Key decision: Not applicable
Unrestricted

Report to Pensions Committee

23 October 2020

Scheme Changes

Report by Director of Finance and Support Services

Summary

The report includes a summary of significant developments that impact the Fund. The McCloud judgement was determined in summer 2019 and the Government published a consultation on the remedy in July 2020. The Fund now needs to put in place procedures to ensure it complies with the amended Regulations introduced to comply with the judgement. The potential workload on the pensions administration team is summarised below. As a result of the McCloud judgement, the previously paused cost mechanism is now commenced with a proposed completion date in 2021.

The report also sets out the issues arising from:

- the Goodwin case whereby an Employment Tribunal has determined aspects of the Teachers Pension Scheme (and therefore potentially aspect of the LGPS) are discriminatory on the grounds of sexual orientation.
- Exit Payments in Local Government which, through primary and secondary legislation, put in place an overall cap on the value of public sector exit payments at £95k and amends LGPS regulations which will impact on redundancy packages for all LGPS members, whether the £95k exit cap is breached or not.
- Further changes to the LGPS Regulations in relation to the ability for employer contributions to be reviewed between formal valuations, to agree payment plans when employers have ab exit debt and the introduction of a deferred employer status – whereby an employer continues to contribute to the Scheme even after their last active leaves, rather than being considered an exiting employer.

Recommendations

(1) The update, including the impact on the pensions administration team and the actuary is noted.

(2) The amendments to the funding strategy statement as a result of employer flexibilities are agreed.

Proposal

1 Background and context

1.1 The benefit structure of the LGPS is set nationally. In April 2014, a series of changes were made to the Scheme to reform the benefits structure. These changes were implemented as part of a wider project across Government to reform public service pensions and put them on a more sustainable, affordable and fairer footing for the longer term. Some protections introduced as part of the reformed benefit structure have since been challenged on the grounds of discrimination, and a resultant pause was place on mechanism introduced to protect the taxpayer from increased costs (cost mechanism).

1.2 Separately the Government has faced further challenge about discriminatory provisions with public sector Schemes (Goodwin), introduced changes to limit exit packages from the public sector to £95,000 and provided a further partial response on its May 2019 consultation on changes to the local valuation cycle and management of employer risk.

2 Rectification as a result of the McCloud judgement

2.1 In June 2019, the Supreme Court rejected the Government's appeal against a ruling which found that the transitional protection introduced to the firefighters' and judges' pension schemes in 2015 amounted to age discrimination for younger workers.

2.2 MHCLG have now set out proposals to remove the unlawful age discrimination identified in the McCloud judgment from the Local Government Pension Scheme. Similar proposals have been set out by HM Treasury for unfunded public service pension schemes (NHS in England and Wales, NHS Scotland, Teachers in England and Wales, Teachers in Scotland, Fire in England, Fire in Wales, Fire in Scotland, Police in England and Wales, Police in Scotland, Civil Service in Great Britain, UK Armed Forces, and the Civil Service).

2.3 The remedy extends the 'transitional protections' underpin that was promised to active members in 2012 who were within 10 years of normal retirement age to all other active members, regardless of age. This underpin gives a member the better of Career Average Revalued Earnings (CARE) or final salary benefits for the eligible period of service.

- Eligibility is restricted to members who were active in the LGPS on 31 March 2012 and who went on to have membership of the CARE scheme (from 1 April 2014), without a break in service of 5 years.
- The underpin period applies between 1 April 2014 and 31 March 2022, but ceases when the member leaves active membership or dies in service;
- The final salary for comparison purposes applies at the point that the member leaves active status or reaches age 65 therefore preserving the final salary link beyond 2022 as long as they are accruing benefits.

2.4 The changes will be retrospective and will apply to anyone who has left, retired or died and who meets the eligibility criteria. In some cases, this will mean retrospectively recalculating benefits for pensioners, and paying arrears and interest.

2.5 The Consultation closed on 8 October 2020 and the County Council's response has been included (Appendix A). In summary the County Council:

- Agreed that the proposal from Government is consistent with the Court of Appeal's ruling (backdated to 1 April 2014), that the changes remove the discrimination highlighted in the McCloud case, that the changes should apply to members of all ages and that the underpin should be until 31 March 2022 (per the previous protections).

- Highlighted in a number of places the work required in relation to data collection and to assess the impact on member benefits (our estimate indicates that over 16,000 member records need to be reviewed), the lead in time required for software providers to develop their programmes to support the changes and the need for consistency and guidance where gaps are present in the data. In respect of the latter we ask for clarification about what is considered to be 'reasonable efforts' and welcome the data collection templates introduced by the LGA which assists with consistency.

- Highlighted some areas where it would be beneficial to have clarity (whether specific members are considered to qualify for the underpin and how the changes interact with the Exit Payment Regulations) and refer to potential further legal challenge from younger members as a result of the proposed remedy not extending the underpin protection to those who joined the Scheme after 31 March 2012.

- Referred to the importance of clear, consistent communication across the LGPS and across all Public Sector Schemes and the impact that the changes will have on the clarity of the Annual Benefit Statements

- Advised that from a funding point of view the 2019 valuation included additional prudence and therefore we do not anticipate revisiting employer contribution rates until the 2022 valuation.

<u>Potential scope of the administrative work required</u>

2.6 The changes present a significant challenge to administering authorities and to employers, not least of which will be a major data collection exercise to enable the final salary underpin to be calculated. Whilst benefits accruing from 1 April 2022 will be career average for all members, the new underpin will require 2008 scheme pay to be recorded for some members for the next 40 years. In addition, for the period from 2014 to 2022, changes in part time hours and service breaks will need to be collected and allowed for.

2.7 As well as collecting the required data the Fund will need to make changes to ongoing administrative systems, update its processes and communications to account for the changes, recalculate and compensate leavers since 2014 if they are impacted by the change and revise how the Fund recalculates leavers' benefits. This represents a significant task.

2.8 Current estimates indicate that over 16,000 member records would require review as a result of the revised underpin.

2.9 The additional resource required to review and rectify member records will be chargeable to the Pension Fund.

<u>Quantifying the funding cost for each employer</u>

2.10 The Fund Actuary does not expect the McCloud remedy to have a significant impact on liabilities or contributions rates for most employers.

2.11 The following actions have been taken by the team:

- The administration team have regular project calls with Civica who provide pension administration software, to develop their response to the changes required and the team are working to scope the likely resource requirement based on members in scope.
- A member news article was provided on the website, which navigates members to the Local Government Association (LGA) Questions and Answers document and regular communications have been provided to employers, via stop presses, updating them of the latest position from LGA and Ministry of Housing, Communities and Local Government (MHCLG). These communications have included the data collection requirements and a data collection spreadsheet.

3 Unpausing of the Cost Mechanism

3.1 The Independent Public Service Pensions Commission recommended in 2011 that the new public service pension schemes should include an employer cost control mechanism to protect the taxpayer from unforeseen increases in scheme costs. The government accepted this recommendation and made provisions for the establishment of such a mechanism in the Public Service Pensions Act 2013 (the Act).

3.2 Two mechanisms were introduced for the LGPS to assess the costs of the reformed scheme: the employer cost cap (ECC) process as operated by HM Treasury, and the future service cost (FSC) process as operated by the LGPS Scheme Advisory Board. It was intended that the Scheme would be assessed every three years against the cost control mechanisms using the data provided to individual actuaries for funding valuations. Both processes could lead to changes to the scheme design or to the level of members' contributions if the mechanisms demonstrate that the cost of the LGPS has moved sufficiently from the target.

3.3 Whilst the government worked to address the unlawful discrimination identified by the courts (McCloud) work on the cost control mechanism was paused. Uncertainties about benefit entitlements have receded and therefore the employer cost cap process will now be restarted. The objective would be to complete the process by next year, taking into account the cost of the proposals to remedy age discrimination as set out in the McCloud consultations.

3.4 At present this is being kept under review but there is no immediate action.

4 Discrimination on the grounds of sexual orientation (Goodwin)

4.1 The Goodwin case relates to a recent tribunal ruling around discrimination on the grounds of sexual orientation, whereby the survivor benefit payable to a male spouse of a female member is less than the equivalent benefit payable to a female spouse of a female member.

4.2 This only impacts the survivor pensions of female members with pre-1988 service who die after 2005. Therefore

4.3 At this stage it is unclear if the Government intend to challenge this ruling and to date, there are no draft regulations or consultation on how to rectify impacted members. However for the reason set out above it is anticipated that there will be a very small overall impact on liabilities, particularly given prudent assumptions made by the Fund Actuary in relation to spouses' pensions for the West Sussex Scheme.

4.4 At present this is being kept under review but there is no immediate action.

5 Exit Payments in Local Government (£95k Cap)

5.1 In 2015 the Government first announced its proposals to prohibit six-figure exit packages from the public sector, by imposing a £95,000 cap on such packages.

5.2 The overall legislation applies to exit packages for local government employers (mainly, but not exclusively, councils and academy trusts

5.3 Primary legislation (Restriction of Public Sector Exit Payment Regulations 2020) has been brought in to put in place an overall cap on the value of public sector exit payments at £95k. This applies to all public sector employees in the LGPS (and the unfunded public sector schemes).

5.4 Secondary legislation for the LGPS, currently out for consultation by MHCLG, puts in place flexibilities for members to manage the £95k cap, but also includes amendments to the compensation regulations which will impact on all LGPS members, whether the £95k exit cap is breached or not. The consultation will close on 9 November 2020.

5.5 The timing differences between the primary and secondary legislation coming into force creates a period of uncertainty for employees at risk of redundancy and for employers in understanding the costs.

5.6 The following aspects are highlighted:

- Total exit packages including strain cost cannot exceed the overall cap contained in the Exit Payment Regulations (£95k). Without the secondary legislation, if the £95k cap applies, the member would be required to pay the difference between the value of their exit package and £95k in order to receive their pension unreduced. However guidance is expected on how the timing difference between primary and secondary legislation should be dealt with by Administering Authorities.

- The combination of the primary and secondary legislation means any member retiring on redundancy grounds, regardless of the value of the redundancy package, whose LGPS benefits go into immediate payment (unless fully reduced) will receive no discretionary redundancy payment. In addition, they will effectively lose their statutory redundancy payment as the member will have to pay the Fund a sum equal to their statutory redundancy payment or their pension will be reduced to recoup this amount. Those on low pay will be impacted. It is expected that (through secondary legislation) members will have the right to choose which elements they want to give up (currently all provided in full):

Option	A	B	C	D
Statutory Redundancy	None	Full	Full	Full
Discretionary Redundancy	None	None	Full	Full
Pension Payment	Full	Partially reduced	Fully reduced	Deferred

5.7 There is considerable uncertainty for members, employers and funds on how to deal with the new legislation and the sector, particularly the actuaries are working with government to gain clarity

5.8 If the changes proposed go ahead the administration involved will be significantly increased to ensure that the correct payments are made given exceptions and some options for the member. Delays in the GAD factors and software updates will also impact.

5.9 The following steps have currently been taken:

- The administration team have made employers aware of the approval by the House of Lords of The Restriction of Public Sector Exit Payments Regulations 202, provided a summary of the impact on members and notified employers of the MHCLG consultation to amend the Local Government Pension Scheme (LGPS) regulations to allow for the Exit payment regulations coming into force.

- Employers have been advised that the administration team will continue to provide redundancy estimates, however these will be caveated that they are calculated on current regulations and strain cost factors which are due to change. The communication also advises that employers will need to have regards for the pending changes and ensure they communicate accordingly with their employees who may be impacted.

5.10 It is assumed there will be a further consultation in due course when draft regulations, although time is now tight to get this in place by the end of 2020.

6 Further changes to the LGPS Regulations - Employer Flexibilities

6.1 MHCLG has published new Regulations on employer flexibilities which will come into force from 23 September 2020. This follows their consultation in May 2019 on changes to the local valuation cycle and management of employer risk.

6.2 The newly introduced flexibilities relate to:

- The ability to review contribution rates between formal valuations due to significant changes to the liabilities (already allowed), significant changes in covenant (this is new) and if an employer requests it (this is new).

- The power to agree payment plans when employers have exit debts.

- The introduction of deferred employer status, which allows an employer to stay in the Fund even if their last active leaves with contributions set at triennial valuations (for deficit recovery).

6.3 The update to the Funding Strategy Statement has been prepared by Officers to ensure that this opportunity is not increasing risk to the Fund by limiting the circumstances which this option might apply (i.e. where there is a guarantee from a secure scheduled body still active in the fund, or those that have a sufficiently strong covenant (in which case they will need to consider how this might be assessed)). As a result the Funding Strategy now includes:

- A definition of a "Deferred Employers" as "a Scheme employer which enters into a deferred debt agreement with the Administering Authority to defer their obligation to make an exit payment and continue to make contributions at the secondary rate ("a deferred debt agreement"). Further information about Deferred Employer status has been included under "Exiting employers"".

- The basis for setting employer contribution rates for a "deferred Employer" using the same discount rate as prior to their deferral, with a probability of meeting their funding target of 75% (which is the most prudent basis for employers participating in the Scheme) using a maximum time horizon of 50% of the duration of the liabilities or a period set by the Administering Authority.

- To reflect that the Administering Authority will consider a request from the Scheme employer to review contributions where the Scheme employer has undertaken to meet the costs of that review and sets out the reasoning for the review (which would be expected to fall into one of the above categories, such as a belief that their covenant has changed materially or significant restructuring impacting their membership).

- To advise that "Except in exceptional circumstances such as an employer nearing cessation, market volatility, and changes to asset values will not be considered as a basis for a change in contributions outside a formal valuation".

- To set out the basis for a Deferred Debt Agreement.

The section from the Funding Strategy Statement in relation to Exiting employers which covers this fifth aspect has been appended as this reflects the most substantial amendments.

7 Other options considered (and reasons for not proposing)

7.1 N/A

8 Consultation, engagement and advice

The County Council receives advice from its actuarial advisers, Hymans Robertson, the Local Government Association and Scheme Advisory Board in relation to Scheme matters. Legal advice is sought as appropriate.

9 Finance

The Pension Fund will be required to cover additional resourcing costs associated with the McCloud rectification work. The impact will be discussed with the administration team.

10 Risk implications and mitigations

The following risks from the Pension Fund's risk register are considered relevant in the context of this report:

Risk	**Mitigating Action (in place or planned)**
Insufficient resources to comply with the Administering Authority's Regulatory responsibilities.	Work closely with the administration team on the response to the Scheme changes and the resource impact.

11 Policy alignment and compliance

The Business Plan includes the objective to implement Scheme changes and consider, respond to and communicate with stakeholders on relevant matters.

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Appendices

Appendix A - Amendments to the statutory underpin – Response by West Sussex County Council

Appendix B – Extract from Funding Strategy Statement (Exiting Employers)

Background papers

N/A