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Sixty second summary

Cost cap results: breaking news

Robert Bilton
Partner and Fund Actuary

Final results of the 2016 (2017 in Scotland) Cost Cap valuations suggest no changes to member benefits or contribution rates in the LGPS England & Wales[1], Scotland[2] and Northern Ireland[3]. The results however are still subject to legal challenge so the final outcome remains unclear.

Brief recap on the Cost Cap

Following the Hutton review, the Cost Cap was introduced as part of the 2014 (2015 in Scotland) reforms as a "safety valve" mechanism for public sector employer pension costs.

The first national Cost Cap valuation for the LGPS in England & Wales and Northern Ireland was at 31 March 2016 (2017 for the LGPS in Scotland). If the scheme's assessed costs change by more than 2% of pay from the baseline target cost, then action is taken via changes in benefits or member contribution rates to bring the cost back in line with the target cost.

Prior 2016/17 Cost Cap valuation results were communicated in Autumn/Winter 2018 and identified savings of more than 2% of pay, i.e. the benefits had got "cheaper" by enough to breach the Cost Cap floor. Employers at the time would be forgiven for asking how the valuation could show the benefits getting cheaper, but it's because the Cost Cap valuations ignore some of the key factors affecting real world contributions (e.g. discount rates).

Before any benefit improvements could be implemented, the 2016/17 Cost Cap valuations were 'paused' as the Government addressed the fallout from the McCloud judgement. In the Government's view, the costs associated with McCloud should be included in the Cost Cap valuation and could result in the Cost Cap breaches either being reduced or totally offset. Until the nature and format of the McCloud remedy was known, the Cost Cap valuations could not proceed.

Latest position

Following the McCloud consultation, and Government's confirmation of their preferred approach for remedying McCloud, the Cost Cap valuations were 'un-paused'. The Government Actuary's Department (GAD) have just published the results of the updated valuations including McCloud costs.

The updated results for the LGPS show there has been no breach of either the Cost Cap floor or ceiling. The table below details the results of the LGPS Cost Cap valuations both before and after amendments to allow for McCloud.

[1] https://www.gov.uk/government/publications/cost-cap-valuation-of-the-local-government-pension-scheme-england-and-wales
[2] https://www.gov.uk/government/publications/cost-cap-valuation-of-the-local-government-pension-scheme-scotland
[3] https://www.gov.uk/government/publications/cost-cap-valuation-of-the-local-government-pension-scheme-northern-ireland

	LGPS England & Wales	LGPS Scotland	LGPS Northern Ireland
Cost Cap result before McCloud	Decrease of 2.8% of pay	Decrease of 2.9% of pay	Decrease of 3.2% of pay
Cost Cap result after McCloud	Decrease of 1.2% of pay	Increase of 0.2% of pay	Decrease of 1.6% of pay
Implied cost of McCloud	1.6% of pay	3.1% of pay	1.6% of pay

These results confirm that there will be no changes to member benefits and/or contribution rates as a result of the 2016/17 Cost Cap valuations. However, these are still subject to ongoing legal challenges about whether the process should have been paused in the first place, and whether the way the McCloud cost has been calculated is appropriate.

Impact on LGPS stakeholders

Assuming the published results stand then:

- From an employer's point of view these results are likely to be welcome as it means that no contribution increases will be required - as a result of the Cost Cap at least.
- Funds may also be breathing a sigh relief as it means no additional work to administer backdated benefit changes or contribution refunds.
- The impact on members will vary. Most members may be unaware of this highly technical process. However, any members who have engaged with the process may have been expecting benefit improvements.

Comments on the results

The magnitude of the McCloud cost is surprising, especially considering that for funding valuations we expect the costs to be small. The high cost is down to two key factors:

- **Salary increase assumption:** The Cost Cap salary increase assumption is 1.5% above CPI inflation. This is noticeably higher than the local assumption used by most funds, but consistent with that used in the original Cost Cap calculations A higher salary increase assumption increases the cost of final salary benefits and therefore makes the final salary benefit underpin more valuable .
- **Pace of recouping the costs:** The HMT Direction Order specifies that the cost associated with McCloud should be recovered before the outcome of the next Cost Cap valuation in 2020 comes into force on 1 April 2023 i.e. a 4 year period (3 years in Scotland). Local funding valuations will seek to recoup any McCloud costs over each employer's funding time horizon which could be as long as 15-20 years. This may explain some of the reason why the McCloud cost in Scotland is much higher.

We understand the policy justification for this approach is that the members present in the schemes today should "pay for" the cost of McCloud since they will benefit from it. However, considering that the Cost Cap valuation uses a recovery period of 15 years for all other sources of cost increases/decreases, the adoption of such a short recovery period for the McCloud costs does raise eyebrows.

Next Steps

Provided the legal challenges are unsuccessful there is no immediate action for LGPS funds to take but, given it has rolled on for nearly 4 years, you may wish to note the outcome at your next Committee meeting and employer event.

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