Current issues

June 2023

Articles this month:

Public-sector pensions update

Much has happened in the public-service pensions world in the last month. Here are some 'highlights'.

Local Government Pension Scheme (LGPS) cost management

The *Local Government Pension Scheme (Amendment) (No. 2) Regulations 2023* enable the switch to a four-yearly cost-management process, and give the LGPS Scheme Advisory Board (SAB) for England and Wales more freedom on when and how to recommend that costs are put back on track.[1] The Department for Levelling Up, Housing and Communities has separately announced the outcomes from a consultation exercise on an earlier, draft version of the Regulations.

The LGPS, like the other public-service schemes, is subject to a statutory cost-control mechanism (CCM) operated by His Majesty's Treasury (HMT). Unlike the other, unfunded schemes, the funded, locally operated LGPS has an additional cost-management process, conducted by the SAB, the recommendations from which are fed into HMT's CCM exercise.

The Regulations facilitate the switching of the SAB's cost-management process from a triennial to a quadrennial exercise, thereby bringing it into sync with HMT's CCM and the intervals between actuarial valuations of the unfunded public-service schemes. (Local fund valuations are still produced triennially.)

The Regulations also remove the 2% margin that extended on either side of the target overall cost of the LGPS, the breach of which was previously a trigger for mandatory recommendations from the SAB on steps to bring costs back to the target. Moreover, the SAB will have more leeway for its recommendations, because the brief will in future be to suggest ways to bring costs 'back to *or towards'* (emphasis added) the target, rather than 'back to' it.

The Regulations came into force on 1 June 2023.

More cost-control news

His Majesty's Treasury has issued a policy statement describing how the CCM will operate, from the 2020 valuations onwards, so that only the costs of the reformed (career-average revalued earnings) schemes are considered. It covers

[1] SI 2023 No. 522.

both the unfunded arrangements (for NHS workers, teachers, civil servants, Armed Forces personnel, police officers and firefighters) and the LGPS.

The statement describes how the policy will apply to the remedy for *'McCloud*' discrimination. Service completed before the initial introduction of the new CARE schemes will not be considered for the CCM, whereas all service after 31 March 2022 will. The unfunded schemes and the funded LGPS had different approaches to the ill-fated, discriminatory transitional protections, so the treatment of service in the transitional period is correspondingly different. In the unfunded schemes, service between 1 April 2015 to 31 March 2022 (the *McCloud* remedy period) will be excluded from the CCM, because members' benefits will be treated as paid from their old schemes (regardless of whether old- or new-scheme benefits are eventually paid for the period). In the LGPS, *McCloud* remedy period service will be taken into account for the CCM, but the effects of the benefit underpin will not.

Treasury Directions will set out the technical details '*in due course*'.

More *McCloud* news

His Majesty's Revenue and Customs has published a second set of draft Regulations on aspects of the remedy for '*McCloud*' discrimination in the public-sector schemes. Highly detailed, and covering numerous scenarios, in broad terms, they aim to place members in the situation in which they would have been had discrimination not occurred.

There is a newsletter to accompany the draft Regulations. It says that HMRC is drafting guidance for public-sector scheme administrators, for publication in the autumn.

The consultation period ends on 19 June 2023.

Even more *McCloud* news

The Department for Levelling Up, Housing and Communities (DLUHC) is consulting on a set of draft regulations for the LGPS, on issues arising from the implementation of the '*McCloud*' remedy. The topics range from the mundane to the abstruse, covering aggregation, transfers under the Public Sector Transfer Club, flexible retirement, divorce, 'excess teacher service', the ability to compensate members for losses, and interest on late payments.

The consultation period ends on 30 June 2023. It is expected that the final regulations will come into force on 1 October 2023.

The length and complexity of the legislation required to implement the McCloud remedy confirms the immensity (perhaps use of 'enormity' is justified here) of the expectations being made of public-sector scheme administrators. Strikingly, in its consultation document on the draft LGPS regulations, the DLUHC says about certain aspects of the implementation that,

> '*Whichever approach is taken… will raise complex issues and will be challenging administratively*',

and that,

> '*This… is a unique and complex part of the government's McCloud project, and the administration… is likely to be exceptionally challenging.*'

We can't recall seeing such bald admissions from government before. Its recognition of the scale of the task is to be welcomed, and we hope that will also be taken into consideration when the timescales and resources required for other projects are being planned.

Call for evidence on DB auto-enrolment standards

The Department for Work and Pensions (DWP) has called for evidence on the alternative quality requirements that defined benefit (DB) and hybrid schemes must meet to be used for auto-enrolment. The DWP has a statutory obligation to review the provisions at least every three years.

To be used for auto-enrolment, a DB scheme must either meet the 'test scheme standard' or satisfy one of two alternative quality requirements: a 'cost of accruals' test[2], or for DB schemes that display money purchase characteristics, the money purchase quality requirements. There was previously a quality requirement based on a scheme meeting the conditions for contracting out of the state additional pensions scheme. The current alternatives to the (somewhat onerous) test scheme standard were introduced when contracting out was abolished.

The DWP is looking for views on whether the alternative quality requirements are still delivering the intended simplification for employers and schemes that can't use the test scheme standard. It is also interested in whether employers or their professional advisers are conducting the tests.

This review also covers the provisions enacted in August 2022 setting out the alternative quality requirements for collective money purchase schemes. The DWP asks whether these provisions remain appropriate for single and connected employers. It also wants to know if they would be appropriate for multi-employer schemes covering non-associated employers if the DWP extends the regime to cover these, as planned in its January 2023 consultation.

Submissions can be made until 19 June 2023.

Potential £250m 'lift' for DC investment innovation

As part of the Long-term Investment for Technology and Science (LIFTS) initiative, the British Business Bank is seeking proposals for the establishment of new funds or investment structures to mobilise institutional investors, particularly DC pension funds, to support UK science and technology innovation. The Government has committed up to £250m in support of successful proposals (having published the results of a request for feedback on the LIFTS initiative).

The deadline for proposals is 28 July 2023.

Acknowledging the reality of the responsible-investment pachyderm

According to a new blog post from the Pensions Regulator, *'The ESG elephant is now in the room'*. The message is that '*ignoring* [environmental, social and governance (ESG)] *factors is no longer an option for pension trustees*'.

The blog describes the Regulator's two-stage ESG regulatory initiative. The first stage was a check on whether trustees had prepared and made available online the required documents, whilst the second part—due to begin in the autumn—will be a qualitative review of the ESG material in a selection of schemes' statements of investment principles and implementation statements, with a focus on adherence to DWP guidance.

The blogger comments reprovingly about some trustees producing '*vague and generic*' disclosures.

[2] Where the total of the ordinary employer and employee contributions has to be between 9% and 13% of pay, depending on the scheme's pensionable earnings definition.

Data breach warnings

The Pensions Regulator issued a statement about a hacking incident involving Capita, the administration services provider. It says that Capita clients should establish whether they have been affected and keep open their lines of communication with the provider. They should also be prepared for member questions, warn them about scams, keep them up to date about the status of the investigation, and be on the look-out for any suspicious transfer activity. There is a note of who to contact if the scheme has suffered a data-security breach, and a link to the Regulator's cyber-security guidance.

The Information Commissioner's Office (ICO) also made a statement about the incident, saying that it has received a large number of reports from affected organisations and is making enquiries. It encourages those that use Capita's services to determine whether their data has been affected, and to report the breach if necessary. It reminds readers that they are obliged to notify the ICO within 72 hours of becoming aware of a personal data breach, unless there is no risk to data subjects' rights and freedoms. The reasons for a decision not to report should be recorded.

No Get-Out-Of-Jail-Free card for dashboards malfeasance

The *Pensions Dashboards (Prohibition of Indemnification) Act 2023* received Royal Assent on 2 May 2023. Once it has been brought fully into force it will prohibit reimbursement out of scheme assets of trustees and managers of pension schemes for any fines imposed under the pensions dashboards legislation, and make it a criminal offence if they are knowingly reimbursed in contravention of the prohibition.

Regulatory blogging

'Unite to meet the pensions challenge'

The Pensions Regulator's new CEO, Nausicaa Delfas, has called for the pensions industry to work together to improve value for money in pension schemes. The refrain about consolidation of under-performing scheme gets another mention, albeit the subject is extended beyond its usual bounds to include defined-benefit superfunds and solutions to the proliferation of small money purchase pots. The blog also mentions the Regulator's 'fundamental' belief that all trustees boards '*should include someone who meets professional standards.*'

Rehashed sponsor-distress guide

The Pensions Regulator '*refreshed*' its guidance on *Protecting schemes from sponsoring employer distress*, with a blog post to advertise the fact.

There seem to be no substantial changes to the guidance. The blog stresses the importance of covenant monitoring and early engagement.

HMRC newsletters: May 2023

Pensions Schemes Newsletter 150, from His Majesty's Revenue and Customs, contains:

- a reminder of the deadline (5 July 2023) for information returns for schemes operating 'relief at source' on member contributions; and
- an announcement about a forthcoming extension to the online Managing Pension Schemes service, to allow submission of pension scheme tax returns (due in spring 2024, for tax years 2023/24 onward).

And Finally…

Whilst waiting patiently for various long-promised developments in Pensions Land to materialize, *AF* was moved to lament how short-changed its denizens are on consultation exercises. What have we got recently? —A couple of draft Technical Actuarial Standards, proposals for how the pensions tax rules will apply to the remedy for *McCloud* discrimination in the public service pension schemes, and a call for evidence on the alternative DB quality requirements for auto-enrolment schemes. Just the mention of 'alternative DB quality requirements' is enough to send most folk to sleep.

Meanwhile, DEFRA is serving (debonairly, with a white napkin draped over one forearm, and in the good crystal glasses)—[*drumroll, please*]—wine reforms.

It's promising (amongst other things) to free us from the tyranny of mushroom-shaped corks and foil wrappers for sparkling wines. Apparently, this will make recycling easier, and encourage responsible consumption—or at least reduce the disheartening prospect of a loss of fizz if the opened bottle's put back in the fridge and saved till the next day (for, say, pouring over one's cornflakes).

This seemed plausible to *AF*, although he can attest that it's also possible to recycle the wee-metal-cap-and-wire constructions into neat miniature dining-room chairs for a doll's house (lockdown changed the definition of recreational activity in some very strange ways). However, his wife challenged the contention about extended fridge-life, pointing out that soft drinks rapidly lose their pizazz despite having screw caps, and that people looking for an excuse to finish the bottle aren't generally in need of an air- (or CO2-) tight argument to persuade them one way or the other…