

Cost Management, Benefit Design and Administration Committee

Meeting of the 12th September 2022

Item 6 Paper B

Cost Management Mechanism

Issue – To note the likely next steps and timetable for both the HM Treasury and SAB's own 2020 cost management processes

Background

1. Last year, HMT consulted on changes to the Cost Control Mechanism following a review by the Government Actuary. There were 3 proposed changes to the existing HMT process:
 - to change the mechanism to only include the costs of service in the reformed schemes;
 - to widen the “corridor” from the existing 2% margin to 3%; and
 - to introduce an additional “economic check” which would operate when there is a breach of the 3% corridor to ensure that wider economic conditions are considered before any breach is implemented through changes to the scheme.
2. The Scheme Advisory Board [responded to the consultation](#) and the government has since included relevant legislative changes in the Public Service Pensions and Judicial Offices Act 2022. HM Treasury has also confirmed that it will implement the necessary changes to secondary legislation as soon as Parliamentary time allows. There will also be changes to the forthcoming Valuation Directions governing the 2020 scheme valuations to reflect the amendments.
3. The next stage is for HM Treasury to set out in a Written Ministerial Statement (WMS) the approach it will take to cost management for the 2020 scheme valuations based on the 2020 scheme valuation data. That may include the sharing of draft Directions which set out the technical detail of how the calculations will be done and the assumptions behind them. Those Directions will apply to all public sector schemes, although Treasury do have the ability to make different provision for different schemes in those Directions.
4. In its consultation response, the Board made proposals to amend its own Cost Management Mechanism (the SAB process). This is currently set out in Regulation 116 of the LGPS Regulations 2013. The policy objectives from a revised SAB Mechanism were:

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- Closer integration with the revised HMT Cost Control Mechanism ;
- To move to a reformed scheme only basis (while retaining the impact of the underpin);
- To move to a 3% corridor (while retaining may/should/must);
- To formally integrate the impact of changes in an LGPS-specific discount rate;
- To transition away from automatic management of the contribution ratio in existing scheme regulations.

Consideration

5. It is not known when Treasury will be in a position to issue the draft Directions which underpin their Cost Control Mechanism process. It is possible that this is further delayed by the change in administration and new policies that new ministers may have on economic forecasting. A key element of the directions will be the choice of discount rate and the government's consultation on the use of the SCAPE discount rate still has not been responded to.
6. Up to now, the SCAPE discount rate methodology has been based on expected long-term GDP growth but alternative methodologies are possible (such as a rate based on index-linked gilts or in reference to the discount rates used by funded schemes).
7. The Secretariat have discussed the proposals on the reform of the SAB's own cost management process with DLUHC officials and we expect to see some movement towards our objectives when the consultation on this is published (hopefully some time in the Autumn).
8. The Secretariat will also be meeting GAD on 6 September to discuss progress with data preparation and the anticipated timeline for the Treasury Cost Control Mechanism process. We will provide an oral update on timings at the meeting.
9. Another related task which happens as part of the Scheme Valuation process is the assessment of employee contribution yields. GAD calculate whether the current member contribution tiers are delivering an average contribution rate of 6.5%. As with the Cost Control Mechanism process this is done based on the data as at 31 March 2020. This means that it won't take into account the significant changes in the National Living Wage since 2020, or the much larger changes anticipated in the coming years. However, the Committee may wish to bear those changes in mind in terms of interpreting results.

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10. The Committee next meets on 21 November. If the draft Directions and DLUHC consultation emerge in good time before then, the secretariat will provide a suggested response for the Committee to consider. Alternatively, the secretariat could convene a special meeting, or ask for comments in writing to Secretariat.

Recommendation – that the committee note the above update.

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