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Councillor Maurice Heaster
LGA Fire Services Management Committee
Local Government House
Smith Square
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15 NOV 2012

Dear Cllr. Heaster,

Thank you for your letter of 30 August to Bob Neill MP, the then Minister for the Fire Service, regarding the allocation of employer costs for the pensions element of the retained firefighter settlement. I apologise for the delay in providing a response whilst we have been looking at your arguments in more detail.

Whilst we have not yet reached a position which would change the Government's approach, I thought that it would be helpful to provide you with a response on a couple of points in your letter, and update you on recent developments regarding how valuations will work in future in public service pensions.

How pensions were funded pre-2006

In your letter, you set out that the Government funded non-employee pension costs prior to 2006. This seems to be a common misunderstanding in the fire service. There are two elements of 'costs' relating to the payment of pensions: firstly, cashflow costs to pay today's pensioners; secondly, contributions paid in respect of future and past service costs, to ensure that the future pension promises, made to today's employees, are fully funded.

On cashflow costs, the position prior to 2006 can be summed up from an extract from the Government consultation paper, *Proposals for new financial arrangements for firefighter pensions: consultation paper*[1], published in 2005:

> "At present each Fire and Rescue Authority is responsible for paying the pensions of its former employees on a pay-as-you-go basis. This means that payment of these pensions comes out of Fire and Rescue Authorities' operating accounts. Central Government grant to Fire and Rescue Authorities includes an element for the cost of pensions but that is based on an estimate of the likely average costs rather than actual spend. Expenditure on pensions of former firefighters, like other elements of local authority expenditure, is financed only partly by Central Government (as part of Formula Grant), with the Council Tax and national non-domestic rates also contributing to covering the cost, along with cash from pension contributions made by current employees."

It is clear that whilst Formula Grant was a contributor to fire and rescue authorities' funding arrangements for pensions, it was not the only source of funds from which the payment of pensions might be expected to be made by fire and rescue authorities. Prior to 2006,

[1] http://www.communities.gov.uk/archived/publications/fire/proposalsnew

pension costs and cashflow volatility rested with fire and rescue authorities. The changes introduced in 2006 removed that cashflow volatility from fire and rescue authorities.

The Government directly took that cashflow volatility on board in exchange for the introduction of the SCAPE (Superannuation Contributions Adjusted for Past Experience) mechanism, which required employer contributions to be treated for actuarial purposes as if paid into a notional pension fund to track scheme experience (although in practice authorities paid them into the local pension account from which pension payments are met). The SCAPE mechanism deals with the second element of the cost of providing pensions, and is intended to ensure that the full costs of employing and remunerating staff are accounted for by employers. Under this arrangement, a surplus or deficit in the notional fund can arise because of changes in genuine features or experience in the pension scheme.

Grants would be been higher if access had been provided pre-2006

Whilst we have established that the Government did not fully fund pensions, even if that were the case, the financing arrangements, pre-2006, in relation to Formula Grant only took into consideration current payments to pensioners. It is unlikely that many retained firefighters would have accrued pension rights and retired between 2000 and 2006. Therefore there would have been little additional grant paid by Government to fire and rescue authorities during this period as there would have been very few retained firefighter pensioners.

Current and future arrangements for handling past service costs

The Government will continue to handle the cashflow volatility arising under the retained settlement. This has not been in question. The element of costs which you believe that Government should bear is the liability that arises as a deficit in the notional fund of the scheme, as a result of scheme experience. The Government did not fund that element of costs pre-2006, but neither did employers. It was a cost that employers were expected to bear, in future, once those pensions came into payment. In relation to retained firefighters, it was not a cost that was ascertainable until the Employment Tribunal's judgement made that clear, and the liability has not yet crystallised.

Given that the past is no indicator to arriving at a solution (and it is important to note that we are not seeking to replicate the past for employers), the current mechanism for handling past service deficits will need to inform that solution, i.e. through notional funds once the liability crystallises as a scheme deficit.

The Treasury paper, *Actuarial valuations of public service pension schemes*[2], published 13 November 2012, set out that a notional fund will be set up in the firefighters' pension scheme following the outcome of the 2012 valuation. There remains further, detailed consideration about the implementation of the notional fund in the 2012 valuation, including how the retained firefighter settlement will be accounted for, on which we remain in close contact with the Treasury.

The Government would need a compelling reason why this particular scheme deficit should be handled differently to deficits that have arisen in other schemes following the introduction of notional funds. It is this last point that we are still considering.

BRANDON LEWIS MP

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[2] http://www.hm-treasury.gov.uk/d/actuarial_valuations_publicservicepension121112.pdf