Public service pensions:
Consultation on the discount rate methodology

Response of the Association of School and College Leaders

A. Introduction

1. The Association of School and College Leaders (ASCL) represents over 21,500 education system leaders, heads, principals, deputies, vice-principals, assistant heads, business managers and other senior staff of state-funded and independent schools and colleges throughout the UK. ASCL members are responsible for the education of more than four million young people in more than 90 per cent of the secondary and tertiary phases, and in an increasing proportion of the primary phase. This places the association in a strong position to consider this issue from the viewpoint of the leaders of schools and colleges of all types.

2. ASCL welcomes the opportunity to contribute to this consultation. However, HMT's consultation paper was published on 24 June 2021 and the deadline for comments is 19 August 2021. This period of eight weeks is barely more than the six week minimum. This is very short for such a significant issue especially when the consultation runs over the school holiday period. There has been little discussion of the SCAPE discount rate methodology over the past decade. Indications have been given that the announcement of any decision on the SCAPE methodology might not be made until December and that any subsequent announcement of a change in the discount rate might not happen until May 2022 at the earliest.

B. Key points

3. ASCL believes it essential to ensure an appropriate balance in identifying the costs of the public sector schemes available in schools and colleges, whilst ensuring the approach enables the schemes to support the primary objective of incentivising a high-quality school and college workforce that can effectively deliver society's needs and expectations.

   ASCL believes that the objectives adopted within the consultation are broadly appropriate for the discount rate methodology, especially the essential focus on stability. To that end ASCL strongly supports an approach based on the Social Time Preference Rate (STPR), as the only one that can achieve the key objectives set out in the consultation.

C. Answers to specific questions

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.

4. ASCL agrees that “Fair reflection of costs” and “Stability” are reasonable objectives for the SCAPE discount rate. In particular, there is the need for stability, with the SCAPE discount rate supporting Government and employers in making long-term decisions on workforce expenditure, whilst minimising unwelcome fluctuations in employer contribution levels. Lack of said stability has led to three changes in the discount rate in the last ten years leaving employers facing pension contributions almost 10% higher. This has had a negative effect of that on their ability to plan-ahead and impacted on some independent schools’ ability to remain in the Teachers’ Pension Scheme (TPS).

   The second objective, “Reflect future risks to Government income” is too uncertain to be used in any meaningful way with the risk not specific to funding future pension contributions.

   Additionally, ASCL considers a fourth desirable objective to be the encouragement of high-quality pension schemes provision, in line with wider Government policy. A crucial part of this policy is to achieve the highest possible level of participation in public service pension schemes. Individuals opting out harm their future pension prospects and are more likely to fall back on benefits in retirement. A lower SCAPE discount rate can act as a disincentive to scheme participation, as seen recently within the independent sector.

Question 2: Do you agree 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.

5. ASCL supports the shortlist of the two possible cited methodologies in the consultation, namely Social Time Preference Rate (STPR) and Gross Domestic Product (GDP), the current paradigm. ASCL is not aware of other suitable methodological candidates which could be used and concurs with the Government’s view, (paragraph 5.3), that other available methodologies are not suitable for public service schemes.

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?

6. Whilst ASCL understands the rationale behind a methodology based on long-term GDP growth, the problem is inherent instability. Linking the SCAPE rate to the most recent OBR forecast is unlikely to meet the stability objective. Consequently, with stability a key objective, ASCL does not support a discount rate methodology based on expected long-term GDP. In addition, as stated in paragraph 5.7, “Projections of expected GDP growth are reliant upon complex assumptions projected decades into the future and so inherently contain a high degree of uncertainty and volatility. The OBR’s long-term GDP projections are revised regularly, and the timing of revisions may not align with planned reviews of the SCAPE discount rate or valuation cycles.” The methodology currently in place yields a rate based on assumptions that come with a high degree of uncertainty.

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?

7. ASCL believes the main advantage of the STPR approach is that it is an accurate reflection of the process of public service pensions. The Government contracts those working in schools and colleges to accrue pension rights through working life contributions, and subsequently provides pension benefits in retirement. Such pensions are therefore a form of public investment and should be discounted in a consistent way with other public sector investments of this kind.

   STPR engenders a more stable SCAPE discount rate which in turn should create more stable contribution rates and should counter any turbulence such as recently seen in 2018, when the SCAPE rate was revised out of cycle.

   There do not appear to be any disadvantages to using SCAPE discount rate methodology based on the STPR. Consideration could be given to some allowance for long-term uncertainties, but there is no case for making an allowance for catastrophic risk as any such catastrophe would impact way beyond public sector pensions.

   ASCL does not agree with any modification to the STPR. The Government's future financial obligations are fungible and therefore the current cost will be the same for future pension provision as that for any other future financial commitments of the same amount.

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

8. It is clear from our answer to question 4 that ASCL strongly recommends using the STPR. The pre-2011 approach to setting the discount is correct. There is no coherent argument as to why HMT should depart from a well-established approach to making a current assessment of future expenditure. None of the proposed GDP methods can meet the stability objective and experience suggests that proposed alternatives for a GDP linked methodology may further volatility. No arguments have been delineated as to why a given financial commitment should be assessed differently, compared to other commitments of a like amount, solely on the grounds that it relates to a public service pension scheme. As paragraph 5.21 states when outlining the rationale for the STPR method, 'as pension promises are made to current employees but will be paid out from the Government's future income stream, pensions reflect a transfer of resources from the public sector in the future to the public sector in the present day. Public service pensions are therefore a form of investment and should be discounted in a consistent way with other public sector investments of this kind'. STPR is used across government to appraise long-term investments/projects and using it for the public service schemes would provide a consistent and sensible basis for assessing present day costs and future impacts on public spending, as it was before 2011.

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

9. ASCL does not immediately identify any direct equalities impacts because of any changes to the SCAPE discount rate methodology. There are, however, indirect effects, in that the maintenance of a good public service pension system is a key element in addressing women's inadequate pensions.

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

10. ASCL agrees that the objective for stability means that any review of the SCAPE discount rate should logically be aligned with the scheme valuation cycle. There should be no need for the proposed retention of out of cycle adjustments, as recent experience highlights the associated disruption.

D. Conclusion

11. I hope that this response is of value to your consultation. ASCL is willing to be further consulted and to assist in any way that it can.

Jacques Szemalikowski
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