

Firefighters' Pension Schemes England Scheme Advisory Board

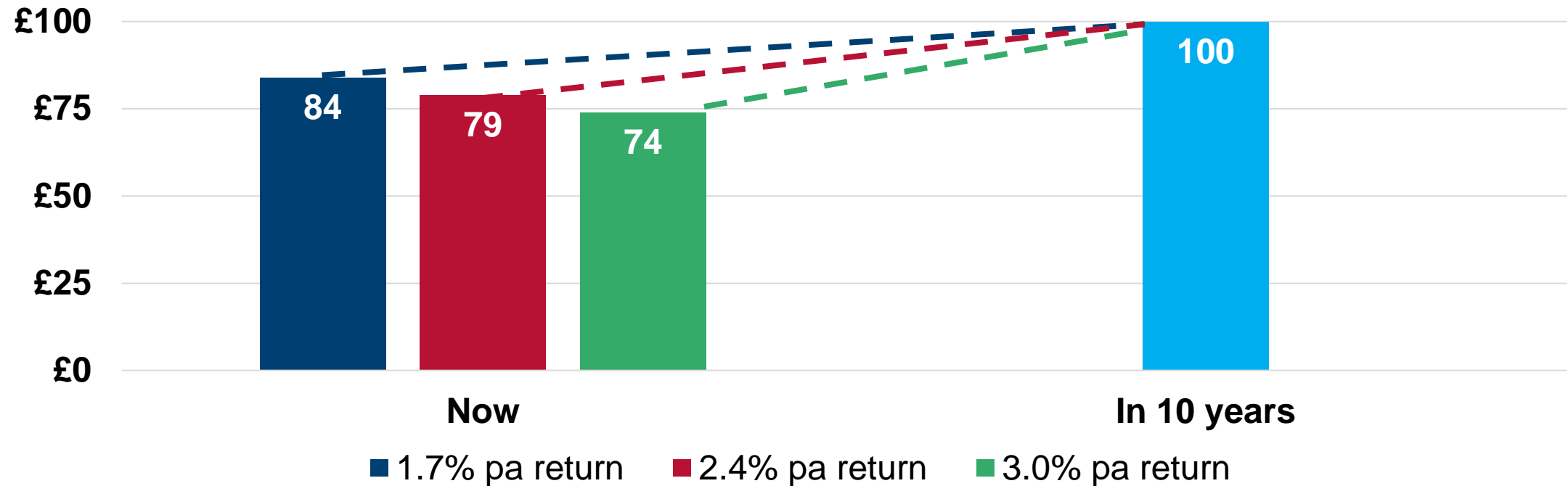
SCAPE discount rate

June 2023

Background

- The Superannuation Contributions Adjusted for Past Experience (SCAPE) discount rate is mainly used to set employer contribution rates to unfunded public service pension schemes.
- It is also used in setting actuarial factors, including early/late retirement factors, cash commutation factors in some Fire Schemes (mainly 92) and Cash Equivalent Transfer Values.
- HM Treasury issued a consultation in June 2021 to review the method used to determine the SCAPE discount rate. The methods considered as part of this consultation were:
 - Long-term GDP growth (used since 2011)
 - Social Time Preference Rate (used up to 2010)
- HM Treasury responded to this consultation in March 2023, confirming SCAPE discount rate would continue to be set in line with long-term GDP growth (set by the Office for Budget Responsibility)
- Also confirmed that the SCAPE discount rate for the 2020 valuations would be $\text{CPI} + 1.7\% \text{ pa}$

Why the discount rate matters



The lower the discount rate, the more money needed today – in other words, the higher the cost of providing future pension benefits.

Recent history of SCAPE discount rate

- SCAPE discount rate has fallen several times over the past decade.
- For 2020 valuation, HMT confirmed the SCAPE discount rate will be CPI + 1.7% pa, a reduction of 0.7% pa compared to the 2016 valuations.
- The FPS 2016 valuation results suggested that a 0.25% reduction in the discount rate would increase costs by c11% of payroll.

Year	Methodology	SCAPE discount rate (above inflation)
Pre 2011	STPR	3.5%
2011	GDP	3.0%
2016	GDP	2.8%
2018	GDP	2.4%
2022	GDP	1.7%

2020 ‘funding’ valuation

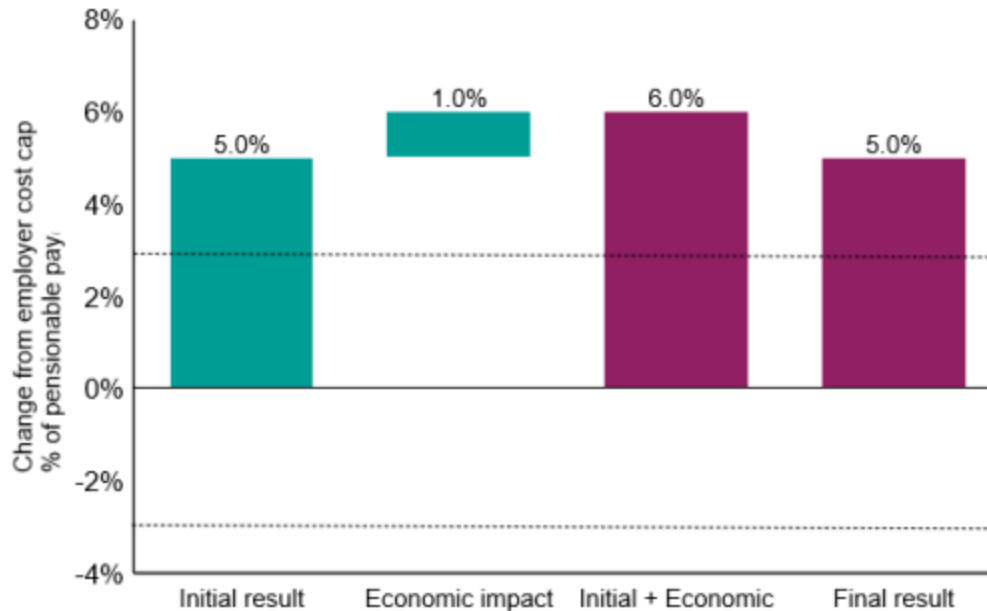
- **The exact impact is not known until the valuation assumptions have been finalised and valuation calculations carried out by GAD.**
- In isolation, a lower SCAPE discount rate will lead to:
 - Higher past service liabilities (i.e. a higher “notional” deficit)
 - Higher cost for benefits building up in the future for active members.
- Both factors above (in isolation) lead to higher employer contribution rates
- *“The Government is aware that the updated SCAPE discount rate will generally lead to higher employer contribution rates...”*

“...The Government has committed to providing funding for increases 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.”

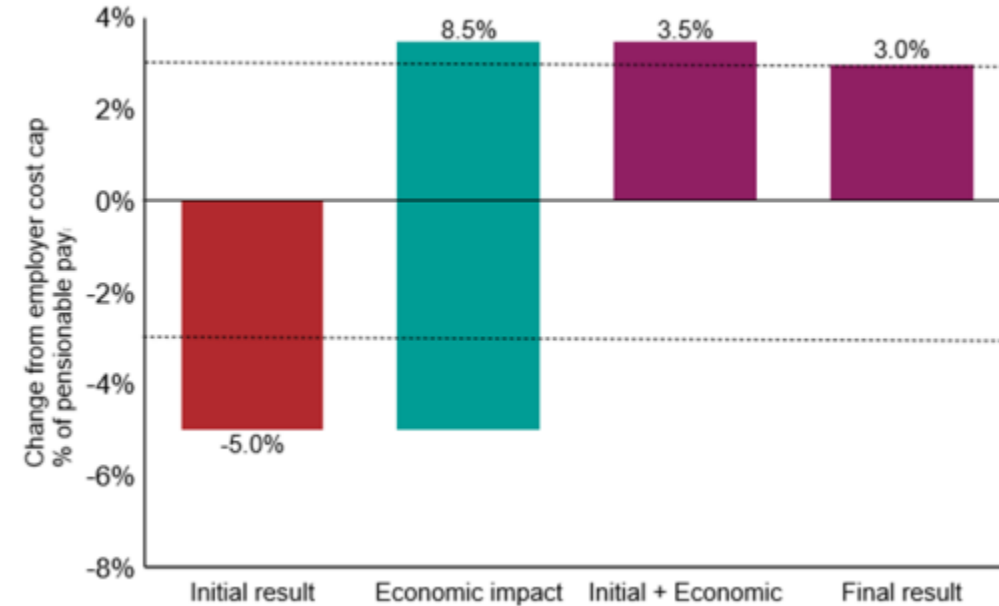
2020 'Cost Cap' valuation

- The 'cost cap' valuation excludes the impact of changes in the SCAPE discount rate, and only considers 'member costs', such as how long members are expected to live.
- However, one of the changes introduced to the cost cap mechanism in 2021 was the introduction of an 'economic check'.
- The economic check assesses the impact of the change in SCAPE discount rate on the cost cap calculation, and can reduce or remove a 'cost cap' breach.
- As a result, the fall in the SCAPE discount rate means that benefit improvements from 2020 valuations are less likely.

Economic check – possible scenarios



Example 1. Changes to SCAPE **can't** cause or increase to a breach.



Example 2. Changes to SCAPE **can** reduce or remove a breach.

Other implications

- The SCAPE discount rate is used to calculate actuarial factors. These include cash commutation, early and late retirement and Cash Equivalent Transfer Values (CETVs).
- GAD are now reviewing all actuarial factors. Revised factors for commutation and CETVs have been published, and Home Office have confirmed others revised factors (including early retirement) will be available by the end of June 2023.
- A lower SCAPE discount rate means:
 - Higher CETVs
 - Higher cash commutation factors for FPS 1992 and Special members of FPS 2006 (Modified) (i.e. members receive more cash for the same amount of pension they give up)
 - Lower early retirement reductions

Example – cash commutation

- Retirement from active at age 60 (considering FPS 1992 only).
- Assume commutes pension for the maximum lump sum permitted under scheme regulation (exchanging 25% of pension for lump sum).
- Members will receive a higher lump sum for giving up the same amount of pension.
- Commutation for FPS 2006 (Standard Members) and FPS 2015 uses a fixed factor of 12:1.

	Previous factors	Revised factors	Difference
Pension before commutation	£20,000 pa	£20,000 pa	-
Cash commutation factor (FPS 1992)	19.4	20.6	-
Cash at retirement (before tax)	£97,000	£103,000*	£6,000*
Pension after commutation	£15,000 pa	£15,000 pa	Nil

**Simplified example. In practice, additional tax charges may apply as lump sum exceeds HMRC maximum.*

Future reviews

- Government confirmed future reviews will take place in line with the valuation cycle, every four years.
- The timing of the review will be determined by HM Treasury based on the valuation timetable and the expected publication of long-term GDP projections by the OBR.
- Government hopes that aligning the review cycle with the valuation cycle will reduce the need for “out of cycle” reviews and improve the stability of the SCAPE discount rate.
- This is more relevant for members of the 1992 Fire (and 1987 Police) Schemes, as the choice of discount rate has a direct impact on members’ benefits.

Disclaimers and warnings

- This material has been prepared by First Actuarial LLP who take full responsibility for it.
- First Actuarial LLP does not accept or assume any responsibility for any consequences arising from any person, other than the intended recipient, using or relying on this material. Third parties should seek their own independent advice as appropriate.
- First Actuarial LLP hold the Institute and Faculty of Actuaries' Quality Assurance Plan accreditation.
- Regulated by the Institute and Faculty of Actuaries in respect of a range of investment business activities.
- First Actuarial LLP is a limited liability partnership registered in England & Wales. Number OC348086. Registered office: First Actuarial LLP, Mayesbrook House, Lawnswood Business Park, Leeds, LS16 6QY. Registered in England & Wales.
- First Actuarial LLP 2023 all rights reserved.