Actuaries for Lawyers – Position statement on the Public Sector Pensions Remedy – 17 February 2021

Transitional/Tapered Protection in public sector pension schemes

Background

In April 2015, most public sector pension schemes were **reformed** largely due to the cost to the Government of continuing to operate the existing **legacy** public sector schemes. The new 2015 schemes were based upon a career average design (replacing the previous final salary structure) and had higher normal retirement ages to save on costs. As part of the reforms, those with 10 years to retirement at a cut-off date of 1 April 2012 were permitted to remain in the **legacy scheme** after the new schemes were introduced in April 2015 (**transitional protection**). Some other members who were more than 10 years from retirement, but met certain other pensionable service and age-related criteria were allowed to stay in the old **legacy scheme** for a period of up to 7 years after 1 April 2015 before being required to move to the new scheme (**tapered protection**).

In December 2018, the Court of Appeal found that some of the reforms unfairly discriminated against members of the judicial and firefighters' pension schemes in particular as transitional protection had been offered to older scheme members. The Court required that this unlawful discrimination be remedied by the Government. In a statement made by Liz Truss, the Chief Secretary to the Treasury, on 15 July 2019, it was confirmed that as 'transitional protection' was offered to members of all the main public service pension schemes, the Government believed that the difference in treatment would need to be remedied across all those schemes. This includes schemes for the NHS, civil service, local government, teachers, police, judiciary, the armed forces and fire and rescue workers. It should be noted that changes to the Local Government Pension Scheme took place in April 2014 rather than April 2015.

In summary, this has meant that the changes introduced to the eight Public Sector Schemes in April 2012 in respect of benefits accrued from April 2015 (April 2014 for the Local Government Pension Scheme) up to April 2022 require remedial action.

Consultation

In order to help to address this issue, the Government issued a consultation document on 16 July 2020 entitled "Public Service Pension schemes: changes to the transitional arrangements to the 2015 schemes - Consultation". The consultation closed on 11 October 2020. For technical reasons, there were separate consultations for the Judicial Pension Scheme and the Local Government Pension Scheme.

In the foreword to the consultation, the Government has stated its intention that rather than just returning all members to the **legacy schemes**, they want to ensure that those people who are better

off in the **reformed schemes** can choose to keep those benefits. They also want to ensure that those closest to retirement age and who were therefore prevented from moving to the **reformed schemes** will now have that choice. The consultation set out two proposals as to how remedy will be applied to affected public sector pension scheme members. Note that this only applies to those individuals who were members of public sector pension schemes on or before 31 March 2012 and on or after 1 April 2015. Under each option, the Government will give eligible members a choice as to which set of scheme benefits is better for them in the period from 1 April 2015 to 31 March 2022.

The Government response to the consultation in respect of the majority of the Public Sector Schemes (so excluding the specific ones for the Local Government and the Judiciary) was published in a document dated February 2021. It is expected that similar responses would be applied to the Judiciary and Local Government Schemes.

Brief Summary of Remedy Proposal by Reference to the Government Response Document

The following is a very brief summary of the proposed remedy (with particular relevance to pension sharing on divorce). Please refer to the original document for the full response which may be accessed via the following link. I have indicated (mainly in brackets) where the point made is referenced in the Government Response Document.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/958635/Public_Sector_Pensions_Consultation_Response.pdf

- Period of remedy covered: 1 April 2015 to 31 March 2022 inclusive (page 5).
- In scope members - Must have been eligible members of a **legacy scheme** immediately prior to 1 April 2012 (chapter 2 starting on page 14).
- The intention is to change eligible active and deferred member records to that of the **legacy scheme** for the period 1 April 2015 to 31 March 2022 (page 5).
- When the eligible active and deferred members retire, they will be given the choice of choosing the **legacy** or the **reformed** benefit for the 2015 to 2022 period of accrual (this is referred to as **DCU** – deferred choice underpin). (A.8 page 44)
- All members will end up in the **reformed scheme** for accrual from 1 April 2022 (from 3.53 page 42).
- Retired members will be offered the choice as soon as practical once the required legislation and processes are in place, and will be applied retrospectively. (A.9 – A.12 page 44 and from 2.99 page 32) There would be income tax implications (from 2.83 page 29, also 2.101 – 2.105).
- Any Annual Allowance penalty at the point of choice/retirement will be compensated for (2.93 page 31).
- There could be adjustments due to member contributions (refunds or payments due, and there could be related tax due or to be refunded based on the year that it was meant to be paid – tax due is immediate, tax refunds in line with HMRC rules, contribution excess due may be spread if agreed, refunds to be paid immediately). (A.29-A.34 page 47)
- For eligible pension credit members, I have quoted the Response Document wording to ensure no misinterpretation of it as follows – "The **CETV** will be calculated as though the

pension debit member had become a deferred member and had elected to transfer their pension rights at the relevant date, so the transfer value will be based on whichever scheme, **legacy** or **reformed**, produces the higher amount in relation to any period of service during the period between 1 April 2015 and 31 March 2022. Where the **CETV** provided to the court would have been higher as a result of the implementation of the **DCU**, the pension credit member's benefits will be increased in proportion with the increase in **CETV** to reflect that additional amount. The changes will come into effect when the **DCU** is implemented in scheme regulations." (A.112 page 59)

- Changes can only be made once legislation goes through for each scheme.(2.77 page 28)
- Legislation must go through by 1 October 2023 – as early as possible is encouraged – this will be in the Primary legislation (2.79 page 29).
- Primary legislation is to be initially introduced with the following aims (3.56 page 42):
    - To close the **legacy schemes** to future accrual from 31 March 2022
    - To remove the transitional protection arrangements (all service to be reinstated in **the legacy scheme** for the **Remedy Period**). This would then leave the salary link on the **legacy** section
    - Future service from 1 April 2022 onwards, to be in the **reformed schemes**
- Secondary legislation relates to the scheme regulations. This relates to technical details as to how specific changes will be made for that particular scheme
- Primary and secondary legislation needs to be passed before the schemes and their administrators can progress (2.77 page 28).

Implications for Pension on Divorce Reports

Once the primary and secondary legislation has been effected then the individual schemes would be able to start their remedial actions. After this point in time, we expect they will provide us with more detail of changes and potential benefits for specific members. We would then propose to include those changes and potential benefits within our calculations based on having more certainty than currently on the potential various benefit levels.

Prior to this, calculations of any expected change would be extremely complex, require many assumptions and would require heavy caveating. We have given this matter a great deal of consideration involving actuarial meetings going through the potential processes, working out the extensive data that may be required, considering the potential modelling, going through the various assumptions required, estimating the likely costs of production and the subsequent additional charges for our clients. We believe that the charges would be relatively high, and that our output may not be considered sufficiently robust enough to carry weight in a court of law due to the uncertainties involved and our necessary resultant caveats.

In addition to this the Response Document was not clear on some points, and we have written to the relevant authorities for clarification.

We will be contacting the pension schemes on a regular basis for updates on when these pension changes will come into effect.

We will be updating this article as more detail becomes available.

Based on the above, **our position in the immediate future** is that our calculations and reports **will not** include any allowance for the potential remedies proposed. We will review this position on an ongoing basis taking into consideration such factors as:

- Clarification being received from the regulators regarding our questions concerning the Government response to the consultation;
- More comprehensive data being published by the public sector pension schemes concerning the alternative remedy benefits available to the pension scheme member for the remedy period, including adjustments for member contribution shortfalls/overpayments;
- Publications by the public sector schemes of secondary pension legislation and/or guidance relating to the technical detail of how they will implement the remedy requirements in practice.

What are the consequences of settling a case based upon the current rules and ignoring remedy proposals?

If an implementation is made on this basis then once the regulations go through and benefits are amended (if required), we are expecting that in most cases the pension credit member and pension debit member should be no worse off than under current practice, given that either or both may receive extra benefit as a consequence of the remedy proposals.

In stating that both parties should be no worse off in most cases following any remedy being implemented, we are not saying that both parties will end up sharing the remedy equally if the case is settled ignoring remedy supplements to benefits. The extent to which remedy supplements are shared will undoubtedly be impacted by the size of any pension share on a pension benefit to which remedy may be applied. The larger the share of this pension, the greater the extent to which the ex-spouse may benefit from any remedy which is applied. Conversely if a small share or no share is applied to a pension to which remedy might be applicable, the lesser the extent to which the ex-spouse may benefit from any remedy which is applied. If the parties agreed to share 50% of the benefits accrued in the 2015 scheme (**reformed scheme**)and the member joined the 2015 scheme in April 2015, there is possibly a higher probability that remedy will be shared more equally than might have otherwise been the case, however this may not necessarily be appropriate in all cases for example:

- Taper members join the 2015 Scheme after 1 April 2015, so some benefits in the remedy period may have been earned in the legacy scheme;
- Fully protected members will have never joined the 2015 scheme, so all of the remedy period benefits would have been earned in the legacy scheme;
- The parties may have a material period of separation and so may consider that some of the current 2015 scheme benefits represent post separation accrual and it is therefore less appropriate to share the 2015 benefits equally;
- If both the member and the ex-spouse have post March 2015 pension accrual of benefits, then to ensure absolute equality of pensions between them it would be necessary to share all of these accruals of benefits on a 50% basis, and sharing 50% of each of these in the favour of the other party may result in quite high pension sharing charges overall.

The above list of bullet points is not exhaustive, and the parties will need to reach agreement based upon the circumstances of their particular case and the relative importance they place on some of the points set out above. They will also need to consider pragmatic issues such as the desire to settle the case sooner rather than later and/or accepting that any pension division may not achieve the precisely equal outcome they intended to achieve had the public sector remedy proposals not complicated matters. It should be noted that absolute equality of pensions in general (ignoring these remedy conditions) is not achievable in practice, because of the various assumptions and approximations within calculations and also due to practical aspects of pension sharing, and as pointed out within this note, the remedy effects on top of this may not change the relative degree of none-exactness.

It is possible that certain current **taper members** end up with reduced benefits, but we are not certain of this at the current point in time. There could also be some who may put forward a case that they took decisions that would have been different "Contingent decisions" (from A.82 page 55), and as a result may have lost out. These latter types of members would have to put forward their case to be individually considered (possibly **taper members** may be able to get a hearing in this way). Nevertheless, we are expecting those that may receive reduced benefits as a result of the remedy procedures (whether **taper** or Contingent decision cases or some other type of case which has not yet been considered) to be a small minority of the total pensions on divorce cases where remedy is applicable.

Should Pension Sharing Orders be deferred?

This is an option but would the parties wish to wait, what could be, until October 2023?

The parties may wish to note that:

- The required legislation is not yet in place;
- We will calculate pension shares based on the current legislative positions (not allowing for the potential remedies);
- This whole remedy only effects eligible members;
- Not all eligible members will end up with benefits different to what they currently are;
- The differences in benefit levels before and after for many eligible members could be relatively small (zero differences for some), and may have little or no impact on the pension sharing orders percentages that we calculate now.

Conclusion

Based on the above, our position at the present time is that based on the information which is currently available, the complexity of the changes being made and the uncertainty as to how changes may be implemented by individual schemes, calculations in our reports will be based on the current legislation in place without any allowance for the potential remedies proposed.

We will aim to highlight to instructing parties some of the limitations/consequences of settling the case without allowing for remedy proposals, and it will be for the parties to reach a decision as to how they propose to proceed in light of the information set out in the report.

Terms Used Above (paragraph and page references are in respect of the Government Response Document mentioned above)

CETV - Cash Equivalent Transfer Value (fuller definition on page 63)
DCU – Deferred Choice Underpin – Definition on page 63 (more details on this starting 2.42 page 22)
Legacy Scheme - The public service pension schemes members were in prior to 1 April 2015 (as per definition on page 64)
Reformed Scheme - The new 2015/2014 Schemes which were based upon a career average design (more technically defined as per the definition on page 66)
Taper Members are those who received **tapered protection** (starting from 2.25 page 19)
Tapered protection on page 66 is as follows -
"Offered to members between 10 and 13.5 or 14 years of Normal Pension Age on 31 March 2012, meaning they could stay in their existing schemes for a period ranging from a few months to several years after 2015. As with transitional protection, this was found to be unlawful discrimination by the courts."
Transitional Protection on page 66 is as follows -
"Given to members within 10 years of Normal Pension Age on 31 March 2012, it meant they remained in their existing (legacy) scheme. This was found to be unlawful discrimination by the courts."

Important caveat to note

Whilst the above note represents our best understanding of the Remedy proposals set out in the document "*Public service pension schemes: changes to the transitional arrangements to the 2015 schemes - Government response to consultation*", we should point out that we cannot provide any absolute guarantees that our interpretation of the above document will precisely follow the position taken by the individual public sector pension schemes in relation to implementing changes to their rules and regulations in practice. Actuaries for Lawyers can bear no responsibility for any losses that may occur as a result of acting upon information set out in this note. Parties taking specific courses of action based upon information set out in this document, do so at their own risk.

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