

LGPS CURRENT ISSUES

February 2022



welcome to brighter

In this edition

In this edition of Mercer Current issues, we provide comment on investment strategy options, Funds may wish to consider which aim to manage inflation risk and we also discuss planning for the 31 March 2022 actuarial valuation for English and Welsh LGPS Funds, which is fast approaching. If you haven't already registered for our valuation webinar on 1 March then please do [register here](#) (a recording will also be available).

We also provide updates on other recent developments and what is to be expected over the next few months. [Click on the headings below to go straight to that section.](#)

Investment Update 3-6

- [Investing in an Era of Higher Inflation](#)
- [Levelling Up](#)
- [Sustainable Investment \(TCFD, 2050, Israel\)](#)

Valuation Matters 7-9

- [Planning for 2022](#)
- [Mortality \(CMI 2021 and Levelling Up\)](#)
- [Section 13 Report](#)

Regulatory round up – where are we now? 10-11

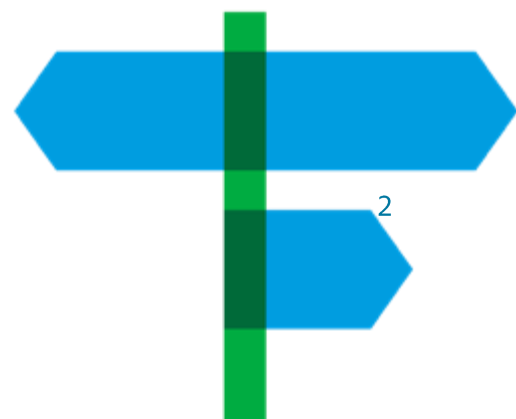
- [McCloud Remedy and Judicial Review](#)
- [LGPC response to amendment regulations consultation](#)
- [Terms of reference for State Pension Age review report published](#)

And in other news... 12-13

- [LGA Changes](#)
- [Finance Act 2022](#)
- [Pension Transfers and Scams](#)
- [Pension Dashboards](#)
- [Cyber Security](#)

What's coming up & dates to remember 14-15

Meet the team & contact details 16-17



Investment Update

Investing in an Era of Higher Inflation

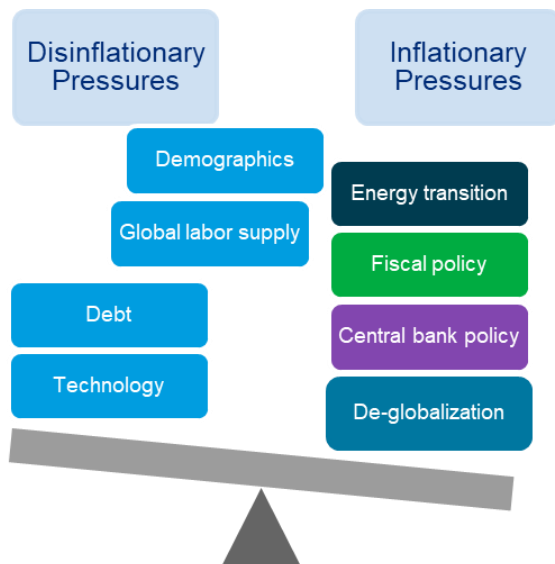
As 2022 progresses, we face the reality that the new normal may already be here. The era of strangely low inflation has ended and the traditional 60/40 portfolio now appears less convincing in providing the required diversification. An ever-growing number of investors are recognising the material nature of ESG factors which has been reinforced by the pandemic.

2022 is an important year for the LGPS. While Funds will seek to understand the post-pandemic impact on valuation assumptions from their actuaries, they will also seek to understand whether their investment portfolio is still fit for purpose.



Positioning for Unexpected Inflation

The transitory story of high inflation is being extended or abandoned as several supply side bottlenecks spread longer than anticipated. **Once inflation exceeds a threshold rate, it creates significant economic costs.** It distorts the allocation of resources, restrains savings and investment, creates sustained wage growth driven by tight labour markets and makes it more difficult for companies and workers to plan for the future.



Unless Funds have existing inflation protection such as Index-Linked Gilts, Treasury Inflation Protected Securities (“TIPS”) or Inflation swaps, **the cost of explicit protection can be expensive.** Funds can however consider the following as part of their inflation sleeve:

- **Real assets have a clear role to play in managing longer term inflation risks.** Prime real estate, core infrastructure and natural resources assets typically offer the strongest inflation links.
- **Commodities** and particularly Gold is known to **preserve real value** when inflation is high and growth is weak.

Looking beyond Traditional Diversifiers

The level of portfolio protection from high-quality debt instruments and the effectiveness of duration, which has been a dominant and powerful risk protection strategy for most investors over the past 40 years, cannot be relied upon going forward, as there is a secular trend of rising rates across global developed markets. In addition, **rising inflation erodes the value of the coupons and principal, fixed rate bondholders receive in the future.**

Investors need more tools in the toolkit and should question the role of fixed income in portfolio construction. Clients should explore alternatives within or outside fixed income to seek diversification.



- **Floating rate assets do not have interest rate risks.** Funds may consider leveraged loans and consider going down the rating spectrum for higher risk adjusted yield.
- While many Funds would already hold an exposure to Private Debt, **it is worth considering whether this allocation should be increased**, keeping in mind the overall liquidity requirement of the Fund.
- **Exposure to low duration assets can provide better protection.** Further higher yielding bonds such as Emerging Market Debt and Subordinate Bank Debt can provide cushion from the impact of rising rates. This can be achieved through an allocation in **Absolute return Bonds or Multi Asset Credit.**
- Mercer have long advocated holding the Equity allocation but building protection strategies around it to reduce the volatility of outcomes. We have discussed this recently in our **De-stress don't distress** article ([here](#)).

*How long this inflation surge will last is probably the most pressing investment question in today's market. **How it affects performance of assets depends on three key points. First, is it likely to be a Demand Pull or a Cost Push inflation or both? Second, how large and sustained is the level of inflation. Third, what is the likely response of policymakers?***

Whatever the outcome, we know that growth will be slower in 2022; central banks will continue to raise rates and traditional equity valuations are being tested by markets. **As such, it is time that Asset Owners review their asset allocation in the face of this heightened risk.**

We do not offer forecast but provide insights based on our research and analysis. Mercer has run a comprehensive set of scenarios and can use these to help Funds position their portfolio under various economic and inflation regimes.

Please feel free to get in touch with your Mercer contact if you would like to find out more.

Levelling Up - Government sets 5% target for LGPS investment in local areas

On 2 February 2022, the UK Government published its white paper on Levelling Up, setting out the **Government's plans to spread economic opportunities more equally across the UK**. The plans are wide-ranging, with the intention to address **six drivers of spatial disparity across "missions"**. The paper outlines the role of institutional investment in the Levelling Up agenda as providers of capital.

Specifically for the LGPS, the paper notes the progress to date with increasing investment in infrastructure, from <£1bn in 2016 to £21bn in 2021, largely through the asset pools.

As part of the proposals, individual **LGPS funds will need to publish their plans to target up to 5% of their assets being invested in "local" projects**.

Full details can be found on page 162 of the white paper, available at the link [here](#). It is expected a consultation will follow later in the year.

Whilst there is not much to report at the moment, we will keep an eye on this and provide further information in the coming months.

Sustainable Investment

The area of responsible investment remains a key focus for LGPS Funds and over recent months, there have been a number of developments in this area. For further information on any of these matters, please contact your usual Mercer consultant and they will put you in touch with **Mercer's Sustainable Investment team** as required.



COP26's primary aim to 'keep 1.5 alive' ended in disappointment

Global leaders met in Glasgow at the end of 2021 for the annual Conference of the Parties ("COP"). One of the key aims was to secure global net zero by 2050 to keep the "Paris Agreement" 1.5-degree warming target within reach.

The **Glasgow Climate Pact**, which details the agreement reached across 197 nations, following the two weeks of negotiations, requests that countries revisit and strengthen commitments and Nationally Determined Contributions ("NDCs") ahead of next year's COP27, with policies consistent with keeping global warming to 1.5 degrees. The Pact includes:

- Reference to "**phasing down**" unabated coal power and "**phasing out**" inefficient fossil fuel subsidies.
- Formal agreement for implementing Article 6, which includes **carbon markets and emissions trading**.
- The disaster relief and adaptation and mitigation support from developed nations to poor countries is behind target, although **developed nations pledged to double the amount given by 2025**.

TPR's Guidance on Climate-Related Risks

The Pensions Regulator's ("TPR") recently published draft guidance to help Funds **meet new standards of governance and reporting in relation to climate-related risks and opportunities**. Even though the guidance published is not LGPS specific, we believe it is useful to read in advance of the consultation for the LGPS, which is expected later this year, and you can find the latest guidance [here](#).

Update on UN Letter about Investments in the Israeli Settlement Economy

In November 2021, the United Nations (UN) Special Rapporteur on the Palestinian Territories, Michael Lynk sent a [letter](#) to all LGPS pension committee chairs (alongside LAPFF and SAB) asking a number of questions of LGPS Funds about their investments.

On **25 January 2022**, a meeting took place between the Chair and representatives of the LAPFF and the SAB secretary with Michael Lynk to discuss his letter. It was made clear that the primary objective of LGPS Funds is to ensure benefits are paid to members but Funds do take human rights issues seriously. **Discussions are to remain ongoing between all parties**.

Valuation Matters

2022 Valuation Planning

For English and Welsh LGPS Funds, the 31 March 2022 actuarial valuation is fast approaching and discussions are already underway in relation to planning for the work that lies ahead, in particular with regard to data quality, demographic studies, employer engagement and also consideration of the key issues that will impact the 2022 funding strategy.

The fourth in our successful series of **LGPS panel debates** will take place on **1 March 2022** and will focus on the hot topics underpinning funding strategy considerations in the current environment. Our panel will share their experiences and thoughts on the following key areas:

- 1. How can you deal with short-term budget pressures versus long-term contribution sustainability given the improvement in funding?*
- 2. How should we deal with increasing inflation pressures, climate risk and COVID impacts?*
- 3. How different will the outcomes be for different employers and how do we manage that?*

If you haven't already registered for the webinar then please use the link [here](#). A recording of the webinar will also be available.

Mortality - CMI's 2021 version of its Mortality Projections Model

The Continuous Mortality Investigation ("CMI") has announced that it intends to place no weight on mortality data for 2021 as well as 2020 in the core version of its next Mortality Projections Model, CMI_2021, **which is due to be published in March 2022**. The Model is widely used by pension schemes, sponsors and actuaries to determine life expectancy assumptions. The current version, CMI_2020, placed no weight on data for 2020. Moving from CMI_2020 to CMI_2021 is likely to result in small reductions in life expectancy; moving from earlier versions will give larger reductions.

New evidence continues to emerge on the impact of the pandemic on the mortality experience of UK defined benefit schemes. We will be considering this when carrying out a study of demographic assumptions as part of the 2022 actuarial valuation process where we



are carrying out your valuation, as well as considering the impact of other risks such as climate change.

Mortality – Levelling Up

The government [white paper](#) also includes details (page 420) of a mission to **narrow the gap in Healthy Life Expectancy (“HLE”) between local areas where it is highest and lowest by 2030, and by 2035 increase the HLE by 5 years.**

Any improvements in life expectancy will increase pension costs, including within the LGPS, to the extent that some benefit payments will be made for longer, notwithstanding any corresponding increases in state pension age, which may serve to mitigate impacts in respect of the 2014 Scheme benefits. We will monitor developments in this area as they arise and will provide further comment in due course.

DLUHC publishes Section 13 Report on 2019 LGPS valuations

On 16th December, the Department for Levelling Up, Housing and Communities (“DLUHC”) published the Government Actuary Department’s [report](#) on the 2019 LGPS valuations for England and Wales. This is following on from discussions over summer 2021 with various interested parties including Mercer. **This is the second formal Section 13 report**, with Section 13 applied for the first time to the fund valuations as at 31 March 2016.



In summary, Section 13 requires the Government Actuary to report on whether the following aims are achieved:

- **Compliance**
- **Consistency**
- **Solvency**
- **Long term cost efficiency**

The 2019 report notes that the **compliance** objective has been met and that in general whilst there appears to have been an improvement in **consistency** in the key assumptions, there is still progress needed and there has been little progress in relation to academy conversions.

In relation to **solvency**, the report makes the comment that liabilities are growing much faster than the size of employers backing them, which therefore presents greater risk going forward,

despite an improvement in funding levels more generally. We agree with this view, which further highlights the importance of employer covenant monitoring and ongoing review.

In relation to **long-term cost efficiency**, GAD reiterates the message of the need to consider the balance of cost between current and future generations of taxpayers and that deficit recovery plans can be demonstrated to be a continuation of the existing plan with appropriate adjustment for experience since previous valuations.

In addition, there is further commentary in their report regarding the use of contingent assets/asset transfers and the additional cost and risk associated with such arrangements with a recommendation for the SAB to consider the governance of such arrangements further.

The report also notes a number of key areas for consideration for the 2022 valuations, including on **McCloud**, the impacts of **COVID-19** and on **climate change reporting**.

Whilst Section 13 should not be the main driver of 2022 valuation funding strategies, we will be taking into account the comments from the 2019 report where appropriate.



Regulatory round up

MCCLOUD REMEDY AND JUDICIAL REVIEWS

The PSPJO Bill

On **21 January 2022**, in advance of moving to Committee Stage in the House of Commons, the Government tabled further [amendments](#) to the Public Sector Pensions and Judicial Offices Bill. As expected, the **key amendment in relation to the LGPS** was to extend the scope of the remedy (by redefining “*remediable service*”) to those members not in pensionable service on 31 March 2012 but in service before then.



Other amendments relevant to the LGPS extended the types of schemes where pensionable service would not count as a disqualifying break, and to allow the final regulations to make provisions in a number of areas, namely in relation to **transfers in, pension credits and debits**, Teachers qualifying for the LGPS and also compensation and interest payments.

Further amendments have been proposed in February 2022, which are to be debated.

The Bill is on track to complete and become an Act by **31 March 2022**.

Judicial Reviews

On **15 December 2021**, six trade unions (the Public and Commercial Services Union, The Fire Brigades Union, the GMP Union, the Royal College of nursing, Unite and the POA Union) filed for a joint Judicial Review to prevent the Government imposing the cost of the McCloud remedy on their members. **The outcomes of this review may have implications for the LGPS if upheld.**

In addition, **on 7 January 2022** whilst not influencing the LGPS at present, a Judicial Review claim submitted by the Police Superintendents' Association ("PSA") in relation to the McCloud Judgment consultation process conducted by HM Treasury in 2020 was dismissed. Although some of the grounds of the claim were ruled arguable, the Judge ruled that there had been legal errors in the decision making process following the consultation. The full judgment can be found [here](#). The PSA has since announced it will seek leave to appeal to the Court of Appeal.

CONSULTATION FOR SCOTTISH FUNDS ON EMPLOYER FLEXIBILITIES AND SURVIVOR BENEFITS

As reported in the previous edition of the LGPS Current Issues, on 1 November, SPPA issued a consultation to seek the views of stakeholders about draft changes to the Local Government Pension Scheme (Scotland) (Amendment) Regulations 2021.

The consultation closed on **21 January 2022** and the outcomes are now awaited.

Further details can be found [here](#).

SECOND REVIEW OF STATE PENSION AGE

The Government has **launched the second review of State Pension Age, the results of which must be published by 7 May 2023**. The Government Actuary will provide a report assessing state pension age in the context of the latest life expectancy projections and Baroness Neville-Rolfe will lead the production of a second report considering recent trends in life expectancy and other relevant factors.

In particular, the review will consider whether the **increase to age 68** (currently legislated to happen between 2044 and 2046) should be brought **forward to 2037-39**, as recommended by the 2017 review.



And in other news...

Local Government Association Changes

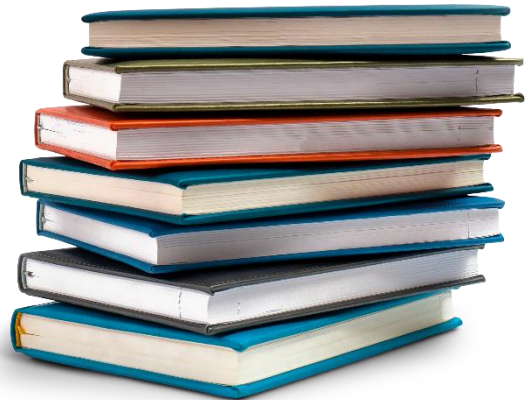
It has been recently announced that **Joanne Donnelly**, currently Senior Pensions Secretary and Deputy SAB secretary and formerly at HM Treasury, will be taking up the role of Head of Pensions at the LGA and Secretary to the Local Government Pension Scheme Advisory Board in England and Wales from 1st April 2022 following Jeff Houston's retirement.

We would like to wish Jeff all the best in his retirement and thank him for the support given to the LGPS over the years.

Finance Act 2022: Increase in the Normal Minimum Pension Age and Retrospective Changes to Scheme Pays Deadlines

Final details of the **increase in Normal Minimum Pension Age (NMPA) from 55 to 57 in April 2028** have been published in the Bill that will become the Finance Act 2022 when it gains Royal Assent next year. The Bill also confirms details of the changes to retrospective mandatory Scheme Pays deadlines from tax year 2016/17 onwards.

On 17 January 2022, HMRC published its latest [newsletter](#), which sets out further information about the plans to increase the normal minimum pension age from 55 to 57 on 6 April 2028.



LGPS administering authorities have already begun to amend their processes in relation to transfer value requests to reduce the likelihood that cases needed to be revisited in the future when changes to the LGPS regulations arising from the NMPA increase are confirmed.

Pension Transfers and Scams

Conditions for statutory transfers

As part of its attempts to combat pension scams, the Government has passed regulations **bringing in new conditions applying to statutory transfers, with effect from 30 November 2021**. The new rules apply to transfers to and from occupational schemes, and contract based schemes, and may require Funds to perform additional due diligence on transfers.

The new requirements are based on a system of “**red**” and “**amber**” flags. Where a red flag is present, the transfer cannot go ahead on a statutory basis.

TPR has published [guidance](#) on the new rules, and the Pension Scams Industry Group (“PSIG”) will be revising its code on combating pension scams later this year to reflect the new position.

The Local Government Association has also provided administering authorities with guidance and template documentation to

assist them with fulfilling their duties to ensure the requirements set out in the regulations are met.

Pensions Dashboards

Work in relation to the implementation of Pensions Dashboards continues at pace and there have been a number of developments over recent months.

On **31 January 2022**, DWP launched a [consultation](#) on the draft Pensions Dashboards Regulations. The consultation closes on 13 March 2022.

The Pensions Dashboards Programme (“PDP”) also released a number of other publications:

- On **15 December 2021**, PDP confirmed [three potential dashboard providers](#) selected to take part in the initial development of the ecosystem. Further comments from PDP, published on 11 January 2022 on the dashboard providers market **can be found [here](#)**.
- On **25 January 2022** the PDP published a [report](#) from Ipsos Mori on their research undertaken on the attitudes of dashboard users, their circumstances, behaviours and views of the dashboard concept, together with PDPs own [summary](#) of the findings.
- The PDPs [November Newsletter / progress report](#) was also published.

On 16 December 2021, the PLSA published an [A to Z industry guide](#), which **identifies 26 key issues** that need to be resolved to make the initial pensions dashboards a success.

Cyber Security

The threat of a cyber-attack remains high on the risk registers for many LGPS Funds.

Alongside specialists in our sister company Marsh, we are able to assist Funds to **understand, measure and manage** their cyber risks through a variety of measures tailored to suit client needs.

If you would like to discuss how Mercer/Marsh can assist your Fund further in this area then please get in touch with your usual Mercer Contact.



What's coming up?

Pooling Guidance / TCFD / Levelling Up

Guidance on pooling in the LGPS and a consultation on TCFD requirements are expected later this summer alongside further details in relation to Levelling Up.

Severance Payments / £95k Exit Cap

Guidance on discretionary severance payments above and beyond statutory payments is expected soon.

No timescales yet on when the Exit Cap may return.

McCloud

The Bill is expected to go through by the 31 March 2022 deadline with a formal government response and draft regulations expected in the summer, with regulations coming into force on 1 October 2023.

Good Governance

Recommendations emerging from the Good Governance Review are expected later this year.

Survivor benefits

A consultation on changes to historic survivor benefits e.g. Goodwin Judgment, is expected in the Spring/Summer.



Dates to remember

Date	Issue	The latest
Expected first half of 2022 (initially expected 6 April 2020 but now delayed)	Governance and 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.
Expected 2022	Governance and draft regulations	As referenced above, there are a number of areas where consultations/regulations/publications are expected during 2022 – namely, TCFD, Asset Pooling, Levelling Up, McCloud, Good Governance, Pensions Dashboard to name a few...
31 March 2022	Actuarial Valuation	Effective date of next actuarial valuation in England and Wales.
31 March 2023	Actuarial Valuation	Effective date of next actuarial valuation in Scotland. Deadline for actuaries to sign off contribution outcomes for 2022 valuation in England and Wales.
1 October 2023	McCloud remedy regulations in force	It is now the Government’s intention that regulations providing for the “McCloud remedy” come into force from 1 October 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: Graeme Pickard

Role: Consulting Actuarial Associate

Joined Mercer: 2022

Place of Birth: Glasgow

Favourite film: Tricky to choose just one but will have to go for Training Day

If you could have dinner with anyone famous from history who would it be: Paul Gascoigne – would be some laugh!

In the hope that we return a more normal existence this year what are you looking forward to doing, that you haven't done for 2 years:

Hopefully finally getting a honeymoon abroad in the sun!!

Name: Roshni Hainsworth

Role: Governance Leader, UK Wealth

Joined Mercer: June 2007 (and again in September 2011....and also left the UK in 2013 to work at Mercer in Vancouver, returning in July 2014)

Place of Birth: Romford (moved to West Yorkshire at the age of 3)

Favourite film: Inception for something beautifully made with an excellent Hans Zimmer soundtrack or Human Traffic for something more light hearted

If you could have dinner with anyone famous from history who would it be: I'm sure you mean further back in history than this but I would choose Freddie Mercury

In the hope that we return a more normal existence this year what are you looking forward to doing, that you haven't done for 2 years: Going to a music festival (Primavera Sound in Barcelona)



Name: Nick Page

Role: Investment Consultant and Risk Management Specialist

Joined Mercer: 2015

Place of Birth: Birkenhead, Merseyside

Favourite film: This was tough but Ghostbusters – great cast, catchy theme tune, and huge dose of nostalgia. Looking forward to seeing what my kids make of it (when they're a bit older).

If you could have dinner with anyone famous from history who would it be: Alexander Hamilton, to see if he's anything like how the musical portrays him.

In the hope that we return a more normal existence this year what are you looking forward to doing, that you haven't done for 2 years: Seeing clients face to face!

Contacts



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



Mark Wilson
mark.wilson@mercer.com
0151 242 7373



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



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



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



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



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



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



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



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



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



Karen Scott
karen.scott@mercer.com
07584 187645

This edition of LGPS: Current Issues is for information purposes only.

The articles do not constitute advice specific to your Fund and you are responsible for obtaining such advice.

Mercer does not accept any liability or responsibility for any action taken as a result of solely reading these articles.

For more information about other training or advice about how any article in this issue relates to your

Fund, please contact your usual Mercer consultant.

Mercer retains all copyright and other intellectual property rights in this publication.

Visit us at www.uk.mercer.com

Copyright 2022 Mercer Limited. All rights reserved