April 2021

Cost control mechanism factsheet

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The government has announced that the pause of the cost control mechanism will be lifted, and the cost control element of the 2016 valuations process will be completed. The costs of addressing the discrimination identified in the McCloud judgment (the proposals for which are set out for public consultation) will be included in this process.

What is the cost control mechanism?

The Independent Public Service Pensions Commission recommended in 2011 that the new public service pension schemes should include an employer cost control mechanism to protect taxpayers from unforeseen increases in scheme costs. Whilst the commission recommended a mechanism to protect the taxpayer from increased cost, the final negotiated mechanism is symmetrical and so also maintains the value of pensions to members when costs fall. The government made provisions to establish the cost control mechanism in the Public Service Pensions Act 2013.

How does the cost cap work?

There may be fluctuations in scheme costs between scheme valuations, which take place every four years. To avoid frequent changes in scheme design as a result of changes in member related costs, there is a 2-percentage point margin above and below a 'target cost' for a scheme. The upper margin forms a 'ceiling', with the lower margin forming a 'floor'. For example, if the target cost is set at 14% of pensionable pay, the ceiling and floor will be set at 16% and 12% respectively. At the valuations, the costs of providing the schemes are calculated and compared to the target cost. If there is a change in costs, and this measure of scheme costs rises above the ceiling or falls below the floor, costs must be brought back to 'target', which ensures that there is no long-term increase or decrease in the costs of the scheme. A long-term increase would not be fair to taxpayers, and a long-term decrease would not be fair to scheme members. Costs may be rebalanced by amending scheme benefits for future accruals, to alter the overall cost of the scheme. Scheme regulations set out a process for agreeing the necessary action with stakeholders, and a default action to be taken if agreement cannot be reached within a reasonable time limit.

What are the government's recent announcements and how do they affect members?

In January 2019, following the Court of Appeal's judgment in the McCloud and Sargeant cases, the government announced a pause to the cost control element of the 2016 valuations. It was right to pause the mechanism, as the uncertainty around member benefits arising from the court judgments made it impossible to assess the value of the schemes to members with any certainty. If the cost control mechanism had not been paused, the mechanism would probably have required schemes to adjust benefits on the basis of incorrect assumptions about benefit entitlements. The Government Actuary agreed that the policy of pausing the mechanism was reasonable.

Following the publication of the McCloud consultation, the uncertainty about scheme benefits that arose as a result of the McCloud judgment has reduced. The government therefore announced in July 2020 that the cost control mechanism will now be un-paused and the cost control element of the 2016 valuations will be completed.

The cost control mechanism is designed to take account of 'member costs' (costs that affect the value of schemes to members). The McCloud remedy proposals – to give members in scope a choice of scheme benefits for the remedy period – will increase the value of schemes to members. Therefore, the costs associated with this will be included in the completion of the cost control process. This means that results will show higher costs than would otherwise have been expected.

When it published its response to the McCloud consultation, the government also announced that it has decided to waive the impact of any ceiling breaches that arise as part of the 2016 cost control valuations process, but to honour any floor breaches. This means no member will see a reduction in benefits and be worse off as a result. This decision has been taken pending the outcome of a review of the cost control mechanism, as the government believes it would be inappropriate to reduce member benefits based on a mechanism that may not be working as intended.

What impact does the government's announcements on waiving ceiling breaches have on you as a member?

The government has decided that no member will see a reduction in their pension benefits at the 2016 valuations. However, the government has also decided that any floor breaches will be honoured, and any benefit increases that are due will be delivered.

Why is the government carrying out a review of the cost control mechanism?

The government has commissioned the Government Actuary to assess whether, and to what extent, the mechanism is meeting its original objectives. This was originally announced in 2018, confirmed in July 2020, and has now begun.

The Government Actuary is expected to report to government in April 2021. The government will then consider the report and respond as soon as possible thereafter.

The aim is to be able to implement any necessary changes ahead of the 2020 valuations process.

What does this mean for the 2020 valuations process?

The policy detail of the 2020 valuations process, and the cost control mechanism, will be set out in due course. As part of the valuation process the government has committed to providing as much notice as possible to members, employers and administrators about any changes to contribution rates.

Where can I find more information?

More information on the government unpausing of the cost control mechanism can be found via the website