TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 8

TEESSIDE PENSION BOARD REPORT

2 NOVEMBER 2020

DIRECTOR OF FINANCE – IAN WRIGHT

Update on Current Issues

1. PURPOSE OF THE REPORT

1.1 To provide Members of the Teesside Pension Board (the Board) with an update on current issues affecting the Pension Fund locally or the Local Government Pension Scheme (LGPS) in general.

2. RECOMMENDATIONS

2.1 That Board Members note this report.

3. FINANCIAL IMPLICATIONS

3.1 There are no specific financial implications in respect of the information contained in this report.

4. GOVERNMENT CONSULTATION ON A REMEDY FOR DISCRIMINATION IDENTIFIED IN THE MCCLOUD / SERGEANT COURT CASES

4.1 All of the main public service pension schemes moved from being final salary schemes to career average pension schemes in 2014 and 2015. As part of this process protections were introduced into each of the schemes' rules to ensure that older members were not disadvantaged by the move to a new scheme. In the LGPS this protection is known as the 'underpin'. This underpin is a check carried out when older members who were in the pre-2008 LGPS when they draw their benefits to see if they would have had higher benefits if the old 'final salary' rules had still applied. As pension is built up at a faster rate in the 'new' LGPS (where individuals earn 1/49th of a year's salary in pension each year compared to 1/60th in the 'old' LGPS), the underpin normally only applies when someone has had significant above inflation pay rises and a significant proportion of their service is before 2008.

4.2 In December 2018, in what became known as the McCloud and Sargeant judgement, the Court of Appeal determined that the protections introduced in the Firefighters' and Judges' pension schemes were age-discriminatory and so unlawful. The Government confirmed in July 2019 that it would accept the judgement as applying across all public service pension schemes (including the LGPS), and they would address the discrimination for all affected members, not just those who made a claim.

4.3 Around a year later, on 16 July 2020 the Government published its consultation on draft regulations including changes to the ‘underpin’ for the LGPS in England and Wales. Full details can be found at the following link:

https://www.gov.uk/government/consultations/local-government-pension-scheme-amendments-to-the-statutory-underpin

These proposals are designed to remove the unlawful discrimination caused by the protection of older members when the LGPS was reformed in 2014. The consultation closed on 8 October 2020.

4.3 The draft regulations set out in the consultation will:

a) remove the condition that requires a member to have been within ten years of their 2008 Scheme normal pension age (almost always age 65) on 1 April 2012 to qualify for underpin protection and
b) introduce other changes to make sure the revised underpin works consistently for all members

The potential link to final salary will continue until the scheme member leaves active membership or reaches age 65 (whichever comes first). All members will only build up benefits on a career average basis from 1 April 2022.

4.4 The regulation changes will have retrospective effect. This means all qualifying leavers since 1 April 2014 will have to have their benefits reassessed to see whether the underpin would have given them higher benefits. This will include retirements, deferred leavers, deaths, transfers-out and trivial commutations. The proposed extended underpin will be carried out in two stages with a provisional check carried out when the member leaves active membership (or age 65) and a final check when benefits are taken. This is so that the impact of early or late retirement factors can be taken into account when determining whether the underpin gives a higher benefit.

4.5 One further consideration is aggregation of membership (where a scheme member decides to combine previous LGPS service into their current period of membership). Under the new proposals scheme members will be required to aggregate benefits in order to qualify for the underpin. This does not apply currently so the consultation proposes allowing active and deferred members who have not aggregated an additional year in which to choose to do so – this will only apply where failure to aggregate would mean the scheme member losing entitlement to the underpin.

4.6 All of these proposal represent a significant ongoing challenge for LGPS pensions administration. Software systems and member communications will need to be adapted and additional processes and routines developed, tested and implemented. For the retrospective element, information will need to be gathered from employers in relation to scheme members' service from 1 April 2014 to date, such as changes to part-time hours. This is information that was previously not needed for those not covered by the 'old' underpin, but it will be needed once these regulations take effect, to check whether the 'new' underpin applies.

4.7 The expected effective date for the introduction of these new regulations is 1 April 2022. All service in the LGPS going forward from that point will earn career average pension, however at that point perhaps a third of active members will continue to be entitled to the new underpin check when they leave and draw their benefits. It is unlikely that very many individuals will benefit from the underpin, but it will be essential to check everyone to see whether they qualify and benefit from it.

4.8 Increasing members' benefits will result in a cost to employers. The consultation states: "The proposals in this paper are estimated to cost LGPS employers £2.5bn in the coming decades, as protected members retire and begin to receive their benefits". AON, the Scheme Actuary, has estimated the overall impact on the Fund as resulting in an average increase in employer contribution rates of around 0.9% of pensionable pay – this cost is already built in to employer contribution rates following the latest triennial valuation. This includes an allowance for the 'cost sharing' exercise that is still expected to be carried out after the underpin changes have been implemented. The actual cost for individual employers within the Fund will only emerge in time and will vary depending on the profile of their membership.

4.9 XPS Administration is considering how best to plan and resource for the implementation of the new underpin and has already communicated with employers to advise them of the additional data that will be required in respect of scheme members (including those who have left since 1 April 2014). XPS Administration also submitted a response to the Government consultation document which emphasised the administrative complexity caused by the proposals, whilst recognising the need for the Government to remove discrimination within the Scheme.

5 REFORMING LOCAL GOVERNMENT EXIT PAY

5.1 Following on from Government proposals highlighted in the 2015 Spending Review, subsequent consultation and legislation in 2016, and consultation from HM Treasury in 2019, the Government published further consultation on 7 September 2020 entitled "Reforming local government exit pay – A consultation on the reform of exit payments in local government." This can be found at the following link:

https://www.gov.uk/government/consultations/reforming-local-government-exit-pay

5.2 The consultation reiterates the Government's position on public sector exit payments:

> "The government believes that it is an important principle that exit arrangements are determined at workforce level. However, given that exit arrangements in all workforces are ultimately funded by the taxpayer, it is clearly appropriate for the government to ensure that these provide value for money."

It summarises the key elements of their approach, previously published in 2016, as follows:

- A maximum of three weeks' pay per year of service;
- A maximum of 15 months on the amount of a redundancy payment;
- A maximum salary of £80,000 on which an exit payment can be based;
- Limiting publicly funded pension top-ups;
- A £95k cap on the total of all forms of compensation, including redundancy payments, pension top ups, compromise agreements and special severance payments.

5.3 Regulations which introduce a limit of £95,000 on total exit payments to or in respect of an individual leaving public sector employment have been passed and come into force on 4 November 2020. This creates an issue for Administering Authorities and for Scheme Employers, as the LGPS regulations have not yet been changed. This means the LGPS regulations state a member leaving the LGPS on redundancy or business efficiency grounds aged 55 or more gets their pension benefits paid immediately without any early retirement reduction applied (regardless of employer cost), but the exit cap regulations state any payment to or in respect of them is capped at £95K. The Local Government Association is seeking legal advice on this and is also expecting government guidance on this imminently.

5.3 The latest consultation explains that following preliminary discussions with local government sector representatives the Ministry for Housing, Communities and Local Government (MHCLG) proposes to reform redundancy payment in local government as follows:

a) A maximum tariff for calculating exit payments of three weeks' pay per year of service. Employers could apply tariff rates below these limits.
b) A ceiling of 15 months (66 weeks) on the maximum number of months' or weeks salary that can be paid as a redundancy compensation payment. Employers will have discretion to apply lower limits, as they do at present under 2006 Regulations.
c) A maximum salary of £80,000 on which a redundancy compensation payment can be based, to be reviewed on an annual basis using an appropriate mechanism, for example: CPI (Consumer Prices Index).

5.4 When an active member of the LGPS aged 55 or more leaves their LGPS employment on the grounds of redundancy or business efficiency they currently get immediate access to their LGPS benefits without any early retirement reductions being applied. Their employer pays the cost of providing this unreduced pension benefit, usually as a one-off lump sum payment to the Fund. These employer 'strain costs' can be substantial and often form a large part of the exit cost when someone in the LGPS leaves on redundancy / business efficiency grounds. The consultation sets out proposed changes to the LGPS regulations on leavers on redundancy / business efficiency which will reduce the overall value of the benefit package to most who leave the LGPS on redundancy / business efficiency (regardless of salary level). The changes proposed are as follows:

"We … propose that for members of the LGPS who are at least 55 years old when made redundant, the benefits and the associated strain cost due from the employer should be limited as follows:

- The strain cost cannot exceed the overall cap contained in the Exit Payment Regulations (£95k)
- Strain cost will be further reduced by the value of any Statutory Redundancy Payment required to be paid (which the employee will still receive as a cash payment)
- A further reduction would be made to reflect any voluntary payments made to cover grant of additional pension under regulation 31 of the LGPS Regulations 2013
- Any reduction in the strain cost due to the above limitations may be made up by the worker from his own resources
- The member will receive an actuarially adjusted pension benefit in line with the revised strain cost under these provisions."

5.5 Further provisions will apply:

- Where an employer pays any amount strain cost they can't pay any discretionary redundancy payment in respect of that individual. The only exception is if a redundancy payment would have been of higher value than the strain cost, then the scheme member can have their strain cost paid and receive a cash payment equal to the difference between the strain cost and the discretionary redundancy payment.
- The scheme member can choose to not have a pension enhancement, just receive an actuarially reduced pension and can take the discretionary redundancy payment.
- Employees will have a further option to defer their accrued pension benefits (which would not be enhanced and would not come into immediate payment) and receive their expected payments under their employer's redundancy scheme.

Whatever option is chosen, the £95K cap and the other criteria set out in paragraph 5.2 above would have to apply.

5.6 The consultation recognises that applying a national exit payment cap requires a consistent approach to working out strain costs across the LGPS, as the factors and method of calculation is currently determined by each individual Fund. The Government Actuary's Department has subsequently provided draft actuarial guidance on this for funds to follow.

5.7 The consultation is explicitly "**not** seeking views or representations on the government's position regarding exit pay reform" but is instead asking for information on the effects the proposals will have on regulations currently governing local government exit payments (compensation and early access to pension), and the impact of the criteria set out in paragraph 5.2 above would have on the local government workforce. The consultation ends on 9 November 2020. The Head of Pensions Governance and Investments will consider whether a consultation response should be submitted on behalf of the Council as Administering Authority to the Pension Fund. Any response will be discussed with the Chair and Vice Chair of the Pension Fund Committee prior to submission.

6. PARTIAL GOVERNMENT RESPONSE: REVIEW OF EMPLOYER CONTRIBUTIONS AND FLEXIBILITY ON EXIT PAYMENTS

6.1 The Government issued a consultation ending on 31 July 2019 proposing the following changes to the LGPS:

- Moving to a 4-year instead of 3-year actuarial valuation cycle, including proposals to allow wider review of employer contributions between valuations
- Allowing more flexibility on payments due from employers when they exit the scheme
- Changing the rules on allowing payments to employers when they leave the scheme ('exit credits')
- Changes to the category of employers required to offer LGPS membership (for example, excluding further education colleges from having to offer the LGPS to new entrants)

6.2 The Government response on the reform of exit credits was published on 27 February 2020 and the Government changed the LGPS regulations accordingly so that administering authorities may determine, at their absolute discretion, the exit credit payment due, having regard to any relevant considerations. On 26 August 2020 MHCLG issued a partial response covering some of the other aspects from the July 2019 consultation, namely the ability of administering authority to review employer contributions and apply flexibility on payments due from employers when they leave the scheme. This consultation response can be found at the following link:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/911792/Government_response_Exit_payments_and_review_employer_contributions.pdf

MHCLG also laid regulations - The LGPS (Amendment) (No.2) Regulations 2020 – that give effect to these changes when they come into force on 23 September 2020. The Government has stated that a further response will be issued on the remaining proposals from the July 2019 consultation "in due course".

6.3 On reviewing employer contribution rates between valuations, the Government has concluded that this power should be available in respect of all employers in the scheme (not just admission body employers as currently applies). The Government's new regulations grant administering authorities and employers the following new flexibilities:

- Administering authorities may review the contributions of an employer where there has been a significant change to the liabilities of an employer.
- Administering authorities may review the contributions of an employer where there has been a significant change in the employer's covenant.
- An employer may request a review of contributions from the administering authority.
- Administering authorities will be required to consult with the employer when undertaking a review of the employer's contributions.

In order to provide consistency and transparency in the use of the new power, administering authorities will be required to state their policy on the review of employer contributions in their Funding Strategy Statement (FSS) and obtain advice from their actuary.

6.4 On flexibility over payments due from employers exiting the scheme, the Government recognised that administering authorities are best placed to take account of the diverse range of employers in the LGPS and to use judgement and local knowledge in balancing competing interest. Consequently, the new regulations will:

- Provide administering authorities with a power to spread exit payments from an exiting employer over a period where the employer no longer has active members in the scheme. In order to ensure consistency and transparency administering authorities which wish to make use of the new power will be required to set out within their FSS their policy on spreading exit payments and to obtain advice from their actuary.

- Administering authorities will be expected to determine whether to spread an exit payment, over what period and the proportion of the exit payment to be paid each year, taking account of the interests of all employers and the funds as a whole.

- Introduce "Deferred Employer" as a new category of employer in the scheme together with the facility for administering authorities to enter into a "Deferred Debt Agreement" (DDA) with such an employer. The purpose of this is to formalise arrangements to allow employers with no active members the option to spread payment of deficit over a future period to be agreed with the administering authority. In order to ensure consistency and transparency administering authorities that wish to make use of the new power will be required to set out within their FSS their policy on DDAs and to obtain advice from their actuary.

6.5 The Head of Pensions Governance and Investments will work with the Scheme Actuary to bring a revised draft Funding Strategy Statement for the December Committee to agree prior to consultation with the scheme employers. This revised FSS will set out the Fund's policies in relation reviewing employer contributions and flexibility on exit payments.

7. EARLIEST AGE TO ACCESS PENSION TO INCREASE FROM 55 TO 57

7.1 In 2014 the Government indicated its intention that the earliest age most individuals would be able to choose to draw a pension would increase from age 55 to age 57 with effect from 2028. Thereafter the intention was for the age to increase so that it stayed 10 years below an individual's state pension age.

7.2 Although announced in 2014, this provision has not been put into legislation and is not widely known about. On 3 September 2020 in a written response to parliament, economic secretary John Glen MP said the Government would legislate for this increase in age "in due course". This received significant press coverage and is relevant to all LGPS members (as well as members of most other pension schemes), particularly those who are due to reach age 55 just after the cut-off date (some time in 2028 – as yet unspecified).

7.3 As and when more clarity is provided on this, suitable information will be provided to scheme members, and to the Committee.

8. NEXT STEPS

8.1 Further updates will be provided periodically.

CONTACT OFFICER: Nick Orton – Head of Pensions Governance and Investments

TEL NO.: 01642 729040