PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Eighth Delegated Legislation Committee

DRAFT PUBLIC SERVICE PENSIONS REVALUATION (PRICES) ORDER 2016

Wednesday 2 March 2016

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STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chair: Mr Adrian Bailey

† Afriyie, Adam *(Windsor)* (Con)
† Berry, Jake *(Rossendale and Darwen)* (Con)
Blackford, Ian *(Ross, Skye and Lochaber)* (SNP)
† Cooper, Julie *(Burnley)* (Lab)
† Graham, Richard *(Gloucester)* (Con)
† Gray, Neil *(Airdrie and Shotts)* (SNP)
† Hands, Greg *(Chief Secretary to the Treasury)*
† Heaton-Harris, Chris *(Daventry)* (Con)
† Jarvis, Dan *(Barnsley Central)* (Lab)
† McGinn, Conor *(St Helens North)* (Lab)
† Malhotra, Seema *(Feltham and Heston)* (Lab/Co-op)
† Mann, Scott *(North Cornwall)* (Con)
† Stride, Mel *(Lord Commissioner of Her Majesty's Treasury)*
† Stuart, Graham *(Beverley and Holderness)* (Con)
† Warburton, David *(Somerton and Frome)* (Con)
† Winnick, Mr David *(Walsall North)* (Lab)
Woodcock, John *(Barrow and Furness)* (Lab/Co-op)
† Wragg, William *(Hazel Grove)* (Con)

Alda Barry, *Committee Clerk*

† attended the Committee

Eighth Delegated Legislation Committee

Wednesday 2 March 2016

[MR ADRIAN BAILEY *in the Chair*]

Draft Public Service Pensions Revaluation (Prices) Order 2016

2.30 pm

The Chief Secretary to the Treasury (Greg Hands): I beg to move,

That the Committee has considered the draft Public Service Pensions Revaluation (Prices) Order 2016.

It is a great pleasure to serve under your chairmanship today, Mr Bailey—for the first time, I believe. Allow me to go through the background and the purpose of the order, which I will do in a little detail, if I may beg your forbearance.

In the previous Parliament, the coalition Government took the Public Service Pensions Act 2013 through the House. That was a very important Bill that provided the necessary legislative framework to implement Lord Hutton's recommendations following his independent review of public service pensions.

Lord Hutton's report set out recommendations for public service employees to continue to have access to good quality, sustainable and fairer defined benefit pension schemes. One of his key recommendations was that the Government should replace the existing final salary pension schemes with a new career-average scheme and then, when everything was ready, move existing members to the new scheme for future accruals.

The Government accepted Lord Hutton's recommendations as a basis for discussion with trade unions and employers. Following those discussions, the Government entered into proposed final agreements with the unions, all of which required the introduction of new career-average pension schemes. With the exception of the new career-average section of the local government pension scheme, which had been introduced a year earlier—an important detail I will come to—those new schemes were introduced in April 2015, with most members moving from the final salary schemes to the career-average schemes.

Although I am sure members of the Committee are well aware of the differences between final salary and career average, I will briefly explain them for the record. Under a final salary scheme, a member is paid a pension that reflects their salary towards the end of their career and their length of service. Under the new career-average schemes, a member of the scheme is paid a pension that reflects their earnings over their whole career.

Each year, members earn a pension amount calculated as a proportion of their salary. The rate at which that builds up annually is driven by the accrual rate. The better the accrual rate, the higher the proportion of their salary that builds up each month. Those new pension amounts are added to those built up in earlier years and all are then revalued to ensure that the total of those pension pots maintains a value relative to a particular metric.

The particular rate of revaluation in each scheme is carried out in line with the revaluation metric set out in the scheme design and delivered in scheme regulations. Those metrics were finalised in the published agreements, reached following discussion between schemes and the relevant trade unions. It is the metric of prices revaluation that we are here to discuss today.

Some schemes have regulations that require the accrued pension pots to be revalued in line with earnings, such as the schemes for the armed forces and firefighters. With the rest, their regulations requires them to be revalued in line with prices, or prices plus some percentage.

It is worth setting out some of the background to explain why there are such differences. The Government's starting offer for the scheme design, called the reference scheme, was an accrual rate of one sixtieth, with earnings revaluation. The uniformed services received better starting accrual rates, to reflect the younger normal pension age of their schemes.

The Government agreed, with the TUC, to enter into scheme-specific discussions with the unions representing the respective workforces, to ensure that the final designs reflected the unique nature of those workforces. However, to maintain control of costs and to protect taxpayers, the Treasury set out a cost ceiling process, whereby a scheme improvement in one area of design would result in a compensatory reduction in value of another area of scheme design; in other words, they are all designed to balance out the different considerations to arrive at something that would be within the cost ceiling.

Almost all schemes, with the exception of those for the armed forces and for firefighters, agreed to move away from the Government's preferred revaluation metric of earnings and towards a prices metric. Some schemes went for plain prices, others went for prices plus a constant—prices plus x%. At that time, the Government's preferred prices metric—this is what we are debating—for welfare and public service pensions uprating was the September consumer prices index, as it is today. In exchange for a lower value revaluation metric linked to prices, those schemes gained a faster, or better, accrual rate. This means that schemes, in discussion with the unions, agreed to have less annual uprating of pension pots in exchange for earning more pension each year. I will come back to the practical impacts of this shortly.

For the avoidance of doubt, pensions that are in payment and that are not subject to the revaluation orders we are debating today will continue to be indexed in line with the September CPI figure, although that will mean that those pensions in payment will be frozen this year. What is the purpose of today's debate? The Public Service Pensions Act 2013 requires the Treasury to choose prices and earnings figures on an annual basis. On 2 February the Government announced that those public service schemes that rely on the measure of prices will continue to use September's consumer prices index as the measure of prices revaluation. This means that a figure of minus 0.1% is to be used for the prices element of revaluation. At the same time the Government announced that the earnings measure would be the annual change in whole-economy average weekly earnings, non-seasonally adjusted and including bonuses and arrears, up to September 2015. This means that a figure of 2.0% is to be used for the earnings element of revaluation.

Where a negative figure is to be used for revaluation, as is the case here, the Public Service Pensions Act 2013 requires the order to be subject to the affirmative regulation procedure. As the prices order is negative, it is therefore the purpose of today's debate to agree this draft order so that it can come into effect from 1 April 2016. In many ways, I view this debate as being about not whether the prices figure should be negative or positive, and whether that change is minus 0.1% or, indeed, some positive figure, but whether the Government have chosen the right prices metric for revaluation.

As I said, the metric we have chosen is the September consumer prices index. September CPI, as we all know, is the Government's preferred measure of prices and is used for the indexation of public service pensions in payment, for the uprating of benefits and for the additional state pension. The September CPI figure was the measure used to revalue the career-average local government pension scheme last year when it was introduced a year earlier than the other schemes, setting an important precedent. Members may ask whether we could have chosen another measure, because CPI in September was negative this past year. It is true that we could have chosen another month's CPI figure. We could, for instance, have chosen June's or August's CPI, which would have meant that the revaluation figure was 0%. However, that would create significant uncertainty for members, for schemes and for taxpayers. I will explain this in a bit more detail.

I shall talk first about creating certainty for members. Choosing September's annual CPI figure is in line with the provisions that were agreed on behalf of members by their unions. It provides certainty for members by continuing to choose the Government's preferred measure of prices, rather than picking and choosing a different month based on the view of the Government of the day. Although I cannot commit future Governments to a decision, our decision sets a clear precedent that September CPI will be the figure used for prices revaluation, whether that figure is high, low or negative.

Mr David Winnick (Walsall North) (Lab): Would it be right to come to the conclusion that the people who are adversely affected by what is being proposed are low paid and, therefore, on very small incomes?

Greg Hands: That is not uniformly the case. I will go on to explain the three schemes that are affected: the local government pension scheme, many of whose members have been high earners in their careers; the civil service pension scheme; and the judiciary pension scheme. Although there are low-paid workers in some of those schemes, I do not accept that they are uniformly lower-paid workers; indeed, there will be some fairly high-paid workers in those schemes.

Returning to my point, scheme members want to be treated fairly and consistently, and the order we are debating today delivers that. There should also be certainty for schemes themselves. Not choosing September's CPI figure would create uncertainty for schemes. If a consistent measure of CPI was not used, schemes would find it difficult to determine what the correct measure of prices revaluation should be, both when assessing the cost of the scheme and when setting employer contribution rates.

It would not be unusual for a scheme actuary to place an uncertainty figure in the valuation if we decided not to use the standard September figure, particularly if it was considered that there was doubt about whether a consistent prices metric would be used. That would have the potential to put upward pressure on employer contribution rates, and affect the amount of money that employers have available to employ staff.

Furthermore, choosing a correct and stable measure of prices ensures fairness across schemes. That is a crucial detail. It would be unfair for those schemes that chose faster revaluation, instead of a better revaluation rate, to benefit from both fast accrual and a more generous revaluation metric than the one that they decided upon. That goes back to my point about the balance in each of the schemes that was arrived at after consultation and negotiations with the relevant trade unions.

Graham Stuart (Beverley and Holderness) (Con): Does my right hon. Friend agree that those who are tempted to suggest that we should give flexibility to the Government so that we can have a more generous position in this year should bear in mind that overall it would be unwise to trust Government to choose between various measures? Ultimately, we would expect their choice to be at the expense of the people, rather than that of the Treasury. Therefore, I applaud him for suggesting that we have total consistency and accept that consistency will apply even if the September figure goes peculiarly upward in future.

Greg Hands: Although I cannot go down the same road as my hon. Friend does about trusting the Government, I can say that his point about consistency is right. If there is any sense that the Government were able to move around between different months, according to political whim or motivation, that would introduce a huge amount of uncertainty into the schemes and open up the Government to lobbying. It would also probably open up all of us to being lobbied to choose one month or another. That might end up coming at the cost of the general taxpayer as well as creating instability in the scheme. Consistency is extremely important.

That leads me to the third area: certainty for taxpayers. To depart from what was agreed would also be unfair on the taxpayer. It is possible to argue that revaluing by 0% does not cost much, and that would be right. It would not cost that much, for now. But what about the future? If in the far future there were to be significant deflation, the cost of not revaluing negatively could be far greater. It is unfair in principle that members should be able to benefit only from the upside of inflation, while being shielded from the downside.

To illustrate my argument, I can share with you a quote from page 72 of the report from the independent review of public service pensions undertaken by Lord Hutton:

> "If there is no mechanism for reducing pensions in payment to maintain their real value then there is asymmetric sharing of risk between members and government, since government bears the risk of high inflation and members benefit from periods of deflation".

Furthermore, many other taxpayers are in defined contribution schemes. The value of defined contribution schemes, of course, goes up and down based on the

[Greg Hands]

prevailing economic circumstances at that time and the valuation of bonds, stocks and whatever else might be put into that scheme. Members of the public who are not lucky enough to be in one of the highly valuable public service pension schemes for our highly valued public sector workers, but who face uncertainty from their own defined contribution schemes, should not be expected to subsidise public servants in this way from a potential negative revaluation drawn on by deflation.

So the arguments for continuing to use existing Government policy on the preferred measure of inflation for this order are clear and compelling. I want to move on briefly to the effect the measure has on particular workers, perhaps answering some of the points raised by the hon. Member for Walsall North. The only schemes which will actually be negatively revalued directly under the terms of the Public Service Pensions Act 2013 are those for the civil service, local government and the judiciary. However, you will be interested to know, Mr Bailey, that as the ministerial pension scheme relies on the provisions of this revaluation order, a Minister's career average pension pot will also be negatively revalued. I am not looking for sympathy for myself and the Treasury Whip, but it is worth pointing out that there are knock-on effects beyond this immediate order.

I now return to the main question about the three pension schemes. To give a worked-out example, a local government worker who earns £21,000 a year will earn around £530 of pension this year. That pension pot will be revalued by minus 0.1%, which means a reduction in the nominal value of that pension pot of less than 50p. Even with a comparable pension pot from the previous year—remember that the local government pension scheme was introduced a year early—the total reduction would be less than £1. A civil servant earning £26,000 a year will earn around £600 of pension this year. That pension pot will be revalued by minus 0.1%, which means a reduction in the pension pot of around 60p. So this is not an attack on public sector pensions or on lower paid public sector workers, nor should it be portrayed as one.

In conclusion, the Public Service Pensions Revaluation (Prices) Order 2016 is an important aspect of the move towards more sustainable and fairer pension schemes for public service workers and for taxpayers. As Lord Hutton has said, these recommendations provide a balanced deal. It will ensure that public service workers continue to have good pensions and that taxpayers can have confidence that the costs are controlled. Revaluing in line with scheme agreements that have already been made is an important part of the deal and I look forward to the debate this afternoon.

2.48 pm

Seema Malhotra (Feltham and Heston) (Lab/Co-op): It is a pleasure, Mr Bailey, to serve under your chairmanship. I thank the Chief Secretary for his opening words outlining the background and the reasons we are here today. The new public servants' pension schemes introduced from April 2015, in the most part, under the Public Service Pensions Act 2013, provide for pension benefits based on career average revalued earnings, rather than final salary, following Lord Hutton's report and the negotiations thereafter. A feature of CARE schemes is that an individual builds up benefits in each year of service based on a proportion of earnings and that the earning factor is revalued each year until retirement. The Minister is right that different accrual and revaluation rates were agreed as part of the negotiations for the different schemes. In the schemes for civil servants, local government and the judiciary, the earnings factor is revalued by prices. Similar is true for NHS, teachers' and police pensions, but they feature a small uplift percentage, in line with the agreement reached, and variations in the annual accrual rate. For firefighters and the armed forces, he is right that the revaluation rate uses average earnings.

Turning to the most affected schemes, the local government pension scheme had 1.8 million active members in England and Wales in October 2015. At the end of March 2015, the UK-wide civil service pension scheme had 493,000 active scheme members. Section 9 of the 2013 Act provided for the Treasury to make orders that specify the percentage change in prices or earnings for the purposes of revaluation by reference to the general level of prices or earnings estimated in such a manner as the Treasury considers appropriate. Today's draft order fulfils that requirement in relation to the period 1 April 2015 to end of March this year. The figure specified is indeed a decrease at minus 0.1% and this order is subject to the affirmative procedure because the value is negative.

When the 2013 Act went through Parliament, the former Member for Kilmarnock and Loudoun raised the concerns of trade unions and others that negative growth would allow for negative revaluations. The then Treasury Minister, the right hon. Member for Bromsgrove (Sajid Javid), said:

> "It is important to note that the clause theoretically allows for negative revaluations. It is extremely rare for negative growth to occur. For example, CPI, the Government's preferred measure of prices, has never been negative."—[*Official Report, Public Service Pensions Public Bill Committee,* 13 November 2012; c. 308.]

The concession made was that any such order would be subject to the affirmative procedure and that Parliament would have an opportunity to debate the measure, yet such an order has been brought before the House in the first year of the scheme. Not only has it come before the House, but it comes without any proper impact assessment. The implications of the change were unclear for those who have may retired within the last year. If I understood the Minister's opening comments correctly, the change may not apply to those receiving pensions in payment who have retired in the last year and their pensions will be frozen. It would be helpful if he could reconfirm that and confirm whether any amendment to legislation is required to make it clear for the future.

The Minister also talked about how the Government came to decide on the use of the September 2015 CPI. He is right that the Treasury has a choice in this matter and will know that the year-to-date CPI figures were negative only in April, September and October. It is also the case that pensions in payment and the additional state pension are frozen rather than subject to negative revaluation, so will he explain again why the Government preferred to allow for a negative revaluation rate for active schemes rather than a nil adjustment—a point raised by Lord Whitty and others —when most observers would say that that appears far more consistent?

If the Minister has indeed decided that the change will not apply to those who have received pensions and have retired in the last year, will there be any impact and have any of those who have retired had the option to take any form of lump sum? Would there be any tax implications as a result? Has he taken legal opinion on that point, and if so what was the outcome? Does he have an estimate of the savings that he believes Government Departments will accrue as a result of the decision to apply a negative revaluation rate?

How has the decision been communicated? Will statements be sent out to scheme members, and if so when does the Minister expect that to happen? It would be helpful to hear what impact he believes the negative rate will have on confidence in the new pension scheme arrangements, and what capacity he believes is in place for any queries that people may rightly have when they receive their statement of accrued pension benefits and see that the figure has gone down. The Minister will know that MyCSP's administrative difficulties were recently the subject of a National Audit Office report. Will it answer any queries that may come in on this matter, and will it have the capacity to cope with them? Finally, what assessment has the Treasury made of whether applying a negative revaluation rate rather than a nil adjustment will breach the cap?

2.56 pm

Greg Hands: Let me see whether I can respond to the large number of reasonable questions that the shadow Minister asked me. The first thing to say is that she is right that this matter was debated during the passage of the 2013 Act, and it was pointed out that CPI could go negative in exceptional circumstances. Negative inflation is certainly not totally without precedent. It was useful that that debate was had and that Parliament approved the Act and many of the measures, including those that are now in the order. It approved the idea that if there were to be a negative revaluation, it would have to be brought to the House under the exceptional procedure, recognising that it would be an exceptional event.

Seema Malhotra: The words that were used were that it would also allow for parliamentary scrutiny, but the Minister has introduced the order without any impact assessment. What extra information will he provide?

Greg Hands: It is clear that today's debate allows for parliamentary scrutiny, but the hon. Lady asks about an impact assessment. The impact will be fairly clear, and I will give some more examples.

To illustrate the amounts that we are talking about, let us compare workers in two different schemes, the local government scheme and the NHS scheme, both earning £26,000 a year. The local government worker will have earned about £40 more in their annual pension than the NHS worker, because of the trade-off between the revaluation and accrual rates. Because the revaluation rate will lead to a less favourable calculation for the local government worker but a more favourable one for the NHS worker, the local government worker's pot will be reduced by 50p next year, whereas the NHS worker will get £7 more. Someone in the teachers' scheme who is on £26,000 will also get about £7 per annum based on the revaluation. On the question of pensions in payment, there is a statutory link, so public sector pensions in payment will be frozen for the year without the need for new legislation or a further order.

The hon. Lady asked about the three months of negative CPI. I come back to the five main reasons why we have chosen to use the September CPI figure. First, we should set a precedent of using the CPI month that is most frequently used across Government. Secondly, in terms of the risk sharing, not only should scheme members benefit from the upside risk of revaluation but they should not be shielded from the downside risk. The third reason is consistency. Choosing a figure that is different from the September CPI figure would introduce the idea of significant policy discretion, going back to the point raised by my hon. Friend the Member for Beverley and Holderness, which would open up scope for lobbying and negotiations in an area where one wants a long-term degree of certainty. I think that would be a very unhelpful and unfavourable development.

The fourth reason is that this figure honours the pension settlement. Many of the schemes reached agreement through negotiations with the unions on the basis of CPI-linked revaluation. Choosing the correct CPI figure helps to deliver on that settlement. The final point is about fairness across the schemes. Schemes that choose faster revaluation instead of a better revaluation rate should not be able to benefit from both fast accrual and a more generous revaluation.

Mr Winnick: The Minister has been telling us that it does not make that much difference and that the impact will be minimal. He said in an aside that ministerial pensions would also be affected. As he said, we will not be in great tears about that. Is it not a fact that in practice the CPI does not take into account housing costs, while RPI, which was used previously, did? Although the Minister minimises the impact through the figures he has given, the fact is that those on low income will undoubtedly find their income that much less, taking into account housing costs and the rest. I am not satisfied by any means that this measure is neutral and that it does not matter at all to the people to whom I have referred.

Greg Hands: Let me seek to answer that point. The Government announced in June 2010 that CPI would be used as the most appropriate measure of general level of prices for most benefits and the indexation of public service pensions. There was a legal challenge to that and the decisions of both the High Court and Court of Appeal ruled in the Government's favour, finding that CPI was appropriate for both benefits and pensions uprating.

The third point I would make—

Mr Winnick *rose—*

Greg Hands: Let me answer the first question. The hon. Gentleman will have a longer memory than I have, but RPI has also gone negative in the past. It is not impossible that exactly same phenomenon could happen with RPI, his preferred measure of inflation.

Richard Graham (Gloucester) (Con): I think I am right in saying that RPI was negative in 2008, during the great recession. It is a constant hazard of recessions

[Richard Graham]

that there will be those negative indicators. Am I not also right in thinking that the main reason why CPI was chosen over RPI was precisely that the vast majority of pensioners are not still paying off their mortgages, whereas those people who are have predominantly not retired?

Greg Hands: My hon. Friend is right. For all kinds of good reasons the Government made the decision to move this whole sector of public pensions and benefits from RPI to CPI. I think he is right that at that time RPI had gone negative.

If I could answer the final couple of points from the hon. Member for Feltham and Heston—

Seema Malhotra *rose—*

Greg Hands: Shall I deal with these two and come back to the hon. Lady if I have not answered satisfactorily?

The Chair: It is your prerogative.

Greg Hands: Thank you. All scheme members will receive annual benefit statements setting out the revaluation amount. I am confident that members will understand that, where the unions and Government agreed the terms of the scheme, this agreement must be upheld.

In terms of the savings accrued by Government Departments, if I understood the question correctly, no savings have been assumed, as is consistent with the scheme rules, whatever the prices are. The majority of these pensions will not come into payment, of course, for many years. This is about consistency with the proposed final agreement so that they are fair to workforces, schemes and the taxpayers. I will give way and, if I have not answered all the hon. Lady's questions, I will come back.

Seema Malhotra: I want to probe the Minister further on a few points that he missed or on which I am not completely clear. I understand that pensions in payment are frozen but may I check that in the particular circumstance of those who retire in-year in any month from April onwards, they will not be subject to a reduction? The implications are clear, because that means that any pension paid to members who had retired in-year would be reduced effectively and may have resulted in an overpayment—an unauthorised payment, with tax implications. In this particular circumstance, which may be a slight anomaly, can the Minister provide an absolute guarantee that no legislative change is required and that those who have retired in-year will not be adversely affected? Have any of those who have retired taken any lump sum payments and, if so, are they potential overpayments or not subject to such overpayment under the current law? When will the Government send out statements? Will it be possible to respond to queries that will inevitably be sent to the mailboxes of Opposition Members and to the Minister and others about statements that appear to show that members' accrued pension rights have gone down? Where will those queries be answered? Who will constituents call, and will there be capacity to respond?

Greg Hands: Let me try to answer those further questions. The annual benefits statements will be sent out in the usual way. I am confident that members of schemes will understand what has happened and they will be told about the September CPI figure. I am confident that such inquiries will be dealt with in the usual way. In terms of pensions in payment, I am prepared to reassure hon. Members that we will deal with this complex matter. It is a slightly anomalous matter, which may require a legislative amendment or a small change to the schemes, but I assure the Committee that members will not be adversely affected in the particular case of an in-year withdrawal from the scheme.

Detailed impact assessments were prepared for the new scheme designs and were published by each Department. They will have taken into account prices impacts. The order implements the prices elements of those schemes designs and therefore there is no need to conduct a separate impact assessment for the technical implementation of what has already been decided and laid out.

To revalue using the September CPI figure, which is the subject of the order, is a very important step for the Government to take to be consistent and to set a consistent precedent that will be easily understood. It was for the Government to choose a measure of prices for the purposes of revaluing the prices element of the new career-average public sector pension schemes. The Government have chosen the measure that was agreed with the schemes after negotiation with the unions, following the precedent set by last year's revaluation of the local government pension scheme and also the measure used for indexation of public services pension in payment. I should also re-emphasise that it maintains the real value of these pensions, ensures that there is an appropriate sharing of risk between members and Government and, importantly, that it sets the right precedent for the future. I therefore urge the Committee to support the order.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Public Service Pensions Revaluation (Prices) Order 2016.

3.10 pm

Committee rose.