CONSULTATION ON THE MCCLOUD JUDGEMENT

Introduction

1. This report updates the Committee on the Ministry for Housing Communities and Local Government (MHCLG) consultation on the proposed remedies resulting from the 2019 McCloud Judgement.

2. The McCloud Judgement refers to the case in which the Supreme Court found that transitional protections introduced in the firefighters and judges' pensions schemes in 2015 amounted to age discrimination for younger workers.

3. Similar transitional protections were introduced into other public sector schemes, including the LGPS in 2014, and so the ruling applies to those schemes as well.

Recommendation

4. The Committee is asked to note the content of the consultation on McCloud and that the Committee will be invited to endorse the Fund's response to the consultation via an Electronic Decision Notice.

Background

5. Changes introduced in the Public Service Pensions Act in 2013 meant that public sector pensions moved to a career average revalued earnings (CARE) basis from the former final salary benefits scheme. For the LGPS these changes were introduced in April 2014, with changes to the other public sector schemes coming into effect in April 2015.

6. When the CARE scheme was introduced, transitional protections were given to members who were within 10 years of their normal retirement age at 1 April 2012.

7. Two legal cases challenged the protections on the grounds of age discrimination. The first case, McCloud, related to the judicial pension scheme and the second, Sargeant, related to the firefighters' scheme. Both cases concern the same issue and the outcomes have come to be known as the McCloud Judgement (McCloud).

8. On 20 December 2018, the Court of Appeal found that these protections were unlawful on the grounds of age discrimination and could not be justified. On 27 June 2019 the Supreme Court denied the Government permission to appeal.

9. In a statement by the Chief Secretary to the Treasury on 15 July 2019, Government confirmed that the judgement would be accepted as applying to all public sector schemes where protections for older members were introduced.

10. As the protections have been found to be unlawful then those members who have been discriminated against must be placed in an equivalent position to the protected members. Any remedies need to be 'upwards', i.e. the benefits of unprotected members will be raised rather than the benefits of protected members being reduced.

11. In the LGPS, transitional protections were applied in the form of a ‘statutory underpin’ which means that additional checks are undertaken by administering authorities for protected members to ensure that the pension payable under the reformed scheme is at least as high as it would have been under the final salary scheme.

Consultation

12. On 16 July two consultations were issued, as set out below:

Issued By	Consultation Detail	Closing date
HM Treasury	A consultation on changes to transitional arrangements to the 2015 schemes for the unfunded public sector schemes	11 October
MHCLG	A consultation on amendments to the statutory underpin for the LGPS (England and Wales).	8 October

13. The remainder of this report will relate to the consultation on the amendment to the statutory underpin for the LGPS.

14. The LGPS consultation aims to address age discrimination by removing the requirement for a member to have been within 10 years of their normal retirement age at April 2012 in order to qualify for the underpin.

15. The ‘revised underpin’ as it is to be known, will apply to all members providing they meet the following qualifying criteria:

- They were in service on 31 March 2012 and accrued benefits under the 2014 scheme; and
- Have not had a disqualifying break in service (five years or more).

16. The revised underpin will apply to membership from 1 April 2014 and 31 March 2022 i.e. administering authorities must check whether a qualifying member is better off under the CARE or final salary provisions when calculating their benefits for this period.

17. The Government proposes that the final salary underpin will cease for all LGPS members from April 2022.

18. The regulatory changes are expected to come into effect from 1 April 2022. However, the regulations enabling administering authorities to prepare for the changes may be brought in sooner.

19. The consultation also seeks to remove the existing requirement that a member must leave active service with an ‘immediate entitlement to pension’ in order to qualify for the underpin. The consultation proposes that underpin protection would apply where a member leaves with either a deferred or immediate entitlement to a pension. As the

underpin is extended to younger workers it is more likely that they will leave the scheme before having an immediate entitlement to benefits, which would mean that they would not benefit from underpin protection.

20. The consultation also seeks to amend aspects of the original regulations in several other technical areas to ensure the changes work effectively and consistently for all members.

21. The consultation poses 29 questions to which MHCLG is seeking responses. Committee and Board members were sent links to the full consultation documents, the link to the LGPS consultation document is included below; https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901173/Condoc_-_amendments_to_LGPS_underpin_-_FOR_PUBLICATION.pdf

22. The LGPS consultation closes on 8 October. The Fund is actively engaging with advisors and other administering authorities to ensure its consultation response is as fully informed as possible. It is proposed that the Committee be asked to endorse the proposed consultation response via an Electronic Decision Notice.

23. Although the Fund's consultation response is still being developed a number of key points have emerged thus far, these include:

- **Implementation timescale**.
    i. MHCLG has not set out the date by when it expects funds to have completed the recalculation of affected members' benefits. It is assumed to be 31 March 2022.
    ii. Work on the recalculation of benefits cannot commence until the regulations are laid and we would urge MHCLG to formalise the regulations as soon as possible.
- **Administering authority resourcing**: The remedy proposed is complex and will require considerable resource from the Fund to recalculate benefits for a high number of members. MHCLG need to consider this when determining the timetable for when they expect the work to be completed and to avoid any impact upon business as usual activity.
- **Employer data**: Employers will be required to provide six years' worth of backdated information for their members, for the Fund to be able to carry out the recalculations. Enough time should be provided to allow employers to supply this information.
- **Missing data**: There will be employers who cannot provide the data required in order to recalculate benefits, due to changing payroll providers or ceasing membership of the LGPS. National guidance on dealing with such cases is required.
- **Member communications**: Communicating the changes with members is key, and they must receive clear guidance to explain that any changes to benefits will happen automatically and that they do not need to take any action.

- **System changes**: Pension administration software will need to be amended to apply the regulatory changes. Software providers will require the final regulations to be in place as soon as possible.
- **Cost**: There is a significant resource impact on LGPS funds due to the McCloud judgement. The consultation is silent on what contribution Government will make to the cost of implementing the remedy

Local impact

24. Implementing the McCloud remedy has been described as the biggest challenge to face the LGPS since the introduction of the CARE scheme in 2014. It is a multi-faceted project that will require considerable resource from across the pension fund community.

25. The remedy will require the identification of all qualifying members, including those who have left since April 2014, and who did not qualify for the previous underpin, to recalculate their benefits. The Fund will also need to include their estimate benefit entitlement in their Annual Benefit Statement (ABS) and MHCLG has suggested it would like this to be included in time for the 2021 ABS.

26. The Fund has undertaken an initial estimate of the number of qualifying members and has identified around 19,300 members where a recalculation will be required either immediately or as these members come to leave the scheme. Two thirds of the qualifying members who require a recalculation are active members but a significant number have already left the scheme, as summarised in the table below:

Type of Member	**No. of Members**
Active	12,732
Deferred	4,044
Pensioner	1,837
Transfer Out	504
Deceased	150
Refund/Commutation	41
Total	**19,308**

27. To be able to calculate revised benefits for qualifying members, the Fund will need to obtain additional information from employers dating back to 1 April 2014, which it had ceased to collect due to the change to the CARE scheme (under CARE, benefits are wholly based on earnings not membership).

28. This data will include information such as part time hours worked and service breaks. All employers will be required to provide this information for all eligible employees, including those who have left, dating back to 1 April 2014. This will be a considerable resource impact for some employers, and it will be a challenge to communicate clearly why the information is required, what should be provided, the format and by when data must be supplied.

29. Whilst this will be an administrative burden for employers it is hoped that the majority will be able to provide the information required. However, some employers will have changed payroll providers within the last six years and may no longer have access to the data. In addition, there will be employers who have left the Fund entirely, and the Fund may not be able to obtain any information from them.

30. It is understood that the Scheme Advisory Board (SAB) is working on guidance to assist funds when there is an absence of employer data. However, there will need to be some pragmatic solutions to enable reasonable assumptions in the absence of any other information.

31. The changes to the scheme will apply automatically for qualifying members and they do not need to make a claim. It is important that the Fund conveys this message clearly to its members to avoid them falling victim to claims companies who may promise to claim their pension entitlement in return for a fee.

32. The Fund is working with its administration database provider to understand what support they can provide. However, there will inevitably be a resource implication that the Fund will need to manage in order to avoid any detrimental impact upon business as usual activity.

33. In setting the 2020-21 budget, the Fund identified that McCloud and other major changes would require additional resource. Recruitment is already underway to increase the capacity of the administration team by four to manage growing casework volumes. The number of posts needed was determined prior to receiving the consultation and now that the impact of the remedy is becoming clearer the resource requirement will need to be revisited.

Funding and accounting issues

34. As well as the impact on administration workload, the remedy will have an impact on valuations and accounting disclosures, and these will also have to be worked through and communicated to employers.

35. The consultation estimates the cost of the proposals to remedy the discrimination across the whole of the LGPS will be £2.5bn over the coming decades. This estimate is based on assumptions including future long term pay growth of CPI + 2.2%. If future pay growth is less than the ultimate cost will be lower (and vice versa).

36. SAB issued advice to LGPS funds in May 2019 on the treatment of the McCloud case in valuations in the event there was no finalised outcome by 31 August 2019. The Fund actuary acted in line with the boards advice that for the 2019 valuation all member benefits were calculated in line with the LGPS Regulations in force as at 31 August 2019.

37. The Fund, in line with SAB's advice note, considered how to allow for the McCloud risk in the setting of employer contribution rates and took the following approach:

- increased the prudence in the funding strategy via a higher likelihood of meeting funding target for the Councils who make up the majority of the Fund, and
- made no allowance for the smaller employers until the actual McCloud rectification is known except where there is a cessation valuation

38. As the majority of employers in the Fund are long term participants, the Fund will have time to make future adjustments as more detail on the McCloud remedy emerges and the impact on individual employers becomes clearer.

39. It is not proposed to adjust employer contribution rates until the 2022 formal valuation unless an employer exits the Fund before the next valuation.

40. There will also be the impact of restarting the HMT employer cost cap process, which was paused due to the uncertainty caused by the McCloud case. This will now be brought to a conclusion as the government has confirmed that the cost of the remedy will be fully reflected in the employer cost cap mechanism.

41. The cost cap mechanism aims to ensure the cost to employers (and the tax payer) of public sector pension schemes remain affordable and sustainable in the long term. Where the cost of the scheme moves beyond a 2% margin on either side of the employer cost cap, pension benefits or member contributions must be adjusted to bring costs back to the target (the employer cost cap).

42. As part of the annual IAS19/FRS102 accounting report exercise, employers were given an option of including an estimate of the McCloud impact in their reports. This estimate has now been revised by the Fund actuary following release of the consulation.

43. The revised McCloud estimate for the accounting reports is an increase of 0.3% of active liabilities, from an earlier estimate of an increase of 0.9% of active liabilities. All employers who had a year end of 31 March 2020 have been contacted to advise of the change of estimate and given options to revise their accounting report if they wish.

44. The lower estimate for McCloud will be used for the accounting reports issued for July and August year end employers.

Project management

45. The Fund can not commence work to amend systems, recalculate benefits etc. until the regulations have been formally laid. The focus in the short term will be on engagement within the LGPS to inform the consultation response, communicating with stakeholders, obtaining data from employers and internal project planning.

46. The Fund is developing a detailed plan to manage all aspects of this project. A Project Manager has been assigned to the Fund to assist with this and other key change projects. The Fund is also likely to need additional external support to inform project planning and implementation.

47. It is proposed that the Local Pension Board receive regular updates on the Fund's progress with the project and in turn keep the Committee informed and make any necessary recommendations.

THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK