and Employer Cost Cap) directions 2023”, being prepared by HM Treasury for 2020 scheme valuation in Great Britain.

Next Steps

10. I have included an additional summary document on the background and purpose of valuation and cost control directions containing more detail on the 2023 changes at **Annex B**.

11. I would welcome any views you may have on the draft directions at your earliest convenience. Responses can be emailed to: DOFpensionspolicy@finance-ni.gov.uk,

Yours sincerely



Colette Heaney
Director of Pensions Division

Annex A
(Attached Separately)

Annex B

THE PUBLIC SERVICE PENSIONS (VALUATIONS AND EMPLOYER COST CAP) DIRECTIONS (NORTHERN IRELAND) 2023 - PURPOSE AND CONTENT

Background

The Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2023 are proposed to be made by the Department of Finance under sections 11 and 12 of the Public Service Pensions Act (Northern Ireland) 2014 (PSPA(NI) 2014).

Under the PSPA (NI) 2014 schemes must periodically perform an actuarial valuation of the scheme's financial position, to ensure that the contributions paid into a scheme are sufficient to meet the benefits being paid to members from it.

Valuation and cost control directions made by the Department of Finance under PSPA(NI) 2014 provide instruction to the NI Departments with responsibility for devolved public service pensions schemes within their scope on completing the scheme valuations. These directions include instructions on process for consistent valuation reporting and cost control across all schemes, and the assumptions which should be used in each valuation. They also set out the process for the setting of employer contribution rates in the unfunded schemes.

Each scheme is required by PSPA(NI) 2014 to operate a cost cap mechanism (CCM). The CCM shares scheme costs between employers and scheme members. The target cost is called the Employer Cost Cap, and it is against this that future costs are measured in actuarial valuations. Should costs rise or fall outside an acceptable margin, this is referred to as a 'breach' and the directions contain instruction on process and action to measure and address a cost cap breach at any periodic valuation. In 2021 the Government Actuary reviewed and published a report on the operation of the CCM in public service pension schemes[1]. Following this, HM

[1] Cost control mechanism - Government Actuary's review - Final report - GOV.UK (www.gov.uk)

Treasury launched a public consultation[2] on three reforms to the CCM proposed by the Government Actuary:

i. Designing the cost control mechanism so that it considers only benefits built up in the reformed schemes, known as the 'reformed scheme only design'. This was proposed because although legacy schemes were a cause of changes in costs, benefits could only be amended in the new reformed schemes in the event of a corridor breach;
ii. Widening the corridor from 2% to 3%, reducing the likelihood of breaches;
iii. Introducing an economic check, so that a breach of the mechanism would only be implemented if it would still have occurred had long term economic assumptions been considered.

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 Public Service Pensions and Judicial Offices Act 2022. Following local consultation, the third reform, to widen the cost cap corridor, was introduced by the Department of Finance in the Public Service Pensions (Employer Cost Cap and Specified Restricted Scheme) Regulations (Northern Ireland) 2022[3].

It can be noted that valuation and cost control policy for the NI schemes reflects that of HM Treasury for the similarly constituted and costed schemes in England, Scotland and Wales under equivalent Westminster legislation. HM Treasury is currently taking forward similar consolidated direction changes in its draft *Public Service Pensions (Valuations and Employer Cost Cap) Directions 2023*. The changes made by HM Treasury in respect of its draft 2023 Directions have therefore, where applicable, been replicated in these DoF Directions, aside from a limited number of differences required to reflect circumstances specific to the devolved schemes in Northern Ireland.

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[2] Public service pensions: cost control mechanism consultation - GOV.UK (www.gov.uk)

[3] The Public Service Pensions (Employer Cost Cap and Specified Restricted Scheme) Regulations (Northern Ireland) 2022 | Department of Finance (finance-ni.gov.uk)

Revised provision in the draft Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2023

The main differences compared to the 2014 Directions include:

- The assumption for the SCAPE discount rate is updated from 2.4% to 1.7%. This follows the publication of the Treasury response to its consultation on the discount rate methodology and Written Ministerial Statement (WMS) on 30 March 2023.

- References to the NI Judicial Pension Scheme, which became non-devolved in 2022, have been removed. As the NI Judiciary is now fully encompassed in the UK wide Judicial pension scheme and fully within scope of the HM Treasury directions for purpose of scheme valuations and cost control there is now no requirement to impose direction on the scheme within the consolidated 2023 DoF Directions.

- Economic assumptions, including for CPI, CARE revaluation, general earnings growth and public sector earnings growth assumptions are updated in line with the Spring 2023 Office for Budget Responsibility (OBR) forecast. Long-term earnings assumptions are updated in line with the latest available July 2022 OBR Financial Risks and Sustainability Report.

- The 2023 directions reflect the requirements of the now 'reformed scheme only' design so that only reformed scheme service will be included in the CCM. The effect of legacy scheme costs is now excluded. The approach also takes account of remedy options now available to members with service during the McCloud remedy period (1 April 2015 to 31 March 2022). In the unfunded schemes members in scope of remedy will be able to choose between legacy or reformed scheme design benefits for the remedy period. Regardless of the choice made, these benefits will be paid out of the legacy schemes. Therefore, service for members in scope of remedy over this period will be excluded from the CCM. For scheme members out of scope of the remedy, all service over this period is in the reformed schemes and benefits will be paid out of the reformed schemes. Therefore, this service will be included in the reformed scheme only CCM.

- In the unfunded LGPS(NI) all members are moved to the reformed scheme in 2015 and all service in the remedy period will be included in the CCM, but the impact of the LGPS(NI) underpin will be excluded, thus ensuring the impact of the legacy scheme benefit design is also excluded from the CCM.

- The directions include new provision for the operation of the 'economic check'. As set out in the [Public Service Pensions and Judicial Office Act 2022] this new check is linked to expected long-term GDP and used to validate any breach of the mechanism with reference to long-term economic assumptions. Technical changes are made in the 2023 directions to specify the process to be followed for this change.

- Technical changes are made for treatment of some McCloud related payments in 2020 valuations. Compensation for injury to feelings, tax, or professional fees are not reckoned. Estimates of future payments for member contribution corrections and immediate detriment benefit payments are included.

- A commutation assumption will no longer be directed for public service pension schemes that have a £12:£1 commutation ratio and do not offer an automatic lump sum. This assumption was previously included in the directions due to a lack of 2015 scheme specific experience to enable individual schemes to set a best estimate assumption. Due to improved levels of scheme experience now available this will now be set at scheme level in conjunction with the scheme GAD advisor.

- Valuations will take now account of the actual take-up of 50/50 benefits under the LGPS(NI) scheme for purposes of more accurate and simpler calculations for notional assets and past service liabilities in the CCM, but with the retained effect that changes in the uptake of the 50/50 option would not lead to any benefits changes via the CCM and continue to be an immaterial change in costs. (Note: There may be some minor adjustments required to the wording on LGPS(NI) generally (Direction 49). The Department is consulting GAD on this currently. The outstanding point does not effect a change to the existing policy carried in the directions).

Further commentary on the Directions is contained in the appendix.

APPENDIX

COMMENTARY ON PROVISIONS IN THE DRAFT PUBLIC SERVICE PENSIONS (VALUATIONS AND EMPLOYER COST CAP) DIRECTIONS (NORTHERN IRELAND) 2023

PART 1 – GENERAL

1. Citation & Commencement

Direction 1 names the Directions as the Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2023 and advises that they will come into operation on the date on which they are signed.

2. Revocation of previous Department of Finance Directions

Direction 2 explains that the 2023 Directions revoke the Public Service Pensions (Valuations and Employer Cost Cap) Directions (Northern Ireland) 2014, and the subsequent amendment Directions, namely The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2015, The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2018, The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2019 and The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021.

3. Interpretation

This section defines a range of actuarial terminology used in the valuations. Where applicable, the definition directs the reader to the relevant subsequent direction in terms of performing a calculation.

4 - 6. Scheme Actuary

This section sets out the requirement to appoint an appropriately qualified scheme actuary, who will be required to prepare a valuation report and cost cap valuation report, either together or separately.

7. Effective Date

Schemes are required to perform an actuarial valuation every 4 years. The 'effective date' refers to the date from which the valuation applies. The first valuations under the Public Service Pensions Act (Northern Ireland) 2014 were performed in 2016, and this section lays out that subsequent valuations should occur from 2020 and every 4 years thereafter.

8. Implementation Date & Cost Cap Implementation Date

This direction guides on the 'implementation date', which is the date on which the new pension valuation methodology is put into effect.

9. Implementation Period and Cost Cap Implementation Period

As well as considering past service, valuations calculate the expected cost of benefits that will be accrued during a given period and compare it to the expected contributions to the scheme over the same period. This is known as the 'implementation period'. For the 2020 valuations the directions set and implementation period of 1 April 2024 – 31 March 2027 for the purposes of the employer contribution rate, and 1 April 2023 – 31 March 2027 for the CCM.

10. Membership and Other Data

In order to carry out the valuations, schemes must provide detailed data to the scheme actuary on which to base their analysis. This direction sets the responsibility of scheme actuary to specify which data is required to carry out their assessment, and the scheme to ensure that the specified data is provided.

11 – 19. Methodology & Assumptions

This section specifies a range of methodology and assumptions to be used by the scheme actuary in the 2020 valuations, including: contribution yields; public service earnings growth; annual Pensions Increase; CARE revaluation; mortality projections, and State Pension age. The Pensions Increase (Review) Order & CARE Revaluation Order are made annually by the Department of

Finance. In circumstances where these figures are unavailable, the directions specify the assumptions which should be used.

As noted elsewhere the Short-term CPI, general earnings growth and public sector earnings growth assumptions are updated in line with the Spring 2023 OBR forecast. Long-term earnings assumptions are updated in line with the latest available July 2022 OBR Financial Risks and Sustainability Report.

Direction 14 also specifies the ‘spreading period’ with regards to payment of employer contributions. The default spreading period is 15 years, however the HSC and Teachers pension schemes currently employ a spreading period of 25 years.

‘SCAPE’, referred to in this section, stands for ‘Superannuation Contributions Adjusted for Past Experience’. The SCAPE process aims to ensure that the value of pension benefits being promised are considered at the point at which they are accrued – ensuring employers pay a charge that reflects this appropriately. The rate at which future benefit payments are discounted to give a value in today’s terms, the SCAPE discount rate, is essential to the calculation of employer contribution rates. The assumption for the SCAPE discount rate is now updated from 2.4% to 1.7% following the recent review (see WMS on 30 March 2023).

PART 2 – VALUATIONS & COST CAP VALUATIONS

20. Application of Part

This direction lays out the schemes under the 2014 Act to which this section applies. Of note, the NI Judicial Pension Scheme is not included. Since 2022 the Judicial Pension Scheme has been non-devolved and encompassed in the GB scheme. Therefore, there is no requirement to impose directions on the scheme within the 2023 Directions for NI.

21. Assumptions

This section stipulates assumptions used in the valuations other than those detailed in Directions 12-19.

22 – 24. The Valuation Report: Contents

This section specifies the contents required in the valuation report. There are a range of statements and summaries for inclusion, including analysis of the demographic experience, information about the scheme and the data used, and information about calculation of the employer contribution rate.

25. The Cost Cap Valuation Report: Contents

This section specifies the contents required in the Cost Cap valuation report. Again, there are a range of statements and summaries for inclusion, including information on calculation and analysis of the Core, Economic and Employer Cost Caps.

26 – 32. The Valuation Report: Employer Contribution Rate

Direction 26 specifies what the term 'scheme' refers to in subsequent directions 27 - 32.

Direction 27 stipulates that a statement of the liabilities of the scheme should be included in the report and covers which liabilities should be included.

Direction 28 directs a calculation of the value of the notional assets of the scheme, taking into consideration the scheme income, benefits paid and notional investment returns.

Direction 29 specifies further information about the analysis of the notional assets of the scheme to be included in the report.

Directions 30 – 32 indicate a range of contribution rates and expected contribution yields from members and employers to be included in the report, and how the employer contribution rate should subsequently be calculated.

33 – 48. The Cost Cap Valuation Report: Core Cost Cap of the Scheme

Direction 33 defines references to 'scheme' in subsequent Directions 33A - 48. Notably, this section specifies that references to 'scheme' here should not be taken to include any legacy connected scheme. This is in connection with implementation of the 'reformed scheme only design' element of the reforms to the Cost Cap Mechanism contained in the Public Service Pensions and Judicial Offices Act 2022.

Directions 33A – 48 direct a range of calculations with regards to the Core Cost Cap of the scheme.

Of note, ‘technical immunity’ refers to removal of changes to long-term economic assumptions (and actuarial methodology) from the CCM, in order to mitigate their impact.

49. Scheme Specific Applications

This section concerns the applications of the directions under Part 2 to Local Government Workers, with some differences that are specific to the scheme.

Unlike the majority of public service pension schemes which are ‘unfunded’, the LGPS(NI) is a ‘funded’ scheme. As a funded scheme the LGPS(NI) relies on performance of its underlying fund of invested assets when assessing requirements for its employer contribution rate; there is no requirement to calculate an employer contribution rate for the LGPS(NI) under the Directions as this is captured at the separate fund valuation.

The LGPS(NI) also differs in respect of the McCloud remedy. Provision in the LGPS(NI) scheme includes an ‘underpin’ for those in scope of the transitional protection remedy where, at the point of retirement for a protected member, the scheme would compare the value of pension built up in the CARE scheme from the 1st April 2015 to 31st March 2022 to the value of pension that would have otherwise been built up in the Final Salary Scheme for the same period, providing an enhancement to the CARE pension if the Final Salary Scheme would have paid a higher amount. Of note, modification here removes the impact of this underpin from the CCM since it relates to legacy scheme benefits, in implementation of the reformed scheme only design.

PART 2A – CALCULATING THE EMPLOYER COST CAP

50 - 53. Setting the Employer Cost Cap

Direction 50 lays out the schemes under the 2014 Act to which this section applies. Directions 51 - 53 provide direction on and the assumptions to be used to perform a calculation of the proposed Employer Cost Cap.

PART 3 – ECONOMIC CHECK

54 - 64. This section relates to the new requirements for the 'economic check'. Direction 54(1) lays out the schemes under the 2014 Act to which this section applies. Direction 54(2) specifies that 'scheme' should not be taken to include any legacy connected scheme in this part. Directions 54A – 63 lay out a range of instructions and assumptions in relation to calculation of the Economic Cost Cap of the scheme. Direction 64 discusses the application of the directions under Part 4 to Local Government Workers, with scheme specific modification, again removing the impact of the underpin for those in scope of the transitional protection remedy.

PART 4 – COMPARISON WITH THE EMPLOYER COST CAP

65. This section directs the comparison of the Core Cost Cap and Economic Cost Cap against the Employer Cost Cap, in order to determine if either the upper or lower limits of the Cost Cap Mechanism corridor have been breached, and the action that should be taken to notify the responsible authority if this has occurred. Of note, in application of the 'economic check', action would only be taken if *both* the Core Cost Cap and the Economic Cap indicate that a breach of the same margin has occurred.

PART 5 – CERTIFICATION AND RECTIFICATION

66 - 72. This section directs that, in the event of a corridor breach, where notification has been made to the responsible authority and the responsible authority has provided the scheme actuary with provisional steps to be taken to achieve the target cost for the scheme, the provisional decision cannot be confirmed unless the scheme actuary issues a certificate. The contents required in the certificate are covered here. The section lays out instruction for the recalculation of the Core Cost Cap, Economic Cost Cap and Employer Cost Cap of the scheme assuming that the steps taken to achieve target are in operation, and their subsequent analysis to ensure that the target cost of the scheme has been achieved.