Appendix A

Essex Pension Fund
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Essex County Council

Your Ref:
Date: 17 August 2021

Workforce, Pay and Pensions
HM Treasury
2/Red
1 Horse Guards Road
London
SW1A 2HQ

Sent by e-mail to: SCAPEDiscountRateConsultation@HMTreasury.gov.uk

Dear Sirs,

Public service pensions: Consultation on the discount rate methodology Consultation Response

The Essex Pension Fund welcomes the opportunity to comment on the government's proposals on discount rate methodology. We are responding in our capacity as an Administering Authority within the Local Government Pension Scheme.

Response to questions

Question 1 - Do you agree that these are the correct objectives for the SCAPE discount rate? If not, please explain why and specify any alternative objectives that you think should be included.

The objectives set out in chapter 4 of the consultation document are, in our opinion, sensible. Before setting any actuarial assumptions to complete a valuation, it is first necessary to determine the purpose of the valuation. Actuarial valuations answer questions and so the approach adopted will depend on the question being asked and any other objectives (such a stability of contributions). It may be that different questions and objectives require different approaches and assumptions.

We believe there is some tension between the three stated objectives. Stability and predictability of cost is in our view a key objective so the methodology adopted should not result in frequent and significant changes to employer contribution rates. Equally, the percentage of national income/tax receipts expected to be spent in the long term on public sector pensions should be a key feature of the approach to ensure the pension promise remains affordable. At the same time, the assessment of the cost should be fair and consistent with the assessed cost of other expenditure.

Question 2 - Do you agree that these are the most appropriate methodologies that should be considered? If not, please specify any alternative methodologies that should be considered and how they would fit with the Government's proposed objectives.

Our view is that the two proposed methodologies are the two most obvious candidates but, in our view, both require some modification to make them more likely to meet the stated objectives which we discuss below.

Question 3 - What are the advantages and disadvantages of a SCAPE discount rate methodology based on expected long-term GDP? If this methodology is adopted, should any of the modifications (allowing for short-term GDP projections, allowing for actual experience) be considered?

Of the major public service pension schemes, it is only the Local Government Pension Scheme that is financed on a funded basis. There are many benefits of funded schemes including greater transparency and recognition of cost. There are also disadvantages such as investment risk and potential loss from which unfunded schemes are immune. In completing valuations of LGPS Funds the objectives are broadly the same as those set out in this consultation namely, adopt methods and assumptions that provide a fair view of the likely cost and keep employer contribution rates as stable as possible.

If a GDP approach is to be retained, then we would suggest setting a longer term and less variable GDP approach where the rate is reviewed every (say) ten years (with only minor tweaks expected) but at the same time using actual GDP growth to roll forward the notional fund rather than the actual SCAPE rate. Given actual GDP will vary with economic cycles then this will provide a balance of affordability and stability. Any “underperformance” of actual GDP versus assumed will result in deficits in the notional fund which could then be recovered over say 20 years, thus increasing costs as would be expected but resulting in much smoother and more stable employer contributions and avoid the cliff edges we have seen under the existing mechanism.

Question 4 - What are the advantages and disadvantages of a SCAPE discount rate methodology based on the STPR? If this methodology was adopted, should any modifications (allowing for the public service pension context or allowing for long-term uncertainties) be considered?

There is clearly some logic in adopting a rate that is used in making decisions about how to spend money now for different future benefits. One of the main advantages of adopting the STPR methodology is historically it has been a very stable rate. Whilst there was sound reasoning to adopt the GDP methodology in 2011, it makes sense to reassess the appropriateness of reverting to the STPR rate now, given the instability observed in the SCAPE rate since the GDP methodology was adopted in 2011.

It could be argued that the STPR methodology could meet the stability objectives better than the GDP methodology. A more stable SCAPE discount rate should create more stable contribution rates and should prevent any shocks like those observed in 2018 when the SCAPE rate was revised out of cycle.

Public sector pensions are long term in nature and therefore it doesn’t seem appropriate to use the same discount rate for public sector pensions and the assessment of projects with shorter terms e.g., less than 30 years. It therefore seems appropriate to adopt a modification to the STPR to reflect the longer-term nature of public sector pensions and so something less than the 3.5% above CPI.

Question 5 - Which SCAPE discount rate methodology do you recommend, and why?

As already discussed, we believe that the discount rate that is to be adopted will depend on the purpose for which it is put or equivalently what question is being asked in the first place. There is no single “correct” approach.

The question being asked in the consultation document is how the level of employer contribution in the unfunded schemes is to be calculated. We do not therefore feel we are able to respond on this point as a Funded scheme.

Question 6 - Are there any equalities impacts of changes to the SCAPE discount rate methodology that the Government should consider?

As the proposed reform would apply to all benefits, we do not see any obvious equalities impacts.

Question 7 - Do you agree with the proposal for reviews of the SCAPE discount rate to be aligned with the scheme valuation cycle?

All actuarial assumptions should be reviewed on a regular basis but with the objective of having a stable level of employer contribution rate for a reasonable time period. In the Local Government Pension Scheme, assumptions are reviewed at every valuation and it would seem logical for the SCAPE rate to be reviewed during the unfunded scheme valuation cycles too.

Yours sincerely

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