

**NORTHUMBERLAND COUNTY COUNCIL PENSION FUND
Pension Fund Panel Meeting 21 June 2019**



South Tyneside Council

Pensions Committee

Date: 5th March 2019

Pensions Administration (for information and discussion)

Report of the Head of Pensions

Purpose of Report

1. This report briefs the Committee on developments in pension administration.
2. The Committee is asked to note the report.

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LGPS Technical Amendments to Benefits

3. Committee was informed in November 2018 of proposed amendments to the LGPS Regulations 2013. The amendments focus on three areas:
 - survivor benefits – introducing changes to provide that pensions paid to survivors of civil partnerships or same-sex marriages will be equal to those provided to widows of male members. The changes will be backdated to the date civil partnerships and same-sex marriages were implemented, this means that LGPS administering authorities will need to revisit all awards made under the current rules to civil/same-sex partners and pay any additional sums that are due;
 - introducing a general power for MHCLG to issue statutory guidance; and
 - correcting the unintended error in the LGPS (Amendment) Regulations 2018 to provide that deferred members who left under the 1995 Regulations are able to take payment of their LGPS pension without the need for their former employer's consent from age 55, with the appropriate actuarial reduction.
4. The consultation period on the proposed amendments expired on 29 November 2018, and the amendments were introduced into law on 10 January 2019.

MHCLG consultation – LGPS: Fair Deal – Strengthening Pension Protection

5. When a local authority, or other Best Value body, is outsourcing a service which results in the compulsory TUPE transfer of staff, the outsourcing employer is currently required to ensure:
 - continued LGPS membership; or
 - access to a Government Actuary's Department ("GAD") certified broadly comparable scheme.
6. MHCLG is now undertaking a consultation exercise to change the above requirements by introducing Fair Deal in the LGPS. Fair Deal is not new and has applied to other public sector bodies for several years. However, whilst long mooted, this has not previously applied to local authorities or other Best Value bodies.
7. If introduced, Fair Deal will remove the option for staff to be granted access to a GAD certified broadly comparable scheme. Instead, outsourcing 'Fair Deal Employers' (this term will include most Scheduled and Designation Bodies) will be required to provide continued LGPS membership for "Protected Transferees" (a person with LGPS eligibility employed by a Fair Deal Employer).

8. The proposed removal of the GAD certified broadly comparable option is welcomed, as is the protection for transferring staff of a range of Scheduled and Designation Bodies. These safeguards will help to maintain LGPS membership.
9. Whilst the introduction of Fair Deal in the LGPS has long been expected, the current consultation includes a number of suggested changes that we had not previously envisaged. This includes:
 - the power for admission agreements to contain risk sharing provisions;
 - the extension of the ‘Deemed Employer’ regime as an alternative to admitted body status;
 - 1) provisions on automatic asset and liability transfer in the event of takeover / merger.
10. At the time of writing, officers are liaising with other administering authorities and stakeholders (such as the LGA and Aon) as we formulate our views on some of the proposed amendments.
11. The consultation period is open until 4 April 2019, and the Fund will be submitting a response in due course.

Ongoing Consultation – Guaranteed Minimum Pensions

12. In a number of earlier reports the Committee has been advised that in February 2017 the Fund responded to an HM Treasury (“HMT”) consultation on options for how the Guaranteed Minimum Pension element of pensions paid to those members who will reach state pension age on or after 6th December 2018 should be indexed. Since then members have been provided with an update at each meeting.
13. In January 2018, HMT published its response to this consultation. This acknowledged that it is a complex area and more time is required to identify a long term solution. As a result, it will now extend the existing interim solution, covering those members of public service schemes reaching state pension age between 6th April 2016 and 5th December 2018 to those that reach state pension age on or before 5th April 2021.
14. Further time will be then be taken to identify the longer term solution.
15. This interim solution increases the value of liabilities in the LGPS, though this increase is not generally material and the Fund Actuary does not envisage any need to review employer contributions to the Fund before the 2019 valuation.

16. The original consultation set out three options for indexation:
- case by case – A comparison of total income received by the pensioner from public and state pensions provision under the old and new system,
 - full indexation - Public sector schemes to directly meet the cost, and
 - conversion - To convert the GMP into a scheme benefit on 1:1 basis.
17. In their response to the consultation, HMT confirmed that it will disregard the case by case solution, acknowledged that full indexation is overly burdensome and indicated that it is likely to further investigate the possibility of conversion. The direction of travel therefore appears to be towards a move to conversion, but it is understood that there is a willingness to keep options open.
18. It is expected that further consultation will take place, but to date no further progress has been made. The Committee will be kept up to date on this matter.

SAB Review - Academies

19. The Scheme Advisory Board (SAB) has commenced a review of the participation of existing academies and had commissioned PwC to investigate these issues and prepare a report.
20. The report, which was released on 17th July 2017, made no recommendations but set out three broad types of approach or mechanisms to try and resolve these issues. These are:
- non-regulatory measures within the LGPS
 - regulatory measures within the scheme, and
 - measures outside of the LGPS, including through primary legislation.
21. The SAB review has been split between a funding working group and an administration working group. The review remains ongoing, but there is nothing further to report at the time of writing.
22. The Committee will continue to be updated on this matter.

SAB Review – Tier 3 Employers

23. In addition to the review noted above, the SAB has also commissioned some work in respect of “Tier 3 employers” in the LGPS.
24. Broadly speaking, Tier 3 employers are those employers which: (i) have no tax raising powers, (ii) are not backed by an employer with tax raising powers; or (iii) are not an academy.

25. It is understood that the SAB is seeking to identify the potential funding, legal and administrative issues and liabilities relating to Tier 3 employers.
26. SAB has established a small working group to review concerns expressed by Tier 3 employers and the ways in which they may be resolved. The working group is tasked with reporting back to the SAB with a set of recommendations for further consideration. At the current time, no changes are expected in advance of the 2019 valuation.
27. The Committee will continue to be updated on this matter.

SAB Review – Good Governance in the LGPS

Options for the Separation of Host Authority and Pension Fund

28. In 2014/15 the SAB commissioned a project to look at the issues and challenges of potentially separating the pensions function of LGPS administering authorities from their host authorities.
29. The review centred on the potential conflicts of interest that can arise. The view was expressed that, in principal, the greater the separation between the Pension Fund and the employers, the lesser the risk there is of a conflict arising.
30. Whilst a report was produced by KPMG on this subject no firm decisions were taken on how to progress and the initiative was largely put on hold as the SAB prioritised other areas of work such as pooling and academies.
31. The SAB now believes it is appropriate to restart this initiative and issued a tender for some follow up work, focussing on two options:
 - a greater degree of separation within existing structures. This involves establishing a single unit to look after pensions within the host authority, which would retain the scheme manager responsibility. This approach appears to be close to the one currently adopted at Tyne and Wear Pension Fund with a separate standalone Pensions Service within South Tyneside Council as the Administering Authority.
 - separation via new structures. This envisages delegation of the function of the scheme manager function in its entirety to a new body, which would then be responsible for all decisions in relation to the Fund. The constitution of the new body would need to be contained in a formal agreement. One option noted for the legal structure of such a new body is a combined authority similar to those in place for transport and planning.
32. Hymans Robertson has been appointed by the SAB to carry out the project on the “good governance of the LGPS”.

33. This review was initially entitled “Options for the Separation of the Host Authority and Pensions Fund”. However, more recently the review has been given a wider remit than simply looking at the autonomy of administering authorities, although this will form part of the project.
34. Hymans’ project is anticipated to be highly consultative and views will be sought from a wide range of stakeholders within the LGPS, including administering authorities.
35. The project is now underway and Hymans are expected to report back to the SAB in April and July.
36. Committee will be updated as this matter progresses.

Cost Management Review

37. A cost control mechanism was introduced in public service pension schemes following the Hutton review. The aim was to provide protection to taxpayers and employees against unexpected changes in pension costs.
38. In the LGPS, the cost cap mechanism is complicated by the fact that there are two control mechanisms in place. Both are complex and work in similar ways but are not identical to each other, and are run by:
 - Scheme Advisory Board (SAB) – this is non-statutory and is intended to give an ‘early warning’ of any changes to costs
 - Her Majesty’s Treasury (HMT) – this is the statutory cost cap, and ‘trumps’ the SAB version. Proposed changes from the SAB exercise can however, be taken into account by the HMT process when considering their exercise.
39. Both caps have a ‘target cost’ (determined using Government Actuary’s Department (GAD) assumptions) and the underlying legislation requires action to be taken if the target under the HMT cost cap is breached by 2% of pay e.g. if the target was 19.5% of pay, a breach would occur if the cost fell to less than 17.5% or rose above 21.5%. The action involves changes to the benefit or employee contribution structure to bring the cost back to the target cost.
40. As noted above the SAB calculation is intended as an early warning mechanism and as such takes place in advance of the HMT calculation.
41. The outcome of the SAB calculation was a total Scheme future service cost of 19%, against a target of 19.5%. Consequently, the SAB has been considering changes to the benefit package and contribution rates to bring the cost back to the target level. It has made a proposal to Government which includes:

- removing Tier 3 ill health benefits with eligible members to receive Tier 2 instead;
 - the introduction of a minimum death in service benefit of £75,000;
 - enhanced early retirement factors for members active on 1 April, applied to all service;
 - some amendments to the employee contribution rates at the lower salary levels and others to address tax anomalies.
42. The reduction in cost is believed to largely be attributable to a lower than assumed increase in life expectancy.
43. If the proposed changes from the SAB are accepted by Government these changes would then be taken into account by the HMT as part of their cost cap calculation when determining if the cost floor has been breached. If after accounting for these changes the floor is still breached further action will need to be taken.
44. The above changes, subject to agreement by Government and following a consultation exercise, were expected to be introduced with effect from 1 April 2019.
45. In advance of this agreement, the LGA and SAB recommended that steps be taken to prepare for these amendments. Consequently, the Fund wrote to Scheme employers and recommended that steps be taken to prepare for changes to the Scheme with effect from 1 April 2019.
46. Despite the direction of travel appearing clear a few weeks ago, an unexpected complication has arisen. This follows central Government deciding to appeal a Court of Appeal decision to the Supreme Court in a case referred to as McCloud.
47. The McCloud case relates to transitional arrangements in the Judges' Pension Scheme that are alleged to amount to age discrimination (a very similar case in the Firefighters' Scheme has been joined with McCloud). Although McCloud does not directly relate to the LGPS, the judgement, if upheld by the Supreme Court, could result in an increase in costs in the LGPS if benefits need to be improved to address age discrimination.
48. Central Government has announced that the Cost Cap Review is now on hold until McCloud has been resolved. This means that the benefits improvements will not be introduced from 1 April 2019, although, subject to McCloud, the amendments may need to be made retrospectively at some point in the future.
49. The current position is causing uncertainty in the LGPS and this is most unwelcome as we approach the 2019 valuation.

50. The LGA has prepared a Q&A document on McCloud to try and address some of the uncertainty. A copy of this document is appended to this report.
51. At the end of the Q&A, the LGA and the SAB has posed the following questions to administering authorities.
- A) To receive guidance from the SAB designed to promote a consistency of approach on how McCloud and/or cost management should be taken account of as part of the 2019 triennial valuation exercise. Such guidance would take the form that;
- 2 If there is no finalised outcome on McCloud/Cost cap (including a commitment by government to detailed benefit changes) by 31st August 2019 then the scheme benefit design used in the valuation should be as set out in current regulations.
 - 3 Each administering authority would then, with their Actuary, consider how they approach (and reflect in their FSS) the risk around this matter in the same way as they would for other financial, employer and demographic risks.
 - 4 Once the outcome of McCloud is known and appropriate benefit changes are made administering authorities would, if they deem appropriate, re-visit employer contributions under such guidance or provision in regulation as may be available at that time.
 - 5 A consistent approach to delaying, or method of estimating, exit credits and payments
- Or
- B) To have no central guidance and instead leave it to each administering authority to determine their own approach to their valuation (including any potential cost from McCloud or cost cap) taking advice from their actuarial adviser.
52. The deadline for the response to these questions is in advance of this meeting, but this issue will have been discussed at the Committee training in February.

Non-Pension Administration-Related Developments that will impact our Employers – Public Sector Exit Payment Reforms

53. The following items are not strictly a matter for LGPS Administering Authorities to consider. They are employer issues which are brought to the Committee for information purposes.

54. As members will be aware, the Government has committed to restricting the size of redundancy payments and other early exit costs across the public sector. There are three areas of potential report in this area:
- the £95,000 Public Sector Exit Payments Cap
 - clawback provisions for high earners (those earning £80,000 or more) returning to public sector employment within twelve months
 - further fundamental reforms to the rules governing the availability and calculation of public sector exit payments.
55. There has been very little progress in these areas for some time. The delays have been such that there was speculation as to whether the required regulatory changes would actually be made to give effect to these areas of previously stated Government policy. This is against the background of the current minority Government and lack of parliamentary time due to the focus on Brexit.
56. It is now understood that MHCLG are minded to introduce standardised factors for early retirement strain on the fund costs across the LGPS, purely for the purposes of testing against the £95k cap. In order to do this, it is expected that there will be a period of voluntary information gathering to see what funds currently do.
57. As so often happens with LGPS regulatory changes, implementation may follow long behind. Officers will continue to keep this matter under review and update Committee accordingly.

Recommendation

58. The Committee is recommended to note the report.

McCloud Q&A

The McCloud case Q&A for administering authorities

This Q&A outlines the potential timescales and possible outcomes of the McCloud case and its impact on the cost cap process. Throughout it will refer to the 'cost cap' which is the Government's Employer Cost Cap process as required under the Public Service Pensions Act 2013. There are also references to the SAB cost management process which is both separate and additional to the cost cap. Further information on both these processes can be found back on the [Cost management page](#) of this site.

At the end there is a question for administering authorities regarding the approach to the 2019 valuation. Please consider your view on this important matter and send your response to robert.holloway@local.gov.uk by Friday 1st March 2019.

What is the McCloud case?

The case concerns the transitional protections given to scheme members, who in 2012 were within 10 years of their normal retirement age, in the judges and firefighters schemes as part of public service pensions reform. Tapered protections were provided for those 3-4 years younger. On 20th December 2018 the Court of Appeal found that these protections were unlawful on the grounds of age discrimination and could not be justified.

What are the potential implications of the case?

If the protections are unlawful then those members who are found to have been discriminated against will need to be offered appropriate remedies to ensure they are placed in an equivalent position to the protected members. Such remedies will need to be 'upwards' - that is the benefits of unprotected members will need to be raised rather than the benefits of protected members being reduced.

If the case is about the judges and firefighters schemes why could it apply to all public service schemes?

Protections were applied to all members within 10 years of retirement in all public service schemes, with the form that protection took varying from scheme to scheme. Although the case only relates directly to two schemes it is anticipated that the principles of the outcome could be accepted as applying to all public service schemes.

Will there be a further appeal?

The Government has applied to the Supreme Court for permission to appeal. Normally a decision on whether to grant permission is received within 3 months of the application, so by mid-April 2019.

Why has the cost cap process been paused due to McCloud?

Should the finding of the Court of Appeal stand then significant changes to public service schemes may be required. Depending on extent and cost of these changes there could be a material impact on the outcome of the cost cap process.

What happens if the application to the Supreme Court is refused?

In this case the matter would be referred back to the Employment Tribunal for a remedy hearing. This would normally involve the submission of detailed evidence and could take 12 months or longer to reach a hearing. Once a Tribunal makes a finding on remedy,

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compensation will be awarded and the schemes amended as appropriate. Alternatively the parties might agree a remedy prior to any hearing and in any event we expect that the cost cap process will be re-run taking into account the remedy and any scheme amendments.

If the application for permission to appeal to the Supreme Court is successful when would a hearing be held?

In normal circumstances this would not be before the end of 2019. It is hoped given the implications of the case that an earlier hearing could be arranged. However, the hearing date is at the discretion of the Supreme Court and will depend on matters such as the priority it attaches to the case, the Court's workload and the current cases timetable.

What happens if the Supreme Court upholds the findings of the Court of Appeal?

As with a rejection of the application for a hearing, the matter would be referred back to the Employment Tribunal for a remedy hearing. This would normally involve the submission of detailed evidence and could take 12 months or longer to reach a hearing. Once a Tribunal makes a finding on remedy, compensation will be awarded and the schemes amended as appropriate. Alternatively the parties might agree a remedy prior to any hearing and in any event we expect that the cost cap process will be re-run taking into account the remedy and any scheme amendments.

What happens if the Supreme Court overturns the Court of Appeal judgment?

In this case we would expect the cost cap process to restart and result in a similar outcome to those at present.

When would any changes to schemes be effective from?

In the case of remedies, if the Court of Appeal judgement stands, these could be backdated to the commencement of existing protections in April 2015 (2014 for LGPS). For cost cap changes the Government has stated its intention to apply these from April 2019.

What LGPS protections could be in scope for McCloud?

Unlike other public service schemes the LGPS moved all members into the CARE scheme whatever their age. However those active members who were within 10 years of their 2008 scheme normal pension age on 31st March 2012 were protected via the statutory underpin. Protected members who meet the criteria for the underpin to apply, will receive the better of their CARE pension or one calculated under 2008 scheme rules.

What remedy could the Employment Tribunal process result in for the LGPS?

The remedy either agreed prior to or by the Employment Tribunal is designed to compensate those members found to have been discriminated against and may or may not be exactly in line with the benefits of protected members. It would therefore be premature to speculate on the form any remedy might take should the Court of Appeal judgement stand.

Would the SAB cost management process still run in the LGPS?

Yes in any outcome, it is the intention that the SAB cost management process (taking into account any remedies as a result of McCloud) would still run prior to the completion of the cost cap. At this point the SAB may choose to resubmit the existing proposals or review the package taking into account the cost of any remedy and the impact of backdating.

Will benefit changes have to be backdated to April 2019?

The SAB is committed to bring forward improvements to benefits costed on the assumption of an April 2019 effective date. However it is concerned about the confusion amongst scheme

members which may be caused by the backdating of benefit changes over a potentially significant period and in particular the impact on those who will have left the scheme, voluntarily or otherwise, after April 2019 and prior to the implementation of any scheme changes. The SAB is also acutely aware of the enormous challenge that would be faced by administering authorities and employers in potentially backdating scheme changes over such a significant period. It is therefore currently exploring legal and actuarial options to mitigate these challenges while meeting its obligation to bring forward changes that reflect in full the cost of benefit improvements from April 2019.

Will any benefit changes from McCloud be taken into account in the 2019 LGPS valuations?

That will depend on when the timing of the various potential outcomes and the availability of a confirmed set of changes. Although such changes could potentially be taken account of up to March 2020, realistically October 2019 is the cut-off date given the need for employers to set budgets for 2020-21. If the changes cannot be accounted for in the 2019 valuations, then depending on their extent and cost, an interim valuation may be needed to reset employer contribution certificates.

Question for LGPS administering authorities

With regards to the 2019 valuations would you prefer:-

A) To receive guidance from the SAB designed to promote a consistency of approach on how McCloud and/or cost management should be taken account of as part of the 2019 triennial valuation exercise. Such guidance would take the form that;

- i. If there is no finalised outcome on McCloud/Cost cap (including a commitment by government to detailed benefit changes) by 31st August 2019 then the scheme benefit design used in the valuation should be as set out in current regulations.
- ii. Each administering authority would then, with their Actuary, consider how they approach (and reflect in their FSS) the risk around this matter in the same way as they would for other financial, employer and demographic risks.
- iii. Once the outcome of McCloud is known and appropriate benefit changes are made administering authorities would, if they deem appropriate, re-visit employer contributions under such guidance or provision in regulation as may be available at that time.
- iv. A consistent approach to delaying or method of estimating exit credits and payments

Or

B) To have no central guidance and instead leave it to each administering authority to determine their own approach to their valuation (including any potential cost from McCloud or cost cap) taking advice from their actuarial adviser.