Pension Fund Committee

Title: Employer cost cap and McCloud

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Local members affected:

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Summary

This report is to provide the Committee with an update on the current position in relation to the cost cap mechanism and the McCloud Ruling.

Recommendation

The Committee are asked to NOTE the contents of this report.

Background

Following reports from the Independent Public Services Pension Commission, government legislated in the Public Services Pensions Act 2013 for a new framework from 2014 for the LGPS (2015 for all other public service pension schemes). It was designed to manage some of the costs and risks to the Exchequer of providing public service pensions. In the LGPS in England & Wales, two mechanisms were introduced to do this.

- the employer cost cap (ECC) process as operated by HM Treasury, and
- the future service cost cap (FSC) process as operated by the LGPS Scheme Advisory Board.

The target cost for the ECC process is 14.6% of employer contributions.
The target cost for the FSC is 19.5% as a total of employer and scheme member contributions at a 2:1 ratio (13% employers: 6.5% scheme members).

If there is movement of +/-1% from the target cost, action should be taken. If +/-2% from the target cost, action must be taken. These could be changes to the design of member benefits or to member contribution rates.

Current position
In September 2018, government announced that public service employers would have to pay more towards their employee's pensions from April 2019 and those public sector workers would get improved pension benefits. The two mechanisms behind this are a reduction in the Superannuation Contributions Adjusted for Past Experience (SCAPE) discount rate and the cost cap mechanisms implemented in 2014.

All public sector pension schemes are subject to valuations so that contributions are set at a level that reflects the costs of benefits accruing. These are undertaken by HM Treasury and are based on assumptions, including the SCAPE discount rate. A reduction in the rate will increase employer contributions and it reduced from 2.8% to 2.4% on 6 September 2018. At the same time, the first cost cap mechanism exercise was undertaken since the reforms were introduced and this showed that the cost of public sector schemes had fallen below the target cost. As a result of this, public sector workers would receive improved pension benefits over the period from April 2019 to March 2023.

The LGPS has the additional FCS process which must also be completed before any changes can be made. On 10 October 2018 the LGPS Scheme Advisory Board (SAB) announced that the total cost of the LGPS was 19% and as such, improvements equal to 0.5% were proposed from April 2019. The proposals were:

- removal of tier 3 ill-health retirements costed on the assumption tier 2 would be awarded instead
- a minimum death in service lump sum of £75,000
- enhanced early retirement factors
- changes to employee contribution rates

On 30 January 2019, before any changes could be implemented, government announced a pause in the cost cap process for all public sector schemes due to the uncertainty caused by the December 2018 ruling of the Court of Appeal in the McCloud case.

The McCloud case
The case concerns the transitional protections given to scheme members as part of the public service pension scheme reforms, who in 2012 were within 10 years of their normal retirement age, in the judges and firefighters schemes. The Court of Appeal found these protections were unlawful on the grounds of age discrimination.

Although the ruling is in relation to only two of the public sector pension schemes, protections were applied during the reforms, albeit in different ways, to all members of public sector pension schemes who were within 10 years of retirement. It is anticipated that the principles of the outcome will apply to all public sector pension schemes.

The government applied to the Supreme Court for permission to appeal this decision and on 27 June 2019, the application was refused. The case will now be referred back to an employment tribunal for a remedy hearing which could take 12 months or longer to be held.
Appropriate measures will need to be put in place by the tribunal to ensure scheme members who were found to be discriminated against, are placed in an equal position to protected members. Measures will need to raise the benefits of unprotected members rather than the benefits of protected members being reduced. Depending on the cost of these measures, there could be a material impact on the outcome of the cost cap mechanism.

Once the outcome of the employment tribunal is known, schemes would be amended and the cost cap process will be re-run. Any protection amendments to the LGPS will be backdated to 2014.

Resource implications

The full implications are unknown until the outcome of the employment tribunal is announced. The expectation is that there will be a requirement to revisit benefits calculated for scheme members who left after 1 April 2014 who have retrospective protections applied.

Legal implications

N/A

Other implications/issues

Once the employment tribunal remedy is announced, calculation of the additional costs of the backdated protections can be assessed. If they do not make good the shortfall against the target cost of the scheme, benefit improvements will need to be implemented.

Feedback from consultation, Local Area Forums and Local Member views (if relevant)

N/A

Background Papers
