London Borough of Barnet Pension Scheme

Note on Recent Legislative and Regulatory Changes impacting on Pensions

The Government has been busy consulting on changes to LGPS regulations and a summary of the proposals recently announced plus the action being taken on each is given below. This note is solely for information. An update on actions taken will be included within the administration report to both the Pension Fund Committee & Local pension Board.

Issues Covered are:

Limits on redundancy payments to staff.

Extending final salary to CARE benefit protections to eliminate age discrimination.

Addressing gender discrimination for spouses pensions.

Clarifications on when a surplus should be returned to employers on cessation.

Increased flexibility to review employer contribution rates and recover deficits on cessation.

Reporting and Governance of Climate Risks.

Limits on Early Leavers Benefits (Exit Payments)

Currently, scheme members made redundant aged over 55 are entitled to statutory redundancy together with any enhanced redundancy offered by the employer and an immediate unreduced pension. Recently enacted changes in regulations will severely limit enhanced pension & redundancy rights for all staff.

The Government first announced in 2015 its proposals to prohibit six-figure exit packages from the public sector, by imposing a £95k cap on such packages. Legislations implementing the cap come into force from 4 November 2020 but to be fully effective require that the LGPS Regulations are also amended. In September, the Government commenced consultation on changes to LGPS Regulations that will affect local government employers (mainly, but not exclusively, councils and academy trusts).

The current LGPS Consultation proposals confirm the £95k cost cap, and how this will work in practice. To summarise:

- The amount of strain cost payable by the employer to the pension fund will be determined using standardised actuarial factors, rather than fund-specific factors already in place;

- If the overall exit package (strain costs plus redundancy payments) is below £95k then benefits can, as now, be paid in full, but only if the member chooses in effect to give up their redundancy pay;
- If the overall package exceeds £95k then the strain cost needs to be addressed, with the member having various options, including:
  (a) LGPS benefits still being paid immediately but on a reduced basis, with no additional compensation;
  (b) LGPS benefits being paid in full, with the member choosing to take less lump sum compensation and potentially paying the excess strain cost;
  (c) LGPS benefits being deferred until normal pension age, where they would be paid unreduced and the individual instead receiving lump sum compensation within the cap limits.

- Regardless of whether the exit cap applies or not, the member is in effect forced to choose which of the following they wish to give up (they cannot have all three as they do now):
  - Statutory Redundancy Pay
  - Full pension – in which case members must give up their statutory redundancy pay
  - Immediate payment - if members take their statutory redundancy pay, they must either have a reduced pension or defer pension until normal pension age.

These changes are much more widespread that was originally expected to limit large value exit packages and will limit redundancy payments to all Council staff regardless of salary.

The draft LGPS regulations implementing the restrictions have a proposed December implementation date. From 4 November 2020 up to the enactment of the change in LGPS Regulations there will be a short period with conflict between the obligations on scheme employers under the Cap Regulations to limit strain cost payments, and the requirement for administering authorities to pay unreduced pensions to qualifying scheme members under existing LGPS regulations. Government has this week written to Council's stating that they expect Council's to apply the LGPS Regulations in accordance with the cap.

The Scheme Advisory Board is seeking a legal opinion on application of the cap pending the revised LGPS Regulations. Theoretically, there could be a situation prior to the new regulations being enacted in which the scheme is required to pay an unreduced pension, but the employer is prevented from paying the full strain cost. The scheme would be required to recover the shortfall in other ways e.g. revised contribution rates.

<u>Implications for LB Barnet and Barnet Pension Fund</u>

The Council and other employers will need to ensure that any member being offered redundancy after 4 November is aware of the new terms. The Pension Fund and employers will have to communicate to ensure that the choices made by the employee are in line with the cap regulations and that when a member elects to pay for an enhanced pension that the payment is received. Should any redundancy be offered between 4 November and when the LGPS regulations are enacted, the Pension Fund may require legal advice as to whether an unreduced pension is payable.

The Pension Fund administrators, WYPF, have been asked to notify the Council of any leaver quotation requests or notifications that have the potential for a strain cost so that appropriate liaison can be undertaken with employers and potentially Legal.

Age Discrimination (McCloud)

The Local Government Pension Scheme (LGPS) is going to change for some members as a result of The Court of Appeal ruling known as the "McCloud judgement". The ruling, made on 20 December 2018, found that when public service pension schemes changed in 2014 and 2015, they had discriminated on the grounds of age, by only providing protection for older members.

In the LGPS, these protections were applied in 2014 when the scheme changed from a final salary scheme to a CARE scheme. All members were automatically moved across to the new scheme, but older members, closer to retirement, were given additional protections, called the "Underpin". These protections were set up to ensure members do not receive less pension in the new scheme, than they would have in the old scheme. As the protections were only applied to members of a certain age, the court has decided that it was 'unlawful on the grounds of age discrimination'.

The government made a statement in July 2019, announcing that, as a result of the McCloud judgment, it would 'take steps to remove the discrimination.' Although the original ruling only directly involved two schemes, the government has confirmed it will be applied to all public service pension schemes. These protections in the LGPS will need to be revised. As a result, if members are affected by the changes, how much pension they get may change.

A government consultation proposes that the revised underpin will apply to all members who meet the criteria for protection regardless of their age who were active members on 31 March 2012 and have acquired post 2014 CARE benefits. The revised underpin will also apply to early leavers and will extend to qualifying members who have left the scheme since April 2014 as well as active members. It will also apply on death in service and survivor benefits.

Implications for LB Barnet Pension Fund

The implications for pension schemes is that the records of all members active on 31 March 2012 will require review, potentially additional data will need collection and

any calculations made in respect of affected members will need correction. Previous benefits and transfers may have to be enhanced. This is going to be a long and time-consuming project and we will be discussing a project plan with WYPF. The Actuary made allowance for McCloud at the last triennial valuation, which was part of the reason for the increase in the fund as a whole primary contribution rate.

Gender Discrimination (Goodwin Case)

In a recent employment tribunal case (Mrs Goodwin v Department for Education) it was concluded that a female member in an opposite sex marriage is treated less favourably than a female in a same sex marriage or civil partnership, and that treatment amounts to direct discrimination on grounds of sexual orientation.

Where schemes contain provisions deemed discriminatory, those provisions must be dis-applied as being contrary to the non-discrimination rule set out in section 61 of the Equality Act 2010.

Same-sex survivors were originally entitled to survivor benefits taking into account the member's service from April 1988, however retrospective amendments remain to be made with effect from 5 December 2005 (the date when civil partnerships became possible), such that those survivor benefits now take into account the member's service from 6 April 1978.

Following the Goodwin Tribunal, regulatory amendments will now need to be made with effect from the same date to extend that entitlement to male survivors of female members.

Where a male spouse survivor of a female scheme member, whose entitlement to the survivor pension arose on or after 5 December 2005, is in receipt of a survivor pension, that pension will be increased in line with above changes.

Implications for LB Barnet Pension Fund

We currently await draft LGPS regulations to be determine the actions proposed by Government. However, any requirement to review members service between 1978 and 1988 is going to be complicated and time consuming.

Cessation Surpluses (Exit Credits)

Historically, when an employer left the LGPS they were billed for any actuarial deficit at the date of departure but any surplus of assets on exit was retained in the Fund and reallocated, usually to an entity from whom the exiting employer had taken on a contract as the reason for its entry to the LGPS. Regulations were changed in May 2018 to permit the payment of surplus (Exit Credit) to the employer at the date of cessation, although the relevant circumstances and factors to be considered were vague.

The Local Government Pension Scheme (Amendment) Regulations 2020 which came into force on 20 March 2020 list the factors to be considered in determining the extent to which a surplus is paid. These include the amount of contributions paid in relation to the surplus and also representations from the employer and any party who

guaranteed their liabilities e.g. the Council. The new regulations include confirmation that the exit credit amount may be zero.

Implications for LB Barnet Pension Fund

The Barnet Funding Strategy Statement has been amended to confirm that consideration will be given to paying all or part of the cessation surplus. In practice this would involve consideration of the factors giving rise to the surplus and whether any other party carried the deficit risk. Factors to consider include:

Extent to which the surplus is due to contributions exceeding benefit accrued
Favourable entry or exit point
Risk sharing agreements in place

It is expected that ceasing employers will actively engage in the determination of surplus allocations. The Pension Fund Committee will be informed prior to the payment of any significant cessation surplus to any employer.

Management of Employer Risk Regulations

New regulations enacted from September 2020 cover the following areas:

1 Review of employer contributions

2 Spreading exit payments

3 Deferred Debt Agreements

Review Employers Contributions

Currently contribution rates can only be changed at the triennial valuation and when an employer is likely to leave the scheme. The new regulations allow contributions to be changed when there has been a significant change in the liabilities or covenant of the employer. Employers can ask for a review, it they are willing to pay.

The practicalities of reviewing an employer's contributions will require the administering authority to:

- consult with the impacted employer,
- state its policy on the review of employer contributions in its Funding Strategy Statement and obtain advice from its actuary, and
- consider the impact on other employers in the fund.

Given the current environment, administering authorities could potentially expect a deluge of employer requests (particularly where employers have their own actuarial/legal advisers). Therefore, quickly establishing an employer contribution review policy and process will be key. Where we become aware of a significant change in employer circumstances, we will discuss with the actuary whether a

change in contribution rate is required. While this is most likely to be changes to deficit contributions it could also entail primary contributions.

Spreading Exit Payments

Current regulations infer that cessation deficits are payable in full as soon as calculated. The new regulations allow the administering authority to agree to spread these over a period which it "considers reasonable". The scheme is required to:

- set out within its FSS its policy on spreading exit payments and to obtain advice from its actuary, and
- take account of the interests of all employers and LGPS funds when determining the payment terms.

Expectation are of protracted discussions around the timing of cessation payments.

Deferred Debt Agreements

This is a variation on spreading exit payments. When an employer no longer has active members in the scheme this triggers a cessation valuation. These new regulations allow the scheme to treat the employer is ongoing and calculate contribution rates (deficit only) at each triennial valuation. A period must be specified before a traditional cessation calculation and events that will terminate the agreement.

The Regulations require:
- a policy statement is required in the FSS after taking actuarial advice,
- consideration of all the evidence available and "use judgement and local knowledge",
- monitor the agreement carefully (including at valuations) to ensure it is on track to meet its funding target
- put in place recovery plans where shortfalls are identified.

There is also an option for allowing a separate [notional] investment strategy for such employers. Quite how the fund would handle a request for a 'low volatility' asset allocation is unclear, especially when employers assets are tracked on a three-yearly basis. This is potentially a catalyst towards employer specific investment strategies which would move the setting of investment strategy from the Pension Fund Committee to individual employers.

Implications for Barnet Pension Fund

Starting discussions on deferred debts or spreading exit payments are employer initiatives. Where there is a proposed move from immediate to deferred payment of a deficit, the amounts must be meaningful to justify discussion and the primary goal of the pension fund is to maximise deficit recovery and protect other employers.

Reporting and governance of climate risks

The Government appears set to require pension funds to report against a framework for managing and reporting climate-related risks and opportunities established by the Taskforce for Climate Related Financial Disclosure. The implementation timetable being discussed would require Barnet's first report by 31 October 2023. The framework is summarised in the table below:

TCFD area	Requirements
Governance	• Establish and maintain oversight of climate related risks and opportunities • Establish and maintain processes that allow the trustees to satisfy themselves that those managing the scheme are assessing and managing climate related risks and opportunities
Strategy	• Identify climate related risks and opportunities that will impact the investment and, for DB schemes, funding strategy of the scheme over different time horizons • Assess the impact of identified risks and opportunities on the scheme's investment and, for DB schemes, funding strategy
Scenario analysis	• At least annually, assess the resilience of the scheme's assets, liabilities and investment and, for DB schemes, funding strategy to climate related risks in at least two scenarios (including one scenario that reflects an annual temperature rise of 1.5 to 2 degrees.
Risk management	• Adopt and maintain processes for identifying, assessing and managing climate-related risks • Ensure the integration of climate-related risks into overall risk management
Metrics	• Select at least one GHG emissions and one non-emissions metrics against which to assess scheme assets against climate related risks and opportunities • At least quarterly, obtain the Scope 1/2/3 emissions of the portfolio and calculate the selected emissions metric • At least quarterly, obtain the necessary data and calculate the non-emissions metrics
Targets	• At least annually, set one target to manage climate relate risk with respect to the chosen metrics and measure performance against this target at least quarterly.

[Extracted from Hymans Robertson Briefing Note]

Key takeaways are:

- Scenario analysis will require impacts of temperature changes on asset classes / holdings to be assessed.
- Quarterly reporting against two climate related metrics, one of which is likely to be Weighted average carbon intensity.
- A requirement to set one target to manage climate related risk and measure against this annually.

<u>Impact for Barnet Pension Fund</u>

Although it is early days and we await firm Government proposals, it does appear that the Pension Fund will have to demonstrate increased attention to climate change. There will be choices to be made in terms of targets and metrics and a

degree of standardisation across LGPS will emerge. While Much of the onus on generating numbers will be on fund managers; enabling fund level reporting will require standardised reporting by managers. It is likely that reporting of pooled assets will be less demanding than non-pooled assets in that we can expect the London CIV to ensure all their managers work to common reporting standards. Further updates will be provided when the draft regulations are published.

Conclusions & Action

In the short-term McCloud and Godwin are going to create additional work for pension administrators and the inhouse team will need to agree with the administrator which records will require amending, how missing information is collected and whether de-minimis limits can be applied. We can expect members to start asking questions and potential unrealistic expectation as to how long this will take to resolve.

Limitations on redundancy payments will anger members although employers will initially take the flack. Scheme' employers have been made aware of the new limits, but we can expect some to ignore these and messy situations where staff have been promised more than they are now entitled.

Rules on surplus sharing, deficit spreading and recalculating contribution rates will generate additional employer conversations and possibly disputes as to how the new options are exercised.

For the moment action relating to climate risk regulations are limited to being aware of developments and discussing fund manager plans to support our reporting.

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