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For the attention of Administering Authorities

13 May 2020

Dear Colleagues,

2020 Triennial Valuations

I am writing to set out SPPA's current position on two key aspects for administering authorities to consider whilst undertaking the 2020 valuations.

Age Discrimination in Public Service Pension Schemes

In December 2018, the Court of Appeal found that the transitional protections introduced to the judicial and firefighters' schemes during the reform of public service pensions in 2015 discriminated on grounds of age. The UK Government sought permission to appeal this decision but this was not granted, and on 15 July 2019 the UK Government issued a written ministerial statement to confirm that as transitional protection was provided in all public service schemes, the ruling had implications for all those schemes, including the Scottish Local Government Pension Scheme (SLGPS). Details of the Court of Appeal ruling, hereafter referred to as *McCloud*, are available here.

Whilst initial proposals to address the specific discrimination in the SLGPS have been shared with the scheme advisory board, there remains uncertainty around the timing and changes needed in light of *McCloud*. This uncertainty is something that administering authorities will need to consider when carrying out the 2020 triennial valuation. We are aware that a lack of clarity may lead to differences in approach between funds and, all other things being equal, could possibly result in material differences in employer contribution rates. We are keen to avoid this where possible.

We therefore suggest that all Scottish administering authorities, for the purposes of the 2020 triennial valuation, should value members' benefits as per the various Regulations in force at 31 March 2020 except for the following assumptions:

- It should be assumed that the current underpin (which only applies to those members within 10 years of their NPA at 31 March 2012) will be revised and apply to all members who were active in the scheme at 31 March 2012.
- The extension of the underpin will apply to all those members who were active at 31 March 2012 but have left active status since 1 April 2015.
- The underpin will apply to all service accrued between 1 April 2015 and 31 March 2022.

SPPA expects that all administering authorities will reflect the above amendments when valuing past service liabilities and setting employer contribution rates at the 2020 triennial valuation and confirm their approach in the Funding Strategy Statement. It is likely that the Government Actuary's Department will also seek to ensure that this is the case when carrying out their Report under Section 13 of the Public Service Pensions Act 2013.

SPPA emphasises that this is an assumption about how the *McCloud* case will be resolved. It should be noted that it does not necessarily follow that this will be the actual outcome of any resolution and we ask that this should not be communicated as such to any stakeholder at this stage. Therefore, administering authorities should make provision in their funding strategy for the ability to revisit employer contributions if the actual outcome is materially different from that outlined above.

Administering authorities should also consider with their actuary what allowance is made for *McCloud* in the valuation of exit payments and credits and other day-to-day funding assessments.

Employer Cost Cap considerations

The reforms introduced to public service pensions from 1 April 2015 (or a year earlier in the case of the local government scheme in England and Wales) also included a new cost control mechanism, known as the employer cost cap.

The purpose of the mechanism was to introduce a way of sharing pension cost increases and savings between the employer (ultimately often the taxpayer) and scheme members. To assess these costs, a cost cap valuation is carried out by GAD under directions issued by HM Treasury. The first round of cost cap valuations were carried out for nearly all public sector schemes at 31 March 2016. These valuations identified a significant cost saving due mainly to lower than expected salary increases and improvements in life expectancy. The magnitude of the cost saving was, on average, between 3-5% of pay and under the mechanism where costs have increased or reduced by more than 2%, steps must be taken to return the scheme to the target cost.

The first cost cap valuation for LGPS Scotland was due to take place at 31 March 2017. As you are aware, GAD commenced this process however it has not yet been completed, as the cost cap element of scheme valuations was suspended by the UK Government in early 2019 pending the resolution of McCloud. In a written ministerial statement on 25 March 2020, the Economic Secretary to the Treasury outlined the UK Government's intention to provide an update on the cost cap mechanism alongside proposals to address McCloud.

We realise the challenges that actuaries face in considering the uncertainties in *McCloud* and the cost cap, particularly given the tight timescales for completing valuations. We regret that we are currently unable to suggest how provision might be made for any running of the cost cap process but hope to have more clarity in the next two months. We will write to administering authorities to provide an update at the earliest opportunity.

Yours sincerely

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