

Get ready for the *McCloud* retrospective pensions remedy

Choices, choices, no choice!



A guide for pension schemes and administrators

From 1 October 2023, the *McCloud* retrospective pensions remedy will come into force. This will have wide-ranging implications for public service pension schemes, administrators and affected members alike, as members' benefits may be improved with retrospective effect. Affected members of the "main" schemes (that is, all of the schemes other than those for the judiciary and local government) will have a deferred choice of pension benefits (except for pensioner members and for members who have died, where there will be an "immediate choice"). The judiciary will have an immediate choice and members of the Local Government Pension Scheme (LGPS) will have no choice.

This guide provides a high-level overview of where things currently stand in April 2023 regarding the *McCloud* pensions remedy, how public service pension schemes and administrators should start to prepare, and how we can help you.

Click on the tabs below to find out more about the *McCloud* pensions remedy and our recommended actions.



Background

In 2018, the Court of Appeal found in the **McCloud case** that the way in which pension reforms had been implemented in 2014/2015 was discriminatory. Generally speaking, those reforms had permitted older members of public service schemes (broadly, those within 10 years of Normal Pension Age) to remain in their legacy final salary pension schemes (the legacy schemes), whereas younger members were required to join the reformed career average revalued earnings (CARE) pension from 2014/2015. In the LGPS, all members joined the reformed scheme, but older members benefited from an underpin such that they receive the higher of the career average or the final salary benefits. The Court of Appeal found that the “transitional protection” granted to older members in the judicial and firefighters pension schemes gave rise to unlawful discrimination, contrary to the Equality Act 2010.

In 2019, the government **announced** that the *McCloud* judgment would have implications for all public service pension schemes. These are the schemes for NHS workers, the civil service, local government workers, teachers, police, the armed forces, the judiciary and firefighters.

In 2020, the government consulted on changes to the main public service schemes, and separate consultations took place in relation to the judicial pension schemes, the LGPS, and the Northern Ireland devolved schemes. In 2021, the government published its **response** to the consultation, confirming that the legacy schemes would close on 31 March 2022, and that a retrospective remedy would be implemented to address the period from 2014/2015 to 2022.

On 19 July 2021, a **Bill** was introduced into Parliament, which received Royal Assent on 10 March 2022 to become the **Public Service Pensions and Judicial Offices Act (PSPJOA) 2022**, which provides the legislative powers for the discrimination to be rectified.



The prospective remedy

From 1 April 2022, the prospective remedy came into force, whereby, for the main schemes, all remaining active members of the legacy schemes were moved to the reformed schemes to accrue any future service. The legacy schemes were all closed to future accrual. The prospective remedy was implemented by the PSPJOA 2022 and by regulations made in relation to each of the affected schemes, so as to remove transitional protection going forwards.

A new unregistered pension scheme was **created** for the judiciary, known as the Judicial Pension Scheme 2022.

The LGPS is different to the other affected pension schemes because, in England and Wales, the reforms took place a year earlier on 1 April 2014. The mechanism was also different as all members were moved into the reformed scheme, but members within 10 years of retirement were granted an underpin, such that they receive the higher of the career average or the final salary benefits. Accordingly, no prospective remedy was required for the LGPS as such, and the form of the retrospective remedy will also be different.



The retrospective remedy

Main schemes

From 1 October 2023 (unless regulations commence it earlier), the retrospective remedy will come into force in relation to the main schemes. Broadly, the retrospective remedy applies to all members who were in service on 1 April 2012 and also at any time between 1 April 2015 and 31 March 2022 (the remedy period) and who have not had a disqualifying gap in service of more than five years; service that these members accrued during the remedy period is known as remediable service.

On 1 October 2023, remediable service will be treated as having accrued under the legacy schemes instead of the reformed schemes.

For people who became a pensioner member or who died before 1 October 2023, there will be an immediate choice:

- Pension schemes are required under the PSPJOA 2022 to issue a remediable service statement (RSS) within 18 months of 1 October 2023 (that is, by 31 March 2025) or a later date that the scheme manager considers reasonable.
- These members will then have an opportunity to choose whether they would like to receive legacy benefits or reformed scheme benefits in respect of their remediable service. Their immediate choice must be made within a year of their RSS being issued. That immediate choice will be treated as having effect immediately before they became a pensioner member (or immediately before they died).

Active and deferred members, on 1 October 2023, will have a deferred choice:

- Pension schemes are also required to issue a RSS to these members within 18 months of 1 October 2023 or a later date that the scheme manager considers reasonable, but also annually thereafter.
- In the year prior to the member's expected retirement, members will then have an opportunity to choose whether they would like to receive legacy benefits or reformed scheme benefits in respect of their remediable service. Their deferred choice should be made before their benefits come into payment. The deferred choice will then have effect immediately before they become a pensioner member.

Although the PSPJOA 2022 provides the legislative framework and powers for the retrospective remedy, the detail of its implementation will take place in regulations. Much of the content of those regulations is already set out in **The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions 2022** (known as the Treasury Directions).

Consultations are ongoing in relation to the affected schemes (and further consultations are anticipated in relation to the relevant workforces in relation to Scotland and Northern Ireland too):

- NHS workers in England and Wales: the Department for Health and Social Care launched a **consultation** on 14 March 2023, which is ongoing until 6 June 2023.
- The Civil Service: the Cabinet Office launched a **consultation** on 6 March 2023, which is ongoing until 14 May 2023.
- Police in England and Wales: the Home Office launched a **consultation** on 28 February 2023, which is ongoing until 23 May 2023.
- The Armed Forces: the Ministry of Defence launched a **consultation** on 6 March 2023, which is ongoing until 29 May 2023.
- Firefighters in England: the Home Office launched a **consultation** on 28 February 2023, which is ongoing until 23 May 2023.
- Firefighters in Wales: the Welsh Government launched a **consultation** on 31 March 2023, which is ongoing until 23 June 2023.
- Teachers in England and Wales: the Department for Education launched a **consultation** on 27 March 2023, which is ongoing until 4 June 2023.

The retrospective remedy

The judiciary

During 2023 (the precise date has not yet been confirmed), the retrospective remedy will come into force for the judiciary.

As with the main schemes, broadly, the retrospective remedy applies to all members who were in service on 1 April 2012 and also at any time during the remedy period, and who have not had a disqualifying gap in service of more than five years. Service that these members accrued during the remedy period is also known as remediable service.

Judges will receive an information statement that will explain the alternative benefits available to them.

Judges will have a choice about whether to have benefits in the legacy scheme or in the reformed scheme. That choice will be given effect retrospectively.

The PSPJOA 2022 provides the legislative framework and powers for the retrospective remedy, but the detail of it will be implemented in regulations, made in accordance with the Treasury Directions. The Ministry of Justice launched a **consultation** on 16 December 2022, which closed on 10 February 2023. The outcome of the consultation is currently awaited.



The retrospective remedy

The LGPS

On 1 October 2023, the retrospective remedy will come into force for the LGPS.

As explained, the way in which the pension reforms were implemented were different for the LGPS to the other schemes, and a different form of remedy is therefore required.

In England and Wales, all members have been in the reformed LGPS since 1 April 2014; however, members within 10 years of retirement were granted an underpin, such that they receive the higher of the career average or the final salary benefits.

The PSPJOA 2022, therefore, provides a power to enable the underpin to be extended, so that final salary benefits can be paid to all members with remediable service.

Unlike with the other schemes, members will not have a choice about their benefits; rather, the underpin will work automatically to increase the benefits payable if the legacy scheme would have paid a higher amount.

The PSPJOA 2022 provides the legislative framework and powers for the retrospective remedy, but the detail of it will be implemented in regulations, made in accordance with the Treasury Directions. A **consultation** took place in relation to the LGPS in England and Wales in 2020 (separate consultations took place in relation to the LGPS in Scotland, and the LGPS in Northern Ireland). A **written ministerial statement** was made on 13 May 2021 confirming that the underpin will be extended to younger qualifying members and that further legislation would be made to give effect to that policy. On 6 April 2023, the Department for Levelling Up, Housing and Communities

published a **response** to the consultation, including a useful **factsheet**. There will be a further consultation commencing in the spring of 2023 to seek views on the draft regulations and on other issues relating to the remedy, including in relation to aggregation and flexible retirement.

The LGPS Scheme Advisory Board has, on 3 March 2023, published **guidance** on *McCloud* data issues.



Tax considerations

The retrospective remedy will result in significant changes to members' pension benefits. Tax issues may arise in relation to a variety of pension issues, including the annual allowance tax charge, the lifetime allowance tax charge, unauthorised payment charges and the income tax treatment of contributions.

The Treasury has a power in **section 11 of the Finance Act 2022** to make regulations modifying the relevant tax laws, to address the unlawful discrimination.

A **consultation** took place on draft regulations from 24 November 2022 to 6 January 2023, which included detailed **guidance**.

The Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) Regulations 2023 were made by the Treasury on 2 February 2023 and came into force on 6 April 2023.

Notwithstanding the significant changes to the lifetime allowance and the annual allowance announced in the Spring Budget on 15 March 2023, HMRC has **confirmed** that the *McCloud* remedy will continue to be implemented as planned.



The cost control mechanism

The cost control mechanism, established under the Public Service Pensions Act 2013, provides for periodic valuations of the public service pension schemes to take place. If the scheme's actuarially assessed liabilities exceed specified margins above or below a target cost, the benefits or contributions of active members can be increased or decreased in order to bring the liabilities back to the target cost.

The process of the 2016 valuations was paused in 2019 owing to uncertainties arising from the *McCloud* case. Preliminary valuations had indicated that the liabilities of several schemes were significantly below the target cost, which could have led to members' benefits being improved. However, subsequently, on 7 October 2021, the Treasury made **The Public Service Pensions (Valuations and Employer Cost Cap) (Amendment) Directions 2021**. Among other things, these directions completed the 2016 valuations and provided that

the costs associated with the *McCloud* remedy (which the government has estimated are approximately £17 billion) would be included in the cost control mechanism. The effect of this was that the liabilities increased so that the liabilities of several schemes were within the margins or above the target cost. However, the PSPJOA 2022 provides that benefits will not be reduced if costs exceed the target cost for the 2016 valuations.

The government's decision to include the costs associated with the *McCloud* remedy in the cost control mechanism was challenged in a judicial review brought by the Fire Brigades Union, the British Medical Association and others. On 10 March 2023, the Administrative Court dismissed **the judicial review**.

The next set of valuations for these purposes will be "as at" 31 March 2020. These valuations will be subject to the reforms to the cost control mechanism that the government **consulted**

upon in 2021: namely, a reformed scheme-only design (to remove allowance for legacy schemes in the mechanism), a wider cost corridor, and an economic check (so that benefit changes would only be implemented if they would still have occurred had long-term economic assumptions been considered).

The LGPS is also subject to an additional cost control, through the Scheme Advisory Board Cost Management Process. This operates prior to the Treasury's cost control mechanism. The Department for Levelling Up, Housing and Communities ran a consultation from 30 January 2023 to 24 March 2023 to propose some amendments to this process, and the outcome of that **consultation** is currently awaited.



Recommended actions

1

Consider attending training about the *McCloud* remedy to familiarise yourself with the remedy and the requirements for schemes and administrators. We provide regular updates on developments with the *McCloud* remedy in our monthly UK public service pensions update.

2

Review governance processes to ensure that the impacts and requirements of the *McCloud* remedy are being considered and monitored appropriately.

3

Review your scheme's data against the items that will be required in order to implement the *McCloud* remedy; in particular, in order to identify all affected members and their relevant records. Any gaps should be identified and a plan will be needed to complete the gaps.

4

Administering authorities for the LGPS should also consider the data issues addressed in the Scheme Advisory's Board's recent **guidance** and seek further advice from professionals, if appropriate, to ensure compliance with all of their obligations.

5

Regular updates should be provided in communications to members to inform them about the upcoming implementation of the *McCloud* remedy, what they will need to do, and when.

6

Keep developments with the *McCloud* remedy under review, monitoring the various consultations, scheme regulations, Treasury Directions, tax regulations, and guidance.

Osborne Clarke's pensions practice has been advising public service pension scheme administering authorities and employers for over two decades. Our market leading public service pensions practice has been appointed to the **National LGPS Framework for Legal Services** from its inception in 2015. We were successfully appointed again when the latest framework was launched in January 2023, assuring framework users continued service quality and value. We also have a place on the **Crown Commercial Service's Public Sector Legal Services Panel**, with a specialism in pensions. We can provide the full range legal support to the LGPS and other public service pension schemes. Please feel free to get in touch with one of our experienced pension lawyers to understand how we can support you.

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