**Key points**

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on HM Treasury’s (HMT) consultation on the discount rate methodology used in public service pensions. We recognize the importance of this particularly actuarial issue.

Discount rates are at the heart of many actuarial calculations and to aid in their appropriate use, the IFoA established a framework for the use of discount rates in actuarial work. We would like to draw HMT’s attention to this framework.

We note that there are many possible discount rate methodologies, each with varying implications for scheme members, taxpayers, and other stakeholders. Many of these potential implications have political dimensions, on which, it is inappropriate for the IFoA to take a view. We therefore do not feel able to recommend any particular methodology, but in this response focus on some of the key objectives. As HMT develops specific courses of action we would be delighted to provide more detailed quantitative analyses of their outcomes and implications.

The current approach for calculating the cost of public service pensions gives results that are in many respects counter-intuitive, in that public service pensions appear to be much cheaper to provide than private sector pensions – despite the fact that public service pensions are more secure than many private sector pensions and hence more valuable to recipients.

This creates a widely held perception that the assessment of the cost of public service pensions is inconsistent with that of private sector pensions. However, we note that over the long term the actual costs are likely to be similar, and the difference between the two lies in the timing of the funding. This raises the question of whether the interests of future taxpayers are being adequately recognised.

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on the HM Treasury’s consultation on the discount rate methodology used in public service pensions. We recognize the importance of this particularly actuarial issue. We set out below our response to each of the questions on the consultation document.

**Question 1:** *Do you agree that these are the correct objectives for the SCAPE discount rate? If not, please explain why and specify any alternative objectives that you think should be included.*

1. We agree with the objectives proposed in the consultation document. However, we consider that the objectives should also encompass the impacts on scheme members and to society at large. For instance, there are other important objectives that are not mentioned. We note that the concept of a fair reflection of costs is rather ill defined, as there are many different groups of stakeholders involved, who may have inconsistent views on what constitutes fairness. We agree that employers should pay a charge that is appropriate for public service pension schemes, and suggest that approaches that produce charges that differ significantly from the charges borne by private sector schemes should provide explicit justification of the differences. In addition, we consider that the concept of fairness should embrace fairness between generations of taxpayers.

**Question 2:** *Do you believe that these are the most appropriate methodologies that should be considered? If not, please specify any alternative methodologies that should be considered and how they would fit with the government’s proposed objectives.*

1. We believe that an additional methodology should be considered: one that is consistent with the IFoA’s framework for the use of discount rates in actuarial work (available [here](https://www.actuaries.org.uk/system/files/documents/pdf/discount-rates-web-document-2.pdf)).

**Question 3:** *What are the advantages and disadvantages of a SCAPE discount rate methodology based on expected long-term GDP? If this methodology is adopted, should any of the modifications (allowing for short-term GDP projections, allowing for actual experience) be considered?*

1. A methodology based on long-term expected GDP growth does not facilitate adjustments for the cost of guarantees or for the actual experience and risks. Unlike in private sector pension schemes there is no mechanism for collecting additional contributions if actual experience of mortality and other demographic factors does not reflect the assumptions used in the cost calculations. This means that the full cost of guarantees, and the full risk of experience differing from the assumptions, are borne by future taxpayers instead of being shared between current and future taxpayers.

**Question 4:** *What are the advantages and disadvantages of a SCAPE discount rate methodology based on the STPR? If this methodology was adopted, should any modifications (allowing for the public service pension context or allowing for long-term uncertainties) be considered?*

1. We consider that there are a number of significant disadvantages of a SCAPE discount rate methodology based on the STPR. For more information see <https://www.actuaries.org.uk/system/files/documents/pdf/discountrateswebsitereportruth.pdf> and <https://www.actuaries.org.uk/system/files/documents/pdf/final040111combined.pdf>.

**Question 5:***Which SCAPE discount rate methodology do you recommend and why?*

1. We are unable to make a recommendation as we consider the methodologies all have differing implications for different groups of stakeholders, and that the final decision is a political one.

**Question 6:** *Are there any equalities impacts of changes to the SCAPE discount rate methodology that the Government should consider?*

1. We consider that that the equalities impacts of changes to the SCAPE discount rate methodology should consider intergenerational fairness and fairness between the public and private sectors.

**Question 7:** *Do you agree with the proposal for reviews of the SCAPE discount rate to be aligned with the scheme valuation cycle?*

1. Yes

Should you want to discuss any of the points raised please contact Caolan Ward, Policy Manager (caolan.ward@actuaries.org.uk) in the first instance.

Yours sincerely,

Louise Pryor

**President, Institute and Faculty of Actuaries**