Mercer

LGPS CURRENT ISSUES

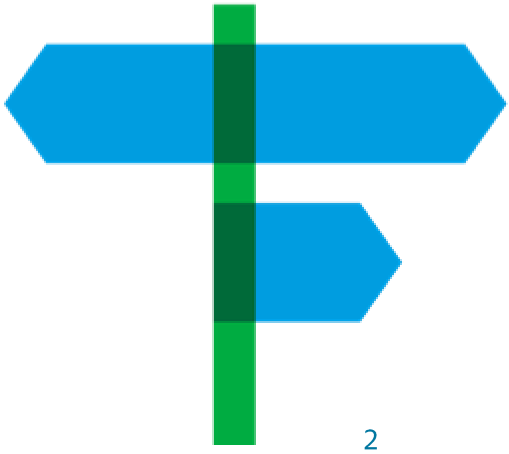
August 2021

welcome to brighter

In this edition

We hope you have been keeping well and staying safe over the summer as restrictions have been lifted all around the UK. With the unlocking of the UK, we trust you have been able to enjoy more time with friends and family and maybe even a staycation, or have this to look forward to in the near future.

In this edition of Mercer Current issues, we provide a focus on climate change, in addition updates on the recent developments and what is to be expected over the next few months.



Regulatory round up

EXIT CREDITS JUDGMENT

On 27 May 2021, a High Court judgment on exit credits found in favour of MHCLG and upheld the retrospective effect of the LGPS (Amendment) Regulations 2020. The case related to the non-payment of a £6.5 million exit credit. The judge noted that 'there were compelling public interest reasons for making the regulations retroactive' and that 'the aim of avoiding windfall payments and protecting the pension funds was legitimate'. The judgment included clarification over how this discretion may be applied and will set a precedent for other cases. The full judgment in relation to this case can be found online. Funds should review the wording in their Funding Strategy Statement regarding the exercise of the discretion to pay an exit credit in light of this judgment. Please get in touch with your usual Mercer consultant if you have any concerns in this area.

PUBLIC SECTOR EXIT PAYMENTS

On 2nd July 2021, MHCLG published a summary on exit payment data for 2019/20 and 2020/21. We expect a further publication by the MHCLG to follow shortly. The summary published outlines that the exit payment paid in 2020/21 averaged at around £26,000 across local authorities (including the pension strain). We anticipate this data will be considered as part of the wider review of the cap on exit payments and more on this is expected later this year.

HMT CONSULTATIONS: COST MANAGEMENT

Following the Government Actuary Department (GAD)'s review of the cost control mechanism for public sector pensions, on 24 June 2021 HMT issued a consultation setting out its proposed reforms to the cost control mechanism.

The consultation includes the following proposals for comment:

- To change the benefits considered by the mechanism to be based on only benefits in the reformed pension schemes and exclude the former schemes from the mechanism (but the continued inclusion of past service in the reformed schemes)
- Widen the 2% corridor for assessing whether a cost breach would trigger a benefit change, to 3%
- The introduction of an "economic check" mechanism when the cost ceiling or floor has breached. This could be the impact of the change in the SCAPE discount rate, which is given as an example, which can be used to mitigate a breach but not in itself trigger a breach.

These changes aim to address the issues identified in GAD's review of the mechanism and on which we have previously commented. Such issues were highlighted by the perverse results stemming from the 2016 cost management review which (prior to allowance for McCloud), *triggered benefit improvements* despite an *increase in costs* due to the fall in the SCAPE rate (and LGPS valuation discount rates generally). Whilst an economic check would help to limit the chance of perverse outcomes arising out of the cost management process and should be welcomed, in our view consideration of only the SCAPE rate would be insufficient to mitigate this risk – particularly for the LGPS where SCAPE is not a driver of employer contribution rates. Instead, we would prefer a more detailed economic check mechanism, which takes into account for LGPS the funded status in determining the discount rate to be used.

Where Funds are preparing their own responses, we have shared our key comments and if you would like to see a copy of our response please get in touch with your usual Mercer consultant.

HMT CONSULTATIONS: SCAPE RATE

HMT has also issued a consultation on the calculation of the SCAPE rate, which is currently based on expected long-term GDP growth. The SCAPE rate is key in the non-funded public service schemes, with its main use being the discount rate for determining pension contributions payable as part of the actuarial valuations. Included in the consultation is a review of the objectives of the rate, where stability is now prioritised alongside the requirement for the rate to provide a fair reflection of costs and to reflect future risks to Government from income.

For the LGPS the use of the SCAPE discount rate is limited to the actuarial factors, including transfer values. Any reduction in the SCAPE discount rate will serve to increase transfer value payments (with any increase in rate having the opposite impact).

We are responding to the consultation and are happy to share this with interested Funds, please get in touch with your usual Mercer consultant if you want to know more about this.

AVCS AND TAX

AVC UPDATE

As with the rest of the LGPS, it is never a quiet time in the AVC sector also!

The transfers from Equitable Life to Utmost last year and the closure by Prudential of their Property Fund in recent months highlights the importance for administering authorities to keep on top of developments in this sector and the need for appropriate (regulated) advice in order that administering authorities can carry out their fiduciary duties. Alongside this, as you will be aware, given the administration performance issues of some AVC providers at the moment we recommend that administering authorities continue to monitor the position and raise their concerns with the relevant parties, escalating these accordingly where appropriate.

Ongoing review of AVC arrangements is an important component of a Fund's governance framework but with recent challenges of Covid, McCloud and the rise and fall of the exit cap, administering authorities have needed to focus time and resource elsewhere. Ongoing review should consider aspects such as:

- provider performance (administration and investment);
- the continued suitability of the fund range members can access and the impact of potential changes to available funds;
- member communications; and
- options to consolidate / transfer provision where possible and appropriate.

For Funds who have not reviewed the continued suitability of their AVC arrangements for some time, we recommend that this is now added to the business plan. The Mercer LGPS AVC Club will be pleased to help you in these areas as needed (please contact your usual Mercer consultant for further details).

PENSION TAX SEASON IS ABOUT TO START!

Whilst administering authorities will have been working hard to finalise and issue Annual Benefit Statements, Pension Saving Statements will need to be sent by 6 October 2021 to those members who exceed £40,000 of pension savings in the 2020/21 tax year. This year's pension tax season is slightly different because this is the first year in which changes to the tapered annual allowance apply.

In March 2020, the Government was facing huge pressure from NHS doctors who had taken early retirement or gave up overtime in order to avoid the risk of being hit with unexpected annual allowance charges. This had been affecting NHS resources, which of course was a particularly present issue in the face of the start of the pandemic.

In his first Budget, Rishi Sunak announced his only change to pensions in the form of a change to the tapered annual allowance. This was that the two tapered annual allowance thresholds for pension tax relief would increase by £90,000. This represented an increase from £110,000 to £200,000 for "threshold income" – broadly total pre-tax income. At the time, it was stated that this change would result in 98% of consultants and 96% of GPs no longer being affected by the taper. Many in the pensions industry had been calling for the complicated annual allowance taper to be scrapped altogether and that this was an opportunity missed, however, the taper increase was welcome news for not just doctors but also a number of LGPS members who were being impacted by the previous levels. This means that for the first year since 2016, members who only rely on their employed income could have a reduced annual allowance if their pensionable salary is in excess of £228,000 as opposed to £124,000.

However, with inflation remaining low we still anticipate a number of members will exceed their annual allowance limit and require support on how to undertake the complex calculations to work out if they have a liability and what their liability is.

Given the general complexities of Pension Taxation we have found that it is important for members to understand what their responsibility is, given it is a “personal” tax and what the responsibility of the administering authority is. At Mercer, we have developed a three-stage process that can help administering authorities provide members with additional information and guidance and also the opportunity to access individual financial advice should they require it at a later stage. The three stages in the support process we can provide constitute:

1. Education – workshops for Fund officers, employer HR representatives, and members.
2. Guidance – high level 1:1 guidance sessions based on an individual's pension saving statement with guidance (not advice) on next steps they should take
3. Advice – detailed sessions with members to discuss their own position, objectives and actions where independent and authorised financial advice can be delivered by a Mercer IFA specialising in the LGPS

As part of the educational workshops for 2021 that we will be delivering, we will be communicating to officers and members the impact of recent changes announced by HMRC on 20 July 2021 in relation to the extending the deadlines for submitting Scheme Pays notifications – further details of this can be found here.

If you would like further details on how Mercer can help administering authorities in relation to pension taxation please contact your usual Mercer consultant in the first instance.

Climate Change

Setting a path to Net Zero

On Monday 9th August, the United Nations Intergovernmental Panel on Climate Change released its sixth report in which it analysed the most up-to-date understanding of the climate system and climate change. The study issued stark warnings about unprecedented global warming and rising sea levels that have been seen in recent years.

In addition to the warnings over the impact of climate change, the report did seek to address what could be done to manage some of the worst impacts and address the key issues that world leaders need to consider.

Whilst none of the findings of the report are necessarily a surprise, it does highlight that action is required sooner rather than later, and this fits in with conversations we have been having with clients around setting a path to net zero. You will already know that you will not achieve net zero by simply divesting from today's high carbon companies, so we have looked to address this across a four-step guide to support LGPS funds in navigating your journey to net zero.

1. **Calculating your baseline:** Before you embark on any journey, you need to know where you are starting from. Understanding your portfolio's current emissions, transition capacity and green exposures, means you can clearly communicate your position to internal or external stakeholders, and monitor your progress.
2. **Assessing your portfolio possibilities:** It is not just about recognising and understanding the risk in your current portfolio but also the opportunities for change and transitioning that exist.

3. **Setting your metrics and targets:** Establishing your long-term goal is crucial but equally important is setting a series of milestone targets along the way that will ensure you stay on course.
4. **Implementing a transition plan:** Once you have taken the first three steps, you'll be well placed to create your transition plan, before sharing your roadmap to success with your internal and external stakeholders.

Webinar

We are hosting a Webinar looking at this subject on Tuesday, 21 September, 11am-12pm. Please contact your usual Mercer contact if you wish to join the session.

TPR publishes Climate Change Strategy

The Pensions Regulator (TPR) published a climate change strategy in April, setting out how it will help Funds meet challenges around climate change as well its own strategic response. TPR believes that any scheme that does not consider climate change is ignoring a major risk to pension savings and may be missing investment opportunities. TPR's new Climate Change Strategy outlines three aims:

1. To create better outcomes in later life for workplace savers by driving employer action on the risks and opportunities from climate change. TPR hopes to achieve this by ensuring that schemes meet the existing requirements for publishing information. It will also produce further guidance for schemes reporting in line with the TCFD framework, will review a selection of scheme implementation statements, and will publish a report on the findings. On compliance, TPR says it will strengthen enforcement where schemes are not meeting their responsibilities.
2. To seek to influence the debates around pensions and climate change - TPR says it will do this through participation in cross industry groups and by working with other regulators.
3. As a business, to take part in the transition to net zero - TPR proposes to publish a Climate Adaptation Report, which will outline how it will use TCFD recommendations as a framework for its own management of climate risk.

And in other news…

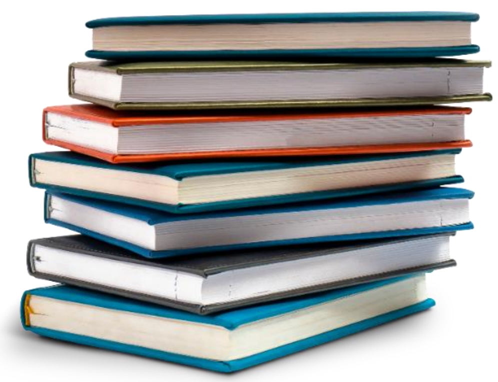
LGPS Non-Club Transfer Out Technical guide

The LGPS Non-Club Transfer Out Technical guide was updated and re-published on 30th July 2021. Version 1.3 of the guide can be found in section 1.2 of the Non-club transfer out technical guide here and in the Scottish regulations under Transfers Out here.

Special Severance Payments by local authorities

On 2 July, MHCLG commenced a consultation on statutory guidance in respect of special severance payments for local authorities.

The intention of the guidance is to limit the use local authorities make of Special Severance Payments (defined as payments made to employees, office workers, contractors, and others outside of statutory, contractual or other requirements) when leaving employment in special service. The guidance sets out the criteria and "truly exceptional circumstances" that should apply to these payments. The consultation ran for 6 weeks until 13th August 2021.



Public Service Pensions Bill

On 19th July 2021, the Public Service Pensions and Judicial Offices Bill (which will pave the way for the implementation of the McCloud remedy) made its way through parliament in the House of Lords with its first reading.

TPR published its Public Sector Survey

The Pension Regulator's (TPR's) published its annual Public Sector Survey on 1st July 2021. The main aim of the survey was to track administration and governance practices in the public sector. The 2020/21 survey also included additional questions in relation to the pension dashboard, responses to the COVID-19 pandemic and action taken in relation to climate related risks.

TPR closes consultation on new single code of practice

On 26 May 2021, TPR closed its consultation on the first phase of its new single code of practice (COP). The proposal is currently to combine its 15 existing codes into a single web-based COP.

The consultation asked for input on the first phase, which will bring together 10 existing codes and introduce additional material on new governance expectations in relation to the "own risk assessment", climate change, cyber security and remuneration policies.

COVID-19 Mortality impact report

On 15th June 2021, the LGPS Board published updated mortality impact reports on two LGPS funds (originally commissioned in September 2020 to specifically analyse the mortality during the Covid-19 pandemic). The updated reports incorporate the winter analysis also. The report can be found here.

The FCA's Long-Term Asset Fund Consultation

In May 2021, the Financial Conduct Authority (FCA) launched a consultation for a new category of authorised fund called a Long-Term Asset Fund (LTAF).

The consultation closed on 25 June 2021, and the FCA intends to publish a final policy statement and final handbook rules later in 2021. The consultation is part of a broader government agenda to facilitate investment in illiquid assets as a viable option for investors with long-term time horizons who understand the risks.

Increase to normal minimum pension age to go ahead

The Government recently published its response to the consultation on increasing the normal minimum pension age from 55 to 57 (from 6 April 2028). Some schemes and members may have protections that override these changes and individuals will be able to keep their protected pension age if they transfer their pension.

Occupational Pensions Stewardship Council

The DWP launched the Occupational Pensions Stewardship Council (OPSC) on 8th July. The aim of the Council is to develop a "stronger overall voice of trustees within the market, especially in relation to service providers". Schemes can also collaborate on stewardship activities such as shareholder resolutions, climate change and corporate governance.

Finance Act 2021

The Finance Act 2021 received Royal Assent on 10 June. The Act gives legal effect to a number of measures announced in March's Budget such as the decision to freeze the lifetime allowance at £1,073,100 for tax years 2021/22 to 2025/26.

What's coming up?

Section 13 – GAD's report on its valuation of the LGPS is due to be published in the autumn.

Pooling guidance – is expected in October 2021, alongside a consultation on climate risk and reporting.

Data Quality – As we get closer and closer to the 2022 valuations, the importance of clean and complete data grows. Funds will be carrying out their annual data quality reviews in the coming months to plan for the valuation. Speak to your Mercer consultant about arranging your review ahead of the valuation.

95k Cap – This is not the last we have heard of the cap and we expect it to come back around soon….

Dates to remember

Date	Issue	The latest
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 in force	It is the Government's intention that regulations providing for the "McCloud remedy" come into force from 1 April 2023.
6 April 2028	Normal minimum pension age to rise to 57	The Government has confirmed the normal minimum pension age (the earliest age from which in most circumstances, members can take a pension without incurring tax penalties) will rise from 55 to 57 from this date (with pension age protection in place for eligible members).
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: Neville Khorshidchehr
Role: Chartered Financial Planner specialising in providing retirement advice to members of the LGPS
Joined Mercer: November 2010
Place of Birth: London
Favourite film: The Usual Suspects, I am definitely partial to a film with a quirky or clever ending!
Did you go anywhere nice this Summer?: Lucky enough to go to Cornwall during the July heatwave, which was like being in the Med.
After the excitement of the Euros what are your predictions for the football season ahead?: The England squad certainly gave us something to cheer this summer and I was certainly a Happy Hammer last season and hope this year brings us a European adventure of our own or an FA cup victory. It's worth remembering the last time England won something they were captained by a West Ham player.

Name: Traci Bennett
Role: Wealth Analyst
Joined Mercer: July 2017
Place of Birth: Nova Scotia, Canada
Favourite film: 10 Things I Hate About You
Did you go anywhere nice this Summer?: No, but definitely looking forward to the time I can start booking trips again. I haven't seen my family since about 2018!
After the excitement of the Euros what are your predictions for the football season ahead? I don't really follow football so wouldn't even be able to guess.

Name: Chris West
Role: Investment Consultant
Joined Mercer: 2012
Place of Birth: Wirral
Favourite film: It's a Wonderful Life (I watch it every Christmas Day) or Scarface for the soundtrack. Although I remember watching Jurassic Park in the cinema as a child and being amazed for days afterwards.
Did you go anywhere nice this Summer?: Liverpool FC's old training ground for my vaccination
After the excitement of the Euros what are your predictions for the football season ahead?: Rafa Benitez to cement his legendary status among LFC supporters ☺

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