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31st July 2017

Dear Marc,

Consultation on the treatment of past service costs in the Firefighters' Pension Scheme 2016 funding valuation

Thank you for the opportunity to provide the views of the Scheme Advisory Board on the treatment of past service costs in the Firefighters' Pension Scheme 2016 funding valuation.

We are pleased to provide our comments with regards to the three particular events identified. However, as we have previously discussed we remain concerned that there are potentially significant past service cost implications with regards to the inconsistent treatment of pensionable pay, and we have taken this opportunity to outline our concerns. The Board feel that if these potential costs are realised they will have a significant impact on the future financial management of the scheme and cost cap mechanism. We would respectfully suggest that the minister takes the opportunity to consult the Scheme Advisory Board further on this issue.

In making our recommendations we have consulted with the SAB Cost Effectiveness Committee, a committee formed of representatives from the SAB, Fire Authorities, practitioner experts and Local Pension Boards in order to form a balanced opinion.

Please find a summary of the SAB decision on these events below and attached to this letter our full response to this consultation.

Scheme Advisory Board Secretariat

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	Employer Contribution Rate	Cost Cap
Milne	This should not be considered an employer cost.	This should not form part of the cost cap calculation, in line with HMT policy on cost cap.
Retained	<p>i. The Board accept that part of the cost of the retained option should be included in the employer contribution rate</p> <p>ii. The Board consider that the cost of service prior to 2007 should be excluded from employer costs</p> <p>iii. The Board would recommend option a, with the caveat that there is a long term measurement of the total costs to allow treasurers to forecast for long term planning.</p>	<p>This should not form part of the cost cap calculation for deferreds and pensioners in line with HMT policy.</p> <p>This should not form part of the cost cap calculation for active service before or after 31st March 2015.</p>
Refunds	This should not be an employer cost.	This should not form part of the cost cap calculation in line with HMT policy.

This response is supported by both the employee and employer representatives of the Scheme Advisory Board.

If you have any questions, please let me know.

Yours sincerely



Malcolm Eastwood
Chairman, Firefighters Pension Scheme (England) Scheme Advisory Board

Scheme Advisory Board Secretariat

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Question 1 - Milne Payments

a) Employer contribution rate

i.) What is your view on the cost of the Milne payments forming part of the employer contribution rate from April 2019?

You may wish to consider factors including but not limited to:

- scheme financing arrangements that applied before April 2006
- introduction of the notional valuation fund in April 2007

b) Cost cap

i.) What is your view on the cost of the Milne payments forming part of the cost cap calculation?

You may wish to consider factors including but not limited to:

- HM Treasury's cost cap definition as set out in the paper provided to 14 June meeting (para 14)
- relates to members who retired before April 2015

Response

a) Employer Contribution

i.) The Scheme Advisory Board's firm view is that the cost of the Milne payments should not be reflected in the employer contribution rate. This should be considered a government cost.

In making their decision the Scheme Advisory Board considered;

- The relevant date of the Milne payments and the scheme financing arrangements that would have been in place if the costs had fallen due.
- Whether the employers could reasonably have known further costs would fall due in the future.
- Paragraphs 20 to 22 of the Home Office paper to SAB on 14th June 2017

- Relevant date of Milne payments

The Milne payments occurred as a result of an ombudsman determination to revise the commutation factors for retirements between 1 December 2001 and 21 August 2006. If those increased payments had fallen due at that time, then due to the financing arrangements that were in place the costs would have been met from the operational accounts with any shortfall met by the government at the time as part of the funding arrangements to Fire Authorities.

The Board also considered that the notional valuation fund that takes into account liabilities of the pension scheme was not established until April 2007.

It is therefore the view of the Scheme Advisory Board that due to the relevant date of the payments, had they been made when they fell due, the additional costs would have been picked up by the government at the time, and should be discounted from the current valuation.

- Employer duty

The Board considered what the duty of the employer was at the time to which the payments relate and whether they complied with legislation. Employers could not have been reasonably expected to know about this cost prior to 2006 or to have made arrangements to provide for it.

Employers can only act within the vires of the scheme, between 2001 and 2006, the relevant rule that applied to the calculation of commutation was rule B7, and rule B7(3) confirms that employers should calculate the lump sum by 'tables prepared' by the government actuary, not 'tables that ought to have been prepared'

"The lump sum is the actuarial equivalent of the commuted portion at the date of retirement, calculated from tables prepared by the Government Actuary . . ."

It is the view of the Scheme Advisory Board that the employers therefore acted in accordance with the legislation at the time, and could not have expected to know that a review of these factors was overdue.

- Paragraphs 20 to 22 of the Home Office paper to SAB on 14th June 2017

The Board thoroughly considered the paragraphs in the paper to the Scheme Advisory Board on 14th June 2017, and make the following comments

Paragraph 20 – If the costs for the increased commutation payments had fallen due at that time, the increased costs would have been met from operational accounts with any shortfall met by the government at the time as part of the funding arrangements to Fire Authorities.

Paragraph 21 – The Board noted the precedent for treating backdated commutation costs in 2009, where employer contributions **were not** increased to cover these costs.

Paragraph 22 – The Board agreed that as the Milne payments were before 2007, they relate to benefits accrued **before** the starting point of the notional valuation fund.

ii.) Cost Cap

The Scheme Advisory Boards firm view is that the cost of the Milne payments should not form part of the cost cap calculation.

In making their decision the Board considered;

- the HMT cost cap definition
- All Milne payments had been made to pensioner members of the scheme who retired before 2007
- Paragraph 23 of the Home Office paper to SAB on 14th June 2017
- HMT cost cap definition

Paragraph 2.24 of the HMT policy note ‘ [Public Service pensions: actuarial valuations and the employer cost cap mechanism](#)’ published March 2014 confirms that some measures should be excluded from it. These include pensioner and deferred members of the scheme.

“2.24 As set out in paragraphs 2.7 to 2.11, the employer contribution rates calculated by the valuations will reflect all future and past service costs associated with the schemes (and connected schemes). However, the cap mechanism has been designed so that some of these elements are excluded from it. As only active members will see their future benefits or contributions adjusted if the ceiling or floor is breached, the government considers that it would be unfair to control all of the costs associated with pensioner and deferred members of the existing pension schemes. These elements of costs will therefore not be controlled by the cost cap mechanism.”

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- All Milne payments have been made to pensioners

The Board discussed that even without the HM Treasury statement that it would be unfair to active members to see an adjustment in benefits for costs relating to members who had already retired or left the scheme.

- Paragraph 23 of the Home Office paper

The Board noted paragraph 23 and agreed that it would be inconsistent with HMT policy to include the Milne payments in the cost-cap mechanism.

Question 2 - Retained option

a) Employer Contribution Rate

- i. What is your view on the cost of the Retained option, in excess of employee contributions received, forming part of the employer contribution rate from April 2019?
- ii. What is your view on the costs for all periods of service being included?

You may wish to consider factors including but not limited to:

- change in fire pensions financing arrangements introduced in 2006
 - introduction of the notional valuation fund in April 2007
- iii. What is your view on the costs that should be recognised at each actuarial valuation for past pensionable service being purchased via regular employee contributions payable each month, from the following options:

a. Pro-rata approach.

Only past service purchased to the valuation date is included in the valuation liabilities.

This would result in a small increase the employer contribution rate from 2019, followed by larger increases from 2023 and 2027.

b. Full recognition, with outstanding employee contributions included as an asset.

All past service is included in the valuation liabilities, but allowance is made for an asset equal to the present value of outstanding employee contributions.

This would result in a larger increase in the employer contribution rate from 2019, but no further increases at future valuations, and potentially a small decrease to the extent that members do not complete their payments.

c. Full recognition

All past service is included in the valuation liabilities. No allowance is made for an asset in respect of outstanding employee contributions.

This would result in the largest increase in the employer contribution rate from 2019.

There would then be a decrease at future valuations, as the outstanding employee contributions towards past service are received (or if members do not complete their payments).

b) Cost cap

- i. What is your view on the cost of the Retained option, in respect of pensioners and deferred members who retired/left before April 2015, forming part of the cost cap calculation?

You may wish to consider factors including but not limited to:

- HM Treasury's cost cap definition as set out in the paper provided to 14 June meeting (para 14)
 - relates to members who retired before April 2015
- ii. What is your view on the cost of the Retained option, in excess of employee contributions received, in respect of pre April 2015 service for active members, forming part of the cost cap calculation?

You may wish to consider factors including but not limited to:

- introduction of the notional cost cap fund in April 2015

Response

a) Employer Contribution

- i. The Scheme Advisory Board accepted the government position that part of the cost of retained option should be included in the employer contribution rate from April 2019.**
- ii. It is the firm view of the Scheme Advisory Board that costs for service prior to 2007 should be excluded from the cost of employer contributions.**
- iii. It is the firm view of the Scheme Advisory Board that option a, a pro-rata approach is the appropriate approach, however they would add the caveat there should be some measurement of the total costs to allow treasurers to forecast for long term planning.**

In making their decision the Board considered;

- That employers had no part of the settlement process of the part time workers case that led to the introduction of the retained scheme.
- Employer responses of the consultation of the retained scheme
- The scheme financing arrangements that would have been in place if retained members had been allowed in the scheme.
- The costs already paid by employers for retained firefighters excluded from the 1992 scheme.
- Paragraphs 31 to 34 of the Home Office paper to SAB on 14th June 2017
- The effect of allowing employees to purchase service over a period of 10 years.
- Views from treasurers with regards to long term planning
- That employers had no part of the settlement process of the part time workers case that led to the introduction of the retained scheme

The Board considered that employer representatives had no involvement in negotiations on terms of the settlement, therefore they recognised that they had no control over the cost of the scheme.

- Employer response to the consultation

The Board noted the employer responses in the relevant paragraphs 27, 28, 29, 40 & 41 of the [response to the consultation](#) published in March 2014.

- Scheme financing arrangements that would have been in place if retained firefighters had been allowed in the 1992 scheme

If the retained firefighters had been permitted access to the scheme in 2000, as they should have been (and of course it was the Secretary of State who made and maintained the statutory instruments setting out the terms of the scheme, not the authorities themselves), the cost associated with their membership would have been reflected in the amount of the formula grant.

It should be noted that fire authorities prior to 2006 were not funded to make payments that they were not actually making.

- Costs already incurred by employers in relation to retained firefighter members as a result of not being able to join the 1992 scheme.

The Board noted that there had already been significant costs to fire authorities operating budgets due to retained firefighters not being allowed to join the scheme, including but not limited to.

- Bounty payments
- Payment of ill-health pensions to qualifying members under Part 8 of the compensation scheme
- Paragraphs 31 to 34 of the Home Office paper to SAB on 14th June 2017

The Board considered the paragraphs in the paper to the Scheme Advisory Board on 14th June 2017, and make the following comments

Paragraph 31 – The Board reluctantly accepted the government consultation that some cost of the retained scheme should fall on the employers contribution.

Paragraph 32 – The Board noted that prior to 2007 the pension scheme benefits were assumed to be fully funded and strongly feel that this should be reflected in the treatment of employer costs prior to 2007.

Paragraph 33 – The Board noted that had retained firefighters been permitted to join the 1992 scheme in 2000 the cost associated with their membership would have been reflected in the amount of the formula grant.

Paragraph 34 – The Board noted the effect of members purchasing the past service over a period of 10 years and agreed this should be reflected in any employer contribution rate.

- The effect of allowing employees to purchase service over a period of 10 years.

The Board discussed the options a, b & c provided in the paper at length, as to whether there would be any benefit to employers in recognising the full liabilities at once. However, after considerable discussion, option c was rejected on the basis that members may leave the scheme and stop paying contributions so it was not sensible to fund the employer cost based on fixed liabilities.

The group discussed whether option b, would allow authorities to plan long term, but recognise the potential savings as an asset. This was rejected on the basis that it still put a significant cost on employers.

The group agreed that option a, a pro-rata approach to funding the liabilities based on service purchased to 31st March 2016 was the most appropriate, however because the options exercise was only open from 1st April 2015 (later extended to September 2015) this would be a very small portion of service included in the 2019 to 2023 employer rate and potential a much larger increase in 2023.

Therefore the caveat to the Board decision to recommend option a, was that there should be some long term measurement of the total costs to allow treasurers to forecast for long term planning.

- Views from treasurers with regards to long term planning

The approach recommended by the Board was discussed with various treasurers who agreed the decision.

b) Cost Cap

- i. It is the firm view of the Scheme Advisory Board that the cost of the retained option in respect of pensioners and deferred members who retired / left before April 2015 should not form part of the cost cap calculation.**
- ii. It is the firm view of the Scheme Advisory Board that the cost of the retained option in respect of active members should not form part of the cost cap calculation.**

In making their decision the Board considered;

- the HMT cost cap definition
- Previous statements that the cost of the retained scheme would not affect the cost cap
- The consultation on the extension to the retained exercise did not mention the effect on costing.
- The timing of the introduction of the retained scheme and its effect on the valuation at 31st March 2015.
- The setting of the baseline cost of 16.8% pensionable pay
- Paragraph 35, 36, 37 & 38 of the Home Office paper to SAB on 14th June 2017

- HMT cost cap definition

Paragraph 2.24 of the HMT policy note ‘ [Public Service pensions: actuarial valuations and the employer cost cap mechanism](#)’ published March 2014. Confirms that some measures should be excluded from it. These include pensioner and deferred members of the scheme.

“2.24 As set out in paragraphs 2.7 to 2.11, the employer contribution rates calculated by the valuations will reflect all future and past service costs associated with the schemes (and connected schemes). However, the cap mechanism has been designed so that some of these elements are excluded from it. As only active members will see their future benefits or contributions adjusted if the ceiling or floor is breached, the government considers that it would be unfair to control all of the costs associated with pensioner and deferred members of the existing pension schemes. These elements of costs will therefore not be controlled by the cost cap mechanism.”

- Previous Statements that the cost of the retained scheme would not affect the cost cap

Section 4 of the notes from the [50th FPC meeting](#) included a statement that any past service pre 1st April 2015 costs would not have an adverse impact on the cost cap mechanism.

4 Scheme Valuations

Valuations and Employer Cost Cap Directions & Employer Cost Cap Regulations (HMT papers)

4.1 Mike Scanlon introduced the HM Treasury papers.

4.2 Cllr Maurice Heaster suggested that costs relating to the RDS Settlement would be a new burden if they were included in the calculations for the 2015 employer cost cap. Mike Scanlon responded by confirming that any past service pre-1 April 2015 costs would be included in the starting cost cap fund as at 31 March 2015. Therefore these costs would not have an adverse impact on the cost cap mechanism (although any future changes to the expected costs in respect of these benefits would impact on the cost cap mechanism, in the same way as would be the case for any other past service liabilities). He said that this was because the draft HMT Directions require that notional scheme assets for the cost cap fund would be set at the same level as the scheme liabilities as at 31 March 2015, based on data as at that date (which would include past service data from the retained settlement). DCLG have noted the **concerns that FRAs will be liable for the past service employer contributions and would respond in the Government response to the RDS Settlement consultation in due course.**

- The consultation on the extension to the retained exercise did not mention the effect on costing.

The Board commented that at the time of the consultation to extend there was no commentary on what affect this might have on the funding of the scheme.

Neither the [consultation](#) (para 3.10) to extend the retained exercise past 1st April 2015, nor the [response](#) (paras 3.14 – 3.20) mentioned that this would have an impact on the scheme costs.

- The timing of the introduction of the retained scheme and its effect on the valuation at 31st March 2015.

The board considered the timing of the exercise. As per above assurances had already been sought that this would not affect the cost-cap mechanism. At no point until this consultation has it been raised that the timing would affect the cost cap.

- The setting of the baseline cost of 16.8% pensionable pay

As per above the Board considered that all service in relation to the 2015 scheme should have formed part of the base cost cap.

- Paragraph 35, 36, 37 & 38 of the Home Office paper to SAB on 14th June 2017

The Board considered the paragraphs in the paper to the Scheme Advisory Board on 14th June 2017, and make the following comments

Paragraph 35 – It is consistent with treatment of Milne payments and paragraph 2.24 of the HMT policy note that pensioner and deferred members should be excluded from the cost-cap mechanism.

Paragraph 36 – The Board noted that due to the extension of the exercise some of the service purchased was post 1st April 2015 until 30th September 2015.

The Board noted that the consultation to extend the exercise to September 2015 did not include any commentary on what effect this might have on the funding of the scheme.

Paragraph 37 – The Board felt quite strongly that neither the options exercise nor the timing of the cost-cap valuation could be described as ‘unexpected’. The necessary revisions to the 2006 scheme and the parallel timetable for the 2015 reform were known for some time, and more should have been done in terms of planning to ensure that any additional costs were taken into account when setting the cost-cap.

Paragraph 38 – The Board noted that the exercise to provide redress to retained firefighters excluded from the 1992 scheme was not ‘unexpected’ and more should have been done to ensure the full costs were reflected in the 31st March 2015 valuation.

Question 3 - Refund Payments

a) Employer Contribution Rate

- i. What is your view on the cost of the Refund payments forming part of the calculation of the employer contribution rate from April 2023?

You may wish to consider factors including but not limited to:

- introduction of the notional valuation fund in April 2007

b) Cost cap

- i. What is your view on the cost of the Refund payments in respect of pensioners and deferred members who retired before April 2015, which represents most of the cost, forming part of the cost cap calculation?

You may wish to consider factors including but not limited to:

- HM Treasury's cost cap definition as set out in the paper provided to 14 June meeting (para 14)
- relates to members who retired before April 2015

Response

a. Employer Contribution

- i. **It is the firm view of the Scheme Advisory Board that the cost of the refund payments should not be reflected in the employer contribution rate. This should be considered a government cost.**

In making their decision the Board considered;

- It is not the fault of employers that the scheme was incorrectly funded by the receipt of overpaid employee contributions
- That employers were not given a refund of employer contributions similar to the employee contributions
- Employer response to consultation
- Paragraphs 42 to 44 of the Home Office paper to SAB on 14th June 2017
- It is not the fault of employers that the scheme was incorrectly funded by the receipt of overpaid employee contributions

The employers had no input into the funding of the scheme, and no opportunity to make adjustments to correct any failings relating to the funding of the scheme.

The Board noted that as a result of the employee contributions, the scheme was over-valued based on contributions that shouldn't have been paid. However the board noted that this was beyond the gift of the employer to control, and they had no opportunity to make adjustments.

- Employers were not given a refund of employer contribution similar to the employee contributions.

The Board noted that employers were still continuing to pay employer contributions for the period being refunded, and would not be receiving similar refunds. It was considered that any attempt to include the cost of the refund payments in the employer contributions would be to doubly penalise the employer for a situation that was outside its' control.

- Employer response to consultation on contributions holiday

The Board noted paragraphs 48 & 59 in the government response to the [consultation](#) on contributions holiday when it was first proposed in 2013.

48. One authority respondent offered an alternative to offering an employers' contribution holiday; they suggested that the "overpayment" of contributions made in the period could be ring-fenced for re-investment, so that each authority only benefited in proportion to its own level of "overpayment". The authority also proposed that scheme members should be allowed to retire on full benefits after 30 years, irrespective of age which would address age discrimination claims and would allow for the reduction of workforces without the financial and industrial relation costs associated with making compulsory redundancies.

59. On the specific issues raised during the consultation, a contributions holiday would mean that the scheme will either not be receiving as much income from employees as expected, or previous contributions made will have to be paid out from the scheme in compensation. This is likely to create a scheme deficit which will need to be recovered from employers and, if it contributes to breaching the employer cost cap, employees. The 'in year' payments to scheme members would be paid via the top-up grant as usual. Employers will need to pay their element of contributions during the contributions holiday period given that there will still be salary and longevity cost risks in respect of these individuals.

- Paragraph 42 to 44 of the Home Office paper to SAB on 14th June 2017

Paragraph 42 – The Board noted that the majority of refund payments were for the period after April 2007, and if they had fallen due at the time would have been picked up by the valuation process.

Paragraph 43 – The Board noted that any change to the employer contribution rate would not take place until after the 2020 valuation.

Paragraph 44 – The Board noted that any refund amount payable that was due to interest or unauthorised tax should certainly not be considered an employer payment and would be contested.

b. Cost Cap

i. It is the firm view of the Scheme Advisory Board that the cost of the refund payments should not form part of the cost cap calculation.

In making their decision the Board considered;

- the HMT cost cap definition
- That the majority of refunds were paid to pensioner members who had retired prior to 2015.
- Paragraphs 45 to 46 of the Home Office paper to SAB on 14th June 2017
- HMT cost cap definition

Paragraph 2.24 of the HMT policy note ‘ [Public Service pensions: actuarial valuations and the employer cost cap mechanism](#)’ published March 2014. Confirms that some measures should be excluded from it. These include pensioner and deferred members of the scheme.

“2.24 As set out in paragraphs 2.7 to 2.11, the employer contribution rates calculated by the valuations will reflect all future and past service costs associated with the schemes (and connected schemes). However, the cap mechanism has been designed so that some of these elements are excluded from it. As only active members will see their future benefits or contributions adjusted if the ceiling or floor is breached, the government considers that it would be unfair to control all of the costs associated with pensioner and deferred members of the existing pension schemes. These elements of costs will therefore not be controlled by the cost cap mechanism.”

- That the majority of refunds were paid to pensioner members who had retired prior to 2015

The Board discussed that even without the HM Treasury statement that it would be unfair to active members to see an adjustment in benefits for costs relating to members who had already retired or left the scheme.

- Paragraph 45 to 46 of the Home Office paper to SAB on 14th June 2017

Paragraph 45 – The Board noted that this was consistent with treatment of Milne payments and pensioner and deferred retained members and paragraph 2.24 of the HMT policy note that pensioner and deferred members should be excluded from the cost-cap mechanism.

Paragraph 46 – The Board noted the comment from Home Office that any payment to active members would be insignificant and would not warrant discussion over any specific treatment.

Additional Concerns

As has been reflected in previous Scheme Advisory Board meetings, the Board has serious concerns that there could be potential consequences on the past service costs due to inconsistent treatment of pensionable pay amongst fire authorities.

It is known that the effects of the Norman v Cheshire judgment have not been considered in full by all Fire authorities, and some authorities are still in the process of making these amendments some years after the judgment.

Additionally, the Board have significant concerns that there are still inconsistent interpretations of the scheme rules, whereby a) some payments which should be pensionable are not being treated as such, and b) some payments which should not be treated as pensionable, are.

In July 2016, in an effort to encourage greater consistency amongst authorities on the treatment of pensionable pay, the Board held a workshop day. Whilst the day was successful in terms of raising awareness of the problem, it confirmed that there are still significant inconsistencies in the interpretation and application of the scheme rules.

Based on this and other anecdotal evidence, the Board have concerns that there is significant potential for another Norman v Cheshire judgment in the future affecting liabilities.

The Board noted the paper published by GAD in January 2013 entitled 'Impact of some pay allowances becoming pensionable', and would note that the issues raised in the note are still significant today.

As such the Board respectfully suggest that these concerns are explored further by the Government Actuaries Department and the Home Office, and that the minister takes the opportunity to consult the Scheme Advisory Board further on this issue.