HYMANS ROBERTSON

Actuarial update

LGPS - Regulatory Changes

Executive Summary

- The outcome of the McCloud court case ruled that the transition protections given to older members when the 2008 LGPS final salary scheme closed are age discriminatory. The remedy is to retrospectively apply the same protections to all members who were in the 2008 LGPS scheme on 31st March 2012. This will result in a small increase in liabilities at Fund level of c£1.1m or 0.08%. Employer contributions already include an allowance for McCloud, therefore no significant impact on rates is expected (all else being equal). However, the administrative effort required to implement the remedy will be significant and we estimate the project will take 2 years or more to complete.
- The 2016 Scheme Advisory Board and HM Treasury cost management valuation processes have recommenced and may result in changes to member benefits or member contribution rates. Any changes will be back dated to 1 April 2019 which may require significant input from the Fund's administration team.
- HM Treasury have announced that an exit payment cap of £95,000 applying to all exits from public sector employers will be in place by the end of the year. Exit payments include redundancy payments, severance payments and **pension strain costs.** If the total value of such payments including strain costs exceeds the £95,000 cap then an employee's pension will be reduced. The LGPS consultation is now live, however, it now also includes plans to further reduce the value of redundancy packages of all members (especially those over age 55), not just those exceeding the £95,000 cap.
- The Goodwin case is another discrimination case addressing discrimination of the grounds of sexual orientation. This would have resulted in a small increase in liabilities at Fund level of c£0.6m or 0.05% of the liabilities. Similar to McCloud, there will be a further administration and communication burden to address by the Fund's administration team.
- The Government published a response to its consultation on "Changes to the valuation cycle and management of employer risk" on 26 August with changes to regulations coming into force on 23 September 2020. Administering Authorities will now have increased powers to review employer contribution rates between valuations and to enter into repayment plans with exiting employers. It also introduces a "deferred employer" status for employers, whilst also giving employers the power to request a review of their contribution rate.

Addressee and purpose

This paper has been commissioned by and is addressed to the London Borough of Hillingdon Council in its capacity as Administering Authority to the London Borough of Hillingdon Pension Fund ("the Fund"). It has been prepared by Hymans Robertson LLP (as Fund Actuary) to assist the Council's Pensions Committee to understand the nature and impact of several recent or expected changes to Regulations on the Fund. This paper should not be used for any other purpose.

Introduction

This paper addresses both funding and administration issues raised by the following regulatory changes and processes.

- McCloud (funding implications and cost);
- Cost management valuations for 2016 and 2020;
- Consultation on the £95k cap including some discussion on how it may impact on employer early retirement and redundancy strain calculations for some employers; and
- Goodwin ruling regarding equality of survivor benefits in same sex marriages again including the funding implications for your Fund and employers.

The McCloud judgement

The cause: transitional protections

One feature of the reform of all public sector pension schemes in the first half of the 2010s was the commitment to protect older members. For the LGPS, this protection was transitional and took the form of an underpin. From 1 April 2014, an eligible member would receive the better of benefits earned under the old 2008 scheme (60ths accrual, final salary, retirement age of 65) or the new 2014 scheme (49ths accrual, Career Average Revalued Earnings (CARE), retirement age equal to State Pension Age).

The format of the protections differed between public sector pension schemes, however, they were all uniform in applying the eligibility criteria – the protections would only be applicable to members who were:

- active in the scheme as at 31 March 2012; and
- within 10 years of their Normal Retirement Age (as defined under the pre-reform scheme rules, 65 in the LGPS) as at 1 April 2012.

Who benefits from the underpin?

A summary of the benefit changes introduced in 2014 are shown below:

	Final Salary scheme	CARE scheme	Impact
Accrual rate	1/60th	1/49th	Increase of 22%
Revaluation rate	Salary increases	Consumer Price Index	Depends on an individual's salary growth
Retirement age	65	State Pension Age (SPA)	Decrease for members where SPA is after 65

Due to the significant increase in benefit being earned each year through the improved accrual rate, a member would only benefit from the underpin if salary increases throughout their working life outweighed the additional 22% of CARE benefit (revalued in line with CPI) that had been earned each year.

The challenge

In 2016/17, members of the Judicial Pension Scheme (including one member named McCloud) brought a claim of age discrimination against the Ministry of Justice (MOJ) due to the imposition of the transitional protections. The members contested that, by applying the protections only to those members within 10 years of retirement at March 2012, younger members of the scheme were at a disadvantage.

The Ministry of Justice conceded that the protections did put younger members at a disadvantage, however they argued that this treatment was justified. The justification being that the members in scope of the protections would likely already have made advanced plans for financing their retirement and any change to their pension scheme may adversely affect these plans.

A separate but similar challenge was also launched by a member of the Firefighters' Pension Scheme.

The Employment Tribunal found against the MOJ and the members' complaints were upheld.

This original decision was appealed by the Government until it reached the Court of Appeal for consideration in November 2018. On 20 December 2018, the Court of Appeal ruled that:

- the Government's appeal was to be dismissed; and
- the claim of discrimination on the grounds of age is valid.

Following on from this ruling, in the first half of 2019 the Government sought leave to appeal this ruling at the Supreme Court. However, in June 2019, the Supreme Court refused the Government's application to appeal, meaning that the Court of Appeal's decision was final.

Following the Court of Appeal's decision at the end of 2018, in January 2019 the decision was been taken by the Government to suspend the ongoing Cost Cap valuations[1]. Further detail about the Cost Cap valuation, its interaction with McCloud and impact on funding is contained later in this note.

After the Supreme Court confirmed they would not hear the Government's appeal, in July 2019, the Government accepted[2] that the protections put in place were discriminatory and committed to remedying the situation. The court cases to date were only in respect of the Judicial and Firefighters' Pension Schemes. However, the Government also accepted that the ruling would, if tested, also apply to all other public sector pension schemes which implemented age-based transitional protections during the reform process. This includes the LGPS.

Since then, discussions have taken place to assess how best to resolve the discriminatory elements of the benefit structure (what has now become commonly referred to as "finding a solution" to "McCloud" or "the McCloud judgement"). It is not a viable option to entirely remove the transitional protections as that would involve reducing the accrued rights of some members (i.e. those eligible for the original protections and who would have benefitted, via higher benefits, from the existence of the protections). Therefore, the discussions have been focussed on how to adequately "level up".

[1] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-01-30/HCWS1286/

[2] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-07-15/HCWS1725/

Remedy

On 16th July 2020 MHCLG published consultation documents[3] setting out detailed proposals for addressing the discrimination. The consultation process closed on 8 October in England and Wales. Hymans Robertson have already published our response to the consultation which can be found at the link below[4].

In summary, the proposed remedy extends the 'transitional protections' underpin (that was promised to active members in 2012 who were within 10 years of normal retirement age) to all other active members, regardless of age. The underpin gives the member the better of CARE or final salary benefits for the eligible period of service.

In general terms, the key features of the underpin are:

- Eligibility is restricted to members who were active in the LGPS on 31 March 2012 and have accrued benefits since 1 April 2014;
- The underpin period applies between 1 April 2014 and 31 March 2022, but ceases when the member leaves active membership or dies in service;
- The final salary for comparison purposes applies at the point that the member leaves active status or reaches age 65; and
- The normal pension age for CARE benefits can be after the normal pension age for final salary benefits. The underpin requires the impact of any applied actuarial reductions to be considered in assessing which benefit is higher.

The changes will be retrospective and will apply to anyone who has left, retired or died and who did not meet the old underpin criteria but meets the new one. In some cases, this will mean retrospectively recalculating benefits for pensioners, and paying arrears and interest.

There is significant complexity in the detail of how the underpin will apply and the consultation addresses the topics of early leavers, deaths in service, early and late retirements, ill health retirements, members with multiple posts, breaks in service and aggregations of service across different LGPS employments, transfers between public sector schemes, annual allowance implications and the requirement to include information on the underpin on members' annual benefit statements.

Impact on funding and employer costs

At whole fund level, we do not expect the McCloud remedy to have a significant impact on the funding position and hence on employer costs.

Based on typical LGPS funding assumptions, we estimate that total liabilities could increase by c.0.2% (or by 0.6% of active liabilities), equivalent to around £0.5bn across the whole of the English & Welsh LGPS. This estimate is significantly less than the £2.5bn quoted in the LGPS consultation. This difference is due to a combination of factors, with the pay growth assumption being a crucial one for the reason set out above. The Government estimate uses CPI +2.2% p.a. which is significantly higher than that used by a typical LGPS fund. For Hillingdon, the pay growth assumption is CPI + 0.3% p.a.. Based on this we estimate that the McCloud underpin will add around 0.08% to the liabilities (equivalent to about £1.1m at the time of writing).

[3] https://www.gov.uk/government/consultations/local-government-pension-scheme-amendments-to-the-statutory-underpin
[4] https://www.hymans.co.uk/media/uploads/Hymans_Robertson_McCloud_Consultation_Response.pdf

Whilst at whole scheme level the impact is small, it may be material at individual employer level. This is where the LGPS differs from the other public sector schemes - everything is funded at employer level and contributions can and do vary materially across the employers in the Fund.

The variation in McCloud underpin impact arises due to differing membership profiles, and particularly age. Younger members will have a longer period of salary increases compared to older members (especially once promotional increases are considered, which tend to be higher at younger ages). There is therefore a higher likelihood that the underpin 'bites' for younger members. Our modelling suggests that some employers may see their total liabilities increase by as much as 5-10% whilst other employers will see no impact at all. There is also the potential for one-off significant increases which may result in an impact greater than noted above, for example, an employer with only one member who is awarded a significant pay increase. It is worth noting that introduction of the underpin to all eligible members, and the fact that the link to final salary will be retained up until the member retires, means that another source of volatility and uncertainty is introduced into the funding of LGPS benefits. We may see employer's funding positions and contribution rates changing by larger amounts between valuations because of this factor.

Formal valuation approach

SAB asked funds and actuaries to allow for McCloud costs at the 2019 valuation in England and Wales when setting funding strategies. For Hillingdon, we increased the required likelihood of achieving full funding for employers from 75% to 80% to build in some margin for McCloud costs. The approach taken to allow for the uncertainty caused by McCloud is set out in Section 2.7 of the Funding Strategy Statement. As a result, we do not anticipate the final remedy for McCloud to materially impact employer contribution rates (all else being equal).

Administration impact of McCloud

Despite the relatively small liability impact of the McCloud ruling, the administration impact will be significant. In conjunction with key stakeholders, the Fund will have to initiate and deliver a project to adjust member's records to reflect the new underpin and to correct any benefits which have already come into payment.

This project will take many months, and potentially years of effort depending on the membership affected. Key stages will include:

Understanding McCloud and establishing a project plan

The key outcomes from this stage will be to identify who is going to be working on the project, the key stakeholders and ensuring that they have the right level of knowledge. This stage would be expected to last until after the consultation process concludes and some outstanding policy decisions have been made. The UK Government have indicated that final Regulations may not be available until 2022/23 but have urged funds to begin work in the interim.

Identifying cases

Cases in scope then need to be identified using the key criteria set out in the consultation. In most funds around 20 -25% of members are likely to be impacted. Most LGPS funds have not collected final salary and working hours since 2014 as this data is not required to administer CARE benefits. Therefore, once the members have been identified, the Fund will then need to ascertain what data is missing.

Adjusting records

Member records will then need to have the correct information collected in order to enable an underpin calculation to be completed. This is one of the most difficult areas of the project and will involve significant engagement with employers to gather salary and working hours data back-dated from 1 April 2014. This will be challenging as some employers will have left the Fund, some may have changed payroll providers and some simply will not have kept the information required. There will be a need for policy decisions on how to approach situations where it is not possible to complete the data record but the Fund must ensure the members' benefits are calculated

accurately and the underpin applied fairly. Going forward, the data specification for employers will have to be changed in order to ensure the correct data is captured within future processes.

Recalculation of benefits

When the data is sourced for identified cases, the members' benefits will need to be re-calculated. For members still in service, or those who have left the Fund before retirement, their accrued pension may have changed and their annual benefit statement may need to be adjusted. There may be annual allowance tax implications for some members. Some of these calculations will be complex as a result of some of the issues mentioned above. Liaison with system providers is underway to specify changes required to the administration software to support the recalculation processes and ongoing requirements to assess the underpin. Early indications are that it may take around 12 months for administration providers to fully develop the calculation routines required once the outcome of the consultation is known.

Calculate arrears and interest and then pay arrears

Arrears and interest payments may be due for some members whose benefits are already in payment, if the McCloud underpin would have resulted in a different pension for these members. In some cases where benefits are changing there may also be tax charges for members. The tax implications of these proposals are complex as members who would not have breached annual allowance under the CARE scheme may breach the annual allowance if they become eligible for an underpin.

Final record adjustment to both the administration and payroll record if applicable

Finally, the member administration and payroll records will need to be updated with the calculated position and this must be maintained going forward.

Audit check and stakeholders

There is a significant list of stakeholders who will be involved in the project including current and former employees, their dependents, fund employers, your actuary, your administrator, the Committee and the Board, MHCLG, Treasury, SAB and others. Different stakeholders require different levels of involvement at the different stages of the project but communication across all groups about progress, issues and outcomes and costs will be vital. Given the complexity of the project checking and audit processes will also have to be robust.

Project management

The size and complexity of this project means that it will also require proportionate project management resource and expertise.

McCloud summary

The impact of the McCloud judgement will result in a small increase in liabilities of around 0.08% (or £1.1m as at the time of writing) and a negligible impact on employer rates. However, remedying the discrimination identified by the McCloud judgment will be a significant undertaking for the Fund's administration team.

Cost Management Valuations 2016 and 2020

In addition to McCloud, the "Cost Management Valuations" are ongoing national processes which are resulting in uncertainty around the benefit structure of the LGPS. These valuations were similarly borne out of the public service pension reform in the early 2010s.

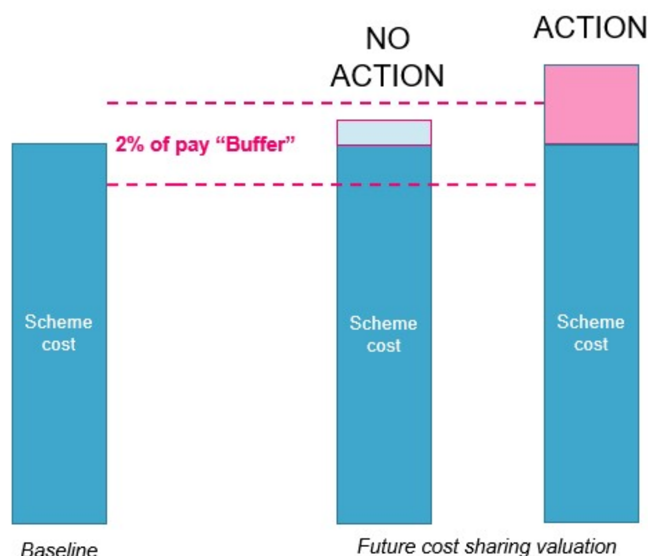
Background

As part of the reforms discussed earlier in this note, a mechanism was put in place which sought to put in a safety valve and protect employers from significant increases in future pension costs and to support the long-term sustainability of a defined benefit pension offering.

Historically, any variations in pension costs fell to the employer to fund as both benefits earned and employee contributions were defined in the Regulations. The cost mechanism sought to re-distribute the risk and share any cost variations with members. Prior to this mechanism being introduced, employer contributions had been on an upwards trend across a number of valuation cycles.

This mechanism works on the basis that every 3 or 4 years (the frequency varies between public sector pension schemes), a valuation at national level will be carried out by the Government Actuary's Department on behalf of Treasury to assess the overall cost of pension provision. The assessed cost will then be compared against a benchmark cost, and if the difference is equivalent to more than 2% of pay, then action will be taken to amend the benefit structure or employee contribution rates such that the current cost matches the benchmark cost. If the variation is less than 2% of pay then no action is taken.

This valuation is carried out on a set of assumptions set by HM Treasury and differ from those used for the purposes of your formal valuation to set employer contributions. One of the key features of the Cost Management valuation is that it limits the factors for inclusion to those that have an impact on the benefit received by a member. Critically, it makes no allowance investment returns earned on assets.



The mechanism was originally intended to act as a capping mechanism on costs i.e. action would only be taken if costs were higher than expected. However, during the reform implementation, the mechanism was amended to a symmetrical design i.e. there would be a cap and a floor on cost. Therefore, if costs were less than expected, then action would be taken to improve the benefit structure to restore the cost to its benchmark level. In essence, the Cost "Cap" became Cost "Sharing".

LGPS England and Wales

Alongside the Treasury Cost Management process (TCM) described above, the LGPS in England and Wales also has a Scheme Advisory Board (SAB) Cost Management process (SCM). The SCM is carried out ahead of the TCM and takes into account different factors from the TCM, including factors which are unique to the LGPS. Importantly, any change in benefits as a result of the outcome of the SCM process is allowed for within the TCM.

The SCM also works slightly differently in how it may implement amendments to benefits if the costs of the scheme have moved.

- A movement of between 0% and 1% from the target in either direction **may** result in agreed recommendations for action to move back to the target.
- A movement of between 1% and 2% from the target in either direction **should** result in agreed recommendations for action to move back to the target.
- A movement of 2% or more from the target in either direction **must** result in agreed recommendations for action to move back to the target.

By contrast, for the TCM mechanism, no corrective action will be required to move the costs back to the target unless there is a movement of 2% or more from the target in either direction. This gives SAB the opportunity to recommend small changes in the benefit structure during the SCM to avoid a larger change being triggered by the TCM process.

The first Cost Cap valuations were carried out as at 31 March 2016 and initial results communicated in Autumn/Winter 2018. Early indications were that the cost of the scheme had fallen as a result of falling improvements in life expectancy and lower than expected pay growth. The SCM process reported a fall of around 1% of pay and the TCM process was expected to report a fall in excess of 2% of pay below target therefore requiring future benefit improvements.

The SCM process proposed benefit improvements of around 1% of pay, mainly involving changes to employee contributions, and it was expected that after these benefit improvements were implemented no further action would be needed by the TCM process as their assessment of the scheme cost would be restored to within the 2% of pay buffer.

These changes were due to come into force under the relevant regulations by 1 April 2019.

Interaction with McCloud

Whilst the Government was dealing with the emerging Cost Cap results, they also learnt of the Court of Appeal's ruling in the McCloud case.

It was the Government's opinion that any increase in benefits due to McCloud should be factored into the ongoing Cost Cap valuations. Given that the McCloud remedy will result in an increase in pension costs, it may be of such a magnitude that the cost saving identified at the Cost Cap valuations reduces to less than 2% of pay when assessed using their approach. If this were to be the case, then no action would be needed to amend benefits from 1 April 2019. (Note that at this stage we are unable to assign a probability to how likely this outcome is).

Therefore, the Government announced in January 2019 that the 2016 Cost Cap valuation process would be put on hold until McCloud was resolved. After the resolution, the Cost Cap valuations would be restarted and, if any changes are required to be made to benefits or employee contributions, then they would be backdated to 1 April 2019.

Legal challenge

The action by Government to suspend the implementation of scheme changes as a result of the Cost Cap valuations has recently been challenged by several Unions (Fire Brigades Union, Public and Commercial Services Union, the Professional Trades Union for Prison, Correctional & Secure Psychiatric Workers and the GMB Union). In April 2020, these Unions filed court proceedings against the UK Government arguing that the suspension breaches the Cost Cap regulations (which states benefits changes must come into force from 1 April 2019)[5].

The challenge also effectively asserts the Unions' belief that the costs associated with resolving McCloud sit outside the Cost Cap mechanism.

The case is still ongoing, however, on 16th July 2020 the Treasury announced that the Costs Management processes for the LGPS will be re-started assuming that the McCloud costs are included in the calculations.

Administration impact

It is too early to tell how the inclusion of McCloud will impact the 2016 Cost Management process. It is possible benefits will no longer be changed or the changes will be narrower in scope. However, if changes are required and backdated to 1 April 2019, there will likely be a material one-off project to adjust benefits earned since that date including similar communication, tax and compensation elements described in the section on McCloud above.

The future of the Cost Cap

The results of the 2016 Cost Cap valuation (i.e. benefits potentially being improved) were likely to have been unexpected when agreeing to implement a symmetrical design. The rigid regulations that were put in place gave the Government no option but to implement benefit increases following the publication of the Cost Cap valuation results.

For many public service schemes, an increase to future benefits was announced at the same time as an increase to contributions (which arose due to a change in the HM Treasury valuation assumptions).

In light of the unexpected results, the Government confirmed in September 2018[6] (when the first initial results started to emerge) that the Cost Cap mechanism will be reviewed ahead of the next round of Cost Cap valuations (due to take place as at 31 March 2020) to ascertain whether it still meets the policy intent.

However, as this review has not yet taken place, the existing legislation will require the next round of Cost Cap valuations to take place as expected. We understand that GAD has recently requested data from the Fund for the 2020 Cost Cap valuation.

---

[5] https://www.fbu.org.uk/news/2020/04/25/firefighters-take-government-court-over-pension-%E2%80%98robbery%E2%80%99

[6] https://hansard.parliament.uk/commons/2018-09-06/debates/18090633000015/PublicServicePensionSchemesQuadrennialValuations

Public Sector Exit Payments

The government first announced plans to cap exit payments in the public sector in 2015. On 10 April 2019 HM Treasury (HMT) launched a consultation on draft regulations, guidance and Directions to implement the cap. HMT published its response to the consultation[7] on 21 July 2020.

Exit Payments £95k Cap

The cap will apply to all public sector employers. The exit payment cap is set at a total of £95,000 with no provision for this amount to be index-linked. Exit payments include redundancy payments (including statutory redundancy payments), severance payments, ***pension strain costs*** – which arise when an LGPS pension is paid unreduced before a member's normal pension age – and other payments made as a consequence of termination of employment. Although statutory redundancy is included as an exit payment it cannot be reduced. If the cap is exceeded, other elements that make up the exit payment must be reduced to achieve an exit payment of £95,000 or less.

The Regulators received ministerial approval on 13 October 2020 and are therefore expected to come into force from 4 November 2020.

Applying the cap in the LGPS

The major impact of the regulations will be on LGPS members aged 55 or over who currently qualify for an unreduced pension because of redundancy or efficiency retirement as well as a severance payment under The Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006.[8] We understand that changes to those regulations will prevent the payment of severance in addition to a pension strain cost. Not only will a severance payment no longer be payable but if a pension strain payment cannot be made in full because of the cap, then the member's pension would be reduced.

Pension strain cost

Currently the pension strain cost that an employer pays on the early retirement or redundancy of a member over the age of 55 is calculated at a local fund level using factors provided by your actuary which reflect your local funding assumptions. These factors were most recently reviewed following the 2019 valuation process. These factors are intended to reflect the difference in cost arising to the Fund as result of paying benefits sooner than expected and for a longer period of years. The local approach to calculating the strain could mean that members in different LGPS funds with the same accrued pension may have a different strain cost to take into account in the calculation of the exit payment limit and hence a different reduction. Therefore, MHCLG have asked the Government Actuary's Department (GAD) to produce standardised factors for use in these calculations.

This will result in equity between members in different funds but will lead to less accurate assessments of the strain costs for the employers and could result in employers paying less in strain costs at the time of exit. Any shortfalls will feed into an employer's position at the next triennial valuation and may result in contribution increases at that time.

How much are pension strain costs?

GAD have not yet published the factors to be used in these calculations so we cannot yet assess with certainty the pension strain amounts. However, using current strain factors for a typical Fund, some case studies are shown below, noting that in all four cases the member's LGPS pension would be a similar amount (broadly £15,000 p.a.).

[7] **https://www.gov.uk/government/consultations/restricting-exit-payments-in-the-public-sector**
[8] **https://www.legislation.gov.uk/uksi/2006/2914/contents/made**

Member	A	B	C	D
Salary	£30,000	£45,000	£90,000	£150,000
Exit Age	55	55	60	64
Service	30 years	20 years	10 years	6 years
Early retirement pension strain	£112,000	£112,000	£58,000	£12,000

Statutory Redundancy Pay

As set out above, statutory redundancy cannot be reduced. However, following discussions with MHCLG, the policy intent is for the member to 'give up' their statutory redundancy if their pension comes into payment. This is not clear in the consultation and is covered in more detail below. This applies independently of the value of a member's exit package.

Implementation issues

Although this policy was first announced back in 2015, there is now a very short timeframe for implementation and for the required changes to Regulations to be made. Any member leaving from an employer subject to the cap, after the end of the year, will have to have the employer strain cost calculated using the new standardised strain factors when available and members' pensions reduced as appropriate. As a result, it will be difficult to provide redundancy cost estimates to employers over the next several months.

There will now be two different processes for early retirements for employers who must apply the public sector exit cap and for employers who are outside of the public sector exit cap.

Future options

MHCLG is looking at options to introduce choice for members and is currently consulting on this. If over aged 55 and made redundant, the member would be able to choose between the following IF their exit package is less than £95,000 in value:

- Having their pension come into payment unreduced, but they would need to pay the Fund an amount equal to their statutory redundancy;
- Having their pension come into payment partially reduced to recover a value equal to their statutory redundancy, but the member would then be able to retain their statutory redundancy (as it is being taken from their pension); or
- Electing for their pension to not come into payment (i.e. deferring their pension). The member would then be able to retain their statutory redundancy.

In addition to the above, if the member's employer is required to pay a strain cost to the Fund if their pension comes into immediate payment, the member cannot receive any discretionary redundancy pay either. If the £95,000 cap were to apply, then further reductions would apply (such as an actuarially reduced pension or reductions to their severance package).

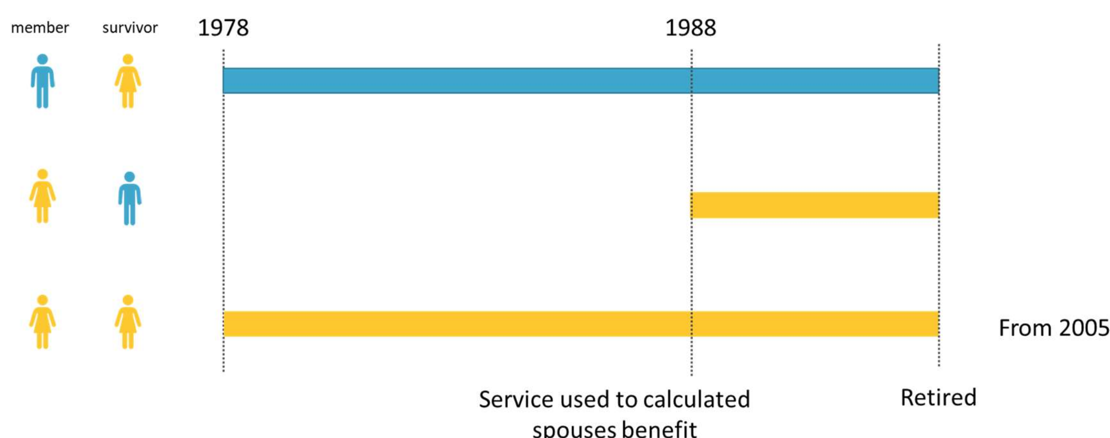
Administration issues

There will be a period where software providers need to update their systems in order to carry out the required calculations. Early indications are that this could take up to 12 months. During this period, the administration team may be required to manually carry out retirement quotes and strain calculations. This may be further complicated that this is only expected to apply to some employers in the scheme, not all. So there may be different process for different employers. In addition, the process of collecting the statutory redundancy from members where they elect to take an unreduced pension will be an additional burden.

Goodwin ruling

The Goodwin tribunal was raised in the Teacher's scheme. It claimed members, or their survivors, were discriminated against due to their sexual orientation. The claim was because the Teacher's scheme provides a survivor's pension which is less favourable for a widower or surviving male partner, than for a widow or surviving female partner of a female scheme member. On 30 June 2020, the Tribunal found in favour of the claimant and agreed there was discrimination.

This finding and remedy is expected to apply across all public service pension schemes, including the LGPS. The diagram below illustrates the inequality in the LGPS.



The first case considers a male member who entered into their partnership/marriage with their spouse or partner after leaving active status. All of this member's service from 1978 until retirement would count towards the calculation of the survivor's pension.

The second case considers a female member who entered into their partnership/marriage with their **male** spouse or partner after leaving active status. Even if they had identical service histories to the male member in the first case, the survivor's pension would only be based on service from 1988 until they retired if they entered into their partnership or marriage after leaving active employment. This was viewed as unfair and female members were given an option to purchase the "missing service" to uplift their dependent's benefit.

However, in 2005, following on from the Walker case, the definition of spouse in the Regulations was expanded to include same sex relationships. In effect, from 2005, if a female had a female spouse or partner and their partnership/marriage was entered into after they left active status, all their service since 1978 counted towards their survivor's pension and they were not required to pay additional contributions to benefit from this uplift. Therefore, the tribunal found discrimination on grounds of sexual orientation.

Remedy and Administration Issues

A group of members, namely females who have a male survivor, may have their survivor's pension uplifted to include any service accrued between 1978 and 1988.

In order to administer this all post-2005 deaths of female members will need to be investigated. In some circumstances, the Fund may not have any data on survivors or their whereabouts which could prove to be a significant challenge. This would be an unwelcome burden alongside McCloud (and potentially Cost Sharing) activity.

For employers, the impact is likely to be a small increase in their liabilities. For Hillingdon, the expected increase in liabilities from Goodwin is 0.05% of the Fund's liabilities (about £0.6m at the time of writing).

As a result, and similar to McCloud, the impact is largely going to be administrative.

Regulation changes to support management of employer risk

In May 2019, MHCLG launched its consultation "Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk". The consultation sought views in the following areas:

a) Changes to the LGPS local fund valuation cycle

b) Increased flexibility for Funds to carry out interim valuations and/or review employer contributions between formal valuations

c) Proposals for flexibility around employer cessation debts

d) Proposals for policy changes for payments of employer exit credits

e) Potential changes to employers required to offer LGPS membership.

The outcome of the exit credit consultation (d) was published in February this year. There has been no update on changes to the valuation cycle proposals (a) or to the employers who are required to offer LGPS access (e).

The response published in August 2020[9] dealt with items (b) and (c), with Regulation changes coming into force on 23 September 2020, allow the Fund to recalculate employer contributions in the following circumstances:

- If there has been a significant change to the liabilities of an employer
- If there has been a significant change in the employer's covenant
- At the request of the employer.

This publication also allows greater flexibility around managing the exit of an employer from the Fund. On exit from the Fund, where the employer is in deficit, the following options may be available:

- The employer pays a full exit payment carried out in line with regulation 64(4) of the 2013 LGPS Regulations;
- The Fund can agree a repayment schedule with an employer to allow them to spread the exit payment over a number of years; or
- The employer can enter into a Deferred Debt Arrangement (DDA) where the employer can continue in the Fund with no active members but continue to pay secondary (deficit) contributions as determined at formal valuations. An employer entering into this arrangement would be known as a "deferred employer".

Whilst many Funds have entered into all these arrangements at some point in time, these will now be fully supported by the regulations.

The Fund's Funding Strategy Statement will need to be updated to reflect the Fund's approach to these changes once guidance from national bodies becomes available (from LGA, MHCLG, CIPFA or the Scheme Advisory Board) and having taken advice from the Fund's actuary.

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

Summary and next steps

This paper highlights several important regulatory changes that will directly impact both members and employers over the coming months and years. Together, they represent a significant challenge to Fund administration processes and bandwidth, especially given the challenges of the current working environment. The Fund will have to consider how to manage this change program including:

- Project planning and management;
- Stakeholder communications;
- Resource requirements;
- Risk management; and
- Appropriate audit and oversight.

We would be pleased to provide further information or support on any of the topics mentioned above.

Reliances, limitations and professional notes

This paper should not be released or disclosed to any third party without our prior consent. Hymans Robertson LLP accepts no liability to any other party unless we have expressly accepted such liability.

This report complies proportionately with the relevant Technical Actuarial Standards set out below:

• TAS 100 (Principles of Technical Actuarial Work); and

• TAS 300 (Pensions).

Prepared by:-

Steven Law FFA

For and on behalf of Hymans Robertson LLP

15th October 2020