Actuaries for Lawyers

Note on the McCloud Judgement and Public Sector Pensions Remedy

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 at that time, 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 believes that the difference in treatment will 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. From April 2022 onwards, ongoing accrual of benefits is in the **reformed scheme** for all public sector members.

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 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. Similar responses have been published for the Judicial and Local Government schemes.

Brief Summary of Remedy Proposal by reference to this 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 as per the following link. We 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) and had pensionable service during the remedy period, 1 April 2015 to 31 March 2022. Individuals who were in service on or before 31 March 2012 but subsequently left and re-joined will be eligible for a remedy assessment provided their break in service was less than five years and meets the criteria for continuous service set out in their scheme regulations.
- 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).
- Eligible retired members will be offered the choice of benefit, as soon as practical, once the required legislation and processes are in place, and this 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).

Difference in the approach to Remedy for the Judicial and Local Government Pension Schemes

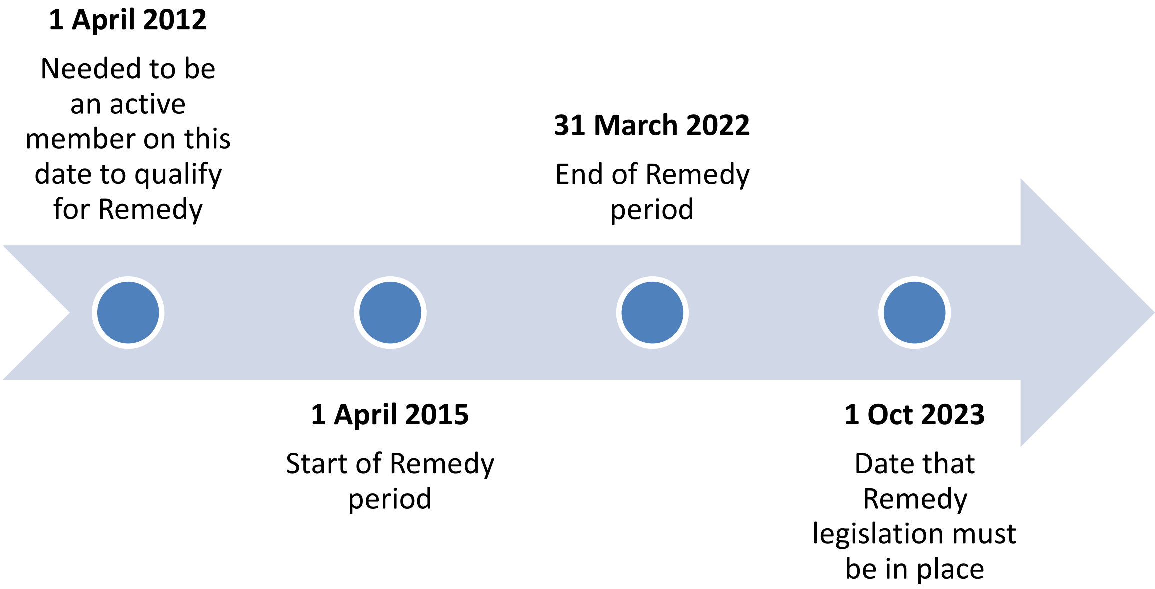
The approach to remedy for the **Judicial Pension Scheme** is that eligible members were required to make an immediate choice on 1 April 2022 as to whether they wished to have their benefits in the 1 April 2015 to 31 March 2022 **remedy period** based upon the **legacy** or **reformed** scheme benefit structure.

In the **Local Government Pension Scheme,** instead of being permitted to remain in the **legacy scheme,** those with 10 years to retirement at a cut-off date of 1 April 2012 were given a guarantee (referred to as the 'statutory underpin') such that additional checks are carried out with the intent of ensuring that that the career average pension payable under the reformed Local Government Pension Scheme is at least as high as the member would have been due under the final salary pension scheme. Where it is not as high, Scheme regulations provide that an addition must be applied to the member's career average pension to make up the shortfall.

In order to help to address this issue, the Government issued a consultation document on 16 July 2020 entitled "Amendments to the Local Government Pension Scheme statutory underpin". The consultation closed on 8 October 2020 and on 13 May 2021, the Government issued a statement confirming the key changes they will make to the Scheme to remove any discrimination. Following consultation, the Government is proposing to remove the condition that required a member to have been within ten years of their normal pension age on 1st April 2012 to be eligible for underpin protection. In removing the discrimination, they are proposing a number of supplementary changes to ensure the revised underpin works effectively and consistently for all members.

It should be pointed out that the underpin will not bite in many cases. It is our understanding that the current underpin calculation is mainly carried out on the retirement or death of a member and no allowance has ever been made for this in calculating CEVs for divorce purposes (as far as we are aware). The impact of the changes proposed may result in a possible increase to the pension benefits received by some members on retirement. The number of members benefitting is likely to become a little larger than was previously the case due to the removal of the age rule that historically applied in order to qualify for this.

Timeline of key dates for public sector remedy



Primary legislation is now in place in the form of Public Service Pensions and Judicial Offices Act 2022 which received Royal Assent on 10 March 2022.

Consultations were initiated regarding the secondary legislation in March 2023 regarding the scheme regulations required to be in place by 1 October 2023. Actuaries for Lawyers responded to that Consultation process which mainly finished at the end of May 2023.

At the time of writing this note we have seen a number of Government responses following completion of these consultations, however it should be noted that such responses are scheme specific.

This latest process of working towards the Scheme Regulations (to be in place by 1 October 2023) has clarified a few points, but there are still some details that are uncertain, and in particular on some divorce matters.

Implications for Pension on Divorce Reports

Whilst there are still some uncertainties, Actuaries for Lawyers is of the view that in most cases, there is sufficient indication of the intended remedies to enable reasonable estimates to be made of the quantum of any remedy where applicable. Nevertheless, due to these uncertainties, we have to advise that our interpretation of the draft regulations may differ in some cases from the eventual application of the final regulations by the scheme and we cannot provide any absolute guarantees in this respect.

We continue to monitor the pension schemes for updates on a regular basis. We would point out that even though the secondary legislation should be in place no later than 1 October 2023, we are still expecting some outstanding queries to continue to remain unanswered until a later date. There is also the potential for different administrators to deal differently with the same issue. We do not consider such issues should generally obstruct us from completing our calculations on a reasonably accurate basis for divorce purposes but would again caution that absolute guarantees cannot be provided until the final rules and regulations for the schemes are fully in place and areas of outstanding uncertainty have been clarified.

Caution regarding latest date a CEV is calculated by the relevant pension scheme

Based on our current understanding of the legislation to be put into place regarding Public Sector Remedy (McCloud), the methodology for calculating Pension Credit and Pension Debit amounts on the application of a Pension Sharing Order (PSO) differs based on whether the latest CEV provided for divorce purposes prior to that Pension Sharing Order being sent to the Pension Scheme is dated before or after 1 October 2023.

Our current calculations are clearly based on CEVs for divorce purposes having been prepared prior to 1 October 2023. Once the date of 1 October 2023 has passed, if a CEV for divorce purposes is provided by the scheme following a previous request for this having been made on a case where the benefits are eligible for remedy assessment and the member in question has not yet made their remedy DCU election by that date, any settlement negotiated based upon CEVs issued prior to 1 October 2023 may no longer be appropriate and it is highly likely that terms of settlement will need to be revisited before any final agreement is reached and before any final order is served on the scheme where relevant. The importance of this point will become more relevant as we approach October 2023 and will continue to be important for some time after this date, particularly where previous negotiations have been based upon CEVs for divorce purposes issued before 1 October 2023.

After 1 October 2023, we consider it advisable to check with the Pension Scheme (as close as practical to and before obtaining the seal and stamp of the Court's approval to a Pension Sharing Order) whether the latest CEV for divorce purposes shown on their Pension Scheme records is dated before or after 1 October 2023. It is recommended that written confirmation is requested of this. If this latest CEV is dated after 30 September 2023 then, as stated above, if the calculations and results within a pension report were based on a CEVs issued prior to 1 October 2023 on a case where the member has not yet made their DCU election, then the calculations are likely to require reworking as otherwise they may no longer be valid.

For the avoidance of doubt when we refer to the latest CEV for divorce purposes on the Pension Scheme record, this is NOT the CEV that is recalculated on the application of a Pension Sharing Order. It is the latest CEV for divorce purposes provided prior to this.

The reason there is this issue is because from 1 October 2023, the intention is to ensure all remedy eligible active and deferred member records show legacy scheme benefits for the period 1 April 2015 to 31 March 2022. So by way of example

- if a settlement has been agreed with a PSO on a reformed benefit (2015 Scheme), which included accrual in the 2015 to 2022 period, and which was calculated based on a CEV dated before 1 October 2023
- However, PSO implementation is not taking place until after 30 September 2023
- And a CEV has been requested prior to the PSO but after 30 September 2023
- Then a PSO over that 2015 scheme will result in a lower pension credit because the accrual for the 2015 to 2022 period will have been transferred into the legacy scheme, and when calculating the CEV for a PSO, the scheme will consider the 2015 to 2022 accrual to be part of the legacy scheme if the recorded prior CEV was dated after 30 September 2023. It should be noted that in this example, if the CEV was dated before 1 October 2023 the scheme will treat the 2015 to 2022 accrual as part of the 2015 scheme for PSO purposes.

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

The overall general response to this question is that one party may end up with a higher than intended share of the pension assets compared to the other party, and in some circumstances this may be significant.

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. There are some unusual circumstances as to where the pension credit post remedy could actually fall. This is expected to be rare and only likely to impact on a very small number of cases where the member had a mixture of legacy and reformed benefits in the 1 April 2015 to 31 March 2022 remedy period (taper members), though even on these cases a reduction is expected to be unlikely in most circumstances. This assumes that negotiations and settlement take place based on CEVs consistently calculated based on either the pre-1 October 2023 benefit structure or the post 1 October 2023 benefit structure. As the example above illustrates, it is possible that one of the parties could be worse off than expected, if remedy results in an element of benefits moving from the reformed scheme to the legacy scheme prior to a pension share being implemented.

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, this may offer an approximate way of sharing the benefit of remedy between the parties, 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, to ensure absolute equality of pensions between them, it would be necessary to share post March 2015 benefits for both parties 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.
- If the party with lower benefits overall has public sector pensions which may benefit from remedy, it is not easy to address this issue by sharing 50% of the post 2015 benefit as it may result in sharing multiple pensions between the parties and disproportionate sharing charges.
- Also as stated in the previous section above, if a CEV is requested after 30 September 2023 then the 2015 to 2022 accrual will be treated as if it were in the legacy scheme, and hence if the reformed scheme benefits alone are subsequently shared, the pension credit member will not receive any benefit from the remedy.

The above list of bullet points is not exhaustive.

What the above highlights is that it is difficult to ensure that both parties end up with equal shares of the relevant pension benefits without specifically allowing for the remedy within the calculations.

Therefore we consider that allowance should be made for the remedy proposals within the calculation routines, and then both the pension credit member and the pension debit member should benefit from remedy to the extent appropriate (within a reasonable and acceptable margin of accuracy).

Should Pension Sharing Orders be deferred?

It is possible that more detail on various uncertainties may be available the longer you wait, but then how long should you wait?

The parties may wish to note that

- The required legislation is not yet in place for most of the affected schemes, and it is possible that it may still not be finalised by the October 2023 target date, but we are actually expecting it will be finalised by then.
- However, the current uncertainties may not have been clarified in the legislation, and so there is no timescale that we can provide for when they may resolved.
- We will calculate pension shares based on our current knowledge of the position allowing for remedy, which in our opinion is a reasonably pragmatic approach, but we have to point out that there are uncertainties
- This whole remedy only affects eligible members and specifically only relevant benefits earned between April 2015 and March 2022.
- 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)

Conclusion

Our position at the present time is that based on the information which is currently available, we will be allowing for remedy within our calculations where appropriate, which will necessarily be suitably caveated.

We will aim to highlight to instructing parties some of the limitations/consequences of settling the case based on our estimated remedy position if appropriate, 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). Note that CEV (Cash Equivalent Value) and CETV mean the same thing and can be used interchangeably
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."

We have left in references to the original Government response document from 2021 for ease of presentation purposes, noting that later documentation deals with each scheme separately.

Important Caveat to note

Whilst the above note represents our best understanding of the Remedy proposals we should point out that we cannot provide any absolute guarantees that our interpretation 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.

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