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Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021

Department of Finance response to consultation with member representatives

22 November 2021

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1. EXECUTIVE SUMMARY

1.1. In line with the requirements for consultation under sections 11(5) & 12(10) of the Public Service Pensions Act (Northern Ireland) 2014 (the Act), the Department of Finance consulted with representatives of public service scheme members between 22 March 2021 and 14 June 2021 on the draft Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021 (the Directions).

1.2. This response document has been published on the Department's website at: https://www.finance-ni.gov.uk/topics/finance/public-service-pensions-policy-and-legislation

1.3. 5 responses were received. A full list is provided at **Annex A**. The Department is grateful to all those who provided comments, on what is a complex and technical area.

1.4. Respondents to the consultation did not comment on the detail of the Directions. The majority of comments concerned the handling of 'McCloud' remedy costs in the 2016 valuations.

1.5. Some respondents to the consultation welcomed the Directions as ensuring good management of public funds and acknowledged that there is now less risk to proceed with the cost cap mechanism. The commitment to waive cost cap ceiling breaches when completing the 2016 revaluation process, which will now extend to devolved schemes under the Public Service Pensions & Judicial Offices Bill, was welcomed by some stakeholders.

1.6. Having considered all responses to the consultation, the Department's view is these Directions are necessary to ensure the costs of schemes are accurately measured and managed, including the cost of the remedy which will end unlawful discrimination for scheme members affected by the McCloud ruling.

1.7. Addressing the discrimination rightly gives members a choice of scheme benefits for the remedy period. This increases the aggregate value of benefits to members and the cost to the schemes. Now that the way forward on the remedy has been established it is important for the financial management and sustainability of the schemes that changes that lead to increased benefit payments to members are recognised and allocated appropriately in the cost control mechanism.

2. BACKGROUND

2.1. Under section 11(2) and 12(3) of the Public Service Pensions Act (Northern Ireland) 2014, the Department of Finance is required to deliver Directions on actuarial valuations and cost control to Departments with responsibility for the devolved public service pension schemes. The Directions are designed to provide a consistent approach on the scheme valuation process, and manage future cost risks for public service employers and the taxpayer. They are not subject to Assembly process.

2.2. The original Directions issued on 26 November 2014 aim to ensure consistency in:

- how valuations should be carried out, including when the valuation is to be carried out;
- the time periods over which a valuation will measure a scheme's assets and liabilities;
- the matters that must be covered by the valuations; and,
- the data, methodology and assumptions to be used in valuations.

2.3. One of the key principles for the 2014 Directions was to ensure they were kept under review and updated in line with changes and developments in policy and relevant assumptions.

2.4. The draft Public Service Pensions (Valuations & Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021 amend the original 2014 valuation and cost cap directions to implement the 'un-pausing' of the cost cap mechanism for public service pension schemes. The cost cap mechanism for public service schemes was paused in March 2019 due to uncertainty about the valuation of public service pension scheme benefits as a consequence of the 'McCloud' judgement.

2.5. Following consultation, the Department of Finance published a policy response to remedy the unlawful discrimination identified as arising in the transitional protections element of reformed public service schemes as a consequence of the McCloud judgement. This will be legislated for in the Public Service Pensions & Judicial Offices Bill at Westminster, and for which a Legislative Consent Motion was agreed by the Assembly on 1 November 2021.

2.6. Following clarity on this matter the cost cap mechanism can be re-established. The draft Directions set out how costs and liabilities arising from the benefits which will now be payable under that remedy are accounted for in scheme valuations.

2.7. The Treasury has now also made Directions for the comparable public service pension schemes in Britain made under the equivalent Westminster Act, and which deal with remedy costs in an identical way.

3. CONSULTATION PROCESS

3.1. The Department formally consulted with representatives of public service employees and scheme members on the draft Directions between 22 March 2021 and 14 June 2021.

3.2. A consultation letter, together with the draft Directions; an accompanying technical annex, and a briefing paper prepared by the Government Actuary Department for the attention of Scheme Advisory Boards (SABs) was issued directly to the Northern Ireland Committee of the Irish Congress of Trade Unions (NIC-ICTU).

3.3. NIC-ICTU comprises representation from trade unions for public service employments affected by the Public Service Pensions Act (Northern Ireland) 2014 under which these Directions are made. The Department of Finance has been engaged in discussions and consultation with NIC-ICTU on Directions at the Collective Consultation Working Group (CCWG) which is the recognised forum for consultation on public service pension policy and legislation since January 2013. Representatives from the Government Actuary's Department attended at the CCWG meeting on 30 March 2021 and 27 May 2021 to provide an overview of the rationale and detail of the draft content of these directions and to field questions on the technical issues regarding the unpausing of the 2016 valuations.

3.4. Employer representatives for each of the devolved schemes are also represented at CCWG and were invited to contribute to the consultation.

3.5. Member representatives for the Police Pension Scheme and the NI Judicial Pension Scheme are currently not formally represented at CCWG and the Department wrote separately to the Lord Chief Justice of Northern Ireland; the Police Federation for Northern Ireland; the PSNI Chief Officer Association, and the PSNI Superintendent Association to alert members of both those schemes to the consultation.

3.6. Public service pension scheme representatives on the interdepartmental Northern Ireland Public Service Pensions Group (NIPSPG) were also directly alerted to the consultation.

4. ISSUES RAISED

Unpausing of the Cost Cap Mechanism and inclusion of McCloud remedy costs in 2016 scheme valuations

4.1. One of the respondents to the consultation expressed explicit support for the unpausing of the Cost Cap Mechanism which the 2021 directions provides for.

4.2. The Chief Police Officers Staff Association (CPOSA) stated in its response - *"CPOSA is mindful of the responsibility of good management of public funds. It is recognised that with more clarity around the McCloud matter it would appear that there is now less risk to proceed with the cost cap mechanism. CPOSA therefore support the proposed unpausing of the cost cap mechanism as set out".*

4.3. Other respondents raised concerns on how the cost of implementing the McCloud remedy would be met and stated their opposition to the classification of remedy liabilities as an employee cost for the purposes of the directions, as in their view, this resulted in scheme members effectively being made to pay the cost of a remedy which results from a Government mistake.

4.4. The Northern Ireland Committee of the Irish Congress of Trades Unions (NIC-ICTU) stated in its response - *"Given the briefings we have had with GAD and the proposals regarding the 2016 scheme valuations it is becoming abundantly clear that government intends to seek to get scheme members to pay for the age discrimination remedy. All trade unions are fundamentally opposed to their members being expected to pay the cost of government's discrimination".*

4.5. Similar views were expressed by the Police Federation for Northern Ireland (PFNI) - *"The projected costs associated with any remedy are clearly additional to those that prevailed at the time the scheme was conceived. PFNI therefore continue to assert that it is grossly unfair to retrospectively expect existing police pension scheme members to now bear the financial costs that any remedy will place on the schemes".*

4.6. Similar views were also expressed by Northern Ireland Retired Police Officers Association [NIRPOA] – *"Recognising that any costs in relation to the remedy proposed by Government is to address their unlawful action, it is inconceivable that this should be retrospectively applied to the existing Police Pension valuation. Indeed, we contend that this would compound the discrimination that has already taken place".*

Department of Finance response

4.7. The remedy on age discrimination increases the value of benefits now payable to many members for the remedy period (2015-2022). The remedy aims to put affected members, as far as possible, in the position they would have been if the discrimination had not occurred. These higher payments to members, increases the cost of the schemes and this must be accurately accounted for in the 2016 valuations to ensure the actual cost and liabilities of the schemes continue to be correctly measured. Cost control for devolved public service pension schemes reflects that of the Treasury for the identical schemes in Britain where the same approach is also being taken.

4.8. Whilst the inclusion of remedy costs in the Directions ensures schemes are accurately valued, their inclusion does not mean members are being made to pay additional costs in the completion of the 2016 valuations. Measures being taken in the Public Service Pensions and Judicial Offices Bill, which is currently being progressed at Westminster, will ensure the additional costs associated with remedy are not paid by scheme members in the 2016 valuations. This Bill makes clear provision that any cost breaches of the upper margin of the cost cap for the public service schemes will not trigger the corrective action which would otherwise normally be required to rectify such a breach, and which would likely result in an increase in member contributions or reduced accrual rate. The Bill will effectively waiver any detrimental cost implications for scheme members arising from the 2016 valuations.

4.9. On 1 November 2021 the Assembly agreed a Legislative Consent Motion for the remedy provisions of the Public Service Pensions and Judicial Offices Bill to extend for the devolved schemes here in the same way as it will apply for the equivalent schemes in Britain. As a result, the waiver of ceiling breach costs will automatically apply for devolved schemes meaning scheme members here will not be required to meet additional costs as a consequence of any cost cap ceiling breaches emerging in the completion of the 2016 valuations.

Proposed scheme changes based on provisional 2016 valuation findings

4.10. Some respondents commented that the completion of 2016 valuations under these Directions meant that improved member benefits indicated in previous projected valuation outcomes would not now be realised and that this was a loss for scheme members.

4.11. This was the position advised from the PFNI - *"To remedy the original 2016 valuation cost cap breach the police pension scheme SAB had recommended a better accrual rate for members. This revaluation proposal will result in this recommendation being dispensed with which therefore culminates in a tangible loss to all scheme members."*

4.12. NIC-ICTU expressed similar concerns - *"The vast majority of public sector pension schemes were anticipating better accrual rates and other different positive benefits across public sector schemes in 2016 before it was decided to pause that process."*

Department of Finance response

4.13. The Department acknowledges that indicative findings for the 2016 valuations which emerged in 2019 did indicate a potential breach of the cost cap floor. However these indicative findings can now be seen to be based on incomplete information on actual scheme costs and liabilities due to uncertainty about the full cost of remedy and future scheme design, and which at that point made any accurate or reliable assessment of those costs not possible.

4.14. In his recent report on the operation of the cost cap mechanism the Government Actuary notes that in reality the cost of schemes rose at the 2016 valuations insofar as employers contribution rates increased by up to 9% of pensionable pay even before the impact of the cost control mechanism. The fact that the preliminary cost cap results for all schemes then showed a breach of the cost cap floor, which would further increase employer contribution rates and the cost to the taxpayer, was indicative of a perverse outcome with reference to the original objectives of the cost cap mechanism to protect taxpayers from unforeseen costs and to provide stability to benefit levels[1]**.**

4.15. The Department maintains the view that the apparent floor breaches previously indicated represent incomplete outcomes for the 2016 valuation process which cannot now reasonably be used as an accurate measure of costs leading to a justified entitlement to additional benefits. Whilst these preliminary results may have indicated potential floor breaches the cost cap work was not completed, and therefore no floor breaches actually occurred.

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1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/993416/Cost_Control_Mechanism_-_GA_Review_-_Final_Report_-_27_May_2021.pdf

Effects for scheme members unaffected by the discrimination and remedy

4.16. Some responses commented on the impact of the remedy on members of the 2015 schemes who would not have been affected by the discrimination identified but nevertheless may be liable for costs.

4.17. The PFNI stated in its response – *"PFNI are most concerned that the cost of remedying the discrimination is being proposed to be factored into the 2016 revaluation. This is particularly galling for those members in the 2015 CARE pension scheme who were actually unaffected by the discrimination and who will not benefit at all from any of the remedies proposed."*

4.18. Similar views were expressed by NIRPOA - *"Those Officers who have joined since 2015 will now clearly be disadvantaged due to a pre-existing discrimination which was none of their making".*

Department of Finance response

4.19. It should be noted that this consultation concerns the management of scheme valuations, including the costs associated with the remedy on age discrimination. Its remit is not the policy for a remedy to remove age discrimination on which the Department has already separately consulted and responded on[2]. It can be noted that the current cost cap mechanism can affect different members in differing ways but perhaps not in the way mainly expected in some responses to the consultation on Directions. The Government Actuary's report on the review of the Cost Cap Mechanism indicated the main drivers of change in the provisional cost cap outcomes which led to the apparent floor breaches were changes in costs and life expectancy trends affecting the legacy schemes. However, the current cost cap rectification process only provides that improvement to benefits can be made in the reformed schemes. Therefore, members of the legacy schemes, wherein the cost savings were mostly attributed, would see no benefit from the floor breach. Members of the CARE schemes, where the risks associated with final salary had already been addressed through the adoption of the career average design and higher normal pension age linked to state pension age, would in fact be the sole beneficiaries.

4.20. The Westminster Government has now consulted on options to address this issue in the operation of the cost cap mechanism and legislative

[2] https://www.finance-ni.gov.uk/publications/response-consultation-proposed-changes-transitional-arrangements-2015-schemes

changes to address this issue will be brought when parliamentary time allows. The proposals for change are based on recommendations made in the Government Actuary's report. This would remove the effects of the legacy schemes so that for its future operation the mechanism would only consider the costs in reformed schemes. This should promote stability in the mechanism and also ensure consistency in that only cost movements in the reformed scheme will lead to adjustments in contributions for its members. This should promote intergenerational fairness between legacy and CARE scheme members in how the cost cap mechanism operates.

Ceiling Breach Waiver

4.21. Some responses noted the positive effects of a waiver on ceiling breaches emerging from the 2016 valuations.

4.22. Northern Ireland Judicial Pension Scheme Advisory Board (NIJPSAB) – *"The Board noted the provisional result of a breach of the cost cap ceiling by 3.9% with no resultant reduction of member benefits at this valuation because of the ceiling breach waiver that has been agreed".*

4.23. The NI Policing Board (NIPB) also acknowledged the waiver would mean no contribution increases would be applied for scheme members as a consequence of the waiver of cost cap ceiling breaches in the 2016 valuations, but that any floor breaches would be honoured.

Department of Finance response

4.24. It can be noted that the waiver on cost cap ceiling breaches is implemented separately in the Public Service Pensions and Judicial Offices Bill, and as such is not a component part of these draft directions. However, it is important to be clear that this commitment to waive cost cap ceiling breaches in the 2016 valuations, working in conjunction with the directions ensures that remedy costs are accurately accounted for and also that scheme members will see no detriment in terms of their member contribution and accrual rates as a consequence of these directions being made to finalise the 2016 valuations. Also as the Public Service Pensions and Judicial Offices Bill makes provision to remove the effect of any breach of the cost cap ceiling for the purposes of the 2016 valuations the proposed provision in 2021 directions on certification of such a ceiling breach is not now required. However the Bill, and existing scheme regulations still contain provision for any breach of the cost cap floor to be honoured.

Recalculation of the original fixed cost cap

4.25. One response queried why the original cost caps were not being recalculated as a consequence of the McCloud outcome?

4.26. The Northern Ireland Judicial Pension Scheme Advisory Board raised this points– *"NIJPSAB members believed that there was an argument that the new membership costs, as a result of McCloud, should lead to a recalculation of the original fixed cost cap since they would have been included in that fixed cost if the scheme had been designed in the first place without the discrimination that we now know to exist. This is in line with the proposed approach for allowing for the inclusion of the fee-paid judiciary in MoJ's scheme valuation which of course NI adopt ".*

Department of Finance Response

4.27. Schemes' employer cost caps were set at the 2012 valuation using best estimate assumptions of the costs at the time the reformed schemes were introduced. This policy decision made at that time is not being revisited. It is normal and expected that actuarial assumptions are updated at each valuation as further experience comes to light and views of the future change. The Department does not believe that employer cost caps need to be reset based on a new set of assumptions. Resetting employer cost caps based on new assumptions would mean that the cost control mechanism failed to provide an effective benchmark to compare scheme costs against their original long-term cost. This reflects the positon taken in the equivalent Treasury directions to schemes in Britain.

4.28. The employer cost cap for the Judicial Pension Scheme 2015 was recalculated in a revision to the 2012 valuation because a legal judgment caused a change in estimated long-term costs of the scheme as a result of changing the composition of the scheme membership. In contrast, the McCloud remedy represents a one-off increase in the value of schemes to members rather than a change in the long-term cost of schemes. It can be noted also that under the Department of Finance directions a valuation report is not required for the devolved Judicial scheme but the report made for the equivalent Ministry of Justice scheme under Treasury directions is applied.

4.29. The amending directions provide that when calculating the transitional protection remedy cost, schemes should use the same members' benefits and contributions as used in the calculations, including the cost cap figure, made prior to the pause of the 2016 cost control valuation process, except where they are determined to have changed as a result of McCloud remedy. This means that calculations will not account for the impact of other litigation which has affected scheme benefits or coverage. It would not be appropriate in this instance to account for other legal developments since the pause which have predominantly affected the value of benefits earned before 2015, as it would mean the benefits being considered would be less closely aligned with the 2016 valuation period.

4.30. Furthermore, subsequent court rulings which extend coverage of pension schemes (either to new members or extending back pensionable service retrospectively) are different in nature to those that affect the value of existing accruals, as in the case of McCloud remedy. McCloud remedy increases the value of schemes for members and therefore it is appropriate to reflect those costs in the mechanism at the 2016 valuations. An amendment is made in the directions at amending direction 49 to clarify this.

Potential Court Challenges

4.31. Some respondents raised the prospect of future legal action against the introduction of the Directions.

4.32. PFNI stated in its response - *"PFNI are aware that the Fire Brigades Union has already commenced legal action is respect of using the 2016 cost cap revaluation to settle the McCloud remedy costs. If this attached draft legislation is enacted PFNI will actively consider taking similar action".*

4.33. NIC-*ICTU* made a similar point - *"Therefore, the proposed amendment in the draft Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021 are not acceptable and if necessary will be challenged in the courts."*

Department of Finance response

4.34. The Department notes the concerns raised by stakeholders. The Department's view is these directions are necessary to ensure the costs of schemes are accurately measured and managed, including the cost of the remedy which is required to be implemented to end unlawful discrimination for scheme members affected by the McCloud ruling.

5. CONCLUSION AND NEXT STEPS

5.1. The Department of Finance acknowledges the contributions made to the consultation exercise by respondents on what is a complex area.

5.2. Addressing the unlawful age discrimination arising from the McCloud ruling rightly gives members a choice of scheme benefits for the remedy period. This increases the aggregate value of benefits to members and is a cost to the schemes. Now that the way forward on the remedy has been established it is important for the financial management and sustainability of the schemes that changes that lead to increased benefit payments to many members are recognised and allocated appropriately in the cost control mechanism. This is addressed by the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021. Operating in conjunction with measures contained in the Public Service Pensions and Judicial Offices Bill for the waiver of cost cap ceiling breaches in the 2016 valuations which the NI Assembly has now agreed shall apply for the devolved schemes here, the directions enable the 2016 valuations to be finalised in a way which acknowledges the cost of remedy without incurring an associated detriment for scheme members.

Next Steps

5.3. In accordance with section 11(4) of the Public Service Pensions Act (Northern Ireland) 2014, the Department of Finance has also consulted with the Government Actuary on these draft amending directions. The Government Actuary has confirmed that he is content that the proposed amendments will deliver results which meet the stated objectives for Directions on valuation and cost control in the public service schemes.

5.4. The Department of Finance will now proceed with the making of the Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions (Northern Ireland) 2021.

5.5. The Directions are not subject to NI Assembly procedure. They take effect upon signature of a senior officer in the Department of Finance.

5.6. When made they will be made available alongside this response on the Department of Finance website at: https://www.finance-ni.gov.uk/topics/finance/public-service-pensions-policy-and-legislation

ANNEX A

List of respondents to the consultation

The Department of Finance received submissions to the consultation from the following Trades Unions, Employers and Scheme Advisory Boards.

- Northern Ireland Committee of the Irish Congress of Trade Unions*****
- Northern Ireland Judicial Pension Scheme Advisory Board
- Northern Ireland Policing Board **(Response received via DoJ)**
- Member representatives on the Police Scheme Advisory Board Northern Ireland** **(Response received via DoJ)**
- Superintendents Association of Northern Ireland***

***** Northern Ireland Committee of the Irish Congress of Trade Unions is the recognised trade union grouping providing collective trade union representation for all public service employments within the remit of the Public Service Pensions Act (Northern Ireland) 2014.

** The Police Scheme Advisory Board for Northern Ireland response detailed the views and observations of individual Police SAB members from: Police Federation for Northern Ireland (PFNI); Northern Ireland Retired Police Officers Association [NIRPOA] and Chief Police Officers Staff Association (CPOSA).

*** The response from the Police Superintendents Association advised it concurred with the comments and views submitted by PFNI.