MERCER

LGPS CURRENT ISSUES

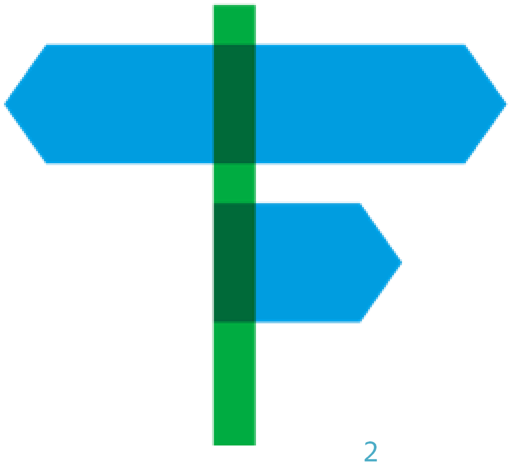
JANUARY 2021

welcome to
brighter

In this edition

Happy New Year! We hope you had a rest over Christmas and enjoyed a break, despite the pressures of the various lockdown measures at the time.

For 2021 so far, it is not so much "out with the old, in with the new" - but more a case of development of the key themes we saw last year with a few new twists as things unfold. We hope this edition of Mercer Current Issues finds you safe and well in these challenging circumstances. This issue provides an update on developments over recent months.



COVID-19

A new year, a new lockdown but 3 new vaccines

At the time of writing, all parts of the UK are experiencing a tightening in lockdown restrictions over the short-term. With this we see continued pressure on employers, the wider economic outlook and of course every individual in relation to their physical, mental and financial wellbeing. First and foremost, we therefore hope this edition of Current Issues finds you safe and well.

In addition to the challenges of new strains and increased lockdown measures, saw a new hope with the advent of an increasing number of vaccines licensed for use in the UK and the implementation of the vaccination programme. In anticipation of the licensing of the vaccines we also saw a climb in growth assets towards the end of last year as the markets began to anticipate and price in the good news.

Notwithstanding the positive reaction from investment markets, the economic outlook remains challenging and this is likely to put pressure on future investment returns on Fund assets and to the extent the returns are not achieved in the future, on employer contributions. This comes at a time where some employers will be facing significant financial challenges as the extended Furlough arrangements unwind.

Ongoing monitoring of funding and covenant for “at risk” employers therefore continues to be a fundamental part of a robust risk management framework. The effects of Covid-19 potentially places more employers into the “at risk” group. Our PFaroe tool is available to provide you with easy access to daily funding information at your fingertips. We recommend a proportionate approach to monitoring however, as we recognise that budgets will be challenging. Therefore it will be important to target spend where the quantum of risk exposure is greatest. Your usual Mercer consultant will be well placed to guide you on what this means for your Fund.

THE CONTINUING IMPACT OF THE COVID-19 OUTBREAK

Extension of the furlough scheme

Due to the new lockdown in England, the Chancellor has extended the furlough scheme until 30 April 2021.

The Chancellor also announced that business in the hospitality, leisure and retail sectors are to receive a one-off grant worth up to £9,000 to support businesses and protect jobs.

Interim Reviews

Given the increased financial pressures likely to be faced by many employers, funds should plan ahead for the 2022 valuation with a view to being able to provide an early warning to employers where there is a potential for contributions to increase.

An interim check on funding and strategy can help funds to provide a more informed picture to employers of the likely direction of travel for the next valuation. This is an area on which we are supporting funds along with probabilistic analysis of the potential range of funding outcomes and risk.

Please get in touch with your usual Mercer consultant if this is something you would like to consider further.

The Pensions Regulator's updated COVID-19 guidance

A review of TPR's COVID-19 related easements was due in September 2020, and TPR announced updates to its COVID-19 guidance on 16 September.

In its updated guidance, TPR notes that the Code sets out other specified circumstances, for example fraud or persistent process failures, in which late contributions would be viewed as material and should be reported to TPR; funds are still expected to report such cases as soon as possible, regardless of the 90 or 150 day timeframe.

Regulatory round up

THE MCCLOUD REMEDY

As you will be aware, on 16 July MHCLG released the much anticipated consultation on the McCloud remedy for the LGPS in England and Wales (here). This article provides a high level summary of recent developments.

To recap, the Court of Appeal's ruling in December 2018 confirmed that the transitional protections provided for members of the Judges' and Firefighters' pension schemes when the public sector pension reforms were implemented in 2014 and 2015, were age discriminatory. This was because eligibility for these protections was based on an age criterion. Similarly, age-restricted transitional protections were also provided across the other public service pension schemes and last year the government announced that it would seek to remedy the position, including for the LGPS. In the LGPS the protections took the form of a final salary underpin to the new CARE benefit structure implemented in 2014.

- In October 2020, SAB published its response (here) to the consultation on the McCloud remedy for the LGPS.
- The Government Actuary's Department ("GAD") have worked with the Northern Ireland Department of Justice by developing its response to the McCloud judgment, and provided wider pensions consultancy advice.
- Further clarity on the timing for the final MHCLG regulations is expected shortly. Statutory guidance is expected to be provided alongside the regulations, to cover issues such as Fund priorities in implementing the remedy.

HM Treasury directions regarding the 2016 COST CAP MECHANISM are now anticipated for early spring 2021. As reported in previous Current Issues, this will **include** the cost of the McCloud remedy in the assessment of the impact on member benefits.

CONTRIBUTION FLEXIBILITIES

Amending regulations came into force with effect from 23 September 2020 which provide the ability for Administrating Authorities to review Employer contributions between valuations under defined circumstances. In addition these regulations introduced a new "deferred" employer status for Employers who have entered into a formal agreement (a "Deferred Debt Agreement") with the Administering Authority and formalised the ability to spread a termination payment over a short period after they have formally exited the Fund.

There are a number of requirements to be adhered to before a Fund can carry out an interim contribution review or offer flexibility to an employer approaching termination. One of these is that the Fund must have set out its policy on its approach within the Funding Strategy Statement.

MHCLG has prepared statutory guidance to funds on the expected content of the policy and this is expected to be published very shortly. In addition, SAB has prepared a more general Q&A style guide to employers and administering authorities regarding operating the flexibilities in practice. The guide is expected to be finalised shortly and issued alongside the statutory guidance.

Central to the policy in both instances will be the assessment and monitoring of employer covenant, which will be key to the decision making process. Monitoring of the funding position will also be very important including consideration of an employer's termination liabilities and how this exposure changes relative to the underlying employer covenant.

Where Mercer is your Fund Actuary, we will be in touch shortly to provide support on the formulation of the Fund's policy, although this has already commenced for many funds.

£95K CAP UPDATE

Dovetailing with Halloween and a Full Moon, funds will be all too aware that in autumn last year the proposed HMT Restriction on Exit Payment Regulations, which would introduce the £95K exit cap, were accelerated and came into force on 4 November 2020. Crucially, however, changes to the LGPS regulations required in order to operate the HMT exit cap regulations, have not yet been made. This created a conflict in respect of members over age 55 who breached the £95K exit cap on redundancy because:

- The prevailing LGPS regulations require funds to pay members a full unreduced pension;
- The newly introduced HMT Restriction on Exit Payment Regulations prevent an employer from paying a benefit package on redundancy that exceeds £95K, including in England and Wales, the pension strain cost of the unreduced pension.

SO WHERE ARE WE NOW?

- **SAB, MHCLG and HMT information and guidance** for funds and Employers has been issued (SAB updates, MHCLG letter, MHCLG Guide, HMT Guidance). This provides guidance on a low risk approach to navigating the current conflicting regulations, until the new LGPS regulations are in force. From a Fund perspective this involves not putting the unreduced pension into payment for an employee who breaches the £95K exit cap and instead offering the member a fully reduced or a deferred pension. This is contrary to the prevailing LGPS regulations in respect of members over age 55 and the Ombudsman has asked that funds be clear in communications with members when a policy decision has been made to not pay the full unreduced pension, this approach is in line with guidance received.
- **Current pension strain factors** should now have been reviewed by funds. This is because whilst previously, strain factors were used only to calculate the funding cost an employer had to pay when an unreduced pension was paid early, this costing now also forms part of the calculation of whether or not a person will be capped (where the employer is subject to the £95K cap regulations). This means that the pension strain cost factors will determine actual benefits a member can receive. Where we are your actuarial advisers, we have provided advice on strain factors and made recommendations on the approach. It is expected that the new LGPS regulations, once in force, will require the use of overarching factors, prepared by the GAD.
- **Legal Challenge** - there will be a Judicial Review of the legitimacy of the accelerated HMT Cap Regulations, which is expected towards the end of March.
- **Ombudsman rulings** relating to the exit cap (specifically the non-payment of immediate unreduced pension) will be paused whilst the Judicial Review is ongoing, although funds should not discourage members from approaching the Ombudsman where the IDRP has ran its course.
- **MHCLG proposals for wider reforms of redundancy pay and additional member options** were consulted on during the latter part of 2020 and we reported on this is the last edition of Current Issues. The consultation period for the draft regulations is now over, however funds and employers should not anticipate these reforms in redundancy calculations as the timing of implementation and the detailed proposals have not yet be confirmed. This is not expected until *after* the outcome of the Judicial Review referred to above, is known.

How Mercer can support funds

We anticipate that many funds will have already experienced high demand for pension strain costs calculations from employers who are implementing structural changes. However many other employers may have pressed pause on making these requests, in the hope that there would be further clarity on the position in the New Year. As it is now clear that there will not be a solution before 31 March, it’s likely that funds see an increased volume of requests from employers no longer able to defer.

To the extent that funds require support in this area, we are able to provide a tool for processing these strain cost calculations. Speak to your Mercer representative for further information on this.

And in other news...

GOVERNMENT RESPONDS TO RPI REFORM CONSULTATION

In March 2020, the Government and UK Statistics Authority issued a consultation on reforming the Retail Prices Index (RPI). On 25 November 2020, the Government responded to the consultation, confirming that RPI will increase in line with CPIH from 2030. The construction of CPIH (the Consumer Prices Index, or CPI, plus housing costs) generally gives lower inflation figures than RPI, so this means RPI inflation will be lower from 2030 than it would otherwise have been.

Impact on assets

In the immediate aftermath of the Government's response to the consultation, we have seen small movements in real gilt prices relative to nominal gilts, suggesting this outcome was largely (but not completely) priced in to the market before the announcement. Such movements will be reflected in a fund's, RPI-linked assets. Over the past two years, uncertainty over the future of the RPI resulted in fewer index-linked gilts being issued by the UK Debt Management Office. With fewer issues, this has arguably has led to excess demand in the market, resulting in Liability Driven Investment (LDI) demand "bidding up" gilt inflation. The Government announcement means there could be a greater index-linked gilt supply from early 2021. Combined with the fact that CPI liabilities will have a better matching asset, our view is that inflation hedging is likely to be more cost-effective in future.

Impact on funding and accounting positions

In addition to the impact on Fund assets described above, there is also a potential impact on the valuation of Fund liabilities even though Fund benefits increase in line with *CPI* rather than *RPI*.   This is because market pricing of RPI is used as a reference point to determine appropriate assumptions for the valuation of CPI linked benefits. Therefore given the change in RPI from 2030 this triggers a review of the methodology used to derive the assumption for valuing CPI benefits also.

BREXIT AND PENSIONS

The UK left the EU on 31 January 2020, entering an 11 month transition period during which our relationship with Europe has been largely "business as usual".

From 1 January 2021, however, the UK has entered a new stage following the deal reached at the end of last year although there remains a number of aspects still to be worked through. TPR has periodically updated its guidance for funds and you can access the latest guidance here.

Investment risk and funding

Brexit gives rise to fears of investment volatility, but in reality it is just one part of a much broader risk landscape; COVID-19 has demonstrated this all too clearly in 2020. TPR's guidance stresses that Brexit-related risk, while real, is a short term issue, and funds need to focus on their long term investment plan and integrated risk management strategy.

Employer covenant

The effect of Brexit on employer covenant may be significant for some employers, for example universities, but it will play out differently depending on the specific circumstances. A robust employer covenant framework should help funds to identify which employers are most at risk from current challenges, including (but not limited to) the impact of Brexit.

Administration

Funds will need to consider what changes are needed in respect of any overseas transfer requests, given the continued uncertainties for many aspects of the Brexit deal that remain outstanding, particularly in respect of financial markets. EEA based receiving schemes may have changed their position on receiving transfers after 31 December, and there is uncertainty over the UK tax position on transfers to Gibraltar schemes after this date.

Some banks have withdrawn UK accounts from EEA resident clients, meaning some EEA based pensioners will have to put alternative arrangements in place for their pension payments. While this is largely a matter for individual members, funds should consider how to handle communications with members who may be affected.

Data protection

The UK's data protection (GDPR) legislation, which reflects the EU directive, currently remains in force. However, where data is sent between the EEA and the UK, current rules may change. It is hoped that the EU will recognise the UK for data protection purposes under "adequacy" provisions, but this is not yet certain. If adequacy status is not granted, receiving data from the EEA is likely to be a particular issue. The UK's data authority, the ICO, has issued guidance on data and Brexit.

CHANGE TO CMI_2020 MORTALITY PROJECTIONS MODEL CONFIRMED

The Institute and Faculty of Actuaries' Continuous Mortality Investigation (CMI) has responded to its consultation on changes to the CMI_2020 version of its model for projecting future improvements in mortality. It has confirmed that, in the core version of the model, no weight will be placed on mortality data for 2020 to avoid the exceptional mortality rates in 2020 from, potentially, distorting the results. However, users who wish to take some account of 2020 rates in the projections will be able to adjust the amount of weight placed on the 2020 data. The other proposed change to the age range used to calibrate the model will not be going ahead.

The change means that moving from the core version of CMI_2019 to the core version of CMI_2020 is likely to result in small reductions in projected life expectancies. The overall impact for any particular scheme of adopting CMI_2020 will depend on a number of factors including the age and sex distribution of the Fund, the particular parameters selected and the current assumption for future mortality improvements.

The CMI_2020 version of the model is due to be published in March 2021 and we will also be considering the impact of this and the COVID-19 outbreak in advance of 2022 valuations.

THE PENSION SCHEMES BILL 2019/21

The Bill has now completed its progress through the House of Commons and will now go back to the House of Lords for final consideration before receiving Royal Assent, which is expected to be by the end of the year.

The Pension Schemes Bill was introduced in 2019 and one of the key aims of Government was to protect members' benefits in DB schemes, largely through enhanced powers for the Pensions Regulator (TPR) and a more prescriptive statutory scheme funding regime. However, the Bill covers a wide range of provisions including:

- **Pensions Dashboards** - the Bill introduces a framework for pension's dashboards, including provisions for state, occupational, personal and stakeholder pension schemes to provide information for qualifying pension's dashboards or any dashboard provided by the Money and Pensions Service.

- **Climate change disclosures for pension schemes** - the Bill was amended to include additional requirements intended to ensure funds have effective governance in relation to climate change risks. It sets out a framework within which funds should consider and disclose the risks. The requirements are expected to apply initially to larger employers.

Looking ahead
Once the Bill is enacted, secondary legislation will be required for most of its provisions. We anticipate further consultations on regulations over the coming year, and some provisions will also need Codes and/or guidance from TPR to be updated in order to fully implement them.

2020 GAD DATA REQUEST

Funds in England and Wales should have submitted the data to GAD as at 31 March 2020 by 23 November 2020.

The outcomes are expected later in the year.

LLOYDS BANKING GROUP JUDGMENT ON GMP EQUALISATION

Following the original Lloyds Banking Group judgment in October 2018, there was a further High Court ruling on 20 November 2020. This provided clarification on the obligations of the Lloyds Banking Group to equalise past transfer values to allow for the effects of Guaranteed Minimum Pensions accrued between 17 May 1990 and 5 April 1997 ("GMP equalisation").

The impact of the ruling in the LGPS is expected to be muted however the position is currently under further consideration with Treasury and we will provide an update on developments in a future edition of Current Issues.

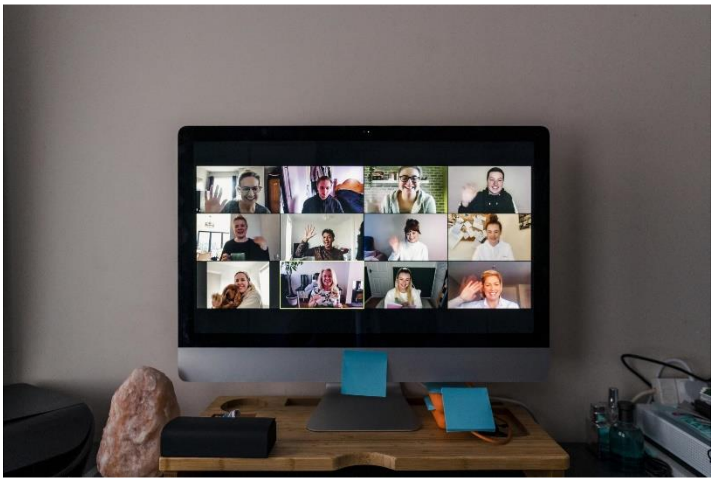
Notwithstanding the potentially muted impact for LGPS of this ruling, it is expected to be on auditors' radar and therefore Funds and Employers may see this raised as part of the audit process. We will provide a comment on this in our standard information we share alongside the accounting information which will aim to address auditor queries that may be raised.

PENSION SCAMS

One of the consequences of COVID-19 outbreak has unfortunately been an increased prevalence of pension scams. At a time when individuals are concerned about their financial and physical health, they are more likely to fall victim to scammers who are experts at targeting the most vulnerable.

Over £30 million has been reportedly lost to pension scammers since 2017. Anecdotally, public sector pension scams seem to be the larger end of the scale.

Although it is an extremely busy time for funds, thought should be given as to how members can be better protected to reduce the risk of pension scams. In particular whether access to a "vetted" firm or panel of firms which provide IFA advice (at the member's cost) could support this and also protect funds from potential future claims.



Dates to remember

DATE	ISSUE	THE LATEST
31 March 2020	2020 Actuarial Valuation	The effective date of the Scottish LGPS actuarial valuations.
6 April 2020	Change in the lifetime Allowance (LTA)	The LTA for 2020/21 is increased from £1,055,000 to £1,073,000 in line with CPI increases.
6 April 2020	Change in tapered Annual Allowance (TAA)	The TAA is to increase so it only applies to individuals with "adjusted income" of over £240,000. The minimum TAA changes from £10,000 to £4,000.
21 July 2020	Call for evidence on pension tax administration for low earners (closed October 2020)	The Treasury has launched a call for evidence concerning the different outcomes for lower earners depending on whether their pension schemes use the relief at source or net pay method of tax relief.
From 10 December 2020	Competition and Markets Authority (CMA) legally binding Order	Investment management firms, investment consultancies and fiduciary management providers) subject to the CMA Order must submit a compliance statement to the CMA within 12 months and 4 weeks of the date when the Order first applied, confirming they have complied with their obligations under the Order.
Expected March 2021	Judicial Review of Exit Cap Regulations	Court date yet to be confirmed but the Judicial Review is expected to proceed during the second half of March 2021.
Expected after Q1 2021	Governance and Registration draft regulations	Regulations that will replace some of the measures in the Competition and Markets Authority (CMA) Order were expected to come into force from 6 April 2020 and have been delayed due to COVID-19. Until such time as they are implemented, the CMA Order will continue to be legally-binding.
2030	RPI to increase in line with CPIH	The Government's consultation response in November 2020 confirmed that RPI will increase in line with CPIH from 2030.

Meet the team

Name: Eleanor Dowling
Role: Pensions Lawyer
Joined Mercer: 21st April 1997 – I moved from Scotland to start work at Mercer in London.
Place of Birth: Glasgow
Favourite series: The first series of True Blood (it deteriorated after that); also Borgen, which was a drama all about the Danish parliament - but was much more interesting than that sounds!
What was your favourite Christmas gift?: A Lindt chocolate bear that I nabbed from my nine year old's huge haul.
Favourite take away: I'm not keen on takeaways… I bought my husband the new Ottolenghi cookbook for Christmas.
What are your New Year resolutions?: Get (much) better at yoga, learn to drive, and get my son enthused about cycling.

Name: Barbara Forbes
Role: Title has changed a few times, if not the role. Used to be "admissions, bonds and terminations calculations workflow manager". Try fitting that on a name badge.
Joined Mercer: 3 September 1990. Seems like decades ago. Oh wait…
Place of Birth: Lancashire
Favourite series: "Grace and Frankie" (I want their beach house), Schitts Creek (I want Moira's wigs) and House of Cards USA (I want Frank's cufflinks)
What was your favourite Christmas gift?: Getting to shoot my son's favourite Christmas gift – an air rifle – at a fixed target I hasten to add…
Favourite take away: I don't really do take away. I do slow cooker. As in slow cooked skirt beef in beer with button onions and mushrooms. Etc.
What are your New Year resolutions?: To get out more. Wish me luck.

Name: Clive Lewis
Role: Principal
Joined Mercer: When the FTSE all share index was at 2,990…
Place of Birth: Liverpool
Favourite series: Impractical Jokers
What was your favourite Christmas gift?: I only get socks but my 8 year old's RC car is pretty "sick"
Favourite take away: Can't beat a Chinese takeaway
What are your New Year resolutions?: Everything in moderation…

Contacts

Paul Middleman
paul.middleman@mercer.com
0151 242 7402

Steve Turner
steve.j.turner@mercer.com
01483 777035

Kieran Harkin
kieran.harkin@mercer.com
0161 957 8016

Nick Buckland
nick.buckland@mercer.com
020 7528 4188

Susan Greenwood
susan.greenwood@mercer.com
0151 242 7220

Michelle Doman
michelle.doman@mercer.com
0161 837 6643

Chris Scott
chris.scott@mercer.com
028 9055 6207

Leanne Johnston
leanne.johnston@mercer.com
0161 837 6649

Nigel Thomas
nigel.thomas@mercer.com
0151 242 7309

Peter Gent
peter.gent1@mercer.com
0151 242 7050

Clive Lewis
clive.lewis@mercer.com
0151 242 7297

Karen Scott
karen.scott@mercer.com
07584 187645

Jonathan Perera
jonathan.perera@mercer.com
0151 242 7434