EXPLANATORY MEMORANDUM TO

THE LOCAL GOVERNMENT PENSION SCHEME (AMENDMENT) (NO. 2) REGULATIONS 2020

2020 No. 893

1. Introduction

1.1 This explanatory memorandum has been prepared by the Ministry for Housing Communities and Local Government and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Local Government Pension Scheme ("the LGPS") provides pensions for local Government workers and employees of Scheme employers and is administered by 87 administering authorities. The new Regulations firstly provide that administering authorities in the LGPS may amend the contributions of Scheme employer(s) between actuarial valuations in certain situations. Secondly, they provide that when a Scheme employer is exiting the LGPS, administering authorities may spread a Scheme employer's exit payment or defer an exit payment under a deferred debt agreement with the Scheme employer.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales.

4.2 The territorial application of this instrument is England and Wales.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 The Public Service Pensions Act 2013 ("the 2013 Act") enables the Secretary of State to make regulations creating schemes of pensions for, amongst others, local government workers.

6.2 In England and Wales, the scheme is governed by the Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations"). The 2013 Regulations were made exercising powers in the Superannuation Act 1972 but section 18 of the 2013 Act provides for them to take effect as scheme regulations.

6.3 The LGPS is a funded scheme administered by 87 administering authorities, which are specified in Part 1 of Schedule 3 to the 2013 Regulations. Administering authorities are responsible for the investment and management of the LGPS assets, the collection of Scheme employer and employee contributions, maintaining membership records and the payment of pension benefits. As part of these responsibilities administering authorities are required to employ a fund actuary to undertake a three-yearly valuation of the fund to ensure that returns from investments and employer and employee contributions are sufficient to meet the benefits payable to members.

6.4 Some Scheme employers (such as local authorities) participate in the LGPS because they are one of a class of Scheme employers required to offer LGPS membership under the2013 Regulations. Others participate under an “admission agreement” because they perform services for or have some connection with a Scheme employer required to offer access to the LGPS. In both cases they are referred to as a “Scheme employer”.

6.5 Regulation 64(1) of the 2013 Regulations defines an “exiting employer”, broadly, as a scheme employer who ceases to have active members participating in an LGPS pension fund. Active members are those actively contributing to the pension scheme and who have not left or begun to take their pension. An “exiting employer” is liable to pay an exit payment if their LGPS liabilities exceed their LGPS assets, or entitled to receive an exit credit, if their LGPS assets exceed their LGPS liabilities.

6.6 In accordance with the Public Service Pensions Act 2013, these regulations follow consultation and have received consent from HM Treasury.

7. Policy background

What is being done and why?

7.1 The Government is increasing the range of options available to administering authorities to manage employer covenant risk in the LGPS. Employer covenant risk arises where a Scheme employer may be unable to meet its future obligations. These changes had been consulted on in 2019 but have been prioritised as a result of the impacts of COVID-19 on employer financial health.

7.2 As part of its role, an administering authority may choose to review Scheme employer covenant strength (the ability of the Scheme employer to meet its obligations to the scheme). Through this, administering authorities may take steps to manage and reduce covenant risks, for example seeking additional security or reviewing contributions for Scheme employers likely to exit. At the three-year fund valuations, administering authorities may take account of covenant strength in setting an employer’s contribution rate. However, the circumstances of Scheme employers may change between valuations, for example due to a change in covenant strength or workforce composition, or local government reorganisation.

7.3 The current rules on exit payments in regulation 64 of the 2013 Regulations (described at paragraph 6.5 above) can be onerous for some Scheme employers, as they require employers to settle their liabilities, which can be highly significant, via a one-off lump sum ‘exit payment’. Employers may therefore keep active members in the scheme, even where it is not in the employer's long-term interests to do so, to avoid triggering the exit payment. There is also a risk that some Scheme employers who become exiting employers could become insolvent if they are unable to meet an exit payment. This has potential implications for employment, delivery of local services and future support for the scheme.

7.4 In 2019 the Government consulted on a range of proposals as set out in section 10 of this Memorandum. The consultation proposed greater powers for administering authorities to review Scheme employer contributions between valuations and increased flexibilities on exit payments in order to address the issues described above.

7.5 Since the consultation, administering authorities and Scheme employers have faced new potential risks as a result of the global COVID-19 pandemic. Some Scheme employers and administering authorities have made representations seeking swift implementation of the review of Scheme employer contributions and increased flexibilities on exit payments proposals, in order to support management and mitigation of these risks.

7.6 The Regulations provide that administering authorities may review contributions where there has been a significant change in liabilities or covenant in respect of any Scheme employer. Scheme employers may also request a review of contributions.

7.7 In order to address the concerns expressed by consultation respondents, administering authorities will be required to consult with the Scheme employer when undertaking a review of the Scheme employer's contributions. Administering authorities will also be required to state their policy on the review of Scheme employer contributions in their Funding Strategy Statement, required under regulation 58 of the 2013 Regulations, and obtain advice from their actuary.

7.8 The Regulations provide administering authorities with a power to spread exit payments from an exiting employer over a defined period, where the Scheme employer no longer has active members in the scheme. They also provide administering authorities with the power to allow an exiting employer to defer the exit payment where they have no active members, subject to entering into a deferred debt agreement, and undertaking to pay secondary contributions as set by valuations. Such agreements will be for a prescribed period which can be varied if both parties agree. Any such agreements will cease when all liabilities (as assessed by the fund actuary) are fully paid. While deferred debt agreements will mean that the period over which an exiting employer's scheme liabilities are fully funded is extended, the existence of a formal legal agreement should provide both employers and administering authorities with certainty and confidence over the future funding of liabilities.

7.9 In order to ensure consistency and transparency, administering authorities that wish to make use of the new powers will be required to set out within their Funding Strategy Statement (required under regulation 58 of the 2013 Regulations), their policy on spreading exit payments, and to obtain advice from their actuary.

7.10 These Regulations come into effect on 23 September 2020.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 The amendments made by these Regulations are relatively minor and it is not considered appropriate to consolidate the 2013 Regulations at this time.

10. Consultation outcome

10.1 Under the Public Service Pensions Act 2013, prior to amendment of the 2013 LGPS Regulations, the Government is required to consult on changes. The consultation, "Changes to the Local Valuation Cycle and the Management of Employer risk", was conducted from 8 May to 31 July 2019[1] and received 279 responses. The consultation sought views on a package of proposals, which included the proposals for review of Scheme employer contributions between valuations and for increased flexibilities on exit payments. Alongside the Regulations, the Government is publishing a partial response in relation to the package of proposals included in these Regulations. The Government also published a partial response on exit credit powers in February 2019 and will publish a partial response to the outstanding proposals in due course.

10.2 The consultation sought views on whether to allow for more flexible review of Scheme employer contributions between valuations, with 97 respondents in support, 26 supporting with reservations and 10 who did not support. Therefore, there was strong support from respondents for the proposed new power for administering authorities to review the contributions of Scheme employers, subject to appropriate safeguards. Administering authorities sought maximum discretion and flexibility while Scheme employers sought clear communication, as well as consistency. There were concerns from administering authorities and other respondents that the proposal to require administering authorities to specify the categories of Scheme employers eligible for reviews would be too rigid and considered that reviews should be available for all Scheme employers.

10.3 In view of responses to the consultation, the Government has concluded that the power to review contributions should apply in respect of all Scheme employers. This will enable administering authorities to respond to the full range of circumstances which may change between valuations, including potential impacts of COVID-19 and some other circumstances, for example when local government reorganisation leads to a change in liabilities.

10.4 The consultation sought the view of whether the exit payment flexibilities should be available to administering authorities as an alternative to current rules on exit payment and 120 of the responses were in favour, 1 supporting with reservations and 5 against. Therefore, the proposals to grant administering authorities additional flexibilities to manage exit payments were also strongly supported by respondents, subject to transparency and consistency for Scheme employers and appropriate management of risk.

10.5 In the context of the COVID-19 pandemic, administering authorities and Scheme employers have made representations to the Government for implementation of the review of contributions and exit payment flexibility proposals in order to assist management and mitigation of COVID-19 risks. The Government therefore wishes to implement these proposals now in order to help administering authorities manage these impacts.

[1] https://www.gov.uk/government/consultations/local-government-pension-scheme-changes-to-the-local-valuation-cycle-and-management-of-employer-risk?=7

11. Guidance

11.1 The Government consulted on the appropriate guidance for these new powers and will work with the Scheme Advisory Board and CIPFA to develop guidance, taking account of the consultation responses.

11.2 The Government aims to publish guidance as soon as possible to help the administering authorities and scheme employers with implementing these powers.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 An Impact Assessment has not been prepared for this instrument because no impact on the private or voluntary sectors is foreseen.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 These Regulations do not include a statutory review clause. The Department will review the effectiveness of these regulations through its continuing engagement with the sector and its work with the LGPS scheme advisory board. The Scheme Advisory Board is a statutory board with a function, under regulation 110 of the 2013 Regulations, to provide advice to the Secretary of State on the desirability of making changes to the scheme.

15. Contact

15.1 Sheila Owen at the Ministry of Housing, Communities and Local Government, email: Sheila.Owen@communities.gov.uk can be contacted with any queries regarding the instrument.

15.2 Suzanne Clarke, Deputy Director for Local Government Finance, at the Ministry of Housing, Communities and Local Government can confirm that this Explanatory Memorandum meets the required standard.

15.3 Simon Clarke MP at the Ministry of Housing, Communities and Local Government can confirm that this Explanatory Memorandum meets the required standard.