

Navigating McCloud

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Agenda for today

1. Origins of “McCloud”
2. Key points from the LGPS proposed remedy
3. Impact on administration, funding and accounting
4. Questions & Answers

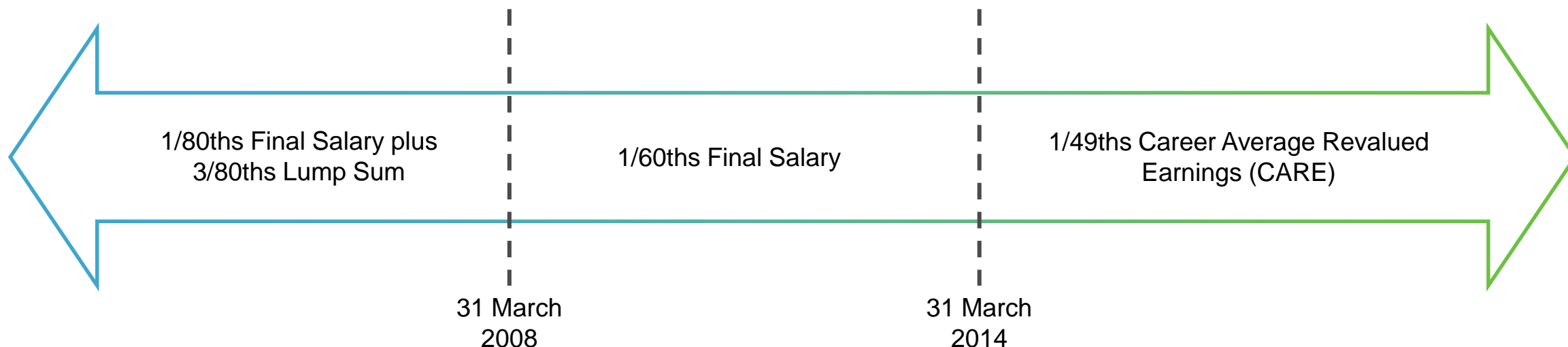


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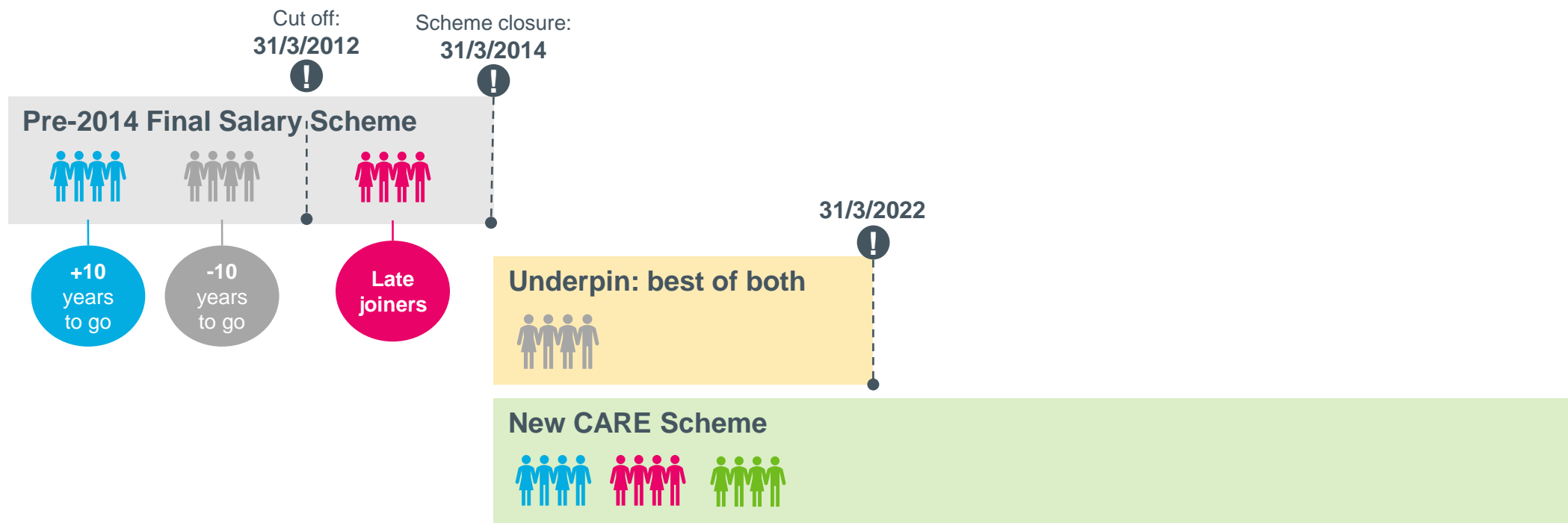
Origins of McCloud

LGPS benefit structure



Latest change to benefit structure was a result of the Hutton Review
Resulted in significant changes to all public sector pension schemes

Smoothing the benefit structure transition



Transitional protections put in place for those close to retirement, against the Hutton Review's recommendations
Similar arrangements also put in place for other public sector schemes


The one profession you do not want to take to court...



- Employment tribunal between the Government and a member (Victoria McCloud) of the Judicial Pension Scheme
- Claims that transitional protections in the Judicial Pension Scheme rules were illegal on the grounds of discrimination
- Similar case also heard in respect of the Firefighters' Pension Scheme (Sargeant)
- Requirement on Government to 'level up' benefits for this discriminated against i.e. provide similar protections

Tribunal ruled that protections were discriminatory on the grounds of age AND also indirectly gender discriminatory

The timeline of events



2016/17 – members of the Judicial and Firefighter Pension Schemes bring a claim of age discrimination
– tribunal upheld the members' complaints

Nov 2018 – 'McCloud' case considered by Court of Appeal after Government contests original decision

Dec 2018 – Court of Appeal upholds original tribunal ruling

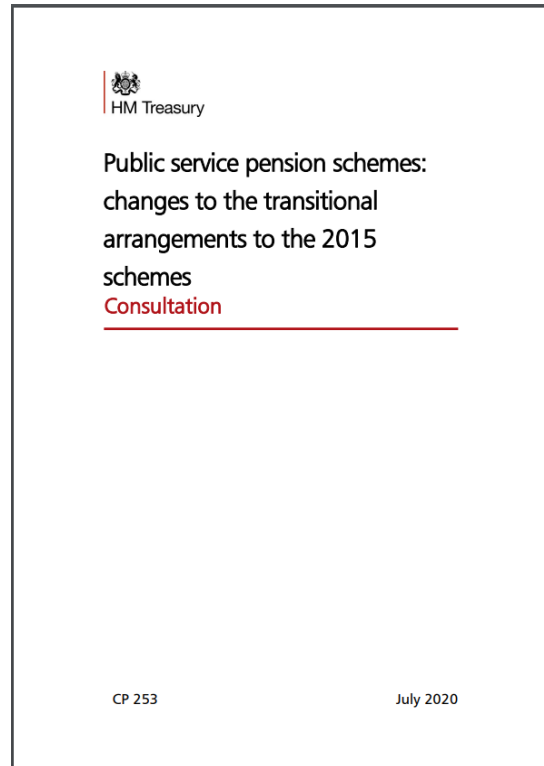
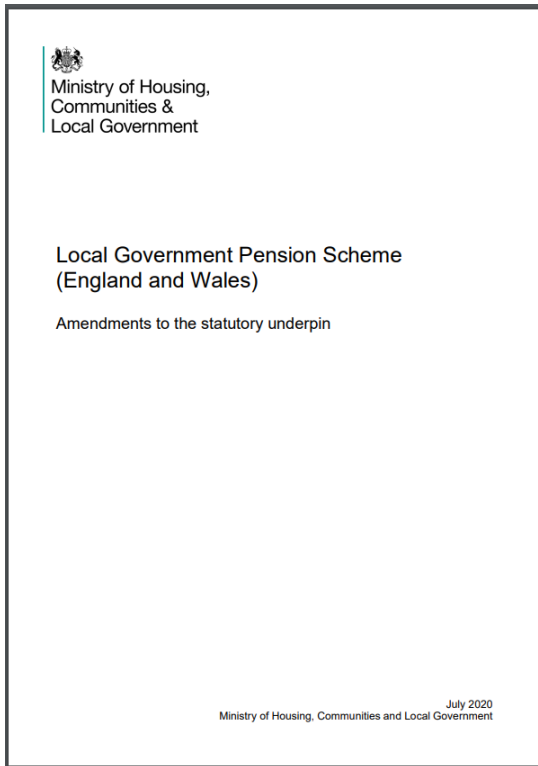
Jun 2019 – Supreme Court refused Government's application to further appeal
– **Auditors ask employers to allow for cost of McCloud in accounts**

July 2019 – Government accepts tribunal ruling and commits to remedying the situation in **ALL** public sector pension schemes (including the LGPS)

2019/20 – Work undertaken by Government and other stakeholders to create a solution to remedy the discrimination (and not introduce any other forms of discrimination)

Government published consultation of remedying McCloud on 16 July 2020

The consultations



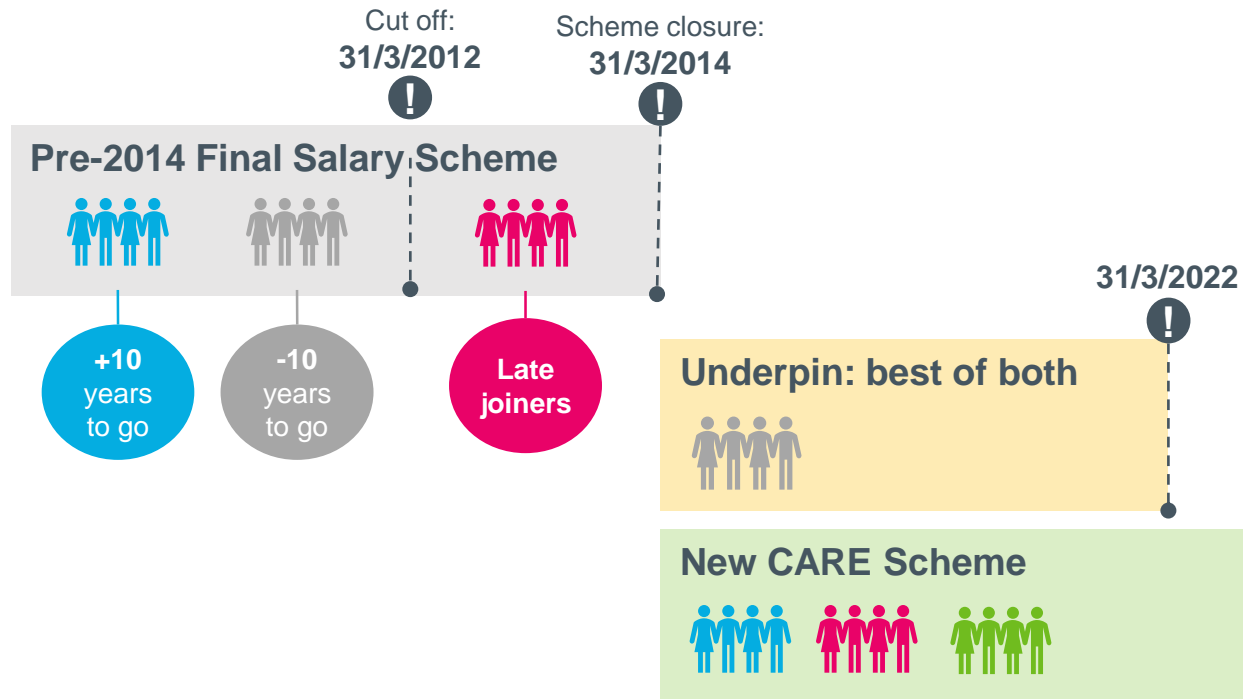
- Government consulting on proposed remedy to McCloud
- MHCLG consultation
 - Applicable to LGPS in England & Wales
 - Closed on 8 October 2020
- HMT consultation
 - Applicable to all unfunded public sector pension schemes e.g. Teachers, Civil Service, Police etc.
 - Different solution to LGPS
 - Closed on 11 October 2020

MHCLG: www.gov.uk/government/consultations/local-government-pension-scheme-amendments-to-the-statutory-underpin

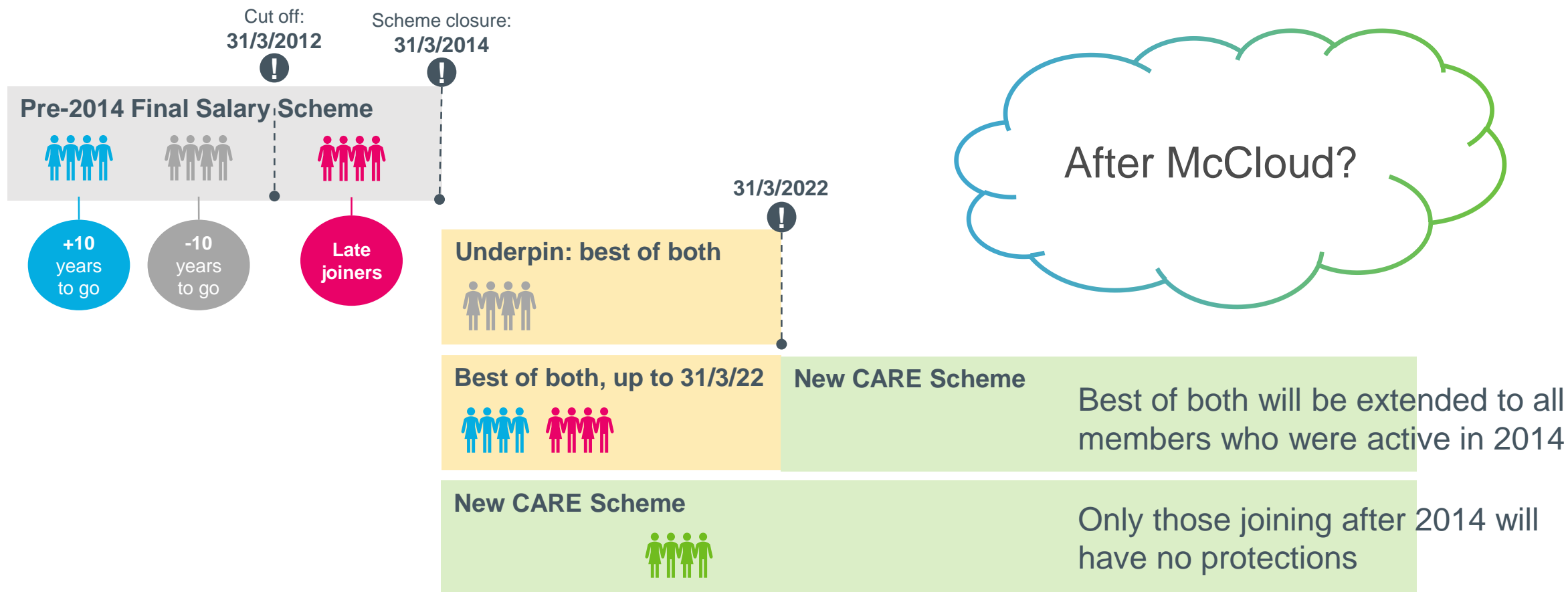
HMT: www.gov.uk/government/consultations/public-service-pension-schemes-consultation-changes-to-the-transitional-arrangements-to-the-2015-schemes

Key points from proposed McCloud remedy

Original assumption on remedy in LGPS

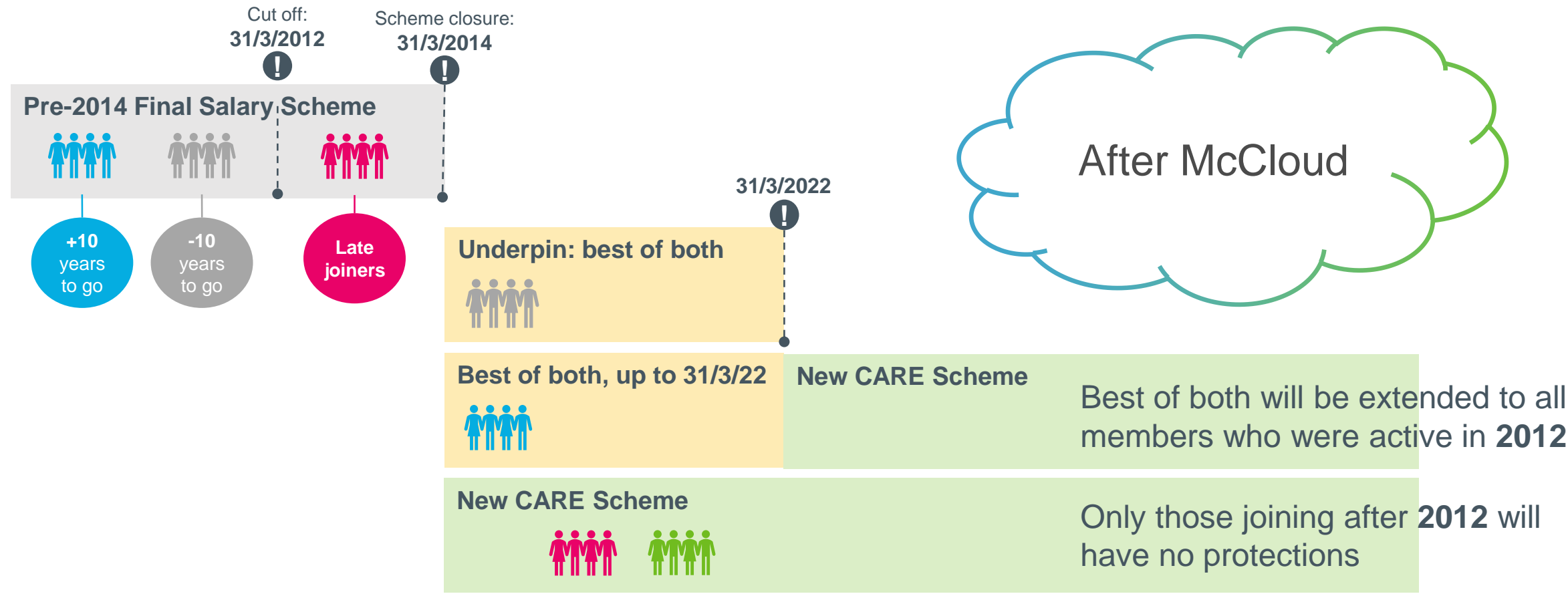


Original assumption on remedy in LGPS



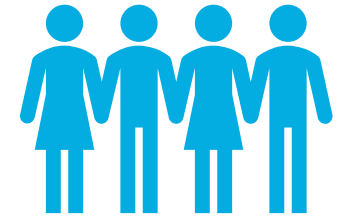
This was the assumption used when making allowance for McCloud in pre July 2020 accounting reports

Proposed remedy in LGPS



Same remedy as expected, except eligibility restricted to only those members active at 31 March 2012

How will it work in practice



Service before
1 April 2008

$$\text{Benefit} = \frac{\text{Service}}{80} \times \text{Final Salary at Retirement/Leaving}$$

Service between
1 April 2008 &
31 March 2014

$$\text{Benefit} = \frac{\text{Service}}{60} \times \text{Final Salary at Retirement/Leaving}$$

Service between
1 April 2014 &
31 March 2022

$$\text{Benefit} = \text{Best of} \left\{ \begin{array}{l} \text{2008 Scheme: } \frac{\text{Service}}{60} \times \text{Final Salary at Retirement/Leaving} \\ \text{2014 Scheme: } \frac{\text{Total Revalued Earnings between 2014 \& 2022}}{49} \end{array} \right.$$

Service from
1 April 2022

$$\text{Benefit} = \frac{\text{Total Revalued Earnings from 2022}}{49}$$

Understanding LGPS benefits becomes very difficult for members



Important points to note

- Proposed changes apply to members who were
 - Active on 31 March 2012;
 - Continued to have membership after 1 April 2014; and
 - Had no break in service of 5 years or more
- Benefits are based on final salary at point member leaves active status or reaches age 65 i.e. possibly beyond 2022
- Different retirement ages in 2008 Scheme (65) and 2014 Scheme (SPA)
- Early and late retirement factors will be applied when comparing which scheme provides most valuable benefits

No certainty about value of benefits earned between 2014-2022 until member retires

Examples!

- **Steady Eddy**

- Aged 47 in 2012
- Full-time worker
- Salary at 2014 of £30k
- Annual pay rises up to retirement of 1% above inflation



Value of benefit earned between 2014 and 2022

Retirement age	65	SPA (67)
2014 Scheme	£6,100	£7,040
2008 Scheme	£6,060	£6,770

- **High Performer**

- Aged 47 in 2012
- Full-time worker
- Salary at 2014 of £30k
- Annual pay rises up to retirement of 1% above inflation with additional increases of 5% in 2022 and 2027



Value of benefit earned between 2014 and 2022

Retirement age	65	SPA (67)
2014 Scheme	£6,100	£7,040
2008 Scheme	£6,670	£7,440

More examples in Annex D of MHCLG's consultation document

What else is proposed to change?

Proposed changes are **retrospective**, so these changes also apply to:

- Members that previously left, transferred out, retired or died

Early Leavers

- Existing protection applied only if member left with **immediate entitlement to benefits**
- Proposal extends eligibility to deferrals

Death in Service & Survivors benefits

- Uncertainty around whether existing protections applied to death in service and survivor benefits
- Proposal confirms protections **will also apply to these benefits**

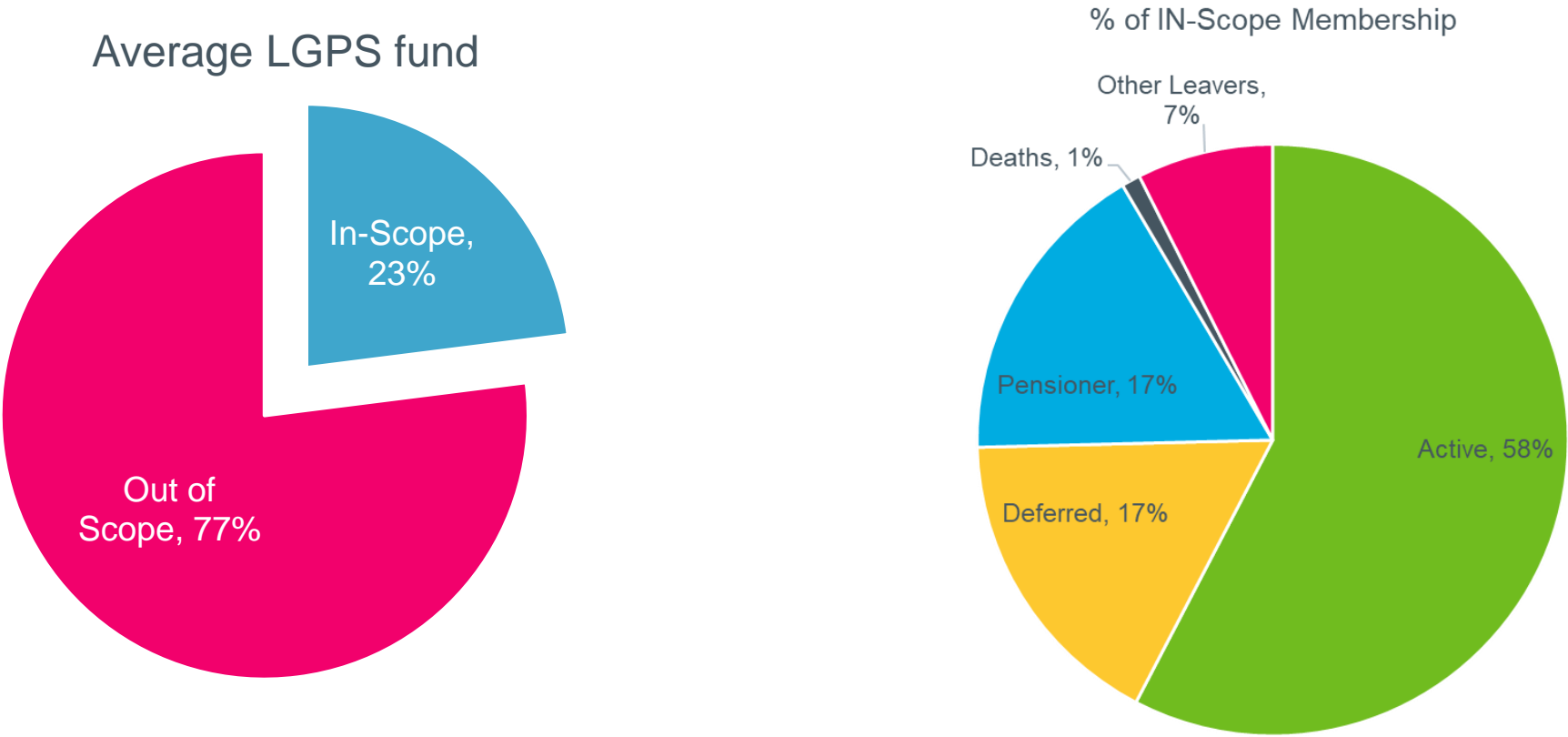
Tax

- **Potential Annual Allowance** tax charges due to an unexpected increase in benefits

MHCLG have used consultation as an opportunity to also refine the operation and application of existing transitional protection mechanism

Impact on administration, funding and accounting

How many members are impacted?



Around 1.2 million LGPS members affected by McCloud

What will the impact be?



Members

- Some may see an increase in benefits, some will see no difference
- Possible tax implications – annual allowance and lifetime allowance
- Understanding what the changes mean now and in the future



Fund

- Administering an underpin can be challenging
- Additional data may be required from employers (both historical and in future)
- Helping members understand their benefits
- Significant pressure on resources



Employers

- May need to submit historical membership and payroll data
- Liabilities and contribution rates may increase
- Ensuring members understand the changes to their benefits

Employers' role will be in data provision and communicating changes to members
Project to implement McCloud resolution will take 2-3 years, possibly longer

Data provision

- For members in scope of McCloud, employers will need to provide
 - Service history back to 31 March 2014 i.e. changes in hours
 - Future change in hours
 - Pensionable pay as defined under the 2008 Scheme
- Historic data provision may be required
 - Ensure that payroll records from 1 April 2014 are preserved
- Similar situation likely to apply in other LGPS funds
 - If you participate in multiple LGPS funds, speak to them and check your records

Watch out for any communications from the Warwickshire Pension Fund about data requirements

Other considerations

Final salary link for service between 2014 & 2022

- Significant pay awards could lead to a larger increase in funding strain
- Result in an increase in contribution rates

Costing redundancy exercises

- If member aged over 55, may be entitled to immediate payment of unreduced benefits
- Underpin makes cost of calculating redundancy strain less certain
- Engage with Fund early in the process if considering this action

Supporting members transferring in benefits

- Current proposal places a significant onus on member to decide how transferred in benefits will be calculated
- Complex financial decision for which members may expect an element of employer support

Another source of risk in the LGPS to consider when making any decisions

Funding impact of McCloud

- In most cases, the underpin won't bite (CARE accrual is 22% higher)

Element	2008 Scheme	2014 Scheme
Accrual rate	60ths	49ths
Pre-retirement revaluation	Salary increases	CPI inflation
Retirement age	65	State Pension Age

- Cost likely to be small at whole fund level – **circa 0.2% of liabilities**
- May be significantly higher for **'immature' employers** e.g. leisure centres, and employers with only 1 or 2 actives that **award a large one-off salary rise**
- Impact on contribution rates for a typical council, ignoring stabilisation:
 - Primary rate up **0.2% of pay**
 - Secondary rate up **0.1% of pay**

Approximate allowance made at 2019 valuation for McCloud via increase in prudence in funding strategies
Aim is to avoid having to recalculate contribution rates ahead of next valuation

Accounting impact of McCloud

Section 3 - Balance sheet, P&L, OCI disclosures as at 31 March 2019

Changes in the Fair Value of Plan Assets, Defined Benefit Obligation and Net Liability for year end 31 March 2019

Period ended 31 March 2019	Assets £(000)	Obligations £(000)	Net (liability) / asset £(000)
Fair value of plan assets	29,028		29,028
Present value of funded liabilities		35,821	(35,821)
Present value of unfunded liabilities		19	(19)
Opening Position as at 31 March 2018	29,028	35,840	(6,812)
Service cost			
Current service cost*		5,259	(5,259)
Past service cost (including curtailments)		432	(432)
Effect of settlements		-	-
Total Service Cost	-	5,691	(5,691)
Net interest			
Interest income on plan assets	831		831
Interest cost on defined benefit obligation		1,051	(1,051)
Impact of asset ceiling on net interest	-	-	-
Total net interest	831	1,051	(220)
Total defined benefit cost recognised in Profit or (Loss)	831	6,742	(5,911)
Cashflows			
Plan participants' contributions	894	894	-
Employer contributions	2,922		2,922
Contributions in respect of unfunded benefits	1		1
Benefits paid	(286)	(286)	-
Unfunded benefits paid	(1)	(1)	-
Effect of business combinations and disposals	-	-	-
Expected closing position	33,389	43,189	(9,800)
Remeasurements			
Changes in demographic assumptions		-	-
Changes in financial assumptions		3,604	(3,604)
Other experience		1	(1)
Return on assets excluding amounts included in net interest	1,130		1,130
Changes in asset ceiling	-	-	-
Total remeasurements recognised in Other Comprehensive Income (OCI)	1,130	3,605	(2,475)
Fair value of plan assets	34,519		34,519
Present value of funded liabilities		46,774	(46,774)
Present value of unfunded liabilities**		20	(20)
Closing position as at 31 March 2019	34,519	46,794	(12,275)

2019

- Most auditors required an allowance to be made for cost of McCloud
- Impact recognised as a Past Service Cost
- Allowance assumed McCloud remedy would apply to all members active at 31 March 2014

2020

- Change in eligibility in McCloud consultation means reduction in cost and liabilities
- Auditors may want this recognised as a Past Service Gain

No clear or consistent guidance about desired approach from auditors
Discuss with your auditor what allowance they expect to be made in the accounting disclosure

Summary

- McCloud is complicated – both the origins and proposed resolution
- Immediate next steps
 - Consider impact on **accounting** (if not done so already)
 - Keep an eye out for **further communications**
 - **Work with the Fund** over any data or information requests
- Additional sources of information
 - Warwickshire Pension Fund's website
www.warwickshirepensionfund.org.uk
 - Hymans Robertson's McCloud consultation briefing note
https://www.hymans.co.uk/media/uploads/Briefing_Note_-_McCloud_Consultations.pdf
 - Hymans Robertson's McCloud consultation formal response
<https://www.hymans.co.uk/insights/research-and-publications/publication/mhclg-mccloud-consultation-response/>
 - Hymans Robertson's LGPS Employers LinkedIn group:
<https://www.linkedin.com/groups/8735581/>

Questions?

Thank you

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