UNISON response to HM Treasury consultation – Public service pensions: Cost control mechanism

UNISON is the UK's largest union and Europe's largest public service union, serving more than 1.3 million members. We represent full-time and part-time staff who provide public services, although they may be employed in both the public and private sectors.

Thousands of our members work in local government working for local councils, schools, libraries, social care and private companies.

Nearly half a million UNISON members work in health care in the NHS and for organisations providing NHS services across the UK, all of whom have access to the NHS Pension Scheme. We also represent members in roles such as the Food Standards Agency who have access to the Principal Civil Service Pension Scheme.

Our members see their pensions as an essential component of their overall remuneration package. Particularly as over 70% of our members are women and are very reliant on having a decent pension on their retirement.

Summary

- UNISON supports the proposal for the cost cap to adopt a reformed scheme only approach as this should lead to increased stability and improved intergenerational fairness.

- UNISON would agree that widening the Corridor should minimise the frequency of cost cap breaches but expresses strong concerns that a widening to +/-3% could represent too big a cliff edge and calls for scheme specific flexibility to help determine what costs should revert to as part of enhancing the stability objective.

- UNISON does not support the proposed economic check and would need significant reassurance from Treasury that any such check would be free from political interference and not able to be manipulated at the whims of Government to be in any position to entertain this.

- The Government needs to be careful that all stakeholders do not lose trust in the Government's 25-year guarantee and not honouring it's promises which could have significant repercussions for scheme membership levels and cashflows moving forward.

Consultation Questions

1. Do you agree that a reformed scheme only design would achieve the right balance of risk between scheme members and the Exchequer (and by extension the taxpayer), and would create a more stable mechanism?

UNISON would broadly agree that a reformed scheme only design would provide a better risk balance and would help to better address issues such as new entrants effectively having to subsidise McCloud remedy costs (which in effect is a cross subsidy from younger members to older members). This would also seem fairer from an intergenerational perspective.

A reformed scheme only approach should lead to greater cost stability which should help to build much needed trust in the mechanism for both scheme members and employers alike.

2. Do you agree with the Government's intention to widen the corridor? If not, why not?

UNISON agrees that widening the corridor should minimise the frequency of cost cap breaches moving forward which ultimately is welcome.

We also agree that relatively stability and predictability of costs is a good thing. Unfortunately, the Government agreed to a mechanism to do just this but failed to honour the outcomes for scheme members where cost cap floor breaches occurred, undermining scheme members' faith going forward. UNISON is clear in the belief that the Government feels it got it wrong when initially designing the parameters of the cost cap mechanism as it was never the intention of there being a cost cap floor breach that could result in member benefit improvements.

It is not a great message to design a cost cap mechanism when on the first valuation cycle all schemes breach the floor and yet member benefit improvements are not applied in accordance with the legislation, on the simple basis that the Government does not like the results.

This is a fundamental breach of both legislation and trust and undermines the whole system. The fact remains that members of the unfunded schemes over the 2016 valuation cycle have essentially overpaid for their benefits and are due benefit improvements but the Government has intervened to stop this.

3. Do you think that a corridor size of +/-3% of pensionable pay is appropriate? If not, why not?

The analysis suggests that a corridor size of +/-3% should result in cost cap breaches approximately once in every ten valuation cycles which, if borne out in practice will provide desired stability.

UNISON does however remain concerned that a wider corridor has drawbacks, most notably that a breach could lead to significant cost and benefit changes once triggered.

For example, if costs rose to 3.3% in the reformed NHS Pension Scheme this could trigger a change in accrual rate from the current 1/54th to 1/60th if costs have to revert to their target cost – a significant change.

For this reason, UNISON would welcome a process which offers more flexibility and discussion between relevant stakeholders, namely Scheme Advisory Boards and the Responsible Authority, to determine the level that costs should revert to in the event of any breach to help avoid significant detrimental cliff edge effects.

This process should also allow the Scheme Advisory Boards to identify and monitor any change in cost pressures and enter discussions with the relevant stakeholders prior to any cost cap breaches occurring.

Although relative cost and benefit stability is welcome, the fact remains that the proposal to widen the corridor emanates from the first set of valuations revealing significant cost floor breaches and the Government's desire to ensure this doesn't happen again.

Given that the Government has not honoured cost cap floor breaches on the first valuation cycle, does it really matter what the corridor size is as will Government simply not seek to interfere again if it doesn't like the results?

4. Do you agree with the proposal to introduce an economic check?

No, as any increase or decrease in scheme costs should be measured purely within the context of the scheme demographics and should not be subject to wider economic issues that may not directly relate to any increase or decrease in scheme costs.

For example, the cost floor breaches relating to the original 2016 valuation results for the unfunded schemes arose primarily due to reductions in assumed life expectancy and the level of future pay increases – not issues that are essentially GDP growth related.

UNISON also remains concerned that the primary motive for looking to introduce an economic check gives HM Treasury “subjective” potential to over-ride results where these are unwelcome.

The review of the cost control mechanism and SCAPE discount rate has after all arisen because of the Chief Secretary to the Treasury’s concern that the first valuation cycle of the unfunded schemes reported a cost cap floor breach and the potential inclusion of an extra economic check variable feels like an attempt to restrict the potential for this to happen again.

The cost control mechanism needs to operate independently from politics and all stakeholders and scheme members need to feel reassured that the sole purpose is to objectively measure costs without results being subject to wider political issues.

Ultimately, UNISON remains unconvinced by the economic check methodology proposed in the consultation and considerable reassurance is needed from HM Treasury to ensure that any economic check is fair, transparent, and free from government manipulation.

We also wish to register our concerns as to whether these proposed changes to the cost control mechanism contradict the Government’s 25-year Guarantee for not making further scheme reforms and undermine the Proposed Final Agreements struck with schemes.

Treasury’s responses in the HMT engagement sessions to this question were underwhelming and UNISON would welcome the Government giving further assurance of its legal standing on this point.

5. Do you think that the SCAPE discount rate, as it currently stands, is an appropriate economic measure for the cost control mechanism?

If, as appears to be the case, the intention is to include the SCAPE discount rate in the proposed economic test UNISON would only potentially support this if this can only offset a breach and cannot cause a breach in the opposite direction.

UNISON’s view is that the SCAPE discount rate methodology needs to change, reverting back to the Social Time Preference Rate (STPR) as quite simply the current methodology is not working, evidenced by the fact that have been three downwards revisions to the discount rate since 2011. The current GDP based methodology is simply too volatile, leading to frequent changes, which only serves to achieve the following:

- Creates uncertainty for scheme members and reduces their confidence in the scheme, leading to opt-outs and reduced scheme income and hence potential contribution yield and cashflow issues

- Makes it more difficult for employers to promote the value of schemes to their employees

- Extra administration and communication resource for both scheme administrators and employers, which again eats into limited budgets

The SCAPE discount rate quite simply needs to offer stability and predictability to aid long-term planning.

UNISON is also of the view that an “economic check” would not be needed if the discount rate methodology once again reverted to the STPR because this essentially is what the STPR seeks to measure.

6. If the SCAPE methodology changes, and the Government considers that the SCAPE discount rate is therefore not an appropriate measure for the cost control mechanism, then do you think that a measure of expected long-term GDP should be used instead? If not, please set out any alternative measures that may be appropriate in this scenario. Please consider in the context of the separate review of the SCAPE methodology currently being undertaken by HM Treasury.

UNISON does not believe that a measure of expected long-term GDP growth is an appropriate measure for the cost control mechanism.

Quite simply the construction of GDP does not relate directly to the drivers underpinning any cost increases in public service pension schemes.

A SCAPE discount rate methodology based on STPR is however more broadly aligned and would offer the stability that all stakeholders crave, enhancing credibility and trust in the cost control mechanism.

7. Do you envisage any equalities impacts from the proposals to reform the cost control mechanism that the Government should take account of?

UNISON believes it is fundamentally unfair for the Government to have paused the original 2016 valuations pending the outcome of the McCloud age discrimination cases and then treating this as a member cost which has subsequently led to there now being no cost cap floor breaches and no need to pass on benefit improvements.

It’s hard to see how this is not age discrimination again as essentially new joiners to the reformed schemes (and indeed all joiners from the 1 April 2012 onwards for the unfunded schemes) are being asked to forego benefit improvements to pay for the costs of the remedy choice option for all members coming within the scope of the transitional protections. How can this be fair? Furthermore, given that on balance most new joiners are likely to be proportionately younger how is this not a clear intergenerational inequality?

It is acknowledged that legacy scheme benefits were the main driver of the original 2016 cost cap floor breaches and yet all reformed scheme benefit members are being asked to pay for this, both over the 2016 valuation cycle and over the long term given there are no benefit improvements.

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