LGPS CURRENT ISSUES

May 2022

welcome to brighter

In this edition

For the first time in a long time, it has been a relatively quiet period for the LGPS recently in terms of Regulatory developments. However, it has by no means been quiet overall with year-end tasks, valuation discussions underway in England and Wales, and of course, consideration of the impact on funding and investment of the ongoing crisis in Ukraine all set against a backdrop of rising inflation and a cost of living crisis.

In this edition, we provide brief updates on recent developments and commentary on what to expect over the next months. Click on the headings below to go straight to that section.

JUBILEE FACTS – To celebrate the Queen's Platinum Jubilee, in this edition we have also added a few facts along the way…
… For example, back in 1952, the Basic State Pension, in its infancy, equated to c£1.63 a week in new money - equivalent to c£55 a week in current prices. This compares with the current Basic State Pension of £141.85 a week. However, as a % of average earnings, the State Pension has actually ***fallen*** *during the Queen's reign from 31% to 23%.*

Investment Update

THE CONFLICT IN UKRAINE

We are deeply saddened by the continuing conflict and our hearts go out to the people of Ukraine as the humanitarian crisis continues to unfold.

The consequences are far reaching and the situation remains fluid. Recent developments impacting LGPS Funds include a request by both the Scheme Advisory Board for England and Wales (**28 February**) and by the Secretary of State for Levelling Up, Housing and Communities (**9 March**) to review and consider Russian asset holdings.

The LGPS Scheme Advisory Board for England and Wales made the following statement on **28 February 2022**, in respect of LGPS Investments in Russia:

"In the light of events in Ukraine and resultant extant and potential sanctions by the UK government any LGPS funds who are not already doing so are advised to consider the implications for their investment portfolios and discuss with their pools and asset managers what action should prudently be taken".

A follow-up note from the Scheme Advisory board was issued on **4 March**. The letter from DLUHC was also sent to all Committee Chairs on **9 March 2022** and recommended all Funds to consider the actions that should be taken in light of the situation taking into account their fiduciary duties and ethical considerations.

There have also been a number of significant investment industry developments including the removal of Russia from global and emerging market indices. LGPS Asset Pools have already begun to take collective decisions to divest from all Russian holdings as soon as practically possible. The situation has also led to The Pensions Regulator highlighting the potential heightened risk of cyber-attacks. Funds should therefore be mindful of this and looking to review/implement their cyber-security policies where appropriate.

Mercer will continue to work with Funds to monitor the situation closely given the market volatility and other investment, funding and governance implications. Alongside our sister company Marsh; we are also able to assist Funds with their cyber-security. **Please contact your usual Mercer Consultant if you would like more information on any of these matters.**

INVESTMENT DECISIONS IN LINE WITH FOREIGN POLICY

On **10 March 2022**, the Public Service Pensions and Judicial Offices Bill received Royal Assent (see further comment below in relation to McCloud). The Act allows the Secretary of State in England and Wales to issue guidance to LGPS administering authorities to instruct them not to make investment decisions that conflict with the UK's foreign and defence policy.

There is no immediate action for administering authorities, as guidance/direction from DLUHC will need to be issued first (which will be subject to a 12-week consultation process).

Further details can be found on the BDS page on the SAB website.

Jubilee Fact – in 1952 most of Britain's top companies underlying the F30 (predecessor of the FTSE100) were in textiles, manufacturing and shipbuilding, compared to global mining, oil companies and financial stocks today.

IMPACT OF RISING INFLATION

Previously in Current Issues we discussed LGPS investment in an era of high inflation. As you will be well aware, the rate of inflation has recently reached its highest level in over 40 years, **with the annual increase in CPI to April 2022 hitting 9%**. This has been driven by various factors initially, but also exacerbated by the impact of the crisis in Ukraine on energy and food prices with other factors such as low unemployment adding to concerns of sustained high inflation.

The Bank of England has already taken some steps to control UK inflation, increasing base rates a number of times in recent months, aiming to encourage saving instead of spending, and hence more price competition. It predicts that this will bring CPI inflation to below its 2% target within a few years. However, there are global influences on UK inflation, which are not within the Bank of England's gift to control. As a result, there is considerable uncertainty in how prolonged the situation may last.

Jubilee Fact – back in 1952 inflation was also around 9%

Funding Matters

2022 Valuation

Whilst it does not seem that long ago the 2019 actuarial valuations in England and Wales were being signed off in the first weeks of lockdown, the effective date for the **31 March 2022** valuations has now passed.

Work is now well underway as Funds, and their advisors and other stakeholders, begin to consider:

- Membership data – based on 31 March 2022 renewal and pension increase exercises. It is imperative that data provided to the actuary is as clean and complete as possible.
- Expected return outlook – a key feature for the 2022 valuations is how Funds will deal with uncertainty, which will be crucial where we are entering into a period where the risk of a low growth/high inflation (“stagflation”) scenario has increased.
- Rising Inflation – which will impact on both pension costs (LGPS benefits are inflation-linked in nature) and contribution affordability for employers who may already be facing increased budgetary pressures.
- Demographic analyses – the most prominent of these is mortality. Whilst many Funds may potentially see funding gains emerging where life expectancy improvements have been slower than built into the assumptions, a key challenge remains in terms of how experience will unfold after the valuation date. In particular, to what extent, if any, will Covid-19, and now the cost of living crisis, have on future life expectancy of Fund members.
- Climate change – it is expected that Funds will be required to carry out climate change scenario analysis as part of their 2022 valuations with further guidance to be provided by the Government Actuary’s Department on minimum expectations in this area. This analysis will form a helpful addition to the risk management toolkit, in testing of the resiliency of the funding strategy under more challenging circumstances.
- Snapshot funding positions – where we are your Fund Actuary, we are preparing snapshot funding positions at 31 March 2022, along with scenario analysis to support the strategy discussions, ahead of the detailed calculations later this year.
- Communication strategy – this will be particularly important to get right for the 2022 valuations given the more challenging outlook and diverse funding outcomes across different types of employers.

You can find out more about our thoughts on the key issues for the 2022 valuation from our recent article with Room 151 here, following on from the webinar we held back in March.

For Scottish LGPS Funds who are not in a valuation year, it will still be important to consider the above factors in order that the impact on funding and investment strategies can be considered further as part of any preparatory work being undertaken in readiness for the 2023 valuations next year.

Regulatory round up

MCCLOUD REMEDY

On **10 March 2022**, the Public Sector Pensions and Judicial Offices Bill received Assent. The next stage in the process will therefore be for Regulations for each of the Public Sector Schemes to be released together with a consultation on draft guidance to assist Funds in implementing the remedy. Both are expected prior to parliamentary recess in the summer.

Further details of Bill itself can be found here.

From a funding perspective, on **22 March 2022**, a letter from Teresa Clay, Head of Local Government Pensions at DLUHC was forwarded to administering authorities setting out DLUHC's recommendations on how the impact of the McCloud Judgment should be taken into account as part of the 31 March 2022 actuarial valuation.

For a number of Mercer LGPS Funds, the recommendations were in line with the treatment already incorporated into the 2019 valuation outcomes and hence no significant changes in approach/outcome are expected as part of the 2022 valuation exercise.

REGULATORY CHANGES IN SCOTLAND

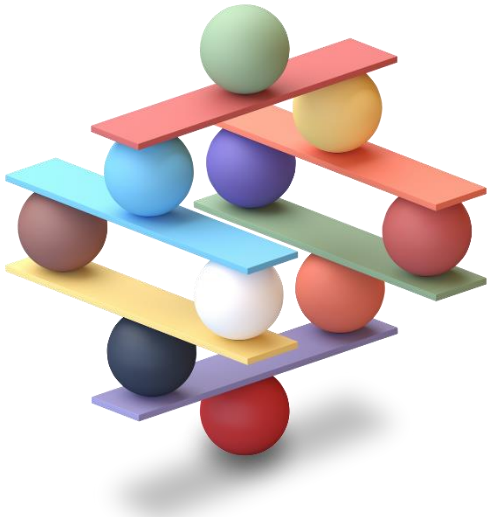
The long awaited update to the Scottish regulations primarily around employer flexibilities was laid on **3 May 2022** and comes in to force from **1 June 2022**.

The regulations amend The LGPS (Scotland) Regulations 2018, to provide further flexibilities for fund authorities in dealing with employers and allow for amendments to an employer's contribution rate in between valuations. The changes mirror those provided by DLUHC for England and Wales in 2020.

The cost cap figure is also amended from **15.5% to 15.2%** in the Scottish LGPS regulations; an error was identified in their original calculation.

Importantly, Scottish Ministers have decided to address retrospective changes to the underpin in respect of the 'McCloud Judgement' separately in the forthcoming The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2022.

STRONGER NUDGE REQUIREMENTS



With effect from 1 June 2022, the Occupational and Personal Pension Schemes (Disclosure of Information) (Requirements to Refer Members to Guidance etc.) (Amendment) Regulations 2022 (SI 2022/30) will be introduced – known as the "Nudge Regulations".

The Nudge Regulations are being introduced by the Government to ensure that individuals are made aware of Pension Wise guidance as part of making decisions about their Defined Contribution (DC) pension savings e.g. retirement / transfer etc. The Regulations therefore apply to LGPS Funds in respect of members with AVC funds.

Administering Authorities will therefore need to offer to book an appointment with Pension Wise for members as part of the application process for taking in-house AVCs (and when a member over age 50 enquires about transferring their AVCs to another defined contribution arrangement).

The LGA guide to the stronger nudge requirements can be found here.

SPECIAL SEVERANCE PAYMENTS – GUIDE FOR LOCAL AUTHORITIES

Although further announcements are still awaited in relation to the exit payments cap, which will impact LGPS Funds (following revocation of the original cap in early 2021), DLUHC commenced a consultation on statutory guidance in respect of "special severance" payments that apply to local authorities in England (i.e. over and above statutory entitlements) back in July 2021, and on **12 May 2022** the Statutory Guidance was published. It can be found here.

LGPS AND THE NEW SINGLE CODE OF PRACTICE – WHAT TO EXPECT

As part of its ongoing drive to improve governance in all types of scheme, including the LGPS, TPR consulted on a single code of practice between March and June 2021 in order to consolidate 10 of the existing codes of practice into one web-based code, but also introducing some significant new requirements.

The draft new code is expected to be in place "in the summer", but the exact timing is not known.

Key areas

The introduction of the new code is expected to coincide with when the outcomes from the LGPS Good Governance review are likely to take effect and there will of course be synergies between the two e.g. the requirement for "own risk assessments" / "biennial independent governance reviews" to be undertaken. Some of the key areas within the new code that apply to all Schemes (including the LGPS) that will need to be considered include:-

- Cyber-security – properly documented controls / systems / requirements of service providers
- Pension scams – what are the warning signs and how can risks be mitigated
- Role of and appointment to the governing body - take into accounting different responsibilities of each party and appoint based on proportionality / fairness and transparency
- Knowledge and understanding – continues to be a key area of focus

While some of the guidance set out in the new code does not directly apply to LGPS, TPR advises that it can still be considered good practice to follow the new code in these areas:

- Business continuity – ensuring robust plans are in place
- ESG/Climate Change – ensure such matters are taken into account in decision making
- Appointing managing advisors and service providers – well documented polices to include delegations / scope of responsibilities etc.
- Remuneration policy – a new module requiring a policy covering key personnel to be developed

What could be done now?

This is an opportunity for governing bodies to refresh their scheme governance frameworks to ensure they observe the terms of the new code where appropriate, or considering best practice where relevant. Many of the provisions will already be in place under existing guidance, but there is a significant amount of work to do to assess how a scheme's governance structure compares with the new Code, and to fill any gaps that exist. Governing bodies could be considering the following steps:-

1. Review the new code and identify areas where practice is not consistent with the guidance, or where best practice is not currently followed

2. Put in place a framework to fill in any gaps that exist

3. Put in place arrangements to monitor the governance framework on a regular basis in future.

4. Arrange training for the governing bodies.

If you would like further details of how Mercer can help Funds prepare for the new code (and the outcomes of the LGPS Good Governance review) then please contact your usual Mercer Consultant.

And in other news…

"…in this world nothing can be said to be certain, except death and taxes" – Benjamin Franklin

The same can be said of the world of pensions.

CMI_2021 Mortality Projections Model published

March 2022 saw the Continuous Mortality Investigation (CMI) publish the CMI_2021 version of its Mortality Projections Model.

The new Model incorporates mortality data produced by the Office for National Statistics (ONS) up to 31 December 2021 and again allows the user to alter the weight placed on data for individual years (i.e. due to the impact of the pandemic).

As with other recent updates to the Model, we continue to see reductions in projected life expectancy from successive CMI models. **The impact on liabilities will ultimately depend on a Fund's liability profile and other assumptions**.

As part of the 2022 actuarial valuation exercise, we are also assessing the potential longer-term impact of the pandemic on future mortality rates in addition to the impact of other likely drivers of improvements, such as lifestyle changes or developments in medical research.

Jubilee Fact – back in 1952, the average pensioner never made it to State Pension Age and the average life expectancy for a new-born was more than 10 years lower than it is today.

Pension Tax Update

The Annual Allowance and inflation!

Although inflation is close to double digits currently, it was not so long ago, back in September 2020, that the Consumer Prices Index (CPI) measure of inflation was just 0.5% and this will be the inflation figure applied by administrating authorities when calculating members' pension input amounts for 2021/22.

Therefore, anyone who has had a promotion or significant pay rise above 0.5% from April 2021, especially for those with significant years' service before 2014 (2015 for Scottish members) is now more likely than ever to breach or get close to the **£40,000** standard Annual Allowance.

Given the Unions fought hard last year to achieve, a 1.50% backdated pay rise for LGPS members in councils **this could mean we see a record year for members who receive pension saving statement by October 2022**.

Whilst rising inflation may mean fewer members are subject to annual allowance tax charges in the future (relative to previous years), recent figures set out in a report from the House of Commons published on 25 April 2022 showed that those members impacted by the Lifetime

Allowance, is expected to grow from 8,510 people in 2019/20 to nearly 30,000 by 2025. Pension tax clearly will not be going away therefore.

Pension Input Amount Recalculations

The Government has also changed the Annual Allowance rules for certain situations where Annual Allowance calculations for previous years are retrospectively amended. The new rules require:

- administering authorities to issue revised pension saving statements (within 3 months of receiving updated information)
- members to make Scheme Pays elections to meet any new charges to emerge within 3 months of receiving the updated information.

With the expected increase in members affected and also the possibility of sending revised pension savings statements, administering authority's need to ensure their processes are updated and need to be prepared for an increased number of questions from members.

It is important for members to be supported in this area and to understand what their (and the administering authority's) responsibilities are, given it is a "personal" tax ultimately.

Our three stage process of **Education / Guidance / Advice** can help administering authorities provide members with additional information and guidance and also the opportunity to access bespoke financial advice should they require it at a later stage. **Please contact your usual Mercer consultant if you require further details of how we can help administering authorities in this area.**

Consultation on the draft Pensions Dashboards Regulations 2022

On **8 March 2022**, the LGA published its response to the DWP consultation and a copy can be found here. This response has raised concerns about the implications for Funds having to implement the McCloud Judgment alongside ensuring they meet any requirements of the Pension Dashboard Programme (PDP) given the staging date proposed for the LGPS of **30 April 2024**.

TPR spotlight on diversity and inclusion

Recent comments from the Pensions Regulator (TPR) have confirmed that diversity across the pension's landscape continues to be an area of focus. Last year, TPR published its **Equality, Diversity and Inclusion (ED&I) strategy** and pledged to work with others in the industry to embed diversity and inclusion across pensions, so that all savers are protected and outcomes improved.

If you would like further details on how Mercer can help Funds/Employers consider their ED&I strategies then please contact your usual Mercer consultant.

Dates to remember

Date	Issue	The latest
31 March 2022	Actuarial Valuation	Effective date of next actuarial valuation in England and Wales.
1 June 2022	Stronger Nudge	Stronger Nudge requirements come into effect
Summer 2022	Draft Regulations (Governance and Administration)	Draft regulations and a response to the consultation on how Funds should implement the McCloud remedy are expected along with further updates in relation to the Single Code of Practice, Good Governance, Pensions Dashboard and Survivor Benefits
Autumn 2022	Draft Regulation (Investment)	An all-encompassing consultation covering TCFD, Asset Pooling, Levelling Up and the Competition and Markets Authority ("CMA") Order is expected
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: Sandy Dickson
Role: Investment Consultant
Joined Mercer: June 2013
Place of Birth: Wandsworth
Favourite film: Tough one, Sing is an excellent film but having watched it on repeat for a month I'd be happy to not see it again for a while. I've watched the Marvel films in order with my daughter recently (she slept through a lot of them) and we're just starting on Tolkien now, so I'll go with the one I'm looking forward to watching the most, Lord of the Rings: The Fellowship of the Rings.
If you could choose one thing to not go up in price in line with inflation, what would it be?: Coffee! The elixir of life at the minute. Having a toddler and a 3 month old, coffee is crucial to my daily functioning.
What is your preference this summer, staycation or vacation? Staycation all the way. The UK has so much to offer, I'm looking forward to travelling the country seeing friends and family, hopefully sampling a few locally brewed beers wherever we go.

Name: Michelle Doman
Role: Senior Actuarial Consultant
Joined Mercer: 2001
Place of Birth: Liverpool
Favourite film: I watched Parasite and the Painted Veil during lockdown which I thought were excellent
If you could choose one thing to not go up in price in line with inflation, what would it be?: Only one? Probably fuel given that it impacts so broadly
What is your preference this summer, staycation or vacation? Now that all depends on the great British weather! I love the sunshine

Name: Paul Bottone
Role: LGPS Accounting Consultant
Joined Mercer: 2005
Place of Birth: London I think
Favourite film: L.A. Confidential
If you could choose one thing to not go up in price in line with inflation, what would it be?: Coffee. Or train fares.
What is your preference this summer, staycation or vacation?
Probably vacation

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