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Ask for: Theresa Grayell
Date: 8 October 2020

Dear Member

PENSION BOARD - THURSDAY, 15 OCTOBER 2020

ITEM 5 APPENDIX 3 McCloud Consultation Response
ITEM 6 APPENDIX 3 Funding Strategy Statement Draft 2020

Please find enclosed, for consideration at next Thursday, 15 October 2020 meeting of the Pension Board, the following reports which replace Appendix 3 to Item 5 and Appendix 3 to Item 6 contained within your agenda pack. These are the correct versions, apologies for any confusion.

Agenda Item No

Yours sincerely

Benjamin Watts
General Counsel

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Date: 8 October 2020

Dear Sirs

Local Government Pension Scheme (LGPS) - Response to consultation: Amendments to the Statutory Underpin

Name	Barbara Cheatle
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I write in response to the Department's consultation on amendments to the statutory underpin which commenced in July 2020.

As agreed by the Scheme Advisory Board we have referenced some of their responses to the consultation in answer to some of the 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. To avoid discrimination all scheme members need to be treated equally and therefore the fairest way is to extend the underpin to younger scheme members.

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

Yes. In order to obtain the benefits of changing the LGPS to a Career Average Revalued Earnings (CARE) scheme.

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

Yes. This does seem the obvious date as this was the date of the introduction of the CARE scheme however by making the regulations retrospective to 1 April 2014 it needs to be acknowledged that this will lead to administrative complexities and heavy additional workloads for both employers and administrators as outlined in the consultation paragraphs 134-136. This additional work will be very costly.

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

Partially. There are outstanding issues requiring further clarification such as the impact on pension sharing orders, scheme pays debits and the default regarding missing data. Also technical issues detailed in Annex A.

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

Yes. The draft regulations provide a framework however the changes are so complex that clear communications will be needed in respect of all parties. To implement the changes by April 2022 will involve huge amounts of extra work for administrators, employers and pension administration system providers in order to collect the data required and that correct calculations can be made. This additional work will be very costly.

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

Our comments on technical matters related to the draft regulations concur with those highlighted by the Scheme Advisory Board and are at Annex A.

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. A requirement for members to have an immediate entitlement to a pension to receive the underpin protection would not remove discrimination.

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

It is possible that members who joined the scheme between 1 April 2012 and 31 March 2014, and therefore have membership based on final salary may challenge why they are not included in the remedy.

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

Yes. If this were to be extended to multiple periods of unaggregated membership it would be inconsistent with other aspects of the scheme and would add to the complexity.

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. With the understanding that communicating this option to scheme members who have previously decided not to aggregate periods of membership will be problematical and as with all option exercises may lead to appeals in the future.

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 consider that the proposals would not have 'significant adverse effects' however may affect scheme members that are unable to aggregate, e.g. concurrent members leaving membership on same day, members who opted out on or after 11 April 2015 etc

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

No comments

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

Yes. Although we believe that the 2 stage underpin process is necessary in order that a true comparison of final salary and CARE benefits takes place member communication at the underpin date of the provisional assessment with no adjustment to the member's benefits at that time will be complex.

Question 14 – Do you have any comments regarding the proposed approaches outlined? and
Question 15 – Do you consider there to be any notable omissions in our proposals on the changes to the underpin?

Technical issues regarding the proposed approaches are included in Annex A. In addition regarding paragraphs 65-102:

Para 66 Each year, a qualifying member's annual benefit statement will include an estimate of how the underpin would have applied to them if they had left the scheme at the end of the scheme year (i.e. as if their underpin date had been 31st March in that year). In these estimates, no account would be taken of actuarial adjustments relating to a member's age.
As DWP ask that annual benefit illustrations should be succinct and easily understandable is this necessary as it will be complex to provide and very difficult to explain the provisional assessment.

Para 67 This implies that for those qualifying members that remain in the scheme beyond their 2008 scheme NPA date that at the underpin date a comparison of their benefits will be triggered and the member will be informed of the results of the comparison with the information that a further check will be undertaken when they reach their underpin crystallisation date. This will incur additional work in obtaining their pay details from their employer at their 2008 scheme NPA date, carrying out calculations and explaining the reason for the comparison at that date when the final comparison will not be undertaken until they leave. This additional work will be very costly.

Para 71 As for response to Para 66 question as to whether this information really is necessary on deferred benefit annual illustrations**.**

Para 93 Agree with proposal

Para 100 Redundancy/Business Efficiency Believe this and other aspects of the consultation may need to be updated due to the proposed changes to the scheme regulations as a result of the Exit Cap.

Para 101 Where the date of commutation is the underpin crystallisation date, we think that the final guarantee amount should be calculated by comparing the assumed benefits and underpin amount benefits themselves (rather than the commutation sums due) and adding the final guarantee amount to the pension account before the trivial commutation/small pot sum is calculated. This is simpler administratively and allows for the increase in benefits to be considered for the annual allowance.

Question 16 – Do you agree that annual benefit statements should include information about a qualifying member's underpin protection? and
Question 17 – Do you have any comments regarding how the underpin should be presented on annual benefit statements?

No. Being on the receiving end of the current questions that are received from scheme members with regard to their annual benefit illustrations and deferred benefit annual updates with regard to the existing split between their final salary and CARE benefits to add information regarding underpins, underpin dates and underpin crystallisation dates and amounts will just add to the complexity that will result in scheme members not engaging. It would be far better to add a note to the illustrations that increases with regard to the underpin for qualifying members will be added to their benefits at the point that they leave/retire etc There is already a drive to make annual benefit statements easier to understand and adding this complexity will not help.

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

Agree. A member's underpin protection can only result in a change to their pension entitlement at their 'underpin crystallisation date' and therefore it would be in this pension input period that the underpin should first be given consideration for the purposes of the annual allowance. As there would be no change to a member's pension entitlement at the point of a member's underpin date, the underpin should not be given consideration for annual allowance purposes in that pension input period.

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

No comment

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

No comment

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 comment

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

The most important principles in order to help members and employers understand the implications of the proposals is simplicity and timing of the provision of the information. Members need to be given concise information, without necessarily the background to this information, at the underpin crystallisation date.

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 for both administering authorities and employers will be colossal 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 as changes will also be required to Fire and Police schemes at the same time. We understand that the systems development is as large if not larger than that required in 2014 and 2015 when schemes changed to CARE schemes and this time the proposal is that the changes to schemes are to be be made at the same time.

We will be required to collect and record a significant amount of backdated data in order to recreate final salary service for members in scope. This will be a challenge in itself but will also undoubtably lead to situations where the data is either difficult or impossible to obtain. In these circumstances we would urge MHCLG or HMT to provide the following clarity;

1. What would constitute ‘reasonable efforts’ by the authority to obtain the data and

2. What the default position should be in relation to members for whom the data is not able to be obtained. For example, to assume full service without breaks if no break information is available and to calculate part time service using pensionable and final pay figures if no hours information is available

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

Authorities should be provided with guidance in the following areas;

1. The priority to be afforded to the calculation and payment of back-dated cases, for example should the order be pension in payment, survivor benefits, deferred benefits, other benefits (e.g. sharing) then transfers?

2. Any timescales by which such cases are expected to have been completed

3. Any timescales by which the recording of notional final salary service is expected to have been completed for active members in scope.

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

Yes remove the requirement to include figures regarding the underpin assessment on annual benefit statements and deferred benefit statements. Information can be provided in the notes etc but amounts should only be provided at the date the member leaves the scheme etc

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?

Clear guidance on the data requirements from employers together with the default information that can be used when the data required is not available.

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

To the collection of data, requirements where this data is not available, communication of the changes and prioritisation of dealing with the different categories of scheme members affected.

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?

The potential costs of the McCloud remedy to employers, administering authorities and tax payers are a concern. It is anticipated that the increase in employer costs as a result of an increase in liabilities will be met during the next scheme valuation and it is likely that increased administering authority costs as a result of implementing the remedy will also be dealt with via this route however ultimately an increase in employer contribution rates will result in increased costs being passed to local taxpayers. The only way to avoid this is to pass the cost onto current scheme members, however some of whom will not benefit from the remedy, via increased employee contribution rates or changes to other scheme benefits.

Yours sincerely

BM Cheatle

Mrs Barbara Cheatle
Pensions Manager
Pension Section

Annex A

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

Amended regulation 89 of the LGPS 2013 Regulations

*See also comments on ABS in answer to questions 16 and 17.
1) Inserted regulations 89(5) and 89(7) refer to 'a 2008 Scheme normal retirement age', which is not defined in the 2013 regulations. Therefore, it might be helpful to include a definition of the term in the 2013 Regulations.

2) Inserted regulation 89(5) to (10) will come into force on the same date that the Amendment regulations take effect. The Amendment regulations do not specify the first scheme year that the annual benefit statements (ABS) will need to include the additional information. For example, if the regulations come into force on 30 June 2021, will the requirements apply to the ABS for active members in relation to Scheme year 2021/22 or 2020/21? It would be helpful to set this out in the regulations.

3) An active member who has taken benefits in relation to the relevant scheme membership on flexible retirement does not have any further underpin/crystallisation dates. However, the wording of inserted regulations 89(5) and 89(7) would still capture these cases and thus administering authorities would need to provide the additional information on the benefit statements following the flexible retirement. This outcome does not appear intended. We would suggest that an amendment is made to inserted regulations 89(5) and 89(7) explicitly excluding active members who have drawn their benefits in relation to the relevant scheme membership on flexible retirement. Consideration will need to be given as to what to show on an ABS for a member who has taken partial flexible retirement.

4) Regulation 89 of the 2013 Regulations assumes that each statement relates to a Scheme year. The statement relating to a Scheme year must then be issued no later than five months after the end of the Scheme year. The wording does not bar the statement being issued before the end of the relevant scheme year. When it comes to statements for deferred members, most administering authorities will issue the statement including the latest pensions increase (PI) Order. This means that the statement includes up-to-date figures at the point of issue. However, it is not always clear whether the statement 'relates' to the previous Scheme year or the Scheme year in which the statement is given. Currently, as long as the statement is issued before the end of 31 August following the end of the previous Scheme year, it doesn't matter. However, inserted regulation 89(6) says that the underpin figures shown on the statement must include the index adjustment to the end of the Scheme year to which the statement relates. If this becomes law, administering authorities will need to understand what scheme year the deferred statement relates to. For example –

- If the ABS relates to the previous Scheme year, the underpin figures would need to be revalued to the end of the previous Scheme year (so, will not include the PI applying in the April between the end of the Scheme year and the date of issuing the statement). If the administering authority includes the latest PI in the other figures, the underpin figures will be a year behind the main figures.
- If the ABS relates to the Scheme year in which the statement is issued, the underpin figures will need to be adjusted to the end of the Scheme year (so, will include the latest PI). In this case, the deadline for the statement would be the following August.

5) Inserted regulation 89(6) says that the provisional underpin amount and provisional assumed benefits, calculated at the underpin date, must be adjusted by the appropriate index rate adjustment to the end of the scheme year to which the statement relates. However, in the year the member leaves the Scheme the provisional assumed benefits should be treated like CARE benefits and will be due a revaluation adjustment (including the tweak to avoid double indexation) for the period from the beginning of the Scheme year to the underpin date – this will be applied on 1 April following the Scheme year in which the member leaves or reaches their 2008 scheme normal pension age. They will also be due part year PI for the period from the underpin date to the end of the Scheme year.

We recommend that the wording is amended to reflect the final part year revaluation adjustment that applies in the year of leaving.

6) The wording in regulation 89(6) also suggests that you revalue the 'provisional guarantee amount' from the underpin date to the end of the relevant Scheme year. This assumes that the difference between the provisional assumed benefits and the provisional underpin amounts remains the same over time. But this may not be true. For example, in the year of leaving, the provisional assumed benefits will be due the revaluation adjustment (including the tweak) for the period from the previous 1 April to the date of leaving and then PI thereafter. The provisional underpin amount will be due PI between the underpin date and the end of the relevant Scheme year. Therefore, the gap between the two amounts may change. We recommend that the 'provisional guarantee amount' should equal the difference between the provisional underpin amount and provisional assumed benefit amounts as at the end of the relevant Scheme year (or £nil where the assumed benefits are more than the underpin amount).

7) Regulation 89(7) provides that, in relation to active members who have met their 2008 Scheme NPA, the provisional underpin amount and provisional assumed benefits should be revalued to the end of the Scheme year to which the statement relates. It does not set out how this should be done. We assume that the provisional underpin amount is increased by pensions increase; however, it is unclear how the provisional assumed benefits are increased. Do these continue to receive revaluation adjustment after the underpin date while the member is an active member, with part year revaluation adjustment (the tweak) applying on 1 April following the date of leaving and then PI from the date of leaving? Or does the revaluation adjustment apply to the provisional assumed benefits up to the underpin date (with tweak applied on 1 April following the underpin date) and PI thereafter?

8) The wording in regulation 89(7) also suggests that you revalue the 'provisional guarantee amount' from the underpin date to the end of the relevant scheme year. This assumes that the difference between the provisional assumed benefits and the provisional underpin amounts remains the same over time. But this may not be true. For example, the provisional assumed benefits will be due further revaluation adjustments, as described above. The provisional underpin amount will be due PI between the underpin date and the end of the relevant scheme year. Therefore, the gap between the two amounts may change. We recommend that the 'provisional guarantee amount' should equal the difference between the provisional underpin amount and provisional assumed benefit amounts as at the end of the relevant scheme year (or £nil where the assumed benefits are then more than the underpin amount).

Draft regulation 6
New regulation 4(1B) of the Transitional Regulations 2014

9) Inserted regulation 4(1B) does not appear to cover members who leave and re-join without a break. This could be interpreted as meaning that such a member would meet the requirements of regulation 4(1)(a) to (c) even if they do not aggregate their benefits which would not deliver the policy intent.

10) Inserted regulation 4(1B) says that a member who has had a break in service/concurrent employment 'only has' a relevant scheme membership if the benefits containing 31 March 2012 membership are aggregated with the 2014 CARE account. This wording appears to cause problems where the member was active on 31 March 2012, left after 31 March 2014 with a deferred benefit or pension and later re-joins. In this case, at the point of originally leaving, the member had relevant scheme membership. But the member has had a break in service. Which means that the member only has relevant scheme membership if the period including 31 March 2012 has been aggregated to a CARE account as a result of the provisions listed in (a) to (c). In our case, it is true that the benefit including the 31 March 2012 is aggregated to 2014 benefits; however, this was not a result of the provisions listed in (a) to (c). So, if the member does not aggregate (or is not able to aggregate) the original benefit with the new benefit, it would appear that the member can't have a relevant scheme membership. Where does this leave the original benefit that was considered to be relevant scheme membership?

11) Inserted regulation 4(1B) specifies the regulations under which an aggregation decision must have been made for relevant scheme membership to apply when separate periods are aggregated. We do not think that it is necessary to list the regulations here – it would be enough to say that the period referred to in paragraph 1(a) has been aggregated with their 2014 Scheme pension account. However, we do think these regulations should be listed in relation to 4(1C) and (1D) – see below.

12) If regulation 4(1B) is going to list the regulations under which the aggregation has taken place they will also need to cover the following situations:
▪ where a member who was active on 31 March 2012 left with a frozen refund, re-joined before 1 April 2014 and then subsequently joined the 2014 scheme by virtue of regulation 5(1) of the Transitional Regulations. This is because the aggregation of the benefits will not be the result of a decision taken under any of the regulations listed.
▪ a member who was active on 31 March 2012, left with a deferred benefit before 1 April 2014, re-joined on or after that date without a disqualifying break and aggregates under reg 5(5) of the Transitional Regulations.

13) Also, inserted regulation 4(1B) appears to cover a member who was active on 31 March 2012, left with a frozen refund (before 1 April 2014), re-joined on or after that date where the frozen refund was aggregated under regulation 10(5) of the Transitional Regulations. However, it should be noted that 'no decision' was required to instigate the aggregation.

New regulation 4(1C) of the Transitional Regulations 2014

14) If regulation 5(5) of the Transitional regulations is inserted in regulation 4(1B), it will also need to be included here.

15) Do the words 'in respect of the active account or the deferred account' need to be added after 'relevant scheme membership' in regulation 4(1C)(a) as the member may have relevant scheme membership for a different account? This would ensure the effect of the aggregation is to qualify the particular deferred or active account as relevant scheme membership.

New regulation 4(1D) of the Transitional Regulations 2014

16) Again, do the words ‘in respect of the active account or the deferred account’ need to be added at the end after ‘relevant scheme membership’, as the member may have relevant scheme membership for a different account. This would ensure the effect of the aggregation is to qualify the particular deferred or active account as relevant scheme membership.

17) We understand that the account to which previous benefits will be added under the extended aggregation window under inserted regulation 4(1D) should be at deferred or active status. This means that the potential receiving account can’t be at pensioner status, frozen refund status, deferred pensioner status or at no status as a result of the benefits being transferred out or trivially commuted. However, it is not clear what status of previous scheme membership can be aggregated under the extended window. The wording of regulation 4(1C) and the previous provisions suggest that the previous membership must have been capable of being aggregated with the active record or the deferred record at some point. We understand that the intention is that the previous membership must be at deferred status at the point of the aggregation (to avoid unwinding pensions in payment). If so, the current wording does not explicitly say that benefits that could have been aggregated to the active/deferred account at some point but have since become pensioner benefits cannot now be aggregated.

18) The regulation does not set out how the aggregation is to be given effect. The regulation needs to be clear that the aggregation is to be treated as if it was done under the aggregation provisions that it could have originally been done under. This will then make it clear what benefits are being bought on aggregation eg CARE or final salary and that a transfer payment is due if the benefits are being aggregated with a different fund.

19) The current wording of inserted regulation 4(1D) would allow certain members to take advantage of the extended aggregation window, when we do not believe that it is the intention for them to be able to do so:

- We understand that the intention is not to allow members to use the extended window to aggregate benefits with benefits that are in payment. However, there is a potential case where this could be possible. This applies where the member, in relation to membership that is not relevant scheme membership, has taken flexible retirement and is still an active member on the date the regulations come into force – this member holds a separate period of membership that includes 31 March 2012. In this case, the member could use the extended window to combine the separate period of membership with the new period of membership. The flexible retirement calculation would then need to be recalculated, taking into account both the newly acquired underpin protection and the aggregated period of membership.
- A member on 31 March 2012 who left after that date and re-joined after their 2008 scheme normal pension age (NPA) would be given the opportunity to aggregate their earlier benefits with their ongoing pension account. As the more recent period of membership does not include any benefits built up before 2008 scheme NPA, those benefits would not attract underpin protection.

20) We believe that the intention is for an extended opportunity to aggregate to be offered to those members who would benefit from underpin protection on a pension record if the aggregation were to take place. We believe a change of wording is required to ensure that the extended opportunity to aggregate is not offered to those members to whom this does not apply.

21) What happens where there are multiple records? For example, where the member has one current active/deferred record and multiple records that include 31 March 2012. Can the member use the extended window to aggregate all the records on to the active/deferred record? What about where the member has multiple active/deferred records and a single record that contains 31 March 2012? Can the member aggregate to one of the active/deferred records and then combine that aggregated record onto a further active/deferred record? What about where the member has multiple active/deferred records and multiple records that include 31 March 2012?

Amended regulation 4(2) of the Transitional Regulations

22) We understand that the intention is that the underpin calculation is done at the end of the following, as appropriate:

- last day of active membership
- the day before the member's 2008 NPA
- the day before the member reduces hours/grade for flexible retirement cases
- the date of death.

However, we do not think the wording of the regulation makes this clear. For example, inserted regulation 4(4) says:
'a member's provisional guarantee amount in a relevant scheme membership is the amount by which a member's provisional underpin amount exceeds the provisional assumed benefits on their underpin date'.

It is not clear whether the comparison is done at the start of the underpin date (so, not including accrual on the underpin date) or at the end of the underpin date. If it is done at the end of the underpin date, then should the regulations specify that in relation to regulation 4(2)(a) the underpin date is the day before the member attains NRA in the 2008 Scheme? If clarification is provided on the above point, consideration will be needed as to how that then interacts with the notional underpin date of 31 March for the purposes of annual benefit statements.

23) Also, in relation to flexible retirement, it would be more appropriate for the regulations to specify the underpin date is the day before the member reduces their hours /grade, as the date the member elects to receive immediate payment will, in most cases, not be the date the benefits become payable from.

New regulation 4(2A) of the Transitional Regulations 2014

24) This regulation says:

'(2A) A member's date of death shall be their underpin date in a relevant Scheme membership where that date is earlier than the date provided for by paragraphs (2)(a) or (2)(b)'

We think this should be (2)(a), (2)(b) or (2)(c). This is because the current wording causes confusion for a member whose underpin date is their flexible retirement date but then dies in service before attaining their 2008 Scheme normal retirement age. Under regulation 4(2), the member's underpin date is the flexible retirement date. However, regulation 4(2A) says that the underpin date is the date of death as it is earlier than the date of leaving or the date the member attained their 2008 Scheme normal pension age.

Amended regulation 4(5)(a) of the Transitional Regulations 2014

25) It would be helpful if the regulation made it clear that the period is 1 April 2014 to 31 March 2022 inclusive.

Amended regulation 4(5)(b) of the Transitional Regulations 2014

26) The use of ‘between’ before 1 April 2014 suggests that the remedy period does not include 31 March 2022 or the underpin date. Again, it would be helpful if the regulation made it clear the period is inclusive of the start and end dates.

27) This regulation sets out that additional contributions paid by the member are to be disregarded when working out the provisional assumed benefits other than contributions paid to cover a period of absence from work with no pensionable pay. It does not set out that additional contributions paid by the employer should also be disregarded (other than contributions to cover absence/leave).

28) There is an issue where a member pays additional contributions to buy lost pension to cover a period of absence from work with no pensionable pay if the period of leave occurs during the remedy period but some or all of the additional contributions are paid after the remedy ends, or after the member attains their 2008 normal pension age. The lost CARE pension is credited in the Scheme year it is paid for, meaning that the whole period will be counted for the underpin amount but not for the assumed benefits. To ensure a fair comparison the lost pension purchased should be included in the assumed benefits, although this would pose problems in reassigning lost pension acquired after the remedy period into a scheme year during the remedy period.

29) The above will also be an issue where an absence spans the period before and after the remedy period.

30) This regulation sets out that AVCs paid by the member are to be disregarded when working out the provisional assumed benefits. It also needs to set out that AVCs paid by the employer should also be disregarded.

Amended regulation 4(5)(d) of the Transitional Regulations 2014

31) Where a member aggregates previous LGPS final salary benefits and those benefits are converted to CARE benefits on aggregation we understand the resulting CARE benefits should be excluded from the calculation of provisional assumed benefits. We do not think the regulations deliver this. We recommend including a provision that explicitly disregards the transferred in CARE benefits in this circumstance.

Regulation 4(5)(f) of the Transitional Regulations 2014

32) Regulation 4(5)(f) and corresponding 4(6)(f) provide that, for the purpose of calculating the provisional assumed benefits and the provisional underpin amount, the active member’s account at the underpin date, should be adjusted to take account of any pension debit or Scheme pays election the member has made.

- As the debits are deducted equally from both the provisional underpin amount and provisional assumed benefits, we think the same outcome could be achieved by not taking making the adjustment. This would be simpler from an administrative point of view. It would also avoid the potential situation where a member’s calculated provisional assumed and underpin benefits are negative. This could happen where the member has a large transfer in from another pension arrangement and is subsequently subject to a pension sharing order.

Because a transfer in is ignored in the calculation of the provisional underpin amount and provisional assumed benefits, but the pension debit is not, the resulting benefits could be negative.

If pension debits are kept in the calculation of the provisional assumed and underpin amounts, MHCLG will need to consider whether the pension debit will need to be recorded separately for the remedy period. This will be necessary if the CARE benefits calculated with reference to the provisional underpin amount and the provisional guarantee amount are awarded an NPA of 65, as is the case under the current regulations.

Amended regulation 4(6) of the Transitional Regulations 2014

33) The draft regulation reads:

‘The provisional underpin amount is calculated by assessing the benefits the member would have had an immediate entitlement to payment of under the 2008 Scheme in a relevant Scheme membership if-‘
The word ‘immediate’ should be removed to deliver policy intent.

Amended regulation 4(6)(a) of the Transitional Regulations 2014

34) Again, it would be helpful if the regulation made it clear the period is inclusive of the start and end dates.

Regulation 4(6)(b)(ii) of the Transitional Regulations 2014

35) The wording of this regulation suggests that where the APC contract is not completed (or deemed to be completed on a tier 1 or tier 2 ill health retirement) none of the absence/leave period would be included. However, the equivalent provision on the provisional assumed benefits for a case where the APC contract was partially completed would include the additional pension acquired. Therefore, for the sake of a fair comparison, does regulation 4(6)(b)(ii) need to include some of the membership where the APC contract is not completed? This will also require an amendment to regulation 8(4) of the Transitional Regulations and potentially Schedule 2(4)(2)(a)(iii) – 85-year rule.

This issue has been raised before by the national technical group.

36) Where an APC contract is incomplete due to death in service, regulation 16 of the 2013 regulations does not provide for the APC contract to be deemed to be completed, in the way that it does for tier 1 or 2 ill health retirements. The reason for this is that the APC does not feed into death-in-service benefits. However, where a member dies in service, should an incomplete APC contract that was taken out to cover a period of absence from work with no pensionable pay be deemed to be complete for the purposes of the underpin?

Amended regulation 4(6)(b)(iii) of the Transitional Regulations 2014

37) Should this regulation clarify that a member who is eligible under regulation 35 of the 2013 regulations for an ill health pension is also deemed to meet the equivalent conditions in the 2007 Benefit Regulations (i.e. the ill health conditions, the tier 1 or 2 conditions, the conditions where reductions in pay/hours are ignored)?

38) An ill-health enhancement is only added if the provisional assumed benefits include an adjustment under regulation 39 of the 2013 regulations. Therefore, if the member, because of a previous ill-health award, is denied any enhancement under regulation 39, no enhancement would be added under regulation 20 of the 2007 Benefit Regulations to the provisional underpin benefits, notwithstanding that, had the 2007 Benefit Regulations applied at the underpin date, the member potentially would have received an enhancement. Is this intended?

New regulation 4(6A) of the Transitional Regulations 2014

39) The regulation requires a comparison of the enhancements that are worked out under regulation 24(2) of the 2007 Benefit Regulations and 41(4)(b) of the 2013 Regulations. The enhancements under these regulations are worked out using 1/160ths; however, for the purpose of this underpin we think the enhancement should be calculated with reference to the member's benefits i.e. 49ths and 60ths, and then proportioned for the relevant survivor benefit(s) as set out in draft regulation 4(21).

New regulation 4(7) of the Transitional Regulations 2014

40) In relation to the payment of pensions, regulation 4(7)(a) to (c) all represent the first date on which the pension becomes payable; however, 4(7)(f) is different because the crystallisation date is the date a member dies and the survivor pension becomes payable the day after the date of death. Is this intended?

41) In relation to flexible retirement, would it not be more appropriate to set out that the crystallisation date is the date of the relevant reduction in hours or grade, rather than saying 'the date from which the member elects to receive payment?

42) Regulation 4(7)(c) refers to 'an ill-health retirement pension' which is not defined in the regulations. Regulations 35 and 38 refer to a 'retirement pension' so we think the words ill-health could be deleted.

43) Regulation 4(7)(c) - should the wording also include 'entitled to receive payment" to align with the other provisions and to make clear that the crystallisation date is the same as the date from which the pension becomes payable.

44) Regulation 4(7)(d) says that the crystallisation date is the date the member receives payment of a trivial commutation/small lump sum. It would be more appropriate to change the wording to the date the administering authority makes the payment.

45) Regulation 4(7)(e) says that the crystallisation date is the date the member transfers their benefits out. We would suggest that the crystallisation date should align with the date at which the transfer value is worked out (in most cases, the guarantee date), rather than when the member transfers out. If this is accepted, an amendment would need to be made to the wording of regulation 4(17) as the transfer payment would not be due at the crystallisation date (i.e. the guarantee date).

46) This regulation does not cover members whose pension automatically comes into payment on their 75th birthday. In which case, we would assume that the crystallisation date would be their 75th birthday.

New regulation 4(8) of the Transitional Regulations 2014

47) In relation to the possible subsequent events, we don't think that (b) and (e) are possible.

48) What is the policy intent where a tier 3 ill health pension is uplifted to a tier 2 at the 18-month review? Should this be a further underpin date? If it is, you will need to consider that a guarantee amount awarded on the first crystallisation date could be wiped out by the enhanced service awarded when the benefit is uplifted.

49) Also, where a deferred pensioner member received a final guarantee amount at the first crystallisation date, this should be removed from the CARE account when the pension is suspended. Otherwise the member could have two underpin additions in their account after the second crystallisation date.

New regulation 4(9) of the Transitional Regulations 2014

50) We think the regulation should specify that the 'retirement pension account' must be increased by the final guarantee amount. Currently it just says 'pension account'.

51) We think that (4)(7)(d) should also be included here. This relates to trivial commutation and small pot payments. If the final guarantee amount is added to the pension account before commutation takes place it will allow for it to be taken into account for the annual allowance. The proposal to compare the trivial commutation sums of the provisional assumed benefits and the provisional underpin amount and then add the difference to the total accrued rights is administratively cumbersome. It also does not allow for the final guarantee amount to be taken account of in the annual allowance.

New regulation 4(11) of the Transitional Regulations 2014

52) If the member elects for partial flexible retirement, what happens to the percentage of the final guarantee amount not transferred into the flexible retirement account? Should this stay in the active pension account? How should it be revalued? We assume it would receive revaluation adjustment (with tweak) to the day before the flexible retirement benefits become payable and then PI?

New regulation 4(12) of the Transitional Regulations 2014

53) It should be noted that the 'final underpin amount' is not technically payable to the member - it is determined simply for the purposes of the comparison and does not take into account 50/50 membership. We think this regulation only needs to provide that the final guarantee amount is not subject to a further reduction. There is no provision in the regulations to provide a second actuarial adjustment to the CARE benefits calculated with reference to the provisional underpin amount, so we don't see it as necessary.

54) Also, if you state that the CARE benefits calculated with reference to the provisional underpin amount are not further adjusted this will cause an issue with partial flexible retirements, where the benefits not taken could potentially be subject to an adjustment at a later date.

New regulation 4(14) of the Transitional Regulations 2014

55) This regulation provides that the provisional underpin amount is updated to the underpin crystallisation date by applying the pension increases that would have applied under the 2007 Benefit Regulations from the underpin date. This does not cover cases where a previous year's final pay is used and there is no PI date between the underpin date and crystallisation date. In this situation, it appears that no pensions increase would be applied which would be incorrect. Does regulation 4(6) need to provide that where a previous year's pay is used, PI should be included in the provisional underpin amount?

New regulation 4(15) of the Transitional Regulations 2014

56) Paragraph (b) assumes that there are no actuarial reductions applicable to CARE benefits payable on redundancy. However, additional pension purchased to cover a period of absence/leave with no pensionable pay is included in provisional assumed benefits and is actuarially reduced for early payment on redundancy. However, the pension for the equivalent period of membership is not actuarially reduced in the provisional underpin amount (see comments above in response to draft regulation 4(6)(b)(ii)).

New regulation 4(16) of the Transitional Regulations 2014

57) This regulation provides that the provisional underpin amount is updated to the underpin crystallisation date by applying the pension increases that would have applied under the 2007 Benefits Regulations from the underpin date. This does not cover cases where a previous year's final pay is used and there is no PI date between the underpin date and crystallisation date. In this situation, it appears that no pensions increase would be applied which would be incorrect. Does regulation 4(6) need to provide that where a previous year's pay is used, pensions increase should be included in the provisional underpin amount?

New regulation 4(17) of the Transitional Regulations 2014

58) The impact on previously paid trivial commutation lump sums needs to be considered; in particular, what happens if when the final guarantee amount is retrospectively added to the valuation at the nominated date the valuation then exceeds £30,000. It would seem unfair for the trivial commutation payment to be considered as an unauthorised payment retrospectively. The recent HMRC newsletter on GMP equalisation may be helpful in considering issues.

59) Should regulation 7(e)(ii) be excluded on the basis that the value of the bulk transfer payment is decided by agreement between an actuary appointed by the Fund and an actuary appointed by the new scheme.

New regulation 4(20) of the Transitional Regulations 2014

60) As we are revaluing the provisional guarantee amount it will not cover cases where a previous year's final pay is used. Does regulation 4(6) need to provide that where a previous year's pay is used, pensions increase should be included in the provisional underpin amount?

New regulation 4(22) of the Transitional Regulations 2014

61) This regulation provides that the provisional guarantee amount must be used when calculating a death grant under regulation 43(3) and 46(3). We assume this means that any final guarantee amount the pensioner was receiving is excluded; however, we think it would be more appropriate for the final guarantee amount to be used when calculating the death grant for a pensioner.

We think this because the death grant calculation is based on 10 times the amount of pension the pensioner would have been entitled to receive less any amounts of commuted lump sum and pension already paid. The member's pension would have included the final guarantee amount, where appropriate, not the provisional guarantee amount. The provisional guarantee amount is used in the calculation of survivor benefits because survivor benefits are not subject to a reduction. However, this does not apply to death grants

Kent County Council Superannuation Fund Funding Strategy Statement

Contents

Introduction

This is the Funding Strategy Statement for the Kent County Council Pension Fund (the Fund). It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 as amended (the Regulations) and describes Kent County Council's strategy, in its capacity as administering authority, for the funding of the Kent County Council Pension Fund.

The Fund's employers and the Fund Actuary, Barnett Waddingham LLP, have been consulted on the contents of this statement.

This statement should be read in conjunction with the Fund's Investment Strategy Statement (ISS) and has been prepared with regard to the guidance (*Preparing and Maintaining a funding strategy statement in the LGPS 2016 edition)* issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Purpose of the Funding Strategy Statement

The purpose of this Funding Strategy Statement (FSS) is to:

- Establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
- Support the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in Regulation 62(6) of the Regulations;
- Ensure that the regulatory requirements to set contributions to meet the future liability to provide Scheme member benefits in a way that ensures the solvency and long-term cost efficiency of the Fund are met; and
- Take a prudent longer-term view of funding those liabilities.

Aims and purpose of the Fund

The aims of the Fund are to:

- Manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due;
- Enable primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admitted bodies), while achieving and maintaining Fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the Fund and employers, and the risk appetite of the administering authority and employers alike; and
- Seek returns on investment within reasonable risk parameters.

The purpose of the Fund is to:

- Pay pensions, lump sums and other benefits to Scheme members as provided for under the Regulations;
- Meet the costs associated in administering the Fund; and
- Receive and invest contributions, transfer values and investment income.

Funding objectives

Contributions are paid to the Fund by Scheme members and the employing bodies to provide for the benefits which will become payable to Scheme members when they fall due.

The funding objectives are to:

- Ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
- Ensure the solvency of the Fund;
- Set levels of employer contribution rates to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions, while taking into account the different characteristics of participating employers;
- Build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and
- Adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.

In developing the funding strategy, the administering authority should also have regard to the likely outcomes of the review carried out under Section 13(4)(c) of the Public Service Pensions Act 2013. Section 13(4)(c) requires an independent review of the actuarial valuations of the LGPS funds; this involves reporting on whether the rate of employer contributions set as part of the actuarial valuations are set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme so far as relating to the pension Fund. The review also looks at compliance and consistency of the actuarial valuations.

Key parties

The key parties involved in the funding process and their responsibilities are set out below.

The administering authority

The administering authority for the Fund is Kent County Council. The main responsibilities of the administering authority are to:

- Operate the Fund in accordance with the LGPS Regulations;
- Collect employee and employer contributions, investment income and other amounts due to the Fund as stipulated in the Regulations;
- Invest the Fund's assets in accordance with the Fund's Investment Strategy Statement;
- Pay the benefits due to Scheme members as stipulated in the Regulations;
- Ensure that cash is available to meet liabilities as and when they fall due;
- Take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default;
- Manage the actuarial valuation process in conjunction with the Fund Actuary;
- Prepare and maintain this FSS and also the ISS after consultation with other interested parties;
- Monitor all aspects of the Fund's performance;
- Effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer; and
- Enable the Local Pension Board to review the valuation process as they see fit.

Scheme employers

In addition to the administering authority, a number of other Scheme employers participate in the Fund.

The responsibilities of each employer that participates in the Fund, including the administering authority, are to:

- Collect employee contributions and pay these together with their own employer contributions, as certified by the Fund Actuary, to the administering authority within the statutory timescales;
- Notify the administering authority of any new Scheme members and any other membership changes promptly;
- Develop a policy on certain discretions and exercise those discretions as permitted under the Regulations;
- Meet the costs of any augmentations or other additional costs in accordance with agreed policies and procedures; and
- Pay any exit payments due on ceasing participation in the Fund.

Scheme members

Active Scheme members are required to make contributions into the Fund as set by the Ministry of Housing, Communities and Local Government (MHCLG).

Fund Actuary

The Fund Actuary for the Fund is Barnett Waddingham LLP. The main responsibilities of the Fund Actuary are to:

- Prepare valuations including the setting of employers' contribution rates at a level to ensure Fund solvency and long-term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the Regulations;
- Prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc;
- Provide advice and valuations on the exiting of employers from the Fund;
- Provide advice and valuations relating to new employers, including recommending the level of bonds or other forms of security required to protect the Fund against the financial effect of employer default;
- Assist the administering authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the Regulations;
- Ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to their role in advising the Fund; and
- Advise on other actuarial matters affecting the financial position of the Fund.

Funding strategy

The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

The most recent actuarial valuation of the Fund was carried out as at 31 March 2019. The results of the 2019 valuation are set out in the table below:

2019 valuation results	
Surplus (Deficit)	(£129m)
Funding level	98%

On a whole Fund level, the primary rate required to cover the employer cost of future benefit accrual was 18.4% of payroll p.a.

The individual employer contribution rates are set out in the Rates and Adjustments Certificate which forms part of the Fund's 2019 valuation report.

The actuarial valuation involves a projection of future cashflows to and from the Fund. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund. A summary of the methods and assumptions adopted is set out in the sections below.

Funding method

The key objective in determining employers' contribution rates is to establish a funding target and then set levels of employer contribution rates to meet that target over an agreed period.

The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund.

For all employers, the method adopted is to consider separately the benefits accrued before the valuation date (past service) and benefits expected to be accrued after the valuation date (future service). These are evaluated as follows:

- The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay and pensions. A funding level in excess of 100% indicates a surplus of assets over liabilities; while a funding level of less than 100% indicates a deficit; and
- The future service funding rate (also referred to as the primary rate as defined in Regulation 62(5) of the Regulations) is the level of contributions required from the individual employers which, in combination with employee contributions is expected to cover the cost of benefits accruing in future.

The adjustment required to the primary rate to calculate an employer's total contribution rate is referred to as the secondary rate, as defined in Regulation 62(7). Further details of how the secondary rate is calculated for employers is given below in the Deficit recovery/surplus amortisation periods section.

The approach to the primary rate will depend on specific employer circumstances and in particular may depend on whether an employer is an "open" employer – one which allows new recruits access to the Fund, or a "closed" employer – one which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the total contribution rate.

For open employers, the actuarial funding method that is adopted is known as the Projected Unit Method. The key feature of this method is that, in assessing the future service cost, the primary rate represents the cost of one year's benefit accrual only.

For closed employers, the actuarial funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over a specific period, such as the length of a contract or the remaining expected working lifetime of active members.

The approach by employer may vary to reflect an employer's specific circumstance, however, in general the closed employers in the Fund are admission bodies who have joined the Fund as part of an outsourcing contract and therefore the Attained Age Method is used in setting their contributions. All other employers (for example councils, higher education bodies and academies) are generally open employers and therefore the Projected Unit Method is used. The administering authority holds details of the open or closed status of each employer.

Valuation assumptions and funding model

In completing the actuarial valuation it is necessary to formulate assumptions about the factors affecting the Fund's future finances such as price inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover etc.

The assumptions adopted at the valuation can therefore be considered as:

- The demographic (or statistical) assumptions which are essentially estimates of the likelihood or timing of benefits and contributions being paid, and
- The financial assumptions which will determine the estimates of the amount of benefits and contributions payable and their current (or present) value.

Future price inflation

The base assumption in any valuation is the future level of price inflation over a period commensurate with the duration of the liabilities, as measured by the Retail Price Index (RPI). This is derived using the 20 year point on the Bank of England implied Retail Price Index (RPI) inflation curve, with consideration of the market conditions over the six months straddling the valuation date. The 20 year point on the curve is taken as 20 years is consistent with the average duration of an LGPS Fund.

Future pension increases

Pension increases are linked to changes in the level of the Consumer Price Index (CPI). Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods. A deduction of 1.0% p.a. is therefore made to the RPI assumption to derive the CPI assumption.

Future pay increases

As some of the benefits are linked to pay levels at retirement, it is necessary to make an assumption as to future levels of pay increases. Historically, there has been a close link between price inflation and pay increases with pay increases exceeding price inflation in the longer term. The long-term pay increase assumption adopted as at 31 March 2019 was CPI plus 1.0% p.a. which includes allowance for promotional increases.

Future investment returns/discount rate

To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount future payments to and from the Fund to present day values.

The discount rate that is adopted will depend on the funding target adopted for each Scheme employer.

The discount rate that is applied to all projected liabilities reflects a prudent estimate of the rate of investment return that is expected to be earned from the Fund's long-term investment strategy by considering average market yields in the six months straddling the valuation date. The discount rate so determined may be referred to as the "ongoing" discount rate.

It may be appropriate for an alternative discount rate approach to be taken to reflect an individual employer's situation. This may be, for example, to reflect an employer targeting a cessation event or to reflect the administering authority's views on the level of risk that an employer poses to the Fund. The Fund Actuary will incorporate any such adjustments after consultation with the administering authority.

A summary of the financial assumptions adopted for the 2019 valuation is set out in the table below:

Financial assumptions as at 31 March 2019	
RPI inflation	3.6% p.a.
CPI inflation	2.6% p.a.
Pension/deferred pension increases and CARE revaluation	In line with CPI inflation
Pay increases	CPI inflation + 1.0% p.a.
Discount rate	4.7% p.a.

Asset valuation

For the purpose of the valuation, the asset value used is the market value of the accumulated fund at the valuation date, adjusted to reflect average market conditions during the six months straddling the valuation date. This is referred to as the smoothed asset value and is calculated as a consistent approach to the valuation of the liabilities.

The Fund's assets are notionally allocated to employers at an individual level by allowing for actual Fund returns achieved on the assets and cashflows paid into and out of the Fund in respect of each employer (e.g. contributions received and benefits paid).

Demographic assumptions

The demographic assumptions incorporated into the valuation are based on Fund-specific experience and national statistics, adjusted as appropriate to reflect the individual circumstances of the Fund and/or individual employers.

Further details of the assumptions adopted are included in the Fund's 2019 valuation report.

McCloud/Sargeant judgements

The McCloud/Sargeant judgements were in relation to two employment tribunal cases which were brought against the government in relation to possible age and gender discrimination in the implementation of transitional protection following the introduction of the reformed 2015 public service pension schemes from 1 April 2015. These judgements were not directly in relation to the LGPS, however, do have implications for the LGPS.

In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounted to unlawful discrimination. On 27 June 2019 the Supreme Court denied the government's request for an appeal in the case. A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits. It has, however, been noted by government in its 15 July 2019 statement that it expects to have to amend all public service schemes, including the LGPS.

Further details of this can be found below in the Regulatory risks section.

At the time of drafting this FSS, it is still unclear how this will affect current and future LGPS benefits. As part of the Fund's 2019 valuation, in order to mitigate the risk of member benefits being uplifted and becoming more expensive, the potential impact of McCloud was covered by the prudence allowance in the discount rate assumption. As the remedy is still to be agreed the cost cannot be calculated with certainty, however, the Fund Actuary expects it is likely to be less than 0.05% of the discount rate assumption.

Guaranteed Minimum Pension (GMP) indexation and equalisation

As part of the restructuring of the state pension provision, the government needs to consider how public service pension payments should be increased in future for members who accrued a Guaranteed Minimum Pension (GMP) from their public service pension scheme and expect to reach State Pension Age (SPA) post-December 2018. In addition, a resulting potential inequality in the payment of public service pensions between men and women needs to be addressed. Information on the current method of indexation and equalisation of public service pension schemes can be found here.

On 22 January 2018, the government published the outcome to its *Indexation and equalisation of GMP in public service pension schemes* consultation, concluding that the requirement for public service pension schemes to fully price protect the GMP element of individuals' public service pension would be extended to those individuals reaching SPA before 6 April 2021. HMT published a Ministerial Direction on 4 December 2018 to implement this outcome, with effect from 6 April 2016. Details of this outcome and the Ministerial Direction can be found here.

The 2019 valuation assumption for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the government providing the remainder of the inflationary increase. For members that reach SPA after this date, it is assumed that the Fund will be required to pay the entire inflationary increase.

Deficit recovery/surplus amortisation periods

Whilst one of the funding objectives is to build up sufficient assets to meet the cost of benefits as they accrue, it is recognised that at any particular point in time, the value of the accumulated assets will be different to the value of accrued liabilities, depending on how the actual experience of the Fund differs to the actuarial assumptions. This theory applies down to an individual employer level; each employer in the Fund has their own share of deficit or surplus attributable to their section of the Fund.

Where the valuation for an employer discloses a deficit then the level of required employer contributions includes an adjustment to fund the deficit over a period of 0 to 16 years. The adjustment may be set either as a percentage of payroll or as a fixed monetary amount.

Where the valuation for an employer discloses a surplus then the level of required employer contribution may include an adjustment to amortise the surplus over an appropriate period.

The deficit recovery periods adopted at the 2019 valuation varied amongst individual employers. Shorter recovery periods have been used where affordable. This will provide a buffer for future adverse experience and reduce the interest cost paid by employers. The deficit recovery period or amortisation period that is adopted for any particular employer will depend on:

- The significance of the surplus or deficit relative to that employer's liabilities;
- The covenant of the individual employer (including any security in place) and any limited period of participation in the Fund;
- The remaining contract length of an employer in the Fund (if applicable); and
- The implications in terms of stability of future levels of employers' contribution.

Where an employer's contribution has to increase significantly then, if appropriate, the increase may be phased in over a period not exceeding three years.

Pooling of individual employers

The policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly, contribution rates are set for individual employers to reflect their own particular circumstances.

However, certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

The funding pools adopted for the Fund at the 2019 valuation are summarised in the table below:

Pool	Type of pooling	Notes
Kent County Council	Past and future service pooling	All employers in the pool pay the same total contribution rate and have the same funding level
Colleges	Past and future service pooling	All employers in the pool pay the same total contribution rate and have the same funding level
Academies	Past and future service pooling	All employers in the pool pay the same total contribution rate and have the same funding level

There are also a number of connected employers within the Fund. Connected employers are those where we understand that the organisation controls all of the employers or has responsibility for all the pension obligations. Examples include parent/subsidiaries or former Transferee Admission Bodies who have ceased to participate where the legacy liabilities have been passed back to the Letting Authority. In these instances, the contribution rate has been determined as a pooled rate.

The main purpose of pooling is to produce more stable employer contribution levels, although recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

Forming/disbanding a funding pool

Where the Fund identifies a group of employers with similar characteristics and potential merits for pooling, it is possible to form a pool for these employers. Advice should be sought from the Fund Actuary to consider the appropriateness and practicalities of forming the funding pool.

Conversely, the Fund may consider it no longer appropriate to pool a group of employers. This could be due to divergence of previously similar characteristics or an employer becoming a dominant party in the pool (such that the results of the pool are largely driven by that dominant employer). Where this scenario arises, advice should be sought from the Fund Actuary.

Funding pools should be monitored on a regular basis, at least at each actuarial valuation, in order to ensure the pooling arrangement remains appropriate.

Risk-sharing

There are employers that participate in the Fund with a risk-sharing arrangement in place with another employer in the Fund.

For example, there are employers participating in the Fund with pass-through provisions: under this arrangement the pass-through employer does not take on the risk of underfunding as this risk remains with the letting authority or relevant guaranteeing employer. When the pass-through employer ceases participation in the Fund, it is not responsible for making any exit payment, nor receiving any exit credit, as any deficit or surplus ultimately falls to the letting authority or relevant guaranteeing employer.

At the 2019 valuation, risk-sharing arrangements were allowed for by allocating any deficit/liabilities covered by the risk-sharing arrangement to the relevant responsible employer.

New employers joining the Fund

When a new employer joins the Fund, the Fund Actuary is required to set the contribution rates payable by the new employer and allocate a share of Fund assets to the new employer as appropriate. The most common types of new employers joining the Fund are admission bodies and new academies. These are considered in more detail below.

Admission bodies

New admission bodies in the Fund are commonly a result of a transfer of staff from an existing employer in the Fund to another body (for example as part of a transfer of services from a council or academy to an external provider under Schedule 2 Part 3 of the Regulations). Typically these transfers will be for a limited period (the contract length), over which the new admission body employer is required to pay contributions into the Fund in respect of the transferred members.

Funding at start of contract

Generally, when a new admission body joins the Fund, they will become responsible for all the pensions risk associated with the benefits accrued by transferring members and the benefits to be accrued over the contract length. This is known as a full risk transfer. In these cases, it may be appropriate that the new admission body is allocated a share of Fund assets equal to the value of the benefits transferred, i.e. the new admission body starts off on a fully funded basis. This is calculated on the relevant funding basis and the opening position may be different when calculated on an alternative basis (e.g. on an accounting basis).

However, there may be special arrangements made as part of the contract such that a full risk transfer approach is not adopted. In these cases, the initial assets allocated to the new admission body will reflect the level of risk transferred and may therefore not be on a fully funded basis or may not reflect the full value of the benefits attributable to the transferring members.

Contribution rate

The contribution rate may be set on an open or a closed basis. Where the funding at the start of the contract is on a fully funded basis then the contribution rate will represent the primary rate only; where there is a deficit allocated to the new admission body then the contribution rate will also incorporate a secondary rate with the aim of recovering the deficit over an appropriate recovery period.

Depending on the details of the arrangement, for example if any risk sharing arrangements are in place, then additional adjustments may be made to determine the contribution rate payable by the new admission body. The approach in these cases will be bespoke to the individual arrangement.

Security

To mitigate the risk to the Fund that a new admission body will not be able to meet its obligations to the Fund in the future, the new admission body may be required to put in place a bond in accordance with Schedule 2 Part 3 of the Regulations, if required by the letting authority and administering authority.

If, for any reason, it is not desirable for a new admission body to enter into a bond, the new admission body may provide an alternative form of security which is satisfactory to the administering authority.

Risk-sharing

Although a full risk transfer (as set out above) is most common, subject to agreement with the administering authority where required, new admission bodies and the relevant letting authority may make a commercial agreement to deal with the pensions risk differently. For example, it may be agreed that all or part of the pensions risk remains with the letting authority.

Although pensions risk may be shared, it is common for the new admission body to remain responsible for pensions costs that arise from:

- above average pay increases, including the effect on service accrued prior to contract commencement; and
- redundancy and early retirement decisions.

The administering authority may consider risk-sharing arrangements as long as the approach is clearly documented in the admission agreement, the transfer agreement or any other side agreement. The arrangement also should not lead to any undue risk to the other employers in the Fund.

Legal and actuarial advice in relation to risk-sharing arrangements should be sought where required.

New academies

When a school converts to academy status, the new academy (or the sponsoring multi-academy trust) becomes a Scheme employer in its own right.

Funding at start

On conversion to academy status, the new academy will become part of the Academies funding pool and will be allocated assets based on the funding level of the pool at the conversion date.

Contribution rate

The contribution rate payable when a new academy joins the Fund will be in line with the contribution rate certified for the Academies funding pool at the 2019 valuation.

Cessation valuations

When a Scheme employer exits the Fund and becomes an exiting employer, as required under the Regulations the Fund Actuary will be asked to carry out an actuarial valuation in order to determine the liabilities in respect of the benefits held by the exiting employer's current and former employees. The Fund Actuary is also required to determine the exit payment due from the exiting employer to the Fund or the exit credit payable from the Fund to the exiting employer.

Any deficit in the Fund in respect of the exiting employer will be due to the Fund as a single lump sum payment, unless it is agreed by the administering authority and the other parties involved that an alternative approach is permissible. For example:

- It may be agreed with the administering authority that the exit payment can be spread over some agreed period;
- the assets and liabilities relating to the employer may transfer within the Fund to another participating employer; or
- the employer's exit may be deferred subject to agreement with the administering authority, for example if it intends to offer Scheme membership to a new employee within the following three years.

Similarly, any surplus in the Fund in respect of the exiting employer may be treated differently to a payment of an exit credit, subject to the agreement between the relevant parties and any legal documentation.

In assessing the value of the liabilities attributable to the exiting employer, the Fund Actuary may adopt differing approaches depending on the employer and the specific details surrounding the employer's cessation scenario.

Exit credit policy

Under advice from MHCLG, administering authorities should set out their exit credit policy in their Funding Strategy Statement. Having regard to any relevant considerations, the administering authority will take the following approach to the payment of exit credits:

- Any employer who cannot demonstrate that they have been exposed to underfunding risk during their participation in the Fund will not be entitled to an exit credit payment. This will include the majority of "pass-through" arrangements. This is on the basis that these employers would not have not been asked to pay an exit payment had a deficit existed at the time of exit.

- The administering authority does not need to enquire into the precise risk sharing arrangement adopted by an employer but it must be satisfied that the risk sharing arrangement has been in place before it will pay out an exit credit. The level of risk that an employer has borne will be taken into account when determining the amount of any exit credit. It is the responsibility of the exiting employer to set out in writing why the arrangements make payment of an exit credit appropriate.

- Any exit credit payable will be subject to a maximum of the actual employer contributions paid into the Fund.

- As detailed above, the Fund Actuary may adopt differing approaches depending on the employer the specific details surrounding the employer's cessation scenario. The default approach to calculating the cessation position will be on a minimum-risk basis unless it can be shown that there is another employer in the Fund who will take on financial responsibility for the liabilities in the future. If the administering authority is satisfied that there is another employer willing to take on responsibility for the liabilities (or that there is some other form of guarantee in place) then the cessation position may be calculated on the ongoing/long-term funding basis.

- The administering authority will pay out any exit credits within six months of the cessation date where possible. A longer time may be agreed between the administering authority and the exiting employer where necessary. For example if the employer does not provide all the relevant information to the administering authority within one month of the cessation date the administering authority will not be able to guarantee payment within six months of the cessation date.

- Under the Regulations, the administering authority has the discretion to take into account any other relevant factors in the calculation of any exit credit payable and they will seek legal advice where appropriate.

Regulatory factors

At the date of drafting this FSS, the government is currently consulting on potential changes to the Regulations, some which may affect the regulations surrounding an employer's exit from the Fund. This is set out in the *Local government pension scheme: changes to the local valuation cycle and the management of employer risk* consultation document.

Further details of this can be found in the Regulatory risks section below.

Bulk transfers

Bulk transfers of staff into or out of the Fund can take place from other LGPS Funds or non-LGPS Funds. In either case, the Fund Actuary for both Funds will be required to negotiate the terms for the bulk transfer – specifically the terms by which the value of assets to be paid from one Fund to the other is calculated.

The agreement will be specific to the situation surrounding each bulk transfer but in general the Fund will look to receive the bulk transfer on no less than a fully funded transfer (i.e. the assets paid from the ceding Fund are sufficient to cover the value of the liabilities on the agreed basis).

A bulk transfer may be required by an issued Direction Order. This is generally in relation to an employer merger, where all the assets and liabilities attributable to the transferring employer in its original Fund are transferred to the receiving Fund.

Links with the Investment Strategy Statement (ISS)

The main link between the Funding Strategy Statement (FSS) and the ISS relates to the discount rate that underlies the funding strategy as set out in the FSS, and the expected rate of investment return which is expected to be achieved by the long-term investment strategy as set out in the ISS.

As explained above, the ongoing discount rate that is adopted in the actuarial valuation is derived by considering the expected return from the long-term investment strategy. This ensures consistency between the funding strategy and investment strategy.

Risks and counter measures

Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

Financial risks

The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets.

The valuation results are most sensitive to the real discount rate (i.e. the difference between the discount rate assumption and the price inflation assumption). Broadly speaking an increase/decrease of 0.5% p.a. in the real discount rate will decrease/increase the valuation of the liabilities by 10%, and decrease/increase the required employer contribution by around 2.5% of payroll p.a.

However, the Investment and Pension Fund Committee regularly monitors the investment returns achieved by the fund managers and receives advice from the independent advisers and officers on investment strategy.

The Committee may also seek advice from the Fund Actuary on valuation related matters.

In addition, the Fund Actuary provides funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

Demographic risks

Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase of one year to life expectancy of all members in the Fund will increase the liabilities by approximately 4%.

The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. For the past two funding valuations, the Fund has commissioned a bespoke longevity analysis by Barnett Waddingham's specialist longevity team in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

The liabilities of the Fund can also increase by more than has been planned as a result of the additional financial costs of early retirements and ill-health retirements. However, the administering authority monitors the incidence of early retirements; and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

Maturity risk

The maturity of a Fund (or of an employer in the Fund) is an assessment of how close on average the members are to retirement (or already retired). The more mature the Fund or employer, the greater proportion of its membership that is near or in retirement. For a mature Fund or employer, the time available to generate investment returns is shorter and therefore the level of maturity needs to be considered as part of setting funding and investment strategies.

The cashflow profile of the Fund needs to be considered alongside the level of maturity: as a Fund matures, the ratio of active to pensioner members falls, meaning the ratio of contributions being paid into the Fund to the benefits being paid out of the Fund also falls. This therefore increases the risk of the Fund having to sell assets in order to meets its benefit payments.

The government has published a consultation (*Local government pension scheme: changes to the local valuation cycle and management of employer risk*) which may affect the Fund's exposure to maturity risk. More information on this can be found in the Regulatory risks section below.

Regulatory risks

The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central government. The tax status of the invested assets is also determined by the government.

The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme.

However, the administering authority participates in any consultation process of any proposed changes in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes.

There are a number of general risks to the Fund and the LGPS, including:

- If the LGPS was to be discontinued in its current form it is not known what would happen to members' benefits.
- The potential effects of GMP equalisation between males and females, if implemented, are not yet known.
- More generally, as a statutory scheme the benefits provided by the LGPS or the structure of the scheme could be changed by the government.
- The State Pension Age is due to be reviewed by the government in the next few years.

At the time of preparing this FSS, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgements, the cost cap mechanism and the timing of future funding valuations consultation. These are discussed in the sections below.

McCloud/Sargeant judgements and cost cap

The 2016 national Scheme valuation was used to determine the results of HM Treasury's (HMT) employer cost cap mechanism for the first time. The HMT cost cap mechanism was brought in after Lord Hutton's review of public service pensions with the aim of providing protection to taxpayers and employees against unexpected changes (expected to be increases) in pension costs. The cost control mechanism only considers "member costs". These are the costs relating to changes in assumptions made to carry out valuations relating to the profile of the Scheme members; e.g. costs relating to how long members are expected to live for and draw their pension. Therefore, assumptions such as future expected levels of investment returns and levels of inflation are not included in the calculation, so have no impact on the cost management outcome.

The 2016 HMT cost cap valuation revealed a fall in these costs and therefore a requirement to enhance Scheme benefits from 1 April 2019. However, as a funded Scheme, the LGPS also had a cost cap mechanism controlled by the Scheme Advisory Board (SAB) in place and HMT allowed SAB to put together a package of proposed benefit changes in order for the LGPS to no longer breach the HMT cost cap. These benefit changes were due to be consulted on with all stakeholders and implemented from 1 April 2019.

However, on 20 December 2018 there was a judgement made by the Court of Appeal which resulted in the government announcing their decision to pause the cost cap process across all public service schemes. This was in relation to two employment tribunal cases which were brought against the government in relation to possible discrimination in the implementation of transitional protection following the introduction of the reformed 2015 public service pension schemes from 1 April 2015. Transitional protection enabled some members to remain in their pre-2015 schemes after 1 April 2015 until retirement or the end of a pre-determined tapered protection period. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

The first case (McCloud) relating to the Judicial Pension Scheme was ruled in favour of the claimants, while the second case (Sargeant) in relation to the Fire scheme was ruled against the claimants. Both rulings were appealed and as the two cases were closely linked, the Court of Appeal decided to combine the two cases. In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounts to unlawful discrimination. On 27 June 2019 the Supreme Court denied the government's request for an appeal in the case. A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits. It has, however, been noted by government in its 15 July 2019 statement that it expects to have to amend all public service schemes, including the LGPS.

At the time of drafting this FSS, it is not yet known what the effect on the current and future LGPS benefits will be.

Consultation: Local government pension scheme: changes to the local valuation cycle and management of employer risk

On 8 May 2019, the government published a consultation seeking views on policy proposals to amend the rules of the LGPS in England and Wales. The consultation covered:

- amendments to the local fund valuations from the current three year (triennial) to a four year (quadrennial) cycle;
- a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle;
- proposals for flexibility on exit payments;
- proposals for further policy changes to exit credits; and
- proposals for changes to the employers required to offer LGPS membership.

The consultation is currently ongoing: the consultation was closed to responses on 31 July 2019 and an outcome is now awaited. This FSS will be revisited once the outcome is known and reviewed where appropriate.

Timing of future actuarial valuations

LGPS valuations currently take place on a triennial basis which results in employer contributions being reviewed every three years. In September 2018 it was announced by the Chief Secretary to HMT, Elizabeth Truss, that the national Scheme valuation would take place on a quadrennial basis (i.e. every four years) along with the other public sector pension schemes. This results of the national Scheme valuation are used to test the cost control cap mechanism and HMT believed that all public sector scheme should have the cost cap test happen at the same time with the next quadrennial valuation in 2020 and then 2024.

Managing employer exits from the Fund

The consultation covers:

- Proposals for flexibility on exit payments. This includes:
    - Formally introducing into the Regulations the ability for the administering authority to allow an exiting employer to spread the required exit payment over a fixed period.
    - Allowing employers with no active employers to defer payment of an exit payment in return for an ongoing commitment to meeting their existing liabilities (deferred employer status).
- Proposals for further policy changes to exit credits. MHCLG issued a partial response to this part of the consultation on 27 February 2020 and an amendment to the Regulations comes into force on 20 March 2020, although have effect from 14 May 2018. The amendment requires Funds to consider the exiting employer's exposure to risk in calculating any exit credit due (for example a pass through employer who is not responsible for any pensions risk would likely not be due an exit credit if the amendments are made to the Regulations) and to have a policy to exit credits in their FSS which has been included earlier in this version

Changes to employers required to offer LGPS membership

At the time of drafting this FSS, under the current Regulations further education corporations, sixth form college corporations and higher education corporations in England and Wales are required to offer membership of the LGPS to their non-teaching staff.

With consideration of the nature of the LGPS and the changes in nature of the further education and higher education sectors, the government has proposed to remove the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer new employees access to the LGPS. As these types of employer participate in the Fund, this could impact on the level of maturity of the Fund and the cashflow profile. For example, increased risk of contribution income being insufficient to meet benefit outgo, if not in the short term then in the long term as the payroll in respect of these types of employers decreases with fewer and fewer active members participating in the Fund.

This also brings an increased risk to the Fund in relation to these employers becoming exiting employers in the Fund. Should they decide not to admit new members to the Fund, the active membership attributable to the employers will gradually reduce to zero, triggering an exit under the Regulations and a potential significant exit payment. This has the associated risk of the employer not being able to meet the exit payment and thus the exit payment falling to the other employers in the Fund.

Employer risks

Many different employers participate in the Fund. Accordingly, it is recognised that a number of employer-specific events could impact on the funding strategy including:

- Structural changes in an individual employer's membership;
- An individual employer deciding to close the Scheme to new employees; and
- An employer ceasing to exist without having fully funded their pension liabilities.

However, the administering authority monitors the position of employers participating in the Fund, particularly those which may be susceptible to the events outlined, and takes advice from the Fund Actuary when required.

In addition, the administering authority keeps in close touch with all individual employers participating in the Fund to ensure that, as administering authority, it has the most up to date information available on individual employer situations. It also keeps individual employers briefed on funding and related issues.

Governance risks

Accurate data is necessary to ensure that members ultimately receive their correct benefits. The administering authority is responsible for keeping data up to date and results of the actuarial valuation depend on accurate data. If incorrect data is valued then there is a risk that the contributions paid are not adequate to cover the cost of the benefits accrued.

Monitoring and review

This FSS is reviewed formally, in consultation with the key parties, at least every three years to tie in with the triennial actuarial valuation process.

The most recent valuation was carried out as at 31 March 2019, certifying the contribution rates payable by each employer in the Fund for the period from 1 April 2020 to 31 March 2023.

The timing of the next funding valuation is due to be confirmed as part of the government's *Local government pension scheme: changes to the local valuation cycle and management of employer risk* consultation which closed on 31 July 2019. At the time of drafting this FSS, it is anticipated that the next funding valuation will be due as at 31 March 2022 but the period for which contributions will be certified remains unconfirmed.

The administering authority also monitors the financial position of the Fund between actuarial valuations and may review the FSS more frequently if necessary.