

MERSEYSIDE PENSION FUND

PENSION BOARD

14 SEPTEMBER 2020

SUBJECT:	PROPOSED McCLOUD JUDGMENT REMEDY AND LGPS CONSULTATION
REPORT OF:	DIRECTOR OF PENSIONS

1.0 EXECUTIVE SUMMARY

- 1.1 On 16 July MHCLG released the much-anticipated consultation on the McCloud remedy for the LGPS in England and Wales, a 12-week consultation covering extensive detail on how the remedy will be applied. The Fund's officers will be responding to the consultation as part of planning for the implementation of the remedy.
- 1.2 Separately the Government has announced that the 2016 Cost Cap HMT assessment for all public sector schemes will be unpaused and critically that the McCloud remedy is to be included in the assessment of the impact on member benefits.
- 1.3 A contribution rate assessment for the McCloud remedy was calculated at the 2019 valuation for Fund employers and the calculations were generally done in line with the proposed underpin in the consultation. Some employers made a provision in their contribution rates and we would not expect to revisit this allowance until the next valuation. For other employers, the Funding Strategy Statement allows us to revisit this where appropriate once the remedy is finalised.

2.0 BACKGROUND AND KEY ISSUES

- 2.1 On 16 July MHCLG released the much-anticipated consultation on the McCloud remedy for the LGPS in England and Wales, accessible at:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901173/Condoc - amendments to LGPS underpin - FOR PUBLICATION.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901173/Condoc_-_amendments_to_LGPS_underpin_-_FOR_PUBLICATION.pdf)

- 2.2 In addition, the Government announced that the 2016 Cost Cap HMT assessment for all public sector schemes will be unpaused and critically that the McCloud remedy is to be included in the assessment of the impact on member benefits; the announcement is accessible at:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901141/Update on the Cost Control Element of the 2016 Valuations.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901141/Update_on_the_Cost_Control_Element_of_the_2016_Valuations.pdf)

The Scheme Advisory Board will need to consider the implications of this in relation to their separate assessment of the LGPS cost cap and its interaction with the HMT assessment. This could mean that the overall cost of McCloud will be offset in part or entirely when the outcome of the 2016 Cost Cap assessment is known.

- 2.3 The key feature of the proposed remedy was broadly as expected in that the final salary scheme underpin is to be extended to a wider group of members for service up to 31 March 2022.

However, there are a small number of areas of detail, which were unexpected, and the Fund will need to carefully consider the practical and financial impacts of this. A key change in the underpin means that the Fund will need to revisit all eligible members since 1 April 2014 including members who no longer have a benefit entitlement e.g. deaths or transfers out.

- 2.4 The proposed remedy brings significant Governance, Data (collection and verification), Communication and Training challenges for the Fund. Whilst we have or expect some centrally produced materials and templates it will take careful planning and resourcing to ensure that the implementation is as smooth as possible.

- 2.5 The number of “in scope” members since 1 April 2014, based on the consultation proposals for the Fund is **34,255** which is a significant undertaking in terms of implementation so will entail careful project and resource management – including potential recruitment or outsourcing of tasks. It will also have an effect on resources and costs for employers.

- 2.6 A contribution rate assessment for the McCloud remedy was calculated at the 2019 valuation for the Fund employers and the calculations were generally done in line with the proposed underpin in the consultation. Some employers made a provision in their contribution rates and we would not expect to revisit this allowance until the next valuation. For other employers the Funding

Strategy Statement allows us to revisit this where appropriate once the remedy is finalised. Consideration will also be needed to whether employers will be requested to adjust contributions once the outcome of the consultation is known later this year.

BACKGROUND HISTORY

2.7 A brief background on the McCloud judgment is as follows.

- Public Sector Schemes introduced major changes to their scheme designs in 2014 (LGPS) and 2015 (other Public Sector Schemes) namely:
 - Career average instead of final salary from 1 April 2014
 - Increase in normal retirement age (NRA) to State Pension Age
- Transitional protection / underpin for active members who were 10 years away from previous NRA (generally age 65) as at 01/04/2012
- The protection compares the benefits payable under the current rules with the benefits that would have been paid if the Scheme had not changed in 2014, with the higher amount paid.
- This protection was challenged by Judicial (Victoria McCloud) and Firefighter's pension schemes as being age discriminatory and became known as the McCloud case.

2.8 In December 2018, the Supreme Court issued a judgment that the protections were age discriminatory and a process commenced culminating in MHCLG releasing the much-anticipated consultation on the McCloud remedy on 16 July 2020. The consultation is open for 12 week and provides extensive detail on how the remedy will be applied.

2.9 It is acknowledged in the consultation document that the proposals will place a huge burden on Funds in relation to data collection, administration, governance, member and employer communications. In addition, there will be an upfront training and education requirement to ensure all stakeholders have the required knowledge to understand the implications.

KEY FEATURES OF THE PROPOSED REMEDY

2.10 The consultation itself is extremely detailed and has 29 questions for consideration with the inclusion of draft Regulations which will be retrospective to 1 April 2014. The level of detail suggests to us that very careful consideration has been given to ensuring as far as possible there are no remaining elements of potential age discrimination. Given that, we would expect the majority, if not all, the changes proposed to be taken forward, the

critical aspects to consider for the Fund are the practical application of the proposals – in particular, in cases where the required data is unavailable or very difficult to obtain.

2.11 A summary of the remedy proposals are set out below:

- The eligibility conditions for the final salary underpin will now exclude the age criterion but are still only applied to active members of the scheme at 31 March 2012
- The underpin will, however, cease to apply for all members in respect of pensionable service from 1 April 2022.
- The underpin will now also apply to members leaving but not immediately drawing benefits, whereas it previously applied only on the sooner of retirement or reaching Normal Pension Age.
- Members benefits are not changed for the impact of the underpin until retirement (“the underpin crystallisation date”), but members need to be informed of the position should they leave pensionable service before retirement. In this situation, the underpin will then need to be re-tested at the point of retirement to allow for the impact of any early/late retirement factors that may be applied.
- The differences in how the new underpin will operate will retrospectively apply to all eligible members and even for those members previously covered by the underpin.
- The underpin will apply only where benefits are aggregated. As this could mean a loss of underpin for some existing members, there will be a 12-month election window where members can opt to retrospectively aggregate benefits thereby retaining the underpin across all service.
- Any increase in benefit due to the underpin will count for Annual Allowance purposes only in the year of the underpin crystallisation date.
- The underpin will have to be revisited for members who have died or transferred out since 2014 which will add complexity to the implementation.
- MHCLG estimate the cost to LGPS employers of their proposals will be £2.5bn over the coming decades, as protected members retire and begin to receive their benefits. The Fund Actuary assessed the cost on the Fund at the 2019 valuation. Allowing for the underpin to cease at 2022 the total estimate is an increase in liabilities of £90m across the Fund which will be funded through increase contributions over the coming years (all other things equal). The impact varies depending on the membership profile of each employer and also crucially, it will depend on the actual pay progression of the in-scope members in the future. The lower the pay growth the lower the cost and vice versa.

2.12 Whilst limiting the underpin to service up to 2022 is welcome in terms of limiting the application of the underpin, the change in the existing underpin and its retrospective application add complexity and cost in a number of areas.

The **collection** and **validation** of the historic data from employers will be critical to implementing the final remedy. The Fund has continued to collect some of the key data items from employers since 1 April 2014 but will need to work with employers to verify this data and consider what is outstanding, not available or very difficult to obtain e.g. historic service breaks or changes in hours. An initial consideration of this data exercise will assist in the Fund response to some of the questions posed in the consultation around the difficulty of gathering the data.

3.0 IMMEDIATE ACTIONS, IMPACTS & CONSIDERATIONS

- 3.1 It is imperative that the Administering Authority responds to the consultation and considers the project to implement the remedy.
- 3.2 The scale of retrospection has significant consequences for the delivery of the project and administration of the Fund, which will require additional resource and potentially external support. Consequently, it will incur further operational costs to implement the proposals for the **34,255** “in scope” members of the Fund over the coming months and years.
- 3.3 In addition, software providers will need to develop automated approaches to loading the required data and also performing the calculations, which will incur costs for the Fund
- 3.4 To assist in mitigation of cost and commonality of application of the remedy across the LGPS, there are templates for data collection from employers and there will be template communication materials produced by the Scheme Advisory Board and LGA. The Fund will use these as much as possible to assist in the project.
- 3.5 It is also critical that the Administering Authority considers with employers how the additional costs of the remedy are funded for those employers who did not make an allowance in their contribution rates at the 2019 valuation. This will need to be considered once the consultation outcome is known but employers need to be made aware of this at an early stage.
- 3.6 There are also consequences for Fund employers, which should not be underestimated. Employers will need to provide the required data going forward as well as assist the Fund with any missing or incorrect historic data. This will place a burden (and likely cost) on the employers, which will vary depending on the availability of the required data and the quality of the data (including that collected already). Employers are likely to need training in this area to cover the requirements of the Fund and their legal duty once the

outcome of the consultation is known. However, this process should start now in terms of keeping employers informed on the consequences of the remedy.

4.0 **RECOMMENDATION**

As the implementation of the final remedy will be required under legislation and guidance once the outcome of the consultation is finalised it is recommended that the Pension Board affirm its support for the approach proposed by officers to develop the project plan for implementation and for use as a basis for responding to the consultation.

This will also inform the costs and resourcing requirements associated with the implementation project. In addition, a process of communication with employers needs to be developed setting out the requirements and also allowing the Fund to understand areas of potential difficulty.

**REPORT
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