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Local Government Finance Stewardship  
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Your Ref:  
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Sent by e-mail to: LGPensions@communities.gov.uk

Dear Sirs,

### **Local Government Pension Scheme (England and Wales) Amendments to the statutory underpin**

The Essex Pension Fund welcomes the opportunity to comment on the proposals to amend the rules governing 'transitional protection' in the Local Government Pension Scheme (LGPS). We are responding in our capacity as an Administering Authority within the scheme.

We generally welcome the proposals to remove the discrimination found in the McCloud and Sargeant cases by extending the underpin to younger scheme members.

We have serious concerns regarding the proposal that annual benefit statements for active members under the 2008 Scheme normal pension age should include information about a qualifying member's underpin protection. We strongly urge the government to remove this requirement from the final amendment regulations for the reasons given in our response to question 16.

We would strongly urge MHCLG to bring forward final regulations as soon as possible to provide certainty around the changes required to systems and processes which will require months to complete. See our response to question 24.

The administration and communications costs of implementing remedy will be substantial for LGPS funds and we believe the government should cover those costs, bearing in mind it proceeded to introduce the original underpin in the full knowledge that to do so would contravene age discrimination legislation. This cost should not fall to local taxpayers. See our response to questions 3 and 29.

### **Response to the consultation questions**

***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, the proposals would appear to be consistent with the Court of Appeal's ruling.

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

Yes, the original underpin could not have applied to service after 31 March 2022 so ceasing the underpin period on that date is consistent with the original government commitment.

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

Yes, to achieve fairness and equality the revised regulations must apply retrospectively.

However, the government should not underestimate the substantial additional administration and communications costs involved for LGPS funds and we believe it should cover funds' additional costs, bearing in mind it proceeded to introduce the original underpin in the full knowledge that to do so would contravene age discrimination legislation.

In chapter 7.34 of the Independent Public Service Pensions Commission: Final Report dated 10 March 2011, Lord Hutton said "Age discrimination legislation also means that it is not possible in practice to provide protection from change for members who are already above a certain age".

It is clear, therefore, that the government knew before it introduced the original underpin that it would contravene age discrimination legislation. For this reason, we believe the government has a duty to cover funds' costs.

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

Yes.

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

The protection would appear to work effectively, however the additional work required of LGPS administrators in particular is colossal and I would draw your attention to our response to Question 3 concerning who should pay for the cost of this additional work.

Also, it is unlikely that all employers will be able to provide every piece of data that is required to calculate the underpin across all eligible members. Funds may, therefore, need to make assumptions to fill in any gaps in the data, which could undermine the effectiveness of the regulations. We would welcome guidance from MHCLG/SAB on how funds should account for any missing data required to calculate the underpin and how this should be communicated with employers and impacted scheme members.

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

No. We have had sight of the LGPS Scheme Advisory Board draft response to this consultation and we support its comments in relation to technical matters contained in the draft regulations.

***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?***

Yes. Requiring members to have an immediate entitlement to a pension at the date they leave the scheme for underpin protection to apply would not remove the unlawful age discrimination.

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

The proposals do not extend the underpin to younger members who joined the Scheme after 31 March 2012 who will have final salary membership but will not qualify for the new protection because the Scheme changes were already publicised when they joined. We think this could be an area of future challenge given that younger members are likely to see the cost of the remedy passed onto them via the cost cap arrangement and the average age of those joining between 1 April 2012 and 31 March 2014 is likely to be younger than those leaving during the same period, which could amount to indirect age discrimination.

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

Yes, this is the approach taken on the 85-year rule and the final salary link. Allowing members to meet the qualifying criteria in respect of multiple periods of unaggregated membership is inconsistent with how the Scheme operates and would be administratively complex.

***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?***

Yes, it would seem proportionate to allow active and deferred members this opportunity where they would lose their right to underpin protection if their benefits were not aggregated. despite the administrative burden

We believe there should be a discretion to allow LGPS funds to extend the 12-month aggregation window in order to provide for cases where there are difficulties communicating with the member.

***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?***

No, we do not consider that the proposals would have significant adverse effects in relation to the pension payable to or in respect of affected members as:

- LGPS administrators will not have taken unaggregated membership into account when calculating the current underpin for members that have retired since 2014.

- Most members who have retired since 2014 are better off under the CARE scheme because of the significantly better accrual rate.

Going forward, the members that are most likely to be affected are:

- concurrent members where membership ends on the same day, so it is not possible to aggregate
- members who opted out on or after 11 April 2015, as the regulations do not permit aggregation if they re-join the Scheme

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

Despite adding yet more administrative complexity, the proposed amendments to widen or clarify the protections would appear to be consistent with the stated aim of ensuring that the underpin works effectively and consistently for all members.

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

Yes, the two-stage process is necessary to ensure a true comparison of final salary and CARE benefits takes place because it takes account of the different normal retirement ages in the two schemes as well as any future changes to State Pension age.

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

We do not agree with the requirement to include information about the underpin in annual benefit statements for active members under the 2008 Scheme normal pension age. See our response to question 16 for more details.

We would also question the need to include “details of the provisional calculations undertaken at their underpin date” in annual benefit statements sent to deferred members. Details of the provisional calculations are included in the deferred benefit statement sent to members on leaving and we believe it would serve no useful purpose to keep including those details every year. Funds should be free to provide deferred members with the details necessary for them to understand how their benefits have increased since the previous statement; providing too much detail in statements makes them more difficult for members to understand and less engaging.

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

Has any consideration has been given to how the proposed remedy will interact with the Restriction of Public Sector Exit Payments Regulations 2020, when enacted. What happens in the situation where a person:

- is awarded an exit payment capped at £95,000 in the period between the exit payment regulations becoming effective and the changes to the underpin taking effect, and
- then receives a retrospective increase to their benefits because of the changes to the underpin?

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

No. We do not agree with the requirement to include information about the underpin in annual benefit statements for active members under the 2008 Scheme normal pension age and we strongly urge the government to remove this requirement from the final amendment regulations.

Our primary reasons for not agreeing are three-fold:

1. There is a very real danger including such notional details could be both misleading and create a false expectation for many members

For example, a member could, in a given year, have a notional underpin amount because of high pay growth. But the same member may then experience comparatively low pay growth over the years to retirement to an extent that, at the underpin crystallisation date, the underpin no longer applies.

2. Funds would have to prioritise correcting active and deferred member records and updating systems for the purposes of complying with the new ABS requirement over the far more pressing issue of revisiting pensions in payment / recalculation of death benefits etc.
3. Annual benefit statements should be kept as simple as possible so members can understand them – to include a notional calculation of a provisional assessment will not achieve this.

Whilst we believe the calculation of a provisional assessment of the underpin at the underpin date serves a useful purpose, we do not believe a notional calculation of a provisional assessment each year serves a useful purpose.

The revised underpin will “bite” for relatively few members and, for those for whom it does, any increase will be small. We strongly believe that the underpin can only usefully be calculated at the underpin date and the underpin crystallisation date.

Further, the consultation proposes that annual benefit statements include the provisional guarantee amount, the provisional assumed benefits and the provisional underpin amount. The provisional assumed benefits figure represents the CARE pension the member has built up during the remedy period, it is this figure that is used to compare with the benefits the member would have built up had they remained in the final salary scheme. By necessity, the figure does not include any pension bought by a transfer in, any additional pension the member / employer has bought (except if it is bought to buy back pension lost in a period of authorised leave) and it is assumed the member is always in the main section. For some members, the provisional assumed benefits figure could be very different to the actual CARE benefits they have built up during the remedy period and this could lead to further confusion.

If the government does decide to proceed with such a requirement, and we strongly urge it not to, then the requirement should not come into effect until at least 2025 to

allow funds to prioritise revisiting pensions in payment / recalculation of death benefits etc.

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

As set out in our response to question 16, we do not agree with the requirement to include information about the underpin in annual benefit statements for active members under the 2008 Scheme normal pension age. Annual benefit statements need to remain as simple and easy to understand as possible so that members engage with them and find them useful. To include a notional calculation of a provisional assessment of the underpin would make the statements more complex and would serve only to confuse and misinform members.

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

We believe a consistent approach must be taken and, on balance, the general approach in relation to the current underpin and the annual allowance should continue in relation to the revised underpin and annual allowance.

The underpin crystallisation date is the only date at which the definitive value of the underpin is calculated and, therefore, the date at which the member experiences the actual pension growth attributable to the underpin.

Whilst this approach could have the effect of causing a spike in the closing value of a member's benefits in the pension input period in which the underpin crystallisation date occurs, this approach also means an affected member is more likely to have some unused annual allowance remaining from the previous 3 years which they can use to offset any tax charge.

Also, the alternative approach of capturing the value of any notional underpin on a year by year basis would come with unwelcome side effects; for example, applying the notional underpin in any given year may cause the member to breach the annual allowance, even though the member is a number of years away from retirement. The same member may then experience comparatively low pay growth over the years to retirement to an extent that, at the underpin crystallisation date, the underpin no longer applies. In these circumstances the member would have paid a tax charge on a benefit that was ultimately never realised.

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

Yes, we believe they do.

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

Whilst the assessments seem reasonable at face value, we would point out that the GAD analysis is of very limited value in the circumstances.

The consultation itself says "The analysis is based on an "average" member at each particular age. Allowing for variations in individual members' future service or salary progression could produce different figures". We would point out that it is precisely

those variations in individual members' future service or salary progression which will determine whether or not the revised underpin will "bite".

***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)?***

No.

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

No.

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

Keep the message to members simple and generic because relatively few active members will ultimately have an increase to their pension because of the underpin and, for those that do, any increase will be small.

Emphasise that (a) relatively few members will be impacted by the underpin, (b) any increases will be small and (c) the underpin process will be applied automatically, so as not to create false expectation.

Communications with employers should focus on the importance and practical requirements of providing the data required to operate the underpin and any assumptions being made where member data is missing.

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

The administrative impact of these proposals will be significant and meeting them will depend to a great extent on the timing of regulations and the certainty around the changes required to systems and processes. In particular, the changes to administrative systems will require months to complete and could be further delayed if changes are also required to Fire and police schemes at the same time.

In this regard we would strongly urge MHCLG to bring forward final regulations as soon as possible, even if their implementation date is in line with other public sector schemes (i.e. 2022). Doing so would provide the certainty and notice needed to ensure the disruption to systems and processes is minimised and provide authorities with the ability to effectively implement the remedy for members.

We estimate that in the Essex Pension Fund there will be in the region of 17,000 active members in scope plus 24,000 leavers requiring retrospective review.

We believe the government should cover funds' additional costs relating to McCloud and remedy because it proceeded to introduce the original underpin in the full knowledge that to do so would contravene age discrimination legislation - see our response to question 3.

Whilst the underpin will not actually impact most members' benefits, funds will be required to undertake underpin calculations for 1,000s of active members going forward. This will also require additional expenditure updating administration systems to be able to identify and carry out the revised underpin calculations for members in scope.

Applying the underpin test retrospectively to 24,000 members is a massive undertaking which will take several years to complete and will inevitably involve manual intervention and calculations in many cases.

The scale and complexity of this exercise could also create a significant communications challenge for LGPS funds.

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

Cases where members have already retired (or died) should be the priority as the underpin could impact on a member's (or survivor's) current retirement income. Thereafter, members closer to their underpin crystallisation date should be prioritised.

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

As set out in our response to question 16, we do not agree with the requirement to include information about the underpin on active ABS for members under the 2008 Scheme normal pension age. If the requirement remains, we think there should be a lead in time of at least 12 months to ensure that administering authorities can prioritise retrospectively recalculating benefits.

***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?***

One area where additional guidance would be welcome is what to do when an employer is incapable of providing historic member data. Ideally, SAB should issue guidance for employers and administering authorities when making assumptions about service and salary history in the absence of complete information to provide a clear and consistent approach across the scheme and prevent funds being challenged on approaches used if no guidance is provided.

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

We support a consistent approach to member communications and, as set out in our response to question 23, communications should be simple and generic with the emphasis that (a) relatively few members will be impacted by the underpin, (b) any increases will be small and (c) the underpin process will be applied automatically, so as not to create false expectation.



Communications with employers should equally be simple and focus on the importance and practical requirements of providing the data required to operate the underpin and any assumptions being made where member data is missing.

***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 LGPS is a 'balance of cost' arrangement with fixed member contribution rates, the cost of the McCloud remedy will ultimately be met by employers. Many of these employers are councils that are funded by local taxpayers. However, whilst an increase in LGPS liabilities is unavoidable, funds have local control over the pace at which these costs are managed over time. The majority of the costs will fall on employers with a long-term funding horizon and we generally don't expect material changes to contribution rates to arise from application of the remedy.

Accurate analysis of the financial funding impact of the proposed McCloud remedy is impossible because of the members in scope we do not know which ones will have higher than average pensionable pay increases, how much those increases will be and when those increases will be. Depending on the assumptions used, the impact of the remedy might only add 0.2% to the liabilities of a typical LGPS fund but it could add as much as 1%.

But whilst the impact at whole fund level is likely to be small, it may be more material at individual employer level. The cost impact is likely to be higher for employers with youthful membership profiles, as there is a greater likelihood of the underpin 'biting' for younger members.

The inclusion of McCloud in the national cost management mechanism will reduce, or possibly even wipe out completely, the proposed package of benefit improvements that had been due to take effect from 1 April 2019 in the LGPS in England and Wales.

Aside from the funding cost, the costs to funds in terms of administration and communications will be significant and is likely to run well into six figures for most funds, in terms of extra FTE resource.

As set out in our response to question 3, we believe the government should provide funding to cover funds' additional administration and communications costs, bearing in mind it proceeded to introduce the original underpin in the full knowledge that to do so would contravene age discrimination legislation. The costs of remedying age discrimination introduced into the LGPS by central government should not be met by local taxpayers.

Yours sincerely

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