HYMANS ROBERTSON

60-second summary

SCAPE rate and its impact on the LGPS

Robert Bilton
Partner and Fund Actuary

The SCAPE[1] rate is the discount rate used for the valuation of the unfunded public sector pension schemes in the UK. On 30 March 2023, the UK Government confirmed that it will continue to use long-term GDP growth as the basis for setting the SCAPE rate. Alongside this news, the Government also confirmed that the rate will reduce in line with the Office for Budget Responsibility's lower UK GDP growth forecasts.

What does it all mean?

The main impact of this news is for the unfunded public sector pension schemes such as the NHS, Teachers and Police and Fire. The results of their 2020 valuations are due to be released this year and the lower discount rate (1.7% above inflation, compared with 2.4% previously) will see contributions rise. The magnitude of the rise will vary by scheme and also depend on what happens with other assumptions, but the increase is expected to be material (in isolation, the change in discount rate could see future service rates rise by more than 5% of pay).

In the LGPS, contribution rates are not linked to the SCAPE rate. As the LGPS is funded, the discount rate is based on future expected returns from each fund's assets. However, there are secondary impacts from this news which do affect the LGPS.

Impact on the LGPS

Administration factors

The factors that are used daily to administer the LGPS, eg cash-equivalent transfer values (CETVs), early and late retirements and additional pension purchases, are based on the SCAPE rate.

The Treasury announced on 31 March 2023 that all public sector pension schemes, including the LGPS, should suspend nearly all CETV activities until the factors can be updated for the revised SCAPE rate. New CETV factors are expected in April/May as the Government is aware of the potential administration resource headaches caused by a backlog of transfer value quotations. For the other factors, we're aware that they will be reviewed over the next few months and expect updates to follow as and when progress is made. In the meantime, we understand that LGPS funds should continue to use the current factors to administer the scheme. Further information and recommended actions for Administering Authorities are set out on page 11 of LGA's recent bulletin.

[1] Superannuation Contributions Adjusted for Past Experience

With the 2022 valuations now complete, LGPS funds in England and Wales will be reviewing the factors used to calculate early retirement strains. These are provided by your actuary and based on your own funding assumptions (not the SCAPE rate). Therefore, this news doesn't affect these factors and you should continue to go ahead with the review.

Employer covenant

Whilst the SCAPE rate's impact on contribution rates does not directly affect the LGPS, there will be some employers participating in both the LGPS and unfunded schemes. We expect that most of these 'dual scheme' employers will be education establishments.

In its ministerial statement, the UK Government committed to "*…providing funding for increase in employer contribution rates resulting from the 2020 valuations as a consequence of changes to the SCAPE discount rate; this commitment is for employers whose employment costs are centrally funded through departmental expenditure.*" We therefore expect the increase in the Teachers' Pension Scheme's contributions to be cost neutral for academies and local authority controlled schools. Given their recent reclassification, this may now extend to further and higher education colleges.

However, it's very unlikely that additional funding will be granted to independent schools (most of whose teachers participate in the Teachers' Pension Scheme), and there may also be some further education establishments not entitled to the additional funding. For these employers, the increase in contribution rates in the Teachers' Pension Scheme (coming into force from 1 April 2024) could be significant and place additional burden on their finances.

There may be other instances of 'dual scheme' employers who are not centrally funded through departmental expenditure, eg those providing healthcare. In all these situations, we would recommend LGPS funds engage with potentially affected employers to understand if there's any material impact on their covenant and explore what options there are to manage any deterioration.

Cost control mechanism

The SCAPE rate is used in the cost control mechanism which applies to the LGPS. A lower SCAPE rate increases the assessed costs of each public sector pension scheme, potentially resulting in a breach of the cost control mechanism. Any breach should then lead to a change in benefits.

However, the cost control mechanism has been built such that changes in the discount rate are not allowed to lead to a change in benefits. Instead, it's only 'member costs', such as longevity and ill-health retirement rates, which are analysed as cost changes for the purpose of the mechanism. Therefore, we don't expect the SCAPE rate change itself to be a contributing factor to any breach of the cost control mechanism.

However, the SCAPE rate may have a secondary impact on the results of the cost control mechanism. Following a consultation in 2021, the cost control mechanism was updated to introduce an 'economic check'. This check takes place after the results of the cost control valuation are known. It seeks to avoid the perverse outcome of the 2016 valuation when the contribution rates for the unfunded pension schemes increased (due to a previous reduction in the SCAPE rate) but the cost control valuation indicated a reduction in costs (because member costs were lower than expected), requiring an increase in benefits.

The economic check now means the cost control mechanism takes into account the impact of a change in the SCAPE rate by offsetting it against any member cost savings identified (the economic check is not allowed to result in benefit reductions). Given the magnitude of the reduction in SCAPE rate for the 2020 valuations, it's likely that its impact will offset most, if not all, of any savings attributed to member costs at the 2020 cost control valuation. This reduces the likelihood of the 2020 cost control valuation leading to any benefit improvements. Despite the LGPS's contributions being set independently of the SCAPE rate, the same economic check applies.

If you wish to discuss any of the areas covered in this note, please contact your usual Hymans Robertson consultant.

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk

This communication has been compiled by Hymans Robertson LLP, and is based upon their understanding of legislation and events as at the date of publication. It is designed to be a general information summary and may be subject to change. It is not a definitive analysis of the subject covered or specific to the circumstances of any particular employer, pension scheme or individual. The information contained is not intended to constitute advice, and should not be considered a substitute for specific advice in relation to individual circumstances. Where the subject of this document involves legal issues you may wish to take legal advice. Hymans Robertson LLP accepts no liability for errors or omissions or reliance on any statement or opinion.

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global.

© Hymans Robertson LLP.