

**LOCAL GOVERNMENT PENSION SCHEME (ENGLAND AND WALES):
AMENDMENTS TO THE STATUTORY UNDERPIN**

A RESPONSE TO MHCLG'S CONSULTATION PAPER

OCTOBER 2020



ABOUT THE PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses which provide essential services and advice to UK pensions providers. Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

EXECUTIVE SUMMARY

- ▶ The PLSA supports the Government's proposal to address the discrimination found in the McCloud and Sargeant cases by extending the underpin to younger scheme members with the underpin period applying from the 1st April 2014 to the 31st March 2022.
- ▶ We believe the Government's plan to implement a two-stage underpin process is practical and in line with the stated policy intentions.
- ▶ The proposal to include information about the underpin in members' annual benefit statements is sensible. Consistency for members across the LGPS will be key and so we welcome plans to ask the Scheme Advisory Board (SAB) to develop a standardised approach to how this information will be communicated.
- ▶ Implementing these changes will present a significant challenge to funds and their administrators given the number of members who could be potentially impacted. A substantial number of pension records will need to be updated while benefit calculations relating to members who have left the scheme since 2014 will need to be reviewed. This will be a very large undertaking, particularly at a time where pension administrators are already stretched due to the impact of Covid-19 and an increasing workload resulting from GMP rectification as well as projects to improve their data and systems.
- ▶ Gathering the necessary data in order to calculate the underpin will also be a challenge for both administrators and employers. While there is a risk that employers may not hold the necessary data if the employment records are missing or incomplete, while some employers might have exited the scheme in the relevant period.
- ▶ Members have advised us that implementing the changes could take from 12 to over 24 months due to the amount of resource they have to dedicate to implementing such large scale changes alongside their necessary functions, it is therefore important that administering authorities are given enough time to implement the proposals to ensure that their other tasks, such as benefit payments, do not suffer as a result.
- ▶ While the PLSA understands the reasons why the Government has proposed an additional 12 month period for members to elect to aggregate previous periods of LGPS membership, given the complexity of the changes we are concerned that this period is may not be sufficient for members to undertake the actions necessary to come to the decision, while almost 40% of the PLSA LGPS members stated that this process would take over a year. Rather, we recommend administrative authorities should be given the discretion to extend this 12 month period.
- ▶ Standardised guidance will be vital in ensuring consistency in how the changes are implemented across the LGPS. We urge the Government and the Scheme Advisory Board (SAB) to develop guidance for administrators regarding issues including how they should approach case prioritisation, how to treat member queries, for standard

communications to members and what should be done in the event that they cannot collect all of the data needed to do the calculations. This will be particularly important to ensure fair outcomes for members and their survivors.

INTRODUCTION

- ▶ The Pensions and Lifetime Savings Association (PLSA) welcomes the opportunity to respond to the Ministry of Housing, Communities & Local Government's (MHCLG's) consultation on proposed changes to the statutory underpin.
- ▶ The PLSA conducted a survey with its members and consulted with its Local Authority Committee on the proposals set out in the consultation. We welcome many of the Government's proposals in the consultation, including plans to address the discrimination found by the Court of Appeal by extending the underpin to younger scheme members, to have an underpin period applying from the 1st April 2014 to the 31st March 2022 and to introduce a two-stage underpin process.
- ▶ However, we do have concerns about the impact these proposals will have on funds and their administrators as well as employers, given the significant amount of resource and data that will be needed to implement the remedy.

RESPONSE

Question 1 – Do you agree with our proposal to remove the discrimination found in the McCloud and Sargeant cases by extending the underpin to younger scheme members?

- ▶ Yes, we believe that the proposal will address the discrimination found by the Court of Appeal.

Question 2 – Do you agree that the underpin period should end in March 2022?

- ▶ We agree that the underpin period should apply up to the 31st March 2022.

Question 3 – Do you agree that the revised regulations should apply retrospectively to 1st April 2014?

- ▶ In order to remove the discrimination found in the ruling, and treat members of the scheme in a fair and equitable manner, we agree it is necessary for the regulations to apply retrospectively to the 1st April 2014.

In relation to cases where a member has already retired, the Government may wish to consider implementing a minimum amount that a member's pension is changed as a result of the underpin, for example £1 a month. This approach would reduce the likelihood of members having to deal with the complexity of the changes for what would be a very nominal amount.

It would also relieve some of the administrative burden on schemes in relation to the number of retrospective cases they would need to adjust.

Question 4 – Do the draft regulations implement the revised underpin which we describe in this paper?

- ▶ Yes, we believe the draft regulations will implement the revised underpin as described.

Question 5 – Do the draft regulations provide for a framework of protection which would work effectively for members, employers and administrators?

Members

- ▶ We do believe the protections would work for members.

Employers

- ▶ In order for administering authorities to undertake the underpin calculations, employers will need to provide them with data on eligible members including part-time hours, service breaks and historic salary details relating to both current and former employees. This will be a large undertaking for employers, and it is likely that many will not be able to provide all the necessary data required for the calculation in the event that records are missing or incomplete.
- ▶ As such, guidance will be needed for both employers and funds as to how they should address the issue of missing data and ensure the regulations work effectively.

Administrators

- ▶ We believe that the implementing these changes will present a significant challenge to administrators and guidance will be needed from the Government to ensure the regulations are implemented effectively.
- ▶ In order to implement the changes, administrators will need to update a substantial number of pension records while reviewing any benefit calculations relating to members who have left the scheme since 2014. This will be a very large undertaking, particularly at a time where pension administrators are already stretched due to the impact of Covid-19 and an increasing workload resulting from GMP rectification, the Pensions Dashboard, the 95k cap, changes to exit payments, as well as projects to improve their data and systems.
- ▶ As discussed above, a significant amount of data will have to be gathered in order to calculate the final salary underpin. Not only will administrators be reliant on employers to provide the data (which may not be possible), but they will also depend on software providers to ensure the administrative software is up to date. We are concerned that the effectiveness of the regulations may be undermined if administrators do not have access

to all the data necessary to make the underpin calculations and that any delays in specification would lead to delays in the providers undertaking the system build.

- ▶ Statutory guidance will be needed to ensure consistency in relation to how administrators should approach case prioritisation, how to treat member queries, for standard communications to members and what should be done in the event that they cannot collect all of the data needed to do the calculations.

Question 6 – Do you have other comments on technical matters related to the draft regulations?

- ▶ We do not have any comments.

Question 7 – Do you agree that members should not need to have an immediate entitlement to a pension at the date they leave the scheme for underpin protection to apply?

- ▶ This proposal is sensible and will address the discrimination for all members.

Question 8 – Are there any other comments regarding the proposed underpin qualifying criteria you would like to make?

- ▶ There is a concern that the qualifying criteria for the underpin in relation to members who joined the scheme on or after 1 April 2012, but were not in the scheme on 31 March 2012 is unclear and further clarity from the Government would be useful for funds.

Question 9 – Do you agree that members should meet the underpin qualifying criteria in a single scheme membership for underpin protection to apply?

- ▶ While we agree that the underpin criteria should apply in a single scheme membership, however, as per our answer to question 5, we have concerns over the impact on administrators when it comes to undertaking the work involved to ensure a member meets the criteria.
- ▶ There is also a question as to whether the data is available to confirm that a member meets the criteria in a single scheme membership. For example, employers may not hold the historic details of ex-employees. Guidance will be needed from the Government in this case.

Question 10 – Do you agree with our proposal that certain active and deferred members should have an additional 12 month period to decide to aggregate previous LGPS benefits as a consequence of the proposed changes?

- ▶ While we understand the reasons why the Government has proposed an additional 12 month period, given the complexity of the changes we are concerned that this period is

may not be sufficient for members to undertake the actions necessary to come to the decision.

- ▶ The tasks of identifying and communicating all members who may be eligible will take significant resource from administrative staff, as will adequately responding to any member queries which arise from this. All of this must be done within the 12 month window, reducing the amount of time members will have to make a decision on issues which are not only complex, but are likely to be completely unknown to them up until the first communication they receive from their fund.
- ▶ As such, we believe administrative authorities should be given the discretion to extend this 12 month period, though this could be limited to a specific timeframe, to avoid misuse or creating perverse incentives.

Question 11 – Do you consider that the proposals outlined in paragraphs 50 to 52 would have ‘significant adverse effects’ in relation to the pension payable to or in respect of affected members, as described in section 23 of the Public Service Pensions Act 2013?

- ▶ We do not have any comment.

Question 12 – Do you have any comments on the proposed amendments described in paragraphs 56 to 59?

- ▶ We believe the proposed amendments are consistent with the Government’s policy in relation to the protections.
- ▶ Going forward, guidance for LGPS funds will be needed in terms of application of these proposals.

Question 13 – Do you agree with the two-stage underpin process proposed?

- ▶ Yes, the two-stage underpin process is a sensible approach and is in line with the Government’s stated policy.

Question 14 – Do you have any comments regarding the proposed approaches outlined above?

- ▶ Some PLSA members have raised concerns that the proposals could potentially expose the LGPS to further claims of age discrimination. This could be the case where a member over the age of 65 leaves active service, and rejoins within five years, would then not benefit from the underpin protection.

- ▶ Though the Government has said that this approach is in line with the decision to only provide underpin protection until a member's 2008 Scheme NPA, the Government may wish to consider whether to remove the age limit.

Question 15 – Do you consider there to be any notable omissions in our proposals on the changes to the underpin?

- ▶ We do not believe there are any notable omissions in the proposals relating to the changes to the underpin, but do believe the Government should consider the views expressed in question 14.

Question 16 – Do you agree that annual benefit statements should include information about a qualifying member's underpin protection?

- ▶ It would be useful for those members who are effected by the underpin to receive information about it in their annual benefit statements.

Question 17 – Do you have any comments regarding how the underpin should be presented on annual benefit statements?

- ▶ Consistency will be important as to how the information is presented to members across the LGPS, therefore the proposal to ask the Scheme Advisory Board (SAB) to develop a standardised approach to wording is welcome.
- ▶ We are concerned that including the provisional underpin amount and provisional guarantee amount for active members could lead to confusion given that the amounts would change each year. It may be prudent to either omit the amount to avoid such confusion, or include wording to explain to members that the amount will only be fully known once the member takes their benefits.

Question 18 – Do you have any comments on the potential issue identified in paragraph 110?

- ▶ On balance we believe that it is sensible to test the underpin against the annual allowance at the underpin crystallisation date given that this will be the date that the underpin will have an impact on the member's benefits. This approach also has the benefit that any increase may be able to be offset if a member has unused annual allowance.
- ▶ However, as the Government outlines in the consultation, we understand that this approach could result in a member seeing a larger pension input amount in the period of the underpin crystallisation date as opposed to an approach where the underpin value is considered annually whilst the member remains active.

- ▶ The approach may also not work for any member who has a relatively low career average pension in respect of the underpin period, but goes on to be a higher-earner as their career progresses.
- ▶ As such, it may be sensible to adopt the approach to apply the annual allowance test at the underpin crystallisation date in the short to medium term as the underpin remains relatively modest, but keep the approach under review for the longer term, with the potential to shift to an annual assessment if the median underpin grows more significant in value. It would be unfair for individuals to receive a tax penalty as a result of correction, and this risk should be mitigated or an exemption granted.

Question 19 – Do the proposals contained in this consultation adequately address the discrimination found in the ‘McCloud’ and ‘Sargeant’ cases?

- ▶ We do believe that the proposals address the discrimination found in the two cases.

Question 20 – Do you agree with our equalities impact assessment?

- ▶ We do not have any comments on the equalities impact assessment.

Question 21 - Are you aware of additional data sets that would help assess the potential impacts of the proposed changes on the LGPS membership, in particular for the protected characteristics not covered by the GAD analysis (age and sex)?

- ▶ We are not.

Question 22 – Are there other comments or observations on equalities impacts you would wish to make?

- ▶ We do not have any comments on the equalities impacts.

Question 23 – What principles should be adopted to help members and employers understand the implications of the proposals outlined in this paper?

- ▶ It is important that standardised communications across LGPS funds will ensure consistency and help both employers and members better understand the implications of the proposals. We believe that the Scheme Advisory Board is best placed to develop this material which can then be adapted by Funds when necessary.

- ▶ Given the complexity of the changes, it is important that members receive communications, whether through websites (including FAQs), newsletters, benefit statements, and letters, to name a few, providing them with information on the underpin process and what it means for them in practice while also setting out realistic expectations when it comes to the impact on their benefits and when these will be made. These should be as straightforward and done in a way that is as easy to understand as possible.
- ▶ Communications with employers should be focused on what will be required from them in terms of the data for the underpin calculation and what should be done in the event that the data is missing or incomplete. Given that many employers may also be working with limited resources, it is vital to engage with them as to how the LGPS fund can support them in this task.

Question 24 – Do you have any comments to make on the administrative impacts of the proposals outlined in this paper?

- ▶ Despite many being unlikely to see an additional underpin payment, funds will be required to check the benefits and carry out underpin calculations for all those who may fall into the scope of the changes, which has been estimated to be between 1-1.5 million members¹.
- ▶ These proposals will inevitably increase the administrative burden on LGPS funds, at a time where administrative teams are already struggling with the impacts of Covid-19 and other projects (please see our answer to question 5).
- ▶ Obtaining the necessary data from employers to produce the underpin calculation will be a large challenge for administrators. Though employer records are for the most part straightforward, the sheer number of members that will need to be checked will inevitably result in employers not being able to provide all of the data. This may be because employers not holding the historic payroll data, or hold information on part-time hours or service breaks. Additionally, employers may no longer be active, which will add complexity in trying to obtain historic records.
- ▶ Applying the underpin calculations to members that have retired or left the scheme will also be a challenge for administrators, particularly in cases where the retrospective underpin will see the member owed backdated payments or, in even more complex cases, a payment needing to be made to a survivor's pension.
- ▶ Administrators will also be relying on administration software systems, which will need to be updated in order to carry out the underpin calculations. If this is not done in a

¹ Aon (2020) see here: <https://www.aon.com/unitedkingdom/media-room/articles/lgps-schemes-must-act-impact-of-mccloud.jsp>

timely manner, administrators could be left to carry out these calculations manually, taking up additional time and resource. Steps will need to be taken to ensure software providers are efficient in updating their software to minimise the burden on schemes.

- ▶ Given the scale and complexity of the change to the underpin, communicating the changes to members will also be a significant exercise for administering authorities.
- ▶ Furthermore, issues may arise if administering authorities take different approaches to implementing and communicating the changes to members. In order to address this, we urge the Government to develop standardised guidance in how funds should approach implementation. This could range from how to communicate with members to how administrators should prioritise cases.
- ▶ Members have advised us that implementing the changes could take from 12 to over 24 months. This can depend on scale, for example larger funds and those with more employers will have a larger task than smaller funds and may need more time or due to the amount of resource they have to dedicate to implementing such large scale changes alongside their necessary functions. It is therefore important that administering authorities are given enough time to implement the proposals to ensure that their other tasks, such as benefit payments, do not suffer as a result.

Question 25 – What principles should be adopted in determining how to prioritise cases?

- ▶ In terms of prioritising cases, we believe priority should be given to those members who have already retired or those on survivor's benefits as the underpin will have direct impact on their current retirement income.
- ▶ Following this, cases where members have transferred out and those close to their crystallisation date should be dealt with.

Question 26 – Are there material ways in which the proposals could be simplified to ease the impacts on employers, software systems and scheme administrators?

- ▶ Given the intent of the policy, we do not believe simplifying the proposals is possible.
- ▶ However, as discussed in our answers to questions 24 and 25, we do believe clear guidance will be needed detailing how cases should be dealt with and what should be done in the event that data is unavailable, will help reduce the burden on both funds and employers.

Question 27 – What issues should be covered in administrative guidance issued by the Scheme Advisory Board, in particular regarding the potential additional data requirements that would apply to employers?

- ▶ In order to ensure that a consistent approach is taken to the data requirements, we believe it would be useful if SAB provided guidance on how funds should approach cases where data is missing or incomplete.

Question 28 – On what matters should there be a consistent approach to implementation of the changes proposed?

- ▶ Guidance from SAB in relation to administration, data and communications to ensure consistency in the approach to implementation would be useful.
- ▶ As per our answer to question 27, we also believe guidance will be necessary in the event that member data is missing or incomplete.

Question 29 – Do you have any comments regarding the potential costs of McCloud remedy, and steps that should be taken to prevent increased costs being passed to local taxpayers?

- ▶ As the Government has outlined in the consultation, the costs of implementing the remedy are likely to be substantial. We also understand that the cost of implementing the remedy will mostly fall on the employers, with many of these being third tier employers which are funded by the taxpayer. It is expected that these costs will vary depending on the employer and their membership profile, with some seeing higher costs while others may see very little impact.
- ▶ However, prior to the last valuation in 2019, SAB requested funds and actuaries factor in McCloud costs when setting out their funding strategies, as such, many funds will have made preparations for the cost of implementing the remedy for themselves and their employers. It is therefore unlikely that member contribution rates will be revisited until the next valuation in 2022.
- ▶ There is a concern that the cost to funds in relation to administration and communications will be considerable and should not be underestimated, with some of our members expecting the costs to run into six figures. Though these much of these costs are likely to be unavoidable, some could be mitigated by providing structured guidance to ensure consistency and reduce the amount of resource needed in determining how to implement the remedy, as well as resources such as communication templates and FAQs for members. The Government may also want to consider running a pilot for the changes, to examine the full impact this will have on funds.