



# Local Government Pension Scheme: Amendments to the statutory underpin

## Policy consultation

X October 2020

## Introduction

Please find set out below the West Midlands Pension Fund response to the MHCLG Consultation entitled Local Government Pension Scheme “Amendments to the statutory underpin” issued on 16 July 2020. The City of Wolverhampton Council is the Administering Authority of the West Midlands Pension Fund (“the Fund”), and this response is submitted from the perspective of the Fund.

The West Midlands Pension Fund is a fund within the Local Government Pension Scheme and one of the UK’s largest pension funds. The Fund administers the pension benefits of over 300,000 members, with over 700 participating scheme employers and manages invested assets in excess of £16bn to meet benefit payments to members over the long term.

## General Comments

The Fund recognises the significant amount of work performed by MHCLG and its advisors in forming the detailed proposals contained within the Consultation document.

In summary, the key points within the Fund’s response to this consultation are:

- **Implementation timescale.**
  - o MHCLG has not set out the subsequent timetable for implementation of the revised regulations and expected timeframe for completing the recalculation of affected members’ benefits. There are a number of practical constraints to implementation inline with the proposals set out in the consultations and all stakeholders will need to be aware that the scale and period required to review and amend benefits retrospectively, where required, is significant.
  - o Work on the recalculation of benefits cannot commence until the regulations are laid and the Fund urges MHCLG to formalise the regulations as soon as possible, and allow a sufficient timeframe to set up (12 months) and then implement (2 years)
- **Administering authority resourcing:** The remedy proposed is complex and will require considerable resource from the Fund to recalculate benefits for a significant number (in the order of 79,000 for the Fund) of members. MHCLG need to consider this when determining the timetable for when they expect the work to be completed and note the potential impact upon business as usual activity.
- **Missing data:** There are significant risks that there will be employers who cannot provide the data required in order to recalculate benefits, due to changing payroll providers or ceasing membership of

the LGPS. Guidance on dealing with such cases is required, not least to support in developing a standard approach across the LGPS and other public sector schemes

- **Member communications:** Communicating the changes with members is key, and they must receive clear guidance to explain that any changes to benefits will happen automatically and that they do not need to take any action. Standardised communications would be welcome to support consistent messaging across all LGPS Funds.
- **System changes:** Pension administration software will need to be amended to reflect the regulatory changes. Changes will affect multiple calculation routines and require re-writing of benefit records. Software providers will require the final regulations (and clarity on interpretation) to be in place as soon as possible, together with lead-in time for system change and testing for such large-scale reform.  
**Cost:** Although the funding strain is not expected to exceed the level allowed for in the Fund's 2019 actuarial valuation, the impact on individual employers, once benefits records are fully worked through, may be significant and all will note the significant resource impact on both payroll teams and LGPS funds as a result of the ruling and scope and nature of the remedy proposed, leading to increase in operational cost.

## Consultation

Question	West Midlands Pension Fund Response
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?	<p>Yes</p> <p>In order to address the discrimination found within the McCloud and Sargeant cases, the age criteria within the LGPS Regulations for the Statutory Underpin needs to be removed, and the provisions will then extend its application to younger scheme members (where they meet all other membership criteria).</p>
2 - Do you agree that the underpin period should end in March 2022?	<p>We understand the reasons for the proposal to limit the underpin protection period (as regards members' benefit accruals). By limiting this period, it will also ensure that future costs of the scheme are managed in accordance with the original policy intention from when the CARE scheme was introduced.</p> <p>We agree that the period of protection should end in March 2022.</p>
3 - Do you agree that the revised regulations should apply retrospectively to 1st April 2014?	<p>Yes, in order to be fair to all members of the scheme, the revised regulations do need to be applied retrospectively to 1 April 2014. However, it must be noted that due to the length of time for the retrospective application of the remedy this will create significant workloads for pension fund administration teams.</p>
4 - Do the draft regulations implement the revised underpin which we describe in this paper?	<p>The Fund are not qualified to comment on the legality and accuracy or completeness of the draft regulations. However, the Fund does not agree that it is necessary for the regulations to include an amendment to the benefit statement calculation (See responses to Q16 and Q17) and we would prefer a written statement, which is a scheme wide standard statement, explaining the underpin to be included in the explanations on the statement. The inclusion of a figure that will vary each year and may not be payable when the benefits are paid will likely result in confusions for members. Based on initial analysis we do not expect a material change in member benefits to emerge and therefore question the value in adding this to an illustrative statement of benefits for those who have not yet retired as a number of more material factors can and will influence the final benefit outcome.</p>
5 - Do the draft regulations provide for a framework of protection which would work effectively for members, employers and administrators?	<p>The protection appears to work effectively, however the additional work required of employers and especially LGPS Funds should not be underestimated.</p> <p>It is likely that a significant number of employers will not be able to provide every piece of data that is required to calculate the underpin across all eligible members e.g. historic salary details for ex-employees. Funds may therefore be unable to implement the amended underpin. For example, c10% of employers have ceased within the Fund and are no longer active employers, and it is recommended that standard guidance should be provided, rather than employers or funds applying different criteria so as to avoid undermining the effectiveness of the regulations. Guidance from MHCLG/SAB is required 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, to ensure a consistent approach is being carried out across all LGPS Funds.</p>

Question	West Midlands Pension Fund Response
6 - Do you have other comments on technical matters related to the draft regulations?	We have no other comments on technical matters related to the draft Regulations, however it is noted the draft Regulations need to be more specific relating to the members who have transferred out of the local government pension scheme and how Funds should manage these, in terms of the balance of payments to be made.
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?	In order to allow for consistent and equitable treatment to all membership groups we agree that members should not have to have an immediate entitlement to a pension.
8 - Are there any other comments regarding the proposed underpin qualifying criteria you would like to make?	<p>The Fund does have some concerns about the proposed criteria and notes that the proposal leaves the Scheme subject to further challenge. Although the proposal is in line with the previous underpin, should the underpin criteria be extended to include those members who joined the scheme on or after 1 April 2012, even though they may not have been in the scheme on 31 March 2012. We are concerned that some members could challenge this remedy insofar as those members who joined the scheme a few days later will not be entitled to benefit from the protection over the two years to April 2014.</p> <p>Therefore, in order to avoid complaints/challenge from members who joined in the period 1 April 2012 – 31 March 2014 (and so would not benefit from the new proposed underpin), we suggest reviewing the merit of extending the qualifying period start date to 1 April 2012. It is recognised that the argument included in the consultation is that it was well publicised that the LGPS benefits were reforming at the time, but it is a concern that this could be open to potential future challenge.</p>
9 - Do you agree that members should meet the underpin qualifying criteria in a single scheme membership for underpin protection to apply?	Yes, the Fund agrees with the principle that members should meet the criteria in a single scheme membership for the underpin to apply. However, the Fund does have some concerns about the detail of the proposals around aggregation, please see the response to Q10.

Question	West Midlands Pension Fund Response
<p>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?</p>	<p>The Fund has concerns about the providing members with one time only 12-month window to make an aggregation decision.</p> <p>We believe that it will be difficult for a member to understand why they need to reconsider their previous decision and make a new decision now. Clear and consistent scheme wide communication will be required. Furthermore, this proposal will be asking members to make a decision based on an unknown, therefore it will be difficult for members to make decisions on aggregation as the full position of the new underpin will not be properly known for all members within the 12-month decision period, and most likely until the point of retirement. Asking members to make a financial decision in respect of a situation that is likely to be unknown at the time of the decision may be open to further challenge/appeals from members in the future. There is a risk that some members may change their mind following communication about the changes, however when it comes to the point of retirement they are not in the anticipated improved position with their benefits, which could open the scheme and Fund up to legal challenge.</p> <p>It must also be noted that this will lead to a material administrative burden as all potentially eligible members (estimated c5000 members for the Fund) will need to be communicated with, in a meaningful way, during the same period. This is likely to lead to substantial queries from members, with no clear answers being able to be provided, leading to a risk of complaints. Although indicative members in scope can be estimated, there are difficulties in identifying all members that are covered by this 12-month window.</p> <p>There are additional risks where members may have benefits spread across other LGPS funds and so the full extent of an underpin driven aggregation decision might be unknown or incomplete.</p> <p>Therefore, it is recommended that consideration is given to enable Funds to apply an extension of 12-month window at their discretion, which enables the 12 month window to be applied from the point the member is informed, as there are concerns for Funds realistically being able to manage this work alongside current workloads and other McCloud casework.</p>

Question	West Midlands Pension Fund Response
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?	One area of concern is that those who opted out after April 2015 and have re-joined and those who have previously elected to keep their membership separate and are not being offered the opportunity to aggregate, therefore consideration should be given to offer the same provision to these members, to protect against future challenge. Although, it is recognized that this will add another layer of work for administrators.
12 - Do you have any comments on the proposed amendments described in paragraphs 56 to 59 (breaks in service, early/late retirement factors, DIS, survivor benefits)?	<p>The proposed amendments to widen or clarify the protections would appear to be consistent with the general protections being sought going forward. It is noted, however, that the amendments to the protections will result in considerable additional work for administrators to collate the data and revisit these cases. Therefore, clear and consistent guidance is needed for all LGPS funds to adopt</p> <p>Regulations and/or guidance will also need to be provided to deal with the following situations:</p> <ul style="list-style-type: none"> <li>- how to deal with retrospective changes where a transfer out has already been paid and the new scheme is not willing to accept a balance payment</li> <li>- how LGPS Funds should manage payments following rectification of interfund cases</li> <li>- Guidance and Consideration also to be given to the wider reforms underway which impact on the local government scheme, in particular the £95k cap. and interaction with changes proposed in the "reforming local government exit pay" consultation issued by MHCLG in September 2020.</li> </ul>
13 - Do you agree with the two-stage underpin process proposed?	Yes, the two stage underpin proposal seems fair and ensures the delivery of the policy intention, ensuring and enabling clear communication to members. It must also be noted that the Benefit Statement shows the benefits accrued at 31 March each year and at SPA, however two stage underpin proposal, requires calculation at the date you actually leave and the date you receive payment of your benefits, therefore this two stage process does not correlate to the information on the annual benefit statement.
14 - Do you have any comments regarding the proposed approaches outlined above?	<p>The proposed process for Club Transfers places a significant onus on the member as it requires them to make a decision as to how their benefits will be treated in the receiving scheme. Inevitably, this will be a complex decision which could have financial implications for the member, where the full details will not be known until retirement. This is an area where a consistent approach across the public sector and clear communication to members will be critically important.</p> <p>As mentioned in response to question 12, consideration and further guidance is required on how this proposal interacts with other scheme reforms, in particular the £95k cap.</p>

Question	West Midlands Pension Fund Response
15 - Do you consider there to be any notable omissions in our proposals on the changes to the underpin?	Further clarity is required on certain elements as detailed in our response, in particular limited information has been provided on pension sharing orders which have been completed over the period, and further clarity and guidance is required on the work required for these cases. In addition, guidance is required on pension debits for divorce and scheme pays cases and the expectation of how these should be managed in terms of retrospective tax liability testing.
16 - Do you agree that annual benefit statements should include information about a qualifying member's underpin protection?	<p>We do agree that the underpin protection should be referred to on the annual benefit statement, but do not agree in quoting the underpin guarantee amount.</p> <p>For active members, it is likely that this figure would vary from one year to the next and will be confusing for the members, especially as the numbers expected to be affected by the reforms are low, therefore has limited value of including on the statement.</p> <p>We would welcome and support a scheme-wide standard statement that informs the member that in addition to the benefits quoted on the statement, they may also get an uplift, under the protections within the scheme and this will not be fully known until they access their retirement benefits, providing a link to further information about the reforms on the LGA member website. This is a consistent approach for other protection elements in the scheme i.e. use of a higher previous year's final pay which are not currently included in the annual benefit statement, which could have a more significant impact, than the proposed underpin uplift on the amount of benefits being quoted on the statement. It is more reasonable to include this indicative figure on the deferred benefit statement, however for consistency and remove confusion by members it is recommended that a standard approach is taken and it is not included.</p> <p>In addition, this could only be introduced if the software systems could calculate accurately with the different scenarios and would increase the burden when coinciding with a time of significant administrative system changes required for the implementation of the remedy. Therefore, further clarification and guidance is required in regard to the timing of any inclusion of the proposed underpin on benefit statements.</p>
17 - Do you have any comments regarding how the underpin should be presented on annual benefit statements?	Please see our response to Q16. We recommend that standard wording should be a nationally adopted minimum standard/best practice, and it should be consistent across all LGPS funds. As many people are members of multiple LGPS funds, consistent communications will reduce the risk of confusion for members.

Question	West Midlands Pension Fund Response
18 - Do you have any comments on the potential issue identified in paragraph 110?	We recognise the potential issues identified but are supportive that the final guarantee amount gets credited to a member's benefits at the underpin crystallisation date and so contributes to the Annual Allowance check for that year only, and the member's overall LTA value. The numbers affected are expected to be minimal, however at this stage, given that the effects of the revised underpin will be with us for many years, it is difficult to know what the full scale of the issue might be in terms of the numbers who might be impacted and of those, how many will not have the benefit of unused annual allowance to offset any breach. It must be noted the current arrangements and level for annual allowance do not fully meet the policy objective to limit the tax relief for high earners, and those members caught include lower earners with long service. Therefore, it is expected that there will be a lot of additional testing and administration for limited tax revenue. Therefore, we request consideration be given by MHCLG to seeking an exemption for adjustments linked to McCloud. Due to changes in tax rules and limits, there may be instances where tax is payable on implementation and retesting of the revised underpin which would not have emerged had the underpin been in place at the time when benefits were accrued.
19 - Do the proposals contained in this consultation adequately address the discrimination found in the 'McCloud' and 'Sargeant' cases?	Whilst the proposals do appear to address the McCloud and Sargeant cases, there are some concerns about the criteria being open to further challenge, please see our response to Q8. By not covering those members 1 April 2012 – 31 March 2014. Despite the scheme changes being publicised, it is not reasonable to have expected members to have known and fully understand the change in scheme. The regulations were not released until 2013, and therefore limited communication would have been undertaken with members before this detail was available. Therefore, this could open the scheme up to future challenge of discrimination for these members who joined the scheme on or after 1 April 2012.
20 - Do you agree with our equalities impact assessment?	The Fund has no comment in this area; however it is recognised the work undertaken by MHCLG and its advisors on the equalities impact, likelihoods of outcomes and other related aspects.
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)?	The Fund is not in a position to comment on this area.
22 - Are there other comments or observations on equalities impacts you would wish to make?	As noted in our responses to earlier questions, we do have some concerns about the criteria being put forward and ultimately believes the scheme could be subject to further challenge, by excluding those members who joined the scheme on or after 1 April 2012, even though they may not have been in the scheme on 31 March 2012.

Question	West Midlands Pension Fund Response
<p>23 - What principles should be adopted to help members and employers understand the implications of the proposals outlined in this paper?</p>	<p>Standardised and consistent treatment/communications across all LGPS funds will help employers and members understand the proposals (recognising some minor fund specific changes may be necessary as well as branding/personalisation).</p> <p>It is requested that consistent communications be centrally developed and provided to LGPS Funds. It would be helpful if an ongoing communications plan is developed so Funds are aware of areas covered centrally and focus resources in the areas not being looked at centrally and localized messages where relevant. This is requested for both members and employers.</p> <p>Member communications will need to ensure that members are provided with assurance that the underpin process is fair and is being applied accurately and is an automatic process not by member individual claim or request. It will also need to ensure it manages any misconceptions on that value of the underpin, that the number of cases where it is applied will be small.</p>
<p>24 - Do you have any comments to make on the administrative impacts of the proposals outlined in this paper?</p>	<p>While the underpin will not actually take effect for most members, a large number of members (1 in 4 for WMPF) are potentially affected and will require review and ongoing record maintenance by employers and Funds. This challenge faced by Funds is significant, given the case-by-case approach which will be needed in many cases and the tasks arising in terms of forward-looking changes and retrospective changes make this far reaching and with shortened timescales. This involves identifying members, updating records, employer engagement, communication alongside existing workloads and further regulatory changes. It is therefore key that the finalised regulations are confirmed as soon as possible, and a sufficient lead in time to implement is given to software providers and Funds. We welcome clarity on timeline as soon as possible to enable effective planning, project management and efficient implementation.</p> <p>The key challenge will be to obtain the data required from employers. There will inevitably be situations where employers will not be able to provide the required data. This may be due to those employers no longer existing or historic payroll data not being retained and agreed assumptions and processes for managing this casework, guidance is required for where the essential data is not able to be provided for service breaks and or part time hours to ensure a consistent approach across the LGPS.</p> <p>Due to the potential scale of administrative work, and the estimation that only a small number of members will be positively affected by the new remedy, consideration and guidance would be welcomed on rectification tolerance levels for Funds to adopt, balancing cost and benefit of updates, as used in other large-scale rectification exercises like GMP Rectification.</p>

Question	West Midlands Pension Fund Response
<p>25 - What principles should be adopted in determining how to prioritise cases?</p>	<p>The key initial part of the project will be the collation of data which needs to be undertaken in the first instance, this will then feed into the updating of active member records and rectification of pensioner and deferred records.</p> <p>Our initial view of priority groups for rectification of benefits, is to look at those members who are closest to their retirement age, to ensure the calculations are correct for the point of payment and do not require rework. Following on from this, those members in receipt of their pension or who have deceased, as the underpin could impact on a member's or survivors benefits. Focus could then be given to the remaining deferred members on an age-related basis. The remaining casework should then be tackled, which includes transfers.</p> <p>Rectifications are important, particularly for those in payment, but software providers need to ensure systems are updated as soon as possible to ensure backlogs are not created and the scale of rectification does not continue to increase and become a continual cycle of work for administrators. Whilst bulk processing can be developed in areas, its effectiveness is reliant on other interrelated processes being up to date. All efforts should be made to support in minimising manual work and enabling efficient implementation.</p>
<p>26 - Are there material ways in which the proposals could be simplified to ease the impacts on employers, software systems and scheme administrators?</p>	<p>Clear guidance (perhaps statutory) clarifying how cases should be dealt with where data is not available from employers and how this can be reasonable ascertained, would allow provide simplification. The Fund would also welcome guidance on a deadline to be communicated to employers for the provision of data, i.e. 6 months post 31 March 2022. Furthermore, centrally agreed assumptions to be applied across the LGPS for instances where data cannot be provided.</p> <p>Furthermore, nationally agreed tolerances that identify minimum thresholds before retrospective changes/updates are made, balancing cost and benefit of updates, which could simplify the proposals, introducing efficiencies for funds and employers.</p>
<p>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?</p>	<p>We recommend that clear guidance is provided to identify at what point the administrative costs outweigh the benefits of having perfect data records. As a minimum, it would be useful for Funds to have the ability to make this decision on a discretionary basis and perform their own individual value for money assessment.</p> <p>The Fund is supportive of a nationally agreed approach with clear guidance on what steps must be taken and exhausted before an agreed simplified approach can be adopted. Furthermore, the inclusion of assumptions to be made by Funds where data cannot be supplied.</p>

Question	West Midlands Pension Fund Response
<p>28 - On what matters should there be a consistent approach to implementation of the changes proposed?</p>	<p>Please see earlier responses regarding standard and clear communications for members and employers and administrative guidance for Funds. This guidance should include communication templates (to enable Funds to tailor if required) and actions to take in certain circumstances, including but not limited to, no replies, data absences, retrospective actions for pensioners.</p> <p>It would also be helpful for clear guidance to be available for auditors, in relation to pension fund accounting. This would support the pre-empt many queries and dialogue with auditors across the many employers within the scheme.</p>
<p>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?</p>	<p>Standard approach and consistency</p> <p>The administrative burden is a significant one and therefore the costs relating to administration could be significant for Funds, and therefore the implementation of the proposed remedies will have financial implications for the Fund, in particular in terms of additional resources, software development costs, external advisor support and communication activities. The provision of the finalised regulations and draft guidance as soon as possible with a sufficient leading time before they are 'live' will potentially support Funds manage implementation costs. Some employers may also incur costs for their own resources and extraction of data from their payroll systems.</p> <p>The Fund made an allowance for the possible McCloud remedy in the 2019 valuation and we understand allowance was also made by most employers in the 2019 and 2020 IAS19/FRS102 accounting figures, however the application of the proposed remedy to the individual workforce of an employer may result in an outcome different to the Fund-wide allowance. In general, the contribution rate impact is likely to be small, but may be more significant for employers with younger membership profile.</p> <p>The regulations and policies for all LGPS funds must be updated to ensure that full estimated McCloud costs are recovered through contribution requirements on both an ongoing basis for any employers who are not currently meeting the funding cost, but also in an employer exit scenario. Guidance should be clear and explicit to require fund policies and practices to be updated to ensure the final agreed remedy costs are attributed to the relevant employer and those costs are not borne by local taxpayers or any other groups in the Fund. This may mean some Funds need to revisit contribution requirements before the next valuation for certain employers, and therefore a facility to revise costs in these circumstances should be included in the Regulations and guidance issued in relation to the separate contribution flexibilities.</p>