

**Agenda Item No. 4 (f)**

**DERBYSHIRE COUNTY COUNCIL  
PENSIONS AND INVESTMENTS COMMITTEE**

**9 September 2020**

**Report of the Director of Finance and ICT**

**MHCLG AMENDMENTS TO THE STATUTORY UNDERPIN  
CONSULTATION**

**1 Purpose of the Report**

To advise the Pensions and Investments Committee (Committee) of the publication of the Ministry of Housing, Communities and Local Government's (MHCLG) consultation on draft regulations introducing proposed changes to the LGPS statutory underpin protection. The changes are intended to remove unlawful discrimination found by the Courts in relation to public service pension scheme transitional protection arrangements. The judgement of unlawful discrimination is commonly referred to as the McCloud Judgement.

To seek approval for the Director of Finance & ICT, in consultation with the Chair of the Committee, to consider the Fund's response to the consultation and to authorise its submission to MHCLG.

**2 Information and Analysis**

**McCloud Judgement**

The McCloud case relates to transitional protections given to scheme members in the judges' and firefighters' schemes which were found to be unlawful by the Court of Appeal on the grounds of age discrimination. Following the judgement, the Government announced that remedies relating to the judgement would be made in relation to all the public service pension schemes. Risks related to the McCloud judgement have been included on Derbyshire Pension Fund's (the Fund) Risk Register since May 2019.

When the LGPS benefit structure was reformed in 2014, transitional protections were applied to certain older members close to normal retirement age. The benefits accrued from 1 April 2014 by these members are subject to an 'underpin' which means that they cannot be

lower than what they would have received under the previous benefit structure.

### **Proposed Remedy**

The draft regulations set out in the MHCLG consultation propose to:

- remove the condition that requires a member to have been within ten years of their 2008 Scheme normal pension age on 1 April 2012 to be eligible for underpin protection. Members who were active in the 2008 Scheme on 31 March 2012 and who have accrued benefits under the 2014 Scheme without a disqualifying break in service would have underpin protection, subject to aggregation requirements (members will be required to aggregate benefits to qualify for the underpin – aggregation relates to the joining together of separate LGPS employment accounts)
- extend the underpin protection to apply where a member leaves with either a deferred or an immediate entitlement to a pension (previously the underpin did not apply to leavers with a deferred benefit entitlement)

The underpin is essentially an administrative test undertaken at the earlier of the date a qualifying member leaves active service and the date they reach their 2008 Scheme normal pension age. The underpin gives the member the better of the 2014 Scheme CARE (career average revalued earnings) or 2008 Scheme final salary benefits for the eligible period of service.

The final salary for comparison purposes applies at the point that the member leaves active service or reaches age 65.

The underpin period applies between 1 April 2014 and 31 March 2022 but ceases when a member leaves active service or reaches age 65. From 1 April 2022 all service in the LGPS will be on a career average basis, with no underpin.

The changes will be retrospective which means that benefits for all qualifying leavers since 1 April 2014 will need to be reviewed to determine whether the extended underpin will produce a higher benefit. Qualifying leavers include: retirements; deferred leavers; deaths; transfers out; and trivial commutations (commutation relates to converting a 'small' pension entitlement into a one-off lump sum payment to be made by the Fund, effectively discharging any further liability).

### **Impact on Members**

The MHCLG consultation sets out the likely impact of the proposed changes on the membership of the LGPS as assessed by the Government Actuary's Department (GAD):

- older active members on 31 March 2019 are more likely to qualify for the revised underpin than younger active members
- active members between the ages of 41 and 55 as at 31 March 2019 are more likely to benefit from the revised underpin than their younger or older colleagues
- men are marginally more likely to qualify for the revised underpin and benefit to a greater extent from underpin protection than women, in line with the membership profile of the LGPS

Analysis by Hymans Robertson (Hymans), the Fund's actuary, suggests that around **1.2m** members of the LGPS, roughly equivalent to a quarter of all members, may be affected by the revised underpin. The MHCLG consultation notes that for many members the underpin protection will not result in an increase in their pension entitlement. Where an increase is applied, it is likely to be small as most members will build up a higher pension in the career average pension scheme than they would have under the final salary scheme.

### **Impact on Employers**

Any increase in benefits for members will need to be funded by scheme employers. At a whole scheme level, Hymans estimate that total liabilities might increase by around **0.2%**, equivalent to around **£0.5bn** across the whole of the English and Welsh LGPS.

This estimate is significantly less than the **£2.5bn** quoted in the MHCLG consultation. The difference is largely due to the materially higher pay growth assumption used by GAD.

Hymans forecast that the impact of the remedy might be to increase average primary contributions by around **0.2%** of pay, with an increase in secondary contributions of around **0.1%** of pay. The actuary made an allowance for McCloud in the assessment of employer contribution rates at the 2019 actuarial valuation by increasing the required likelihood of reaching the funding target.

Whilst the impact at the whole scheme level is expected to be small, it may be material at an individual employer level.

### **Impact on Fund Administration**

The implementation of the proposed remedy will have a significant affect on the administration of the scheme. Initial analysis had indicated that around 26,000 members of the Fund are likely to fall into the scope of the proposed changes to the underpin. The implementation of the remedy will involve:

- a review of all pension processes and communications to see which are affected by the new regulations
- engagement with the supplier of the Fund's pension administration system to discuss and influence development plans for bulk uploading and calculations related to the implementation of the McCloud remedy
- user acceptance testing on any pension administration system developments
- a comprehensive staff training exercise
- the collection of any additional data from employers needed to perform underpin calculations
- a large number of underpin calculations on an ongoing basis and as a retrospective exercise for leavers
- the payment of backdated benefit adjustments
- effective communication with scheme members and employers

### **Project Board**

A McCloud Project Board has been established to govern the implementation of the remedy and a Project Manager has been assigned to lead the programme. The initial workstreams are:

- governance
- case identification
- staffing/resources
- communications

Further workstreams will be added as the programme progresses.

### **3 Consultation**

The MHCLG consultation will close on 8<sup>th</sup> October 2020. The Local Government Association (LGA) and the Fund's actuary will be submitting responses to the consultation which will be shared in advance of the closing date.

The Project Board is currently working through the MHCLG consultation document and will formulate a response to the consultation in due course, taking into consideration the responses from Hymans and the LGA.

Approval is sought for the Director of Finance & ICT, in consultation with the Chair of the Committee, to consider the Fund's response to the consultation and to authorise its submission to MHCLG.

#### **4 Other Considerations**

In preparing this report the relevance of the following further factors has been considered: financial, legal, human rights, human resources, equality and diversity, health, environmental, transport, property, social value and prevention of crime and disorder.

#### **5 Background Papers**

All background papers are held by the Head of Pension Fund.

#### **6 Officer's Recommendation**

That the Committee:

- I. Notes the publication of MHCLG's consultation on draft regulations introducing proposed changes to the LGPS statutory underpin protection.
- II. Delegates the consideration of the Fund's response to the consultation, and the approval of its submission to MHCLG, to the Director of Finance & ICT in conjunction with the Chair of the Committee.

**Peter Handford**

**Director of Finance and ICT**