Mercer

LGPS CURRENT ISSUES

27 May 2021

welcome to brighter

In this edition

We hope you have been keeping well and staying safe over the past few months. With the unlocking of the UK now in full swing, we trust you have been able to enjoy more time with family and venture out for a meal or drink, or have this to look forward to in the near future.

As we progress further into 2021, this edition of Mercer Current issues updates you on the recent developments on ongoing national issues and legislation that impact the LGPS and also what is to be expected over the next few months.

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Regulatory round up

THE MCCLOUD REMEDY

On 13 May 2021, a Written Ministerial Statement was published which outlines the Government's intentions in applying the remedy that is required to the Local Government Pension Scheme in England and Wales following the McCloud judgment. This confirmed that it is the Government's intention that Regulations providing for the "McCloud remedy" are expected to come into force from 1 April 2023.

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. On 16 July 2020, MHCLG released the much anticipated consultation on the McCloud remedy for the LGPS in England and Wales (here). The consultation closed on 8 October 2020 and a response to the consultation is expected later this year.

The key points from the Statement, which were in line with expectations, were:

Scheme regulations giving effect to the above changes will be retrospective to 1st April 2014.

Underpin protection will apply to LGPS members who were active in the scheme on 31st March 2012 and had membership of the career average scheme without a continuous break in service of more than five years.

The period of protection will apply from 1st April 2014 to 31st March 2022 but will cease the earlier of where a member leaves active membership or reaches their final salary scheme normal retirement age (normally 65) before 31st March 2022.

Where a member stays in active membership beyond 31st March 2022, the comparison of their benefits will be based on their final salary when they leave the LGPS, or when they reach their final salary scheme normal retirement age, if earlier.

EMPLOYER CONTRIBUTION FLEXIBILITIES

Following the new regulations introduced in September 2020, at the beginning of March, the MHCLG published its statutory guidance on the content of the Funding Strategy Statement where administering authorities decide to adopt the “employer contribution flexibilities”. To re-cap, these are the new powers available to administering authorities to review employer contributions between valuations and provide more flexible termination strategies. Alongside the statutory guidance, the Scheme Advisory Board published its Guide to Employers and Administering Authorities on how to operate the employer contribution flexibilities in practice.

The new Regulations allow Funds to review contributions between valuations under prescribed circumstances. In addition, for employers who wish to curtail the build-up of future benefit accrual but cannot afford the termination payment, a new option of “deferred employer status” can be made available. Although a discretion, Funds are actively encouraged by SAB to adopt the employer contribution flexibilities. SAB also encourages employers to ask Funds to clearly state their reasons for not adopting the flexibilities, if this is the case.

The contribution flexibilities are more than “just” a lifeline to struggling employers, albeit that could be an important consequence in some cases. In our view, the flexibilities provide additional armoury to Funds in their risk management toolkit. Allowing contributions to flex to meet changing covenant or liabilities provides an opportunity to collect more upfront cash (where covenant has improved or liabilities have increased) or alternatively improve security/the likelihood of future recovery, where covenant has deteriorated. Alongside implementation of the new flexibilities, it will be key to ensure that your covenant monitoring framework remains fit for purpose in this new world. Please speak to your usual Mercer consultant if you would like further support in this area.

THE RETURN OF THE EXIT CAP

We understand that Councils have recently been asked to provide information on historic redundancy costs over the past 5 years. This information will then be considered as part of the Government's review of the cap on exit payments and it is our understanding that it remains a key policy objective to reintroduce a limit on exit payments as soon as possible. Although it may prove to be too ambitious to implement a new cap this year, we expect to see more details in the months ahead on the form this will take and the timeline.

Where we provide actuarial advice to Funds, Early Retirement Strain cost factors were considered last autumn as part of the introduction of the (now revoked) £95k Exit Cap. At that time, an interim measure was put in place pending the expected introduction of standardised GAD factors across all Funds. Given the uncertainty on the timing for the introduction of the new exit cap (and whether or not this will incorporate standardised GAD Early Retirement Strain cost factors), we have reviewed the Strain Cost Factors and will be writing out to Funds shortly to confirm next steps.

COST MANAGEMENT

The 2016 cost management process is now in full swing, following the pause in 2019 due to the uncertainties associated with the McCloud judgment and impact for LGPS. The key question now under consideration relates to whether (and if so, how) the cost of the McCloud remedy will be taken into account. HMT has already confirmed that the McCloud remedy will be taken into account in its process (further details here), although "how" is yet to be confirmed. The first question of "whether to allow for McCloud" remains under discussion with the SAB and further news is expected during the summer.

If the McCloud remedy is included in the SAB cost management mechanism, it then depends crucially on how the costs will be spread within the process as to whether or not benefit improvements are triggered. The practicalities of retrospective benefit improvements (at a time when there are already significant administration resourcing challenges due to the implementation of the McCloud remedy) will be an important consideration if any changes are put forwards.

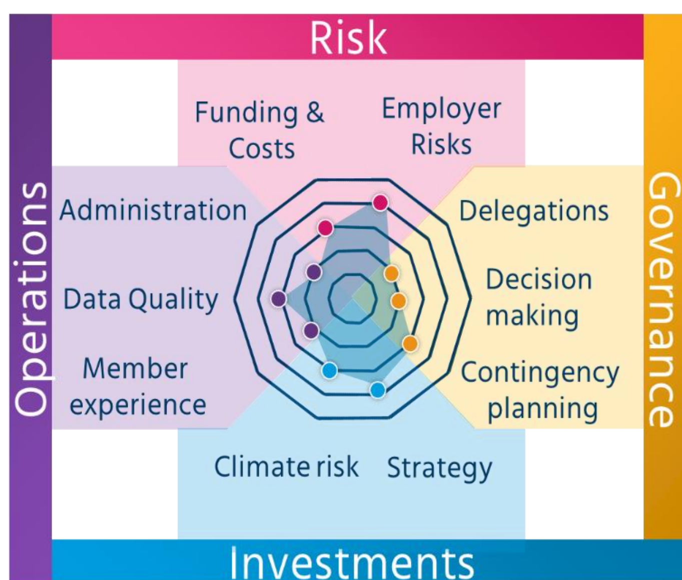
In relation to the unfunded schemes, HMT has confirmed that where the inclusion of McCloud remedy costs leads to a breach of a cost cap, thereby potentially triggering a benefit reduction, a reduction to benefits will not be applied. Once HMT has completed its 2016 cost control process, the mechanism will be reviewed ahead of the 2020 exercise being commenced.

Governance under the Spotlight

The governance requirements for pension schemes, both in the Public and Private Sectors are changing with the Pensions Regulator (tPR) currently consulting on its plans to move to a Single Modular Code and with recommendations from the Good Governance Project in the LGPS having been released in the first quarter of 2021. Since 2019, there is a regulatory requirement for '*trustees* to have an effective system of governance proportionate to the size, nature and complexity of the scheme and to carry out and document an own risk assessment'. One of the recommendations from **the Good Governance Project** for the LGPS was to require a biennial independent governance review, and this approach is completely consistent with the private sector.

In anticipation of the increasingly onerous requirements on the horizon and recognising the added value a strong system of governance can bring, Mercer has launched a solution to support Funds in adapting to the changing landscape.

Forsensic integrated risk management ("firm")



FIRM is an independent, peer-reviewed assessment of the top 10 high-level aspects influencing a LGPS Fund's operation and compliance, including; Risk, Governance, Investments and Operations,

Studying up to 200 data points, FIRM drills down into the underlying factors that contribute to each of the aspects administering authorities need to manage.

FIRM draws on 200 years' experience of Mercer's Subject Matter Experts who have developed the solution. These include its investment and covenant consultants, LGPS Actuaries, administrators, and technical experts in each of the key areas administering authorities rely on.

We believe this offering will be a valuable benefit for all defined benefit (DB) schemes, including the LGPS. We have built on the work undertaken to date to adapt the FIRM assessment for a low cost high value assessment for the LGPS. If you would like to hear more about this, please contact your Mercer consultant.

Climate Change

ESG in the spotlight

In November, the Chancellor announced that the UK would issue its first Sovereign Green Bond in 2021. Over time, a “green gilt curve” will be built out, with the money raised from new issues helping to fund projects that provide positive environmental benefits. So far, sixteen governments have issued sovereign green bonds, with total issuance of $80 billion and, with over $52 trillion of outstanding debt globally, over the coming years there is considerable scope for growth in this market.

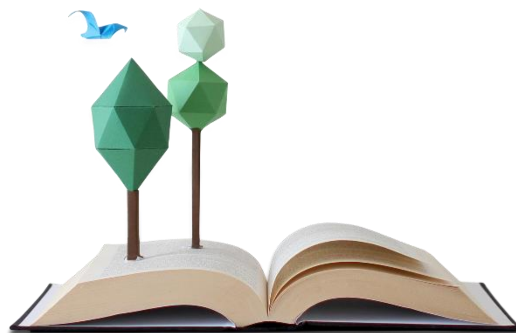
What is a Green Gilt?

A green corporate bond is defined in the EU as one where the proceeds raised are directed to sustainable development projects. However, green gilts may not follow the exact same premise. Evidence from other countries and a statement from Debt Management Office’s Chief Executive Sir Robert Stheeman, suggests that strict ring fencing of monies raised from green gilts is unlikely. Instead, it is likely that issuance will be linked to budget expenditure that contributes towards achieving environmental and climate objectives. The Swedish Government raised $3.2 billion using this approach in its inaugural 10-year bond in September 2020.

Green gilts may thus be viewed as a first step in raising finance towards UK sustainable initiatives, helping the UK to meet its goal of achieving net zero carbon emissions by 2050. They should also be a catalyst for directing a greater proportion of expenditure towards such initiatives and to the adoption of broader measures of the benefits from these initiatives.

Why would pension funds be interested?

Issuance of green gilts follows a long campaign by investors and UK fund managers, to meet investors' appetite for investments that will help them reduce their carbon footprint and meet the requirements of the Taskforce on Climate related Financial Disclosures (TCFD).



In general, green (corporate) bonds have traded at yields below those of their standard counterparts at issuance, perhaps partly due to demand, but also because their nature – deriving their yields from sustainable investment –might make them less likely to default. It is too early to say whether green gilts may come at a premium (lower yield) or a discount (higher yield) and the already strong demand for longer dated gilts is likely to cloud the picture, but it is possible that green gilts may be issued at a premium. However, that does not necessarily mean that green gilts are not worthy of consideration for those investors with wider commitment to building an ESG focused fixed income portfolio. Further, the Chancellor's announcement is an important first step in developing a green gilt market for the UK; a market that will certainly evolve once it has found its feet.

Pensions Scheme Act

The Government responded to the August 2020 consultation on its climate change policy proposals on 27 January 2021. With the response, it opened a further consultation on draft statutory guidance and draft regulations under the Pension Schemes Act 2021, as well as issuing final non-statutory guidance from the Pensions Climate Risk Industry Group (PCRIG). TPR has also launched its own climate strategy.

The draft regulations being consulted on propose that the first schemes to be impacted by the climate change sections of the Act will be schemes with more than £5bn of assets on the first scheme year-end on or after 1 March. These schemes will need to comply with new climate governance requirements from 1 October 2021 and issue a Taskforce on Climate related Financial Disclosures (TCFD) compliant report on how they have addressed climate risks within 7 months of the end of the scheme year in progress at 1 October 2021.

TCFD and the LGPS: are you ready?

"The UK is set to be the first major economy to require climate risk to be specifically considered and then reported on by pension schemes", says Guy Opperman, Minister for Pensions and Financial Inclusion 2021.

The measures announced by the Minister will require schemes to assess and report on the financial risks of climate change within their portfolios, in line with the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.

It is widely believed that in the near future similar regulatory requirements will be implemented within the Local Government Pension Scheme (LGPS). Mercer is fully supportive of early adoption of the framework and believe that now is the time for LGPS Funds to start planning for TCFD reporting. We have therefore prepared a checklist against each of the TCFD requirements to provide a high level understanding of what Funds will need to do to meet TCFD requirements.

And in other news…

GMP Indexation

Following HM Treasury's 2020 consultation on future GMP indexation, it has been confirmed that HMT will not be adopting a "GMP conversion" approach for the LGPS. Instead the current indexation provisions will be extended to cover those members of public service pension schemes reaching State Pension age from 6 April 2021. Further details are available here.

Pension Scheme's Bill

On 11th February 2021, the Pension Scheme's Bill received royal assent and became the Pension Schemes Act 2021.

In addition to tough new powers for TPR, it also paves the way for pension dashboards, Collective Defined Contribution schemes and climate risk reporting (as covered above).

Face-to-face meetings

As you may already be aware, the appeal against Councils to meet face-to-face after 7 May 2021 was denied. The published judgment confirms that Councils are required to hold meetings in person.

On 25 March, Luke Hall MP (Minister for Regional Growth and Local Government) set out rules and guidance and stated examples of actions and next steps to alleviate the potential risks of meeting in person. He has also launched a call for evidence on the use of the virtual meeting arrangements and to gather views on the question of whether there should be permanent arrangements and if so, for which meetings.

Section 13

Every three years, the Government Actuary is required to undertake report under section 13 of the Public Service Pensions Act 2013 in connection with the actuarial valuations of the 91 funds in the LGPS. The purpose of the report is to consider whether the following aims are achieved:

- Compliance;
- Consistency;
- Solvency; and
- Long term cost efficiency.

Over the last few months, GAD has been reviewing the data provided following the 2019 valuations and carried out analysis to determine the extent to which the above aims are considered to have been met. GAD has also had calls with any Funds that have triggered under their assessment criterion to further understand the position. Where we are your actuary we have carried out a preliminary review of the information as set out in GAD's draft summaries and used in their analysis. These have been shared with you for further comment.

Based on our discussions with GAD it appears as though very few Funds have triggered under GAD's criterion and funding levels have generally improved. Key areas that have generated a request for further discussion have been in relation to alternative financing methods to support the deficit recovery plan, the use of minimum spread periods where

these would otherwise be very short (and in our view lead to increased cost volatility) and phasing of contributions beyond the period of the rates and adjustments certificate.

The final report is expected to be published within the next couple of months.

2020 Scheme Annual Report

The eighth Annual Report for the Local Government Pension Scheme (LGPS) in England and Wales was published and outlines the key highlights in the LGPS over 2020.

BT, M&S and Ford challenge the RPI formula

As you will already be aware, in November 2020 the government announced that it would not prevent the UKSA from implementing its proposal to calculate the Retail Prices Index (RPI) using the data and methodology underlying the Consumer Prices Index with Housing (CPIH). Parties affected by the decision were given three months to object, by way of a judicial review, to its decision. Three schemes (the BT, Ford and M&S pension schemes) filed their objection with the Courts on 9 April, having been given an extension to the original 24 February 2021 deadline. The Government and UKSA have 21 days from receipt of the submission to reply to the challenge and then the Court will decide if there is a case to consider.

The reasons for the review are the potential effects on pension benefits and on the value of index-linked assets.

New GAD guidance published

On 11 May MHCLG issued new actuarial guidance covering:

- Annual allowance charges
- Conversion of AVCs to transfer credits
- Purchase of additional pension
- Application of a pension credit
- Purchase of additional survivor benefits
- Conversion of lump sum into pension
- Early payment of pension; and
- Late retirement

The guidance has been updated to reflect changes in LGPS and wider pensions legislation, but it does not include new factors. The guidance, covering letter and the spreadsheet of current factors are available here.

And last but not least...remember the New Fair Deal and 4 year valuation cycle proposals?

"New fair deal" - the provision of guaranteed LGPS access for employees whose employment is outsourced from a "Fair Deal" employer. The option of the new employer establishing a "broadly comparable" scheme as an alternative will in effect become redundant.

"4 year valuation cycle" – the new employer contribution flexibilities implements the proposals partially (see article on page 4 for further details). The other aspects of the

proposals relate to the extension of the valuation cycle from 3 years to 4 years and removing the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer membership of the LGPS to their non-teaching staff for new entrants.

Through our national discussions we understand that these proposals remain on the agenda but the need to prioritise the swathe of urgent issues arising due to COVID-19, they have necessarily been pushed back. We may expect to hear further on these next year.

Dates to remember

Date	Issue	The latest
11 February 2021	Consultation on normal minimum pension age (NMPA)	The government has reconfirmed the normal minimum pension age is to rise from 55 to 57 from 6 April 2028. It is consulting on the details of implementing the increase, including rules around protecting those individuals with an existing (unconditional) right to retire before age 57. The consultation closed on 22 April 2021.
3 March 2021	Budget Day announcement on freezing of lifetime allowance	The Lifetime Allowance will be frozen at its current rate of £1,073,100 until the 2025/26 tax year, rather than rising in line with CPI increases as scheduled.
17 March 2021	Consultation on single code of practice	This first phase initially consolidates 10 of the existing codes of practice into one web-based code consisting of 51 topic-focused modules. The new code also addresses the new governance requirements arising from IORP II.
Expected Q2/Q3	Consultation on scams	Consultation is expected on draft regulations (under the Pension Schemes Act 2021) covering scams. Commencement of the scams measures (relating to transfer restrictions) is expected in early Autumn.
Expected Q3/Q4	Consultation on pensions dashboard	The government aims to consult on proposed regulations for the dashboard later this year and lay draft regulations before Parliament for debate in 2022. Delivery of the dashboard is still projected to be in 2023.
30 September 2021	Extended Coronavirus Job Retention Scheme due to end	The Coronavirus Job Retention Scheme (CJRS), which was due to end on 30 April, has been extended across the UK until the end of September 2021. From July, employers will have to pay 10% toward hours not worked, increasing to 20% for August and September.
Expected first half of 2022 (initially expected 6 April 2020 but now delayed)	Governance and Registration draft regulations	Regulations that will replace some of the measures in the Competition and Markets Authority (CMA) Order have been delayed. Until they are implemented, the CMA Order will continue to be legally binding.
1 April 2023	McCloud remedy regulations	It is the Government's intention that regulations providing for the "McCloud remedy" come into force from 1 April 2023.
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: Ciaran Shanahan
Role: Wealth Analyst
Joined Mercer: September 2015 (time flies when you are having fun…)
Place of Birth: Northampton
Favourite film: Home Alone
What will be the first restaurant you visit now restrictions have eased?: Gusto on the Albert Docks in Liverpool
Do you have any holidays booked for the summer?: Conwy, Wales

Name: Laura Evans
Role: LGPS Actuary
Joined Mercer: Depends on whether you count from the first time I joined (September 2001) or the second (January 2006) ☺
Place of Birth: Oxford Street Maternity Hospital, Liverpool (now student flats – I actually lived there for my second year of Uni)
Favourite film: Star Wars: The Empire Strikes Back (Episode IV)
What will be the first restaurant you visit now restrictions have eased?: Booked in for dinner, bed and breakfast at The Punch Bowl Inn, Crosthwaite (I am very excited!)
Do you have any holidays booked for the summer?: So far only booked a few nights away in the UK in August. Keeping fingers crossed for a nice warm summer.

Name: Paul Clare
Role: Actuary
Joined Mercer: 2010
Place of Birth: Ormskirk, Lancashire (apparently this means I am not a true Scouser…)
Favourite film: Forrest Gump
What will be the first restaurant you visit now restrictions have eased?: You can't beat a good Greek…
Do you have any holidays booked for the summer?: Not yet!

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

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

Lucy Tusa
lucy.tusa@mercer.com
020 7178 6941

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

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