Firefighters' Pension Scheme: Heads of Agreement

Firefighters’ Pension Scheme: Heads of Agreement

February 2012
Department for Communities and Local Government

© *Crown copyright, 2012*

Copyright in the typographical arrangement rests with the Crown.

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit http://www.nationalarchives.gov.uk/doc/open-government-licence/ or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or e-mail: psi@nationalarchives.gsi.gov.uk.

This document/publication is also available on our website at www.communities.gov.uk

Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

February 2012

ISBN: 978-1-4098-3345-1

Firefighters’ Pension Scheme: Heads of Agreement

This document sets out the Heads of Agreement on the parameters to govern scheme design for the Firefighters’ Pension Scheme in England to be introduced from April 2015 (‘the 2015 scheme’). This sets out the Government’s final position on the main elements of scheme design, provided that agreement can be reached on the core parameters, which unions have agreed to take to their Executives following discussions. To that end, further work will take place over the coming weeks, and Executives can consult their members as appropriate. The Government and the fire service unions remain committed to maintaining a constructive dialogue during discussions over the detailed elements of the scheme design, and whilst members are being consulted. Discussion and analysis will take place through the Pension Reform Group for the Firefighters’ Pension Scheme.

Accrued rights protection guarantee

1. There will be full statutory protection for accrued rights for all members as follows:
    a. all benefits accrued under final salary arrangements will be linked to the members’ final salary, in accordance with the rules of the members’ current schemes, when they leave the reformed scheme
    b. full recognition of a members’ expectation to double accrual for service accrued under the Firefighters’ Pension Scheme 1992 (‘the 1992 scheme’), so that a members’ full continuous pensionable service upon retirement will be used to calculate an averaged accrual rate to be applied to service accrued under the 1992 scheme
    c. members to be able to access their 1992 scheme benefits when they retire at that scheme’s ordinary pension age (i.e. from age 50 with 25 or more years pensionable service), subject to abatement rules for that scheme. Pensionable service for the purpose of calculating the ordinary pension age will include any continuous pensionable service accrued under both the 1992 scheme and the 2015 scheme
    d. members will continue to have access to an actuarially assessed commutation factor for benefits accrued under the 1992 scheme

Transitional protection

2. There will be statutory based transitional protections for certain categories of members, as follows:

    a. all active scheme members who, as of 1 April 2012, have 10 years or less to their current Normal Pension Age[1] will see no change in when they can retire, nor any decrease in the amount of pension they receive at their current Normal Pension Age. This protection will be achieved by the member remaining in their current scheme until they retire.

    b. there will be a further 4 years of tapered protection for scheme members. Members who are up to 14 years from their current Normal Pension Age, as of 1 April 2012, will have limited protection so that on average for every month of age they are beyond 10 years of their Normal Pension Age, they gain about 53 days of protection. The last day of protected service for any member will be 31 March 2022. At the end of the protected period, they will be transferred into the new pension scheme arrangements. Further details on how the tapered protection will apply can be found at **Annex A**.

Main scheme design parameters for a new Firefighters' Pension Scheme

3. The main parameters of the new scheme from 2015 are set out below. Discussions will continue on a number of areas set out in **Annex B**.

    a. a pension scheme design based on career average revalued earnings

    b. a provisional accrual rate of 1/58.7th of pensionable earnings each year, subject to further agreement on the outstanding issues set out in Annex B

    c. there will be no cap on how much pension can be accrued

    d. a revaluation rate of active members' benefits in line with average weekly earnings

    e. pensions in payment and deferred benefits to increase in line with Prices Index (currently CPI)

---

[1] The Normal Pension Age for the purpose of the Firefighters' Pension Scheme 1992 is age 55, for the New Firefighters' Pension Scheme 2006 it is age 60.

f. average member contributions of 13.2% from April 2015, with some protection for new entrants. However, as announced by the Chief Secretary to the Treasury on 20 December, the Government will review the impact of the proposed 2012-13 contribution changes, including the effect of membership opt-outs, before taking final decisions on how future increases will be delivered in 2013-14 and 2014-15, and in the new scheme. Interested parties will have a full opportunity to provide evidence and their views to the Government as part of the review.

g. flexible retirement from the scheme's minimum pension age of 55, built around the scheme's normal pension age of 60, with members able to take their pension from minimum pension age as follows*:*

   - for all active members who are aged 57 or more at retirement, 2015 scheme benefits taken before Normal Pension Age will be actuarially reduced with reference to the 2015 scheme's Normal Pension Age, rather than the deferred pension age

   - all other members will have their 2015 scheme benefits actuarially reduced on a cost neutral basis from the scheme's deferred pension age

h. the Normal Pension Age will be subject to regular review. These reviews will consider the increasing State Pension Age and any changes to it, alongside evidence from interested parties, including unions and employers. It will consider if the Normal Pension Age of 60 remains relevant, taking account of the economical, efficient and effective management of the fire service, the changing profile of the workforce and the occupational demands of, and fitness standards for, firefighting roles

i. this regular review will be informed by such research carried out by the Firefighters' Pension Committee, which will monitor and collate scheme data and experience

j. late retirement factors for members retiring from active service to be actuarially neutral from Normal Pension Age

k. a deferred pension age equal to the individuals' State Pension Age

l. optional lump sum by commutation at a rate of £12 for every £1 per annum of pension foregone in accordance with HMRC limits and regulations

m. abatement in existing schemes to continue

n. ill-health retirement benefits to be based on the arrangements in the 2006 scheme

o. all other ancillary benefits to be based on those contained in the 2006 scheme

p. members rejoining after a period of deferment of less than 5 years can link new service with previous service, as if they had always been an active member

q. members transferring between public service schemes would be treated as having continuous active service

r. an employer contribution cap and floor as set out below.

4. For the purposes of the reform design process for 2015, the Government previously set out the gross cost ceiling of 27.0% and the net cost ceiling of 13.8%. Attached at **Annex C** is a report by the scheme actuary verifying that the expected cost of the proposed scheme design above is within the cost ceiling. This report has been prepared in accordance with the advice in the Government Actuary's Department's report of 7 October 2011: Cost ceilings for scheme level discussions: Advice on data, methodology and assumptions, with suitable adaptations to take account of scheme specific circumstances.

5. The scheme design parameters have been reviewed by HM Treasury who have agreed the approach taken to risk management.

6. This agreement also covers arrangements for an employers cost cap and floor, and a 25 year guarantee (further information at **Annex D**).

Annex A

Tapered protection

1. Scheme members who, on 1 April 2012, are in the Firefighters' Pension Scheme 1992 and between the ages of 41 and 45, or are in the New Firefighters' Pension Scheme 2006 and between the ages of 46 and 50, will continue to accrue pension in their existing scheme on a tapered basis. They gain about 53 days of protection in their existing schemes for every month they are older than 41 years in the 1992 scheme and 46 years in the 2006 scheme, as set out in the table below. Once a members' tapered protection expires, they will be transferred into the new pension scheme.

2. Members will be able to take their 'Part 1' pension on retirement at their current Normal Pension Age for that scheme (or, in the case of members of the 1992 scheme, at their ordinary pension age), subject to abatement rules. After members are transferred into the new pension scheme, they will accrue their 'Part 2' pension in that scheme.

Firefighters' Pension Scheme 1992

Date of Birth		Age at 1 April 2012		Days of protection	Age at end of protection				Date of end of protection
					From		To		
From	To	Year	Month		Year	Month	Year	Month	
02/04/1967	01/05/1967	44	11	2557	54	11	55	0	31/03/2022
02/05/1967	01/06/1967	44	10	2504	54	8	54	9	06/02/2022
02/06/1967	01/07/1967	44	9	2450	54	5	54	6	14/12/2021
02/07/1967	01/08/1967	44	8	2398	54	3	54	4	23/10/2021
02/08/1967	01/09/1967	44	7	2343	54	0	54	1	29/08/2021
02/09/1967	01/10/1967	44	6	2289	53	9	53	10	06/07/2021
02/10/1967	01/11/1967	44	5	2237	53	6	53	7	15/05/2021
02/11/1967	01/12/1967	44	4	2182	53	4	53	5	21/03/2021
02/12/1967	01/01/1968	44	3	2130	53	1	53	2	28/01/2021
02/01/1968	01/02/1968	44	2	2076	52	10	52	11	05/12/2020
02/02/1968	01/03/1968	44	1	2021	52	7	52	8	11/10/2020
02/03/1968	01/04/1968	44	0	1971	52	5	52	6	22/08/2020
02/04/1968	01/05/1968	43	11	1916	52	2	52	3	28/06/2020

02/05/1968	01/06/1968	43	10	1864	51	11	52	0	07/05/2020
02/06/1968	01/07/1968	43	9	1810	51	8	51	9	14/03/2020
02/07/1968	01/08/1968	43	8	1757	51	6	51	7	21/01/2020
02/08/1968	01/09/1968	43	7	1703	51	3	51	4	28/11/2019
02/09/1968	01/10/1968	43	6	1649	51	0	51	1	05/10/2019
02/10/1968	01/11/1968	43	5	1596	50	9	50	10	13/08/2019
02/11/1968	01/12/1968	43	4	1542	50	7	50	8	20/06/2019
02/12/1968	01/01/1969	43	3	1489	50	4	50	5	28/04/2019
02/01/1969	01/02/1969	43	2	1435	50	1	50	2	05/03/2019
02/02/1969	01/03/1969	43	1	1381	49	10	49	11	10/01/2019
02/03/1969	01/04/1969	43	0	1332	49	8	49	9	22/11/2018
02/04/1969	01/05/1969	42	11	1278	49	5	49	6	29/09/2018
02/05/1969	01/06/1969	42	10	1225	49	2	49	3	07/08/2018
02/06/1969	01/07/1969	42	9	1171	48	11	49	0	14/06/2018
02/07/1969	01/08/1969	42	8	1118	48	9	48	10	22/04/2018
02/08/1969	01/09/1969	42	7	1064	48	6	48	7	27/02/2018
02/09/1969	01/10/1969	42	6	1010	48	3	48	4	04/01/2018
02/10/1969	01/11/1969	42	5	957	48	0	48	1	12/11/2017
02/11/1969	01/12/1969	42	4	903	47	10	47	11	19/09/2017
02/12/1969	01/01/1970	42	3	851	47	7	47	8	29/07/2017
02/01/1970	01/02/1970	42	2	796	47	4	47	5	04/06/2017
02/02/1970	01/03/1970	42	1	742	47	1	47	2	11/04/2017
02/03/1970	01/04/1970	42	0	693	46	11	47	0	21/02/2017
02/04/1970	01/05/1970	41	11	639	46	8	46	9	29/12/2016
02/05/1970	01/06/1970	41	10	586	46	5	46	6	06/11/2016
02/06/1970	01/07/1970	41	9	532	46	2	46	3	13/09/2016
02/07/1970	01/08/1970	41	8	480	46	0	46	1	23/07/2016
02/08/1970	01/09/1970	41	7	425	45	9	45	10	29/05/2016
02/09/1970	01/10/1970	41	6	371	45	6	45	7	05/04/2016
02/10/1970	01/11/1970	41	5	319	45	3	45	4	13/02/2016
02/11/1970	01/12/1970	41	4	264	45	1	45	2	20/12/2015
02/12/1970	01/01/1971	41	3	212	44	10	44	11	29/10/2015

02/01/1971	01/02/1971	41	2	158	44	7	44	8	05/09/2015
02/02/1971	01/03/1971	41	1	103	44	4	44	5	12/07/2015
02/03/1971	01/04/1971	41	0	54	44	2	44	3	24/05/2015

New Firefighters' Pension Scheme 2006

Date of Birth		Age at 1 April 2012		Days of protection	Age at end of protection				Date of end of protection
					From		To		
From	To	Year	Month		Year	Month	Year	Month	
02/04/1962	01/05/1962	49	11	2557	59	11	60	0	31/03/2022
02/05/1962	01/06/1962	49	10	2504	59	8	59	9	06/02/2022
02/06/1962	01/07/1962	49	9	2450	59	5	59	6	14/12/2021
02/07/1962	01/08/1962	49	8	2398	59	3	59	4	23/10/2021
02/08/1962	01/09/1962	49	7	2343	59	0	59	1	29/08/2021
02/09/1962	01/10/1962	49	6	2289	58	9	58	10	06/07/2021
02/10/1962	01/11/1962	49	5	2237	58	6	58	7	15/05/2021
02/11/1962	01/12/1962	49	4	2182	58	4	58	5	21/03/2021
02/12/1962	01/01/1963	49	3	2130	58	1	58	2	28/01/2021
02/01/1963	01/02/1963	49	2	2076	57	10	57	11	05/12/2020
02/02/1963	01/03/1963	49	1	2021	57	7	57	8	11/10/2020
02/03/1963	01/04/1963	49	0	1972	57	5	57	6	23/08/2020
02/04/1963	01/05/1963	48	11	1918	57	2	57	3	30/06/2020
02/05/1963	01/06/1963	48	10	1866	56	11	57	0	09/05/2020
02/06/1963	01/07/1963	48	9	1811	56	8	56	9	15/03/2020
02/07/1963	01/08/1963	48	8	1759	56	6	56	7	23/01/2020
02/08/1963	01/09/1963	48	7	1705	56	3	56	4	30/11/2019
02/09/1963	01/10/1963	48	6	1650	56	0	56	1	06/10/2019
02/10/1963	01/11/1963	48	5	1598	55	10	55	11	15/08/2019
02/11/1963	01/12/1963	48	4	1544	55	7	55	8	22/06/2019
02/12/1963	01/01/1964	48	3	1491	55	4	55	5	30/04/2019
02/01/1964	01/02/1964	48	2	1437	55	1	55	2	07/03/2019
02/02/1964	01/03/1964	48	1	1383	54	10	54	11	12/01/2019

02/03/1964	01/04/1964	48	0	1332	54	8	54	9	22/11/2018
02/04/1964	01/05/1964	47	11	1278	54	5	54	6	29/09/2018
02/05/1964	01/06/1964	47	10	1225	54	2	54	3	07/08/2018
02/06/1964	01/07/1964	47	9	1171	53	11	54	0	14/06/2018
02/07/1964	01/08/1964	47	8	1118	53	9	53	10	22/04/2018
02/08/1964	01/09/1964	47	7	1064	53	6	53	7	27/02/2018
02/09/1964	01/10/1964	47	6	1010	53	3	53	4	04/01/2018
02/10/1964	01/11/1964	47	5	957	53	0	53	1	12/11/2017
02/11/1964	01/12/1964	47	4	903	52	10	52	11	19/09/2017
02/12/1964	01/01/1975	47	3	851	52	7	52	8	29/07/2017
02/01/1965	01/02/1965	47	2	796	52	4	52	5	04/06/2017
02/02/1965	01/03/1965	47	1	742	52	1	52	2	11/04/2017
02/03/1965	01/04/1965	47	0	693	51	11	52	0	21/02/2017
02/04/1965	01/05/1965	46	11	639	51	8	51	9	29/12/2016
02/05/1965	01/06/1965	46	10	586	51	5	51	6	06/11/2016
02/06/1965	01/07/1965	46	9	532	51	2	51	3	13/09/2016
02/07/1965	01/08/1965	46	8	480	51	0	51	1	23/07/2016
02/08/1965	01/09/1965	46	7	425	50	9	50	10	29/05/2016
02/09/1965	01/10/1965	46	6	371	50	6	50	7	05/04/2016
02/10/1965	01/11/1965	46	5	319	50	3	50	4	13/02/2016
02/11/1965	01/12/1965	46	4	264	50	1	50	2	20/12/2015
02/12/1965	01/01/1966	46	3	212	49	10	49	11	29/10/2015
02/01/1966	01/02/1966	46	2	158	49	7	49	8	05/09/2015
02/02/1966	01/03/1966	46	1	103	49	4	49	5	12/07/2015
02/03/1966	01/04/1966	46	0	54	49	2	49	3	24/05/2015

Annex B

Areas for further discussion

1. The follow items remain to be discussed in detail with fire service trades unions and employers:

    a. contribution rates and structure in the new firefighters' pension scheme, and the distribution of years 2 and 3 of planned increases in the current schemes. This will follow the outcome of the review into membership opt outs following 2012/13 increases in contributions.

    b. contribution rates to be paid by members benefiting from the transitional protections

    c. a detailed timetable, terms of reference, and process for reviewing the Normal Pension Age

    d. a process for authority initiated early retirement from age 55 in the interests of the economical, efficient and effective management of the fire service

    e. any issues on equality considerations that the unions or employers may raise.

Annex C

Verification report from the Government Actuary's Department

GOVERNMENT ACTUARY'S DEPARTMENT

Firefighters' Pension Arrangements
Verification of scheme-specific proposals

Date: 9 February 2012

Author: Ian Boonin FIA

Table of Contents

1 Introduction

1.1 This report has been prepared by the Government Actuary's Department (GAD) in its capacity as actuarial advisor to the Department for Communities and Local Government (DCLG) in connection with the Firefighters' Pension Arrangements in England (FPA or "the Scheme").

1.2 This report contains our advice on verifying that the new scheme design is within the cost ceiling and sets out the data, methodology and assumptions used in determining the value of the Reference Scheme and the new scheme design.

1.3 I understand that DCLG will forward this report to HM Treasury (HMT).

1.4 The data, methodology and assumptions and new scheme design described in this report are subject to approval by HMT, based on advice from GAD.

1.5 This report follows our normal quality processes for work conducted on public service pension matters.[1]

[1] *The GAD Statement of Understanding http://www.gad.gov.uk/Documents/Occupational%20Pensions/GAD_Statement_of_Understanding_v_1.1_Dec_2011.pdf sets out the standards which the Department currently applies for any work carried out in this area.*

2 Verification Statement

2.1 The Minister for the Fire Service wrote to the fire service unions on 8 December 2011 setting out the gross cost ceilings for the firefighters' pension arrangements. The gross cost ceiling is the scheme specific contribution rate required to provide the Government's preferred design (the "Reference Scheme"). The terms of the Reference Scheme were set out in that letter. The letter set out the following cost ceiling for the Firefighters' Pension Arrangements:

Gross Cost Ceiling	Employers	Employees
27.0%	13.8%	13.2%

2.2 Following scheme level discussions, the Secretary of State for Communities and Local Government has set out the new scheme design for the FPA for service from 1 April 2015. The new scheme design is attached at Appendix A.

2.3 The Government Actuary's Department provided advice to HMT on cost ceilings for scheme level discussions in the note of 7 October 2011: Cost Ceilings for scheme level discussions: Advice on data, methodology and assumptions. Section 8 of that note provided advice on verifying that new scheme designs are within the cost ceiling. This report has been prepared in accordance with the advice outlined in the 7 October 2011 report and subsequent HMT instructions (see appendix C).

2.4 I have compared the cost of the new scheme design set out in Appendix A with the Reference Scheme, and concluded that the new scheme design is within the required cost ceiling. This conclusion is subject to the comments below.

2.5 The conclusion in 2.4 is dependent on the data, methodology and assumptions adopted. These are set out in Section 3.

2.6 The data, methodology, assumptions and new scheme design described in this report are subject to approval by HMT, based on advice from the Government Actuary's Department. HMT have confirmed that they are content.

2.7 The costs of both the new scheme design and the Reference Scheme will change over time. I have considered these possible changes in the scheme costs and conclude that, allowing for this effect, the cost of the new scheme design set out in Appendix A remains within the cost of the Reference Scheme when assessed on the revised assumptions discussed in 3.4 and 3.6. This comparison is discussed in section 5.

2.8 Limitations of this advice are described in section 6.

3 Data, methodology and assumptions

3.1 This section sets out the data, methodology and assumptions used for the comparison.

3.2 The cost ceilings were set in accordance with the data, methodology and assumptions set out in GAD's notes:

> Review of the Firefighters' Pension Scheme (England): Assessment of cost ceiling and scheme specific proposals: Draft cost ceilings – results dated 17 January 2012, which referred to:

> Review of the Firefighters' Pension Scheme (England): Assessment of cost ceiling and scheme specific proposals: Data, methodology and assumptions dated 11 August 2011.

3.3 As required in paragraphs 8.2 to 8.10 of the GAD advice of 7 October 2011, I have considered whether the data, methodology and assumptions used to calculate cost ceilings will be appropriate to provide a fair comparison between the costs of the new scheme design set out in Appendix A with the Reference Scheme.

3.4 The gross cost ceiling outlined in 2.1 above assumed that all members retired on reaching age 60. No allowance was made for early or late retirements. The new scheme design allows for the early retirement terms of members who retire from active service at age 57 and above described in Appendix A.

3.5 In order to provide a fair comparison it is necessary to allow for early retirements in assessing the cost of the new scheme design set out in Appendix A.

3.6 Consequently HMT have requested that:

> The Reference Scheme should be reassessed allowing for the early retirement of half of the unprotected ex-FPS 1992 members at age 52, on terms consistent[2] with the current FPS 1992 scheme. The remaining unprotected ex-FPS 1992 members should be assumed to remain in the scheme.

> We should assume that the introduction of the revised early retirement terms will result in the unprotected ex-FPS 1992 members who would have retired at 60 instead retiring at 57. In the short-term, other members (including all ex-NFPS 2006 members) should be assumed to have the same retirement pattern as in the Reference Scheme.

> In the long-term it should be assumed that the revised early retirement factors will lead to a change in behaviour and 25% of members in active service reaching age 57 will be assumed to retire immediately.

> In addition members who were assumed to withdraw from the scheme between ages 57 and 60 should instead be assumed to take early retirement at the age at which they would have deferred.

3.7 These revised assumptions are used to assess the cost of the new scheme design set out in Appendix A and the Reference Scheme. Note that the contribution rate required for the Reference Scheme using these revised assumptions will differ from the original cost ceiling, and so the cost ceiling outlined in 2.1 above does not play any direct role in the comparison.

[2] There are no early retirement factors in the FPS 1992.

3.8 As a result of the revised early retirement terms, the FPS 1992 liabilities may be expected to increase. As requested by HMT we have assumed that the FPS 1992 past service liability will increase by an amount equivalent to assuming that half of all unprotected ex-FPS 1992 members will change their behaviour to retire at age 57 (three years earlier than they would have otherwise done). It has been assumed that the half of members with the most amount of FPS 1992 scheme service retire at age 52, and the half with the least amount of FPS 1992 scheme service remain in the scheme. I have assumed that this is equivalent to 65% of the pre-2015 liability of unprotected ex-FPS 1992 members relating to retirements at age 52.

3.9 After allowing for this past service cost, the cost of the proposed scheme remains within the revised cost ceiling.

3.10 No allowance has been made for any tapering of the ten-year protection; members who are subject to tapering have been treated as unprotected members.

Summary of data, methodology and assumptions:

3.11 The membership data used to assess the cost of the Reference Scheme and the new scheme design outlined in Appendix A is the most recent full extract of membership data (data as at 31 March 2011) and is summarised in Appendix B.

3.12 This data has been validated and some minor adjustments have been made. It is my opinion that the membership data is suitable for the purposes of this report.

3.13 We have assumed that the profile of the membership as at 2015 is unchanged from 2011, except that 39% of the salary of unprotected scheme members is assumed to relate to ex-FPS 1992 members who will not benefit from protection.

3.14 The methodology used to determine the value of the Reference Scheme and the new scheme design is the standard actuarial methodology known as the Projected Unit Method with a one year control period.

3.15 The key assumptions used to determine the relevant costs are:

> retirement as discussed above.

> a real discount rate of 3% pa in excess of CPI in line with the current SCAPE discount rate

> a nominal discount rate of 5% pa

> earnings increases of 4 ¼ % pa

> CPI increases of 2% pa

> improvements in post-retirement life expectancy in line with the ONS 2008-based principal population projections

> proportion of pension commuted in exchange for a lump sum of 55% of HMRC limits.

> other demographic assumptions, set as best estimates.

4 Sensitivity analysis

4.1 The conclusion in Section 2.4 is sensitive to the data, methodology and assumptions used.

4.2 Given the proposed pension scheme design, the conclusion in Section 2 is particularly sensitive to the following

4.2.1 Age retirement assumptions: The figures provided in this report have been based on the assumption that half of unprotected ex-FPS 1992 and approximately 25% of new entrant active members will retire three years earlier as a result of the introduction of the revised early retirement terms but that no other members will change their behaviour. If a different spread of early retirements were assumed between ages 55 and SPA then the affordable accrual rate may be higher or lower. We have assumed that all benefits have to be drawn from all schemes at the same time.

4.2.2 Withdrawal rates: The new scheme design is expected to be more favourable to those members who remain in service until age 57 than to those who leave before then relative to the Reference Scheme. Thus if a different rate of withdrawals before age 57 were assumed, then the affordable accrual rate may be higher or lower .

4.3 The National Audit Office has noted that the cost of public service pensions, as a proportion of GDP, will rise if GDP growth is permanently lower than expected. The conclusion is sensitive to the assumed rate of earnings growth in excess of inflation. However, the impact of this sensitivity will be very much smaller than changes to the assumed age retirement and withdrawal rates.

5 Comparisons of costs in the longer term

5.1 Paragraphs 8.21 to 8.23 of GAD's note of 7 Oct 2011 stated that if any benefit design options are proposed in which the comparison of costs differs in the short term and the long term, then HM Treasury could consider the issues arising on a case-by-case basis.

5.2 The data used for the comparison is based on membership data as at 31 March 2011.

5.3 HMT have specified that the comparison should allow for the likely increases in average member age due to the increased pension ages.

5.4 The future membership age profile is uncertain. For simplicity, I have performed a comparison for the current membership with average age increased by (60 – average retirement age) / 2.

5.5 The current average retirement age of the scheme is approximately 52 years. I have therefore assumed that all current members are 4 years older than included in the membership data. In order to provide a fair comparison with the long term cost of the scheme I have assumed a State Pension Age of 68 for all members in both the Reference Scheme and the new scheme design.

5.6 I have concluded that, allowing for this effect, the cost of the new scheme design set out in Appendix A remains within the cost of the Reference Scheme when valued on the early retirement pattern discussed in 3.4 and 3.6 above.

6 Limitations

6.1 A number of limitations apply to the comparisons made and the conclusions reached in this report. These are described below.

Verification statement

6.2 The purpose of this report is to provide HMT with the requested statement verifying that the cost of providing the new scheme structure is within specified cost limits.

6.3 This report has been produced on the basis of the comparisons requested by HMT as we understand them, namely:

> On an ongoing basis comparing the Reference Scheme with the new scheme structure allowing for the proposed change in assumptions outlined in 3.4 and 3.6

> On a long term basis comparing the impact of an increase in the average age of the scheme membership

> Sensitivity testing in accordance with assumptions directed by HMT.

6.4 The costs compared for this report will inevitably differ from the ultimate costs of the new scheme and Reference Scheme, for reasons such as:

> the membership data used to calculate the cost will differ from the actual scheme membership to which the new scheme will apply in future. The relative weighting of older and younger members in future may impact on how the proposed and Reference schemes compare in the longer term.

> the outturn will differ from the assumptions made. In particular the current assumed retirement and withdrawal rates may not occur in practice.

The above list is not exhaustive.

6.5 Some of the assumptions adopted are different between the Reference Scheme and the new scheme. Since only one scheme will be implemented in practice, it will not be possible to determine how close the assumption adopted for a scheme design that is not implemented would have been to actual experience.

Data, methodology and assumptions

6.6 The costs being compared are sensitive to the data, methodology and assumptions adopted.

6.7 However the purpose of the comparisons is to verify that the new scheme structure can be provided within the cost limits set relative to the Reference Scheme. The significance of the data, methodology and assumptions used to determine the comparable costs therefore depends on what benefit variations are considered.

6.8 As outlined in 6.4 above changes in the scheme membership or the assumed rates of retirement or withdrawal from service may result in an alternative conclusion being drawn if the comparison had been made at some future time.

6.9 We have not made any allowance in our calculations for the changes in State Pension Age that were announced in the Autumn Statement on 29 November 2011. Any future announcements of changes in the State Pension Age will affect the costs of the Scheme.

Calculations

6.10 Some of the calculations undertaken for the purposes of this document have been based on approximate methods. I do not expect this to materially affect the accrual rate of a scheme design that will pass the tests set out by HM Treasury.

Benefits

6.11 The 'Reference Scheme' set out by HM Treasury and the new scheme design do not specify the full detail of every aspect of the benefit structures. Where there is scope for interpreting what benefits the 'Reference Scheme' of new scheme design includes, the calculations value benefits which are consistent with the recommendations of Lord Hutton's Independent Public Service Pensions Commission and in line with the scheme's current provisions. The approach taken in determining the draft cost ceilings is outlined in our report *Review of the Firefighters' Pension Scheme (England): Assessment of cost ceiling and scheme specific proposals: Data, methodology and assumptions dated 11 August 2011.*

Third party reliance and liability

6.12 This report has been prepared for the Department for Communities and Local Government. I am content for the Department to release this report to third parties (including HM Treasury, other public service schemes, trades unions and parliament), provided that:

> it is released in full

> the advice is not quoted selectively or partially, and

> GAD is identified as the source of the report

6.13 Third parties whose interests may differ from those of the Department for Communities and Local Government should be encouraged to seek their own actuarial advice where appropriate.

6.14 This report has been provided to the Department for Communities and Local Government for the purpose of providing HMT with verification of the new scheme structure for the FPA post 2015. No person other than the Department for Communities and Local Government or third party other than HMT is entitled to place any reliance on the contents of this report, except to any extent explicitly stated herein, and GAD has no liability to any other person or third party for any act or omission taken, either in whole or in part, on the basis of this report.

Appendix A: New scheme design

A.1 The new scheme design is a Career Average Revalued Earnings (CARE) pension scheme which includes the following features:

a) A normal pension age of 60 (and a deferred pension age of State Pension Age)

b) Revaluation of past CARE service for active members in line with earnings

c) Pensions accrue at a rate of 1/58.7 for each year of service

d) Early retirement reduction factors for retirement from active service from age 57 based on the period to normal pension age rather than the period to deferred pension age. Early retirement reduction factors for all other retirements based on the period to deferred pension age.

e) Pensions in payment and in deferment indexed in line with prices[3]

f) No fixed lump sums, optional commutation, with a 12:1 factor for converting pension to lump sum.

g) Ancillary benefits (ill-health, death and survivors benefits) that match the current provisions that are currently available to new members (i.e. a lower tier ill health pensioner receives an unreduced CARE pension; a partner receives same proportion of member's pension as now)

h) Members rejoining after a period of deferment of less than 5 years can link new service with previous service, as if they had always been an active member (so previous accruals are indexed by earnings for that period of deferment)

i) Members transferring between public service schemes would be treated as having continuous active service (which would include those transferring between schemes who had rejoined public service after a gap of less than 5 years)

Members of the Firefighters' Pension Scheme 1992 on 1 April 2012 who are aged 45 or over on that day and members of the New Firefighters' Pension Scheme 2006 on 1 April 2012 who are aged 50 or over receive protection and are able to continue accruing benefits in their current scheme. Members of the Firefighters' Pension Scheme 1992 on 1 April 2012 who are aged 41 or over on that day and members of the New Firefighters' Pension Scheme 2006 on 1 April 2012 who are aged 46 or over will continue to accrue pension in their existing scheme on a tapered basis.

[3] Pensions in payment and in deferment are indexed in line with the Pensions Increase Act 1971 and increases in line with this Act are assumed to be in line with the CPI.

Appendix B: Data

B.1 This appendix contains summary statistics of the data used to value the Reference Scheme and the new scheme structure

B.2 Table B1 contains the number of members in the scheme, their pensionable salaries and their average ages weighted by pensionable salaries.

Table B1 - Active members as at 31 March 2011

	Number	Total Pensionable Salaries (£ million pa)	Average Age weighted by pensionable salaries
Males	33,953	1,064	41.0
Females	1,474	42	35.3
Total	**35,427**	**1,107**	**40.8**

Appendix C: Cost Ceiling Instructions

This report is based on the series of instructions which Treasury officials have provided as listed in the documents below.

- James Richardson's letter to Jeremy Pocklington of 22 July 2011. This outlined the cost ceiling test and stated that "cost ceilings cannot be exceeded in developing scheme specific proposals". Paragraphs 8-11 of Annex A of that letter described in more detail the arrangements for agreeing new scheme designs.

- GAD's note of 7 October 2011 *Cost ceilings for scheme level discussions: Advice on data, methodology and assumptions* which provided advice on appropriate data, methodology and assumptions for the purpose of cost ceiling calculations

- The Chief Secretary to the Treasury's letter to Brendan Barber on 7 October 2011. This confirms that the Government has agreed to spread the costs of transition and past service over a period of 7 years.

- James Richardson's letter to Jeremy Pocklington of 7 December 2011. This described how the cost ceiling test should be applied following the Chief Secretary to the Treasury's statement in the House of Commons on 2 November 2011. In particular, in respect of the 10-year protection announced on 2 November 2011.

- The Chief Secretary to the Treasury's letter to the Secretary of State for Communities and Local Government on 7 December 2011. This stated that the cost ceiling should be consistent with the GAD advice of 7 October 2011 with suitable adaptations to take account of the scheme specific circumstances.

- HMT instructions to DCLG and GAD's HM Treasury and DCLG teams of 8 February 2012. This email described the requirements on the methodology used for valuing the early retirement terms in the new scheme design.

HMT's instructions of 8 February 2012 are set out below.

Costs in respect of protected members.

Since the protected members will remain in the existing scheme, no additional costs would arise in respect of these members from the proposal to provide early retirement factors by reference to the active pension age. In these particular circumstances, HMT is content that the methodology and assumptions should be set accordingly so that the accrual rate in the Heads of Agreement does not reflect any cost in respect of protected members from the proposal to provide these early retirement factors.

Comparisons of cost in the longer term

The assumed retirement patterns for new entrants, as opposed to unprotected FPS members, mean that the relative service costs of this proposed design and the reference scheme vary in the longer term.

HMT intend that the accrual rate in the Heads of Agreement needs to take account of the comparison of costs in the longer term, as well as the comparison in the shorter term. This is consistent with the approach adopted for other schemes where the costs of proposed scheme designs were relatively higher in the longer term, further to paragraphs 8.21 to 8.23 of GAD's note of 7 October 2011.

Treatment of past service costs

A past service cost arises under this proposed scheme design in respect of unprotected FPS members. HMT policy on the treatment of this past service cost is set out below. This is consistent with the approach adopted for other schemes, in particular the approach adopted for the TPS verification report of 19 December 2011.

Having determined a proposed scheme design that remains within the published cost ceiling when assessed across members of all ages (including those within 10 years of pension age) in the long term and the short term, schemes may offer protection for those within 10 years of their scheme's Normal Pension Age on 1 April 2012 and a taper of 3-4 years without any reduction to the accrual rate of proposed scheme design. Schemes may offer transitional arrangements over and above the 10 year protection and 3-4 year taper, but in this case the accrual rate must be reduced to allow for the extra costs of additional protection. The costs of the proposed scheme design with additional transitional protection and reduced accrual rate must not exceed the costs of the original proposed scheme design with the 10 year protection and 3-4 year taper.

Note this requires an iterative process to set the cost limits:

- Firstly the accrual rate required for the proposed design (without additional transition) will need to be calculated – this is then used to set the cost limit for transition / past service costs
- Then this accrual rate would need to be adjusted for transition / past service costs

The 7 year averaging period still applies, and so the transition cost limit is as follows:

Average contribution rate required in 2015-2022 for proposed scheme design (including 10 year protection, taper, transition and adjusted accrual rate)	+	Past service costs spread over 7 years	≤	Average contribution rate required in 2015-2022 for original proposed scheme design (including 10 year protection and taper, but before allowance for transition and adjusted accrual rate)

Difference in member behaviour for new entrants post-2015

The nature of this proposed scheme may lead to differences in member behaviour: in particular, members may choose to retire between age 57 and age 60. In these cases, in accordance with paragraph 8.13 of GAD's note of 7 October 2011, HM Treasury sets assumptions for the purpose of verifying that proposed pension scheme design is within the cost ceiling that are consistent with those used in the calculation of cost ceilings, but HM Treasury considers making allowance for those behavioural differences. Under the reference scheme it is assumed that all age retirements of active members occur at age 60. HM Treasury intends that for the purposes of cost ceiling calculations it should be assumed that for new entrants post-2015 under this proposed scheme design 25% of active members in service at age 57 would retire and take an actuarial reduced benefits at that age.

Annex D

Employer cost cap and floor, opt out review, and 25 year guarantee

Employer cost cap and floor

1. An employer cost cap will be introduced to cover unforeseen events and trends that significantly increase scheme costs. The employer cost cap is intended to provide backstop protection to the taxpayer and will be based on cap and share principles. This means that changes to contribution rates due to ‘member costs’ will be controlled by the cap. Financial cost pressures, including changes to the discount rate, will be met by employers. The employer cost cap will be symmetrical so that, if reduction in member costs fall below a ‘floor’, members’ benefits will be improved.

2. The cost cap will include the impact of changes in costs such as actual or assumed longevity, of careers or the age and gender mix of the workforce. These costs cover all schemes (old and new) and all types of service (past and future) of active, deferred and pensioner members. Changes in actual and assumed price inflation and the discount rate will be excluded from the cost cap.

3. Scheme valuations will take place periodically to assess how the cost of the scheme has increased or reduced. In the event that member costs drive the cost of the scheme above the cap or below the floor, there will be a period of consultation with relevant groups before changes are made to bring costs within the cap and floor. If agreement cannot be reached through consultation, the accrual rate will be adjusted as an automatic default.

4. The employer cost cap will be set at 2% above and the floor set at 2% below the employer contribution rates calculated following a full actuarial valuation ahead of the introduction of the new scheme in 2015. Caps will not be based on cost ceilings.

Reviewing contribution levels and opt-out rates

5. The Government remains committed to securing in full the Spending Review savings of £2.3bn in 2013-14 and £2.8bn in 2014-15 from increased member contributions, and will consult formally on implementation in due course. The Government will review the impact of the 2012-13 contribution increases, including on opt-out, before taking final decisions on how future increases will be delivered. Interested parties will have the opportunity to provide evidence and views to the Government.

25 year guarantee

6. The Chief Secretary to the Treasury set out to Parliament on 2 November an offer on public service pensions that is fair and sustainable, and one that can endure for 25 years. This means that no changes to scheme design, benefits or contribution rates should be necessary for 25 years outside of the processes agreed for the cost cap. To give substance to this, the Government intends to include provisions on the face of the forthcoming Public Service Pensions Bill to ensure a high bar is set for future Governments to change the design of the schemes. The Chief Secretary to the Treasury will also give a commitment to Parliament of no more reform for 25 years.