LGPS CURRENT ISSUES

August 2023

welcome to brighter

In this edition

It’s been a very busy summer already, especially on the sporting front with Wimbledon, the Open, thrilling finishes in both the women’s and men’s Ashes and currently the Women’s World Cup with the Lionesses now just one win away from being World Champions.

Whilst many of you will have already enjoyed your own summer holiday or will be taking yours soon, the same can’t be said for workloads in the LGPS as we approach annual benefit statement, pension saving statement deadlines, the release of McCloud regulations and a recently published pooling consultation. In this edition of the Current Issues, we provide further comment on these and other recent developments, alongside a few summer holiday facts and figures!

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Investment Update

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Next steps on Investment: Pooling Consultation

Following on from the Chancellor's Mansion House speech on 10 July 2023, on 11 July 2023, DLUHC published its long awaited consultation on pooling in the LGPS. The consultation closes on 2 October 2023 and focusses on the following areas.

Area	Proposals
Asset Pooling	• Acceleration of pooling. • 31 March 2025 deadline to transition at least all listed assets. • Potential transition to fewer pools. • Increased transparency of pooling progress in ISS and annual report. • Permit investment in another pool's investment vehicle, via a fund's existing pool.
Levelling Up	• Funds to publish a plan for investing up to 5% of assets in projects which support levelling up anywhere in the UK. • 12 medium term "levelling up missions" set out to define investments which count towards the 5% target. • Funds to report on progress against their plan in the annual report.
Private Equity	• Fund's to consider investments to meet the government's ambition of 10% of the LGPS being invested in Private Equity.

The consultation also includes comment on the provision of investment consultancy services and minor technical amendments to regulations.

Mercer's response to the consultation is currently being prepared and we will share further details with clients in due course. We very much welcome the views of our LGPS clients to help inform our response.

According to the United Nations World Tourism Organization, the most visited country in 2022 was France with nearly 80 million visitors, followed by Spain and the USA. The UK was 7th.

Climate Risk Reporting

On **15 June 2023** a letter from the Minister to the SAB confirmed that the implementation of climate reporting obligations for LGPS Funds (in England and Wales) would be delayed by at least a year until 2024. Reports covering the period 1 April 2024 to 31 March 2025 would therefore need to be produced by December 2025 if regulations are forthcoming in time for the financial year beginning 1 April 2024.

Whilst regulations (and formal reporting) have been delayed, we would still advise that Funds consider what is likely to be required if they haven't done so already. Recent reports from the TPR (in relation to private sector reporting) and the SAB (in relation to planning by LGPS Funds) have shown that:

- The length of reporting has varied – from 10 to 85 pages (average of 34) indicating further work needed to consider content (TPR)
- Data quality/suitability and coverage/accessibility remain a challenge (TPR and SAB)
- Sufficient background information often not provided (TPR)
- Resource/Project planning could be an issue for some Funds (SAB)

To be ready for climate risk reporting, it's important that Funds familiarise themselves with the provisional requirements, agree responsibilities and engage with members and other stakeholders. Please speak to your Mercer consultant if you need assistance in preparing for the climate risk reporting requirements.

Economic Activity of Public Bodies (Overseas Matters) Bill

On **23 June 2023** The Government published a Bill which, if enacted, would prevent administering authorities from making investment decisions "influenced by political or moral disapproval of foreign sates", except where is required by formal Government legal sanctions, embargoes and restrictions. While private sector pension funds have been excluded, the LGPS would be covered by the Bill. TPR would be responsible for overseeing compliance. The Bill will be considered by the House of Commons Public Bill Committee, which is expected to first sit on 5 September 2023. The Committee has issued a call for evidence and the SAB will be considering this further.

The Scheme Advisory Board responded as follows to the announcement of the Bill:

> *We would point out that LGPS is a well-funded and well-run scheme. Administering authorities take their statutory and fiduciary duties around the investment of pension funds very seriously.*
>
> *They also take very seriously their duties under the Equality Act to foster good relations between different communities and to eliminate discrimination.*
>
> *As far as the Board is aware, there is no evidence that any LGPS fund has instituted inappropriate politically motivated boycott or divestment policies*
>
> *We have concerns that there would also be scope for judicial review by "interested third parties" in parallel to TPR action*

Whilst Mercer is not able to offer legal advice, as drafted the Bill does appear to have the potential to limit Pensions Committees from making country-specific exclusions on ESG grounds, unless there is a financial argument for doing so (with some limited exceptions). **We will therefore be monitoring developments closely in relation to the Bill in order that we can provide the necessary advice to Funds as and when required.**

Other news in brief

Sharia Law - the Scheme Advisory Board has appointed Amanah Associates to provide expert advice on a range of issues around Sharia Compliance in the LGPS. The report will be due in the autumn.

UK Pension Investment Conference – on **21 September 2023** we will be holding our annual UK Pension Investment conference in London. Whilst not LGPS focussed, the conference will cover the key investment issues facing UK pension schemes currently, including investment stewardship and the government's recent drive to encourage investment in the UK and private equity . Further details on content will be released in due course but you can register to secure your place here.

The first package holiday reported was in 1841 when Derbyshire Cabinet maker Thomas Cook arranged his first "tour", a bespoke train trip for 500 Temperance supporters from Leicester to Loughborough.

Funding Matters

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Inter-valuation updates

The dust has now settled on completion of the 2022 actuarial valuations in England and Wales. As we approach the mid-way point of the inter-valuation cycle (as scary as that sounds!) we would recommend Funds consider:

- Impact on the funding position of changes in market conditions / economic outlook (e.g. continued high inflation / rising interest rates etc.) alongside approach for terminations/admissions.
- Impact on underyling funding assumptions (and thus funding position) as part of any review of the investment strategy.
- Whether covenant for any employers (where there is a risk of potential unfunded liabilities emerging) has changed – see Covenant section for more details.
- Whether there are any employers for whom exiting the Fund would now be affordable – for example any charities/other employers for whom consideration has been given to putting a DDA or where active membership is maturing and diminishing.

The highest pound to Euro rate was 1.752 on 3 May 2000 (shortly after the Euro was launched in 1999). The lowest was 1.02 on 30 December 2008 during the global financial crisis.

Employer investment/covenant risk

Largely as a consquence of the continued rise in gilt yields over the end of last year and the course of this year, many Funds are seeing requests from employers regarding options that may be made available to "de-risk" their position in the Fund. This is against a backdrop of more affordable termination settlements in current financial market conditions, which employers wish to protect from worsening in the future. These requests include:

- Some form of "partial exit" from the Fund, designed to allow an employer to terminate the Fund in respect of some but not all liabilities. This would leave the remaining employers to underwrite the risks of the employer's terminated liablities, whilst the employer in question remains ongoing in the Fund, underwriting only its remaining liabilities (typically these would be in respect of some or all of the active member liabilities).
- Adoption of a lower risk investment strategy (which may be actual or notional) which would allow the employer to reduce investment risks whilst termination funding levels are higher, and therefore risk reduction is affordable (thereby leaving the Fund less exposed to the employer covenant risk).

These requests are being raised at a national level and clearly there are a number of factors for Funds to consider in relation to these requests, which include:

- Whether a partial termination is a legally viable option
- If it is, is it appropriate for Funds to allow this
- Whether investment de-risking options are already available for employers (some Funds are already operating these) and if not, will the position be reviewed
- If Funds decide not to offer de-risking, will there be recourse for employers against Funds in the future, if market conditions revert and termination deficits have increased when such employers actually exit the Fund.

Please get in touch with your usual Mercer consultant should you require any additional support on these or similar issues.

Strain Costs

Following completion of the 2022 actuarial valuations and following recent changes to early retirement factors arising from a change in the SCAPE discount rate we have reviewed the factors adopted in early retirement strain calculations within the administration systems for those Funds where we are Actuary.

The new strain costs factors will produce costs that are comparative (on average) to current quotations and also, from an administrative perspective, remove the potential for unexpected strain costs to emerge (i.e. where benefits are being reduced).

In the longer term, we would recommend liaising with Funds/Advisors/Software providers to revisit and update the current calculation specfications where necessary e.g. to reflect current interaction between factors and also any potential changes emerging from forthcoming regulatory changes e.g. McCloud etc.

Accounting – Asset Ceilings

Disclosures for 31 July 2023 accounting cases are now in full swing and the larger 31 August 2023 exercise for academies in England Wales also on the horizon. Changes in market conditions (namely rising corporate bond yields), are likely to result in a number of employers being in surplus for the first time on an accounting basis.

Whilst not impacting on what contributions they pay into the Fund, based on experience from the 31 March exercise the change in balance sheet position is likely to lead to employers (and their auditors) potentially raising queries / asking for additional information, which will add to the project management for Funds associated with these exercises.

For further details on the potential scenarios that could emerge, and what options are available to employers, please contact your usual Mercer Consultant.

SAB Publication of 2022 Scheme Valuation Report

On 9 August 2023, the Scheme Advisory Board published a report summarising the outcomes of the 2022 actuarial valuation exercise for all Funds (with information sourced from reports for individual Funds).

Alongside setting out a summary of the main assumptions adopted (discount rate, life expecancy, inflation, salary incrases etc.), the report sets out the following headline balance sheet / contribution outcomes:

- *The average funding level has improved from 98% in 2019 to 107% at 2022 (on local funding bases), with all Funds reporting an improvement in their position since 2019*

- *Average contribution rates to meet future service costs rose from 18.6% of payroll at 2019 to 19.8% of payroll at 2022*

- *Overall, contribution rates fell – reflecting lower deficit contributions – to 21.1% of payroll at 2022 from 22.9% of payroll at 2019*

- *Employee contributions increased marginally from 6.5% of pay to 6.6%*

We would view this report as a pre-cursor to GAD's Section 13 assessment of the 2022 valuations. Whilst it can be difficult to directly compare figures without the fuller details such as overall funding objectives / risk manamagent policies in place etc, Funds will nonetheless be interested to contrast their own position against the aggregate data.

The ATOL scheme, which exists to protect consumers if their travel organiser fails, was first introduced in 1973 following a series of high-profile business failures. It stands for Air Travel Organiser's Licence.

Covenant

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Integrated Risk Management

The level of risk and expected return incorporated into a Fund's investment strategy will feed into the funding strategy adopted by the Actuary when setting Employer contributions. Alongside funding and investment strategies, the third element of an integrated risk management approach that looks to balance risk versus long-term affordability is employer covenant.

Employer covenant is an employer's financial ability to support its pensions obligations now and in the future, effectively underwriting the risks inherent in the investment strategy (member benefits ultimately being paid via a combination of assets and contributions).

How can Mercer help Funds manage Covenant risk?

Led by experts in corporate finance and restructuring, Mercer's specialist covenant team has been providing support to LGPS Funds for nearly 20 years.

The range of services available to Funds has evolved over time, recognising the diverse range of employers now participating in Funds. Examples of how the team now provides direct support in the following areas:

- **Valuation Assessments/Ongoing Monitoring** - We can provide Funds with a covenant tool that can be used on a self-service basis or by ourselves. This tool triages employers using readily available information from their financial accounts, analysing KPIs, and delivering an easily understood Red-Amber-Green rating. The tool can also prepare reports for individual employers to support discussions and to also update Committee/Members.

- **Employer Transactions –** we can help Funds to understand the impact of Employer transactions on their covenant strength e.g. refinancing exercises, mergers and acquisitions, or perhaps assessing the impact of a bulk transfer of liability into a Fund.

- **Employer Distress –** the ability of employers to meet their ongoing contribution requirements can be impacted by macro events such as high inflation and volatile energy prices, or employer specific events such as the loss of contracts or key personnel. This can prompt the need for inter-valuation contribution rate reviews where the Fund determines that the covenant has deteriorated and the employer presents a greater risk to the Fund.

- **Employer Exits –** with the introduction of flexible exit arrangements for employers in recent years, Funds will need to be able to determine an employer's ability to pay a termination contribution in full or over a fixed period.

For all these services, our proportionate approach provides Funds with the key information and advice required to make informed decisions on a timely basis.

Climate Change

Another area in this sector that is becoming more important is Climate Change. Alongside the potential impact on funding and investment strategies (e.g. impact on life expectancy and net-zero targets etc.), employer covenant can also be impacted as employers face and react to climate challenges and regulatory requirements. We can help Funds to consider this in a proportionate manner, focussing on broader sector analysis to consider impacts to particular employer groups, which would complement scenario analysis work in relation to funding and investment impacts.

Further information

Should you wish to discuss further how Mercer can help you manage your covenant risks in any of the above scenarios, please contact your usual Mercer Consultant or Nick Tinker (Nick.Tinker@mercer.com)

According to analysis by Resume.io the country with the most statutory paid leave days in the world is Iran, with 52 (with 27 paid public holidays). The country with the least is Micronesia, with 9.

Regulatory round up

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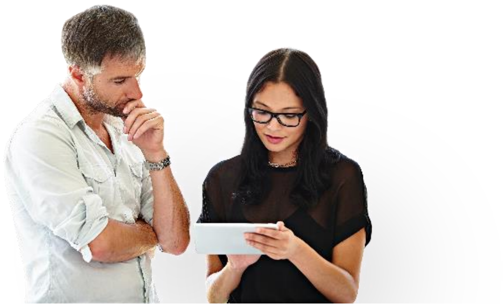
McCloud remedy (various)

Remedy

On 30 May 2023 DLUHC published a consultation and draft regulations concerning the McCloud remedy. As summarised below, alongside setting out new approaches to how underpin protections will be applied (to better align the LGPS with other public service pension schemes) the consultation also sought views on new areas that weren't included in the original consultation.

Area	Comment
Old areas (updated approach)	• Extending protection to pension accounts where prior periods of membership aren't aggregated. • Granting protection where a member has previous membership (prior to 31 March 2012) of other public service pension schemes (even if not transferred to LGPS). • Granting protection to benefits built up in the period to 1 April 2022 after a member (with protection) takes flexible retirement prior to 1 April 2022.
New	• Policies for individuals with excess teacher service. • Compensation for those members who have suffered a loss due to the McCloud case. • Interest terms that will apply for any late payments arising due to McCloud.



The consultation closed on 30 June 2023 and a response is now awaited. Given Regulations are scheduled to be laid three weeks prior to becoming effective on 1 October 2023, the timescales for Funds and Software Providers to be "McCloud ready" is limited and it is crucial that statutory guidance is made available as soon as possible to assist the relevant stakeholders.

Some of the complexities around the implementaiton of the remedy, as highlighted in the consultation document, will undoubtedly put pressure on administration teams and software providers, in particular given the time available prior to 1 October 2023.

If you would like to discuss how Mercer can help you with regard to the McCloud remedy (e.g. indepedently validating/tesitng the data you have collated) then please contact your consultant.

According to Visit Britian, the most popular visitor attraction in the UK (paid) is the Tower of London. The most popular (free) attraction is the Natural History Museum.

Tax

On 22 May 2023 a consultation was launched by HMRC on the Public Service Pension Scheme (Rectification of Unlawful Discrimination) (Tax) (No 2) Regulations 2023 which supplement the first set of regulations which became effective from 6 April 2023 and set out the correct tax treatment for public service pension schemes when implementing the McCloud remedy. Following closure of the consultation on 19 June, HMRC published guidance on 26 June to assist schemes in this area.

Cost management processes

During May 2023, there were a number of developments in relation to both the HMT and SAB Cost Management processes, namely:

- A written ministerial statement published by HMT on 15 May 2023 confirming that reformed scheme design only will be included in the cost control mechanism. Further detail was also provided in a policy paper published alongside the statement.
- A response from DLUHC published on 11 May 2023 setting out its response to the consultation on changes to the SAB's cost management process. As a result of the changes, the SAB and HMT processes will be better aligned going forwards and SAB will be provided with greater flexibility in relation to making recommendations to the Secretary of State where the cost corridor is breached.

- LGPS Regulations were laid on 11 May 2023 to coincide with the DLUHC response (becoming effective on 1 June 2023).

Academies

On 17 May 2023 the DFE published their policy for guaranteeing the outsourcing arrangements of academy trusts in England. The guarantee covers employees eligible for the LGPS who are transferred to a contractor from an academy trust, work for a contractor providing a service to an LEA school which subsequently converts to academy status, or work for a local authority providing services to an academy trust, and the trust subsequently opts to outsource these services to a third party.

The guarantee also changes the requirements for trusts to seek approval from the Education and Skills Funding Agency (ESFA) should the relevant criteria set out in the DFE policy be met.

We would recommend Funds review their existing policies in relation to such outsourcings given the additional security the guarantee now affords and we would be happy to discuss such policies further as required.

Other regulatory news in brief

TPR's New General Code is expected to be published in the Autumn. Further comment on the final code will be included in the next edition.

Cyber Security Following on from the Capita cyber attack in March, TPR updated its website reminding scheme managers of their their responsibilities and accountability in relation to the security of their Funds data. There have also been other recent incidents involving the Ombudsman and MOVEit. again reiterating the importance for Funds to have robust cyber security and business continuity plans in place to manage this risk

Many of the proposed requirements of the General Code are consistent with those in the LGPS Good Governance recommendations. For those Funds wishing to carry out a gap analysis in advance of the General Code becoming effective, including in relation to Cyber Security policies and procedures, then please contact your Mercer consultant.

According to a Travelodge survey, the most popular UK coastal destination in 2023 is Cornwall, followed by Devon and the Isle of Wight.

And in other news…

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Pensions Dashboards Update

The biggest development over the quarter saw DWP lay the Pension Dashboard (Amendment) Regulations 2023. As expected though, the phased staging timeline has been removed from the Regulations and instead a single connection deadline of 31 October 2026 for all Schemes has been set. This removal was confirmed by Laura Trott in a written ministerial statement.

Whilst formally removed from Regulations, Guidance however will still be issued by DWP and MaPS on a Staged Connection timeline for individual schemes (including the LGPS) and Schemes are still expected to continue their preparations accordingly.

In addition, the quarter saw:

- Data Value Guidance and updated Data Accuracy Guidance published by PASA.
- Updated dashboards guidance published by TPR to reflect the Regulations and to set out what schemes need to do to demonstrate their governance and decision making processes etc.
- The Pensions Dashboards (Prohibition of Indemnification) Act 2023 receive Royal Assent and prevents Trustees/Scheme Managers being reimbursed for any penalties imposed.

Gender Pay Gap Report

Following on from their report issued in January 2023 which identified differences in average LGPS pension benefits for male and female members, GAD published an updated report in June 2023 setting out details of the patterns identified in their investigations. In particular, the report highlights the complex interaction between part-time working, service breaks and career progression for women.

Going forwards, the SAB is to establish a working group to consider next steps in light of the GAD report, and has proposed that consistent reports be published across all public sector schemes as part of the quadrennial scheme valuation process.

Abolition of Lifetime Allowance

Following on from the announcements in the Spring Budget in March 2023, On 18 July 2023, a consultation was issued by HMRC formally setting out its approach to abolishing the Lifetime Allowance from 6 April 2024 onwards. The consultation includes comment on what limits will apply to lump sum benefits in the future and how such benefits will be taxed.

The Finance (No 2) Act 2023 also received Royal Assent in July 2023 thereby delivering the tax changes announced in the budget.

The only 7 start hotel in the world is the Burj Al Arab in Dubai

Meet the team

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Each issue we share some interesting facts about three members of our team at Mercer. This issue, meet Liam, Sarah and Nick.

Name: Liam Culshaw

Role: Actuarial Analyst

Joined Mercer: June 2023

Place of Birth: Liverpool

Favourite film: Very difficult to pick just one, but some that spring to mind are Pulp Fiction, Full Metal Jacket, and One Flew Over the Cuckoo's Nest.

If money was no object, where in the world would you want to travel to on holiday, and why? Probably either the Great Lakes in North America, or somewhere of historical significance such as the pyramids of Giza, Gunung Padang or Machu Picchu.

Can you speak a foreign language / do you try to when overseas? I'm not currently able to speak a foreign language but I have now completed 200 concurrent days on a language app to learn Spanish, so hopefully someday!

Name: Sarah Rafferty

Role: Cyber Security Consultant

Joined Marsh (Mercer sister company): May 2023

Place of Birth: London

Favourite film: Any sort of romcom!

If money was no object, where in the world would you want to travel to on holiday, and why? To the Bahamas to swim with the pigs!

Can you speak a foreign language / do you try to when overseas? Never!

Name: Nick Tinker

Role: Mercer's LGPS Employer Covenant lead

Joined Mercer: November 2019

Place of Birth: Leeds

Favourite film: Love Actually

If money was no object, where in the world would you want to travel to on holiday, and why?
I'd love to have the time and money to spend three months traveling by train around the old cities of Europe. As a new graduate, the exciting thrills and spills of a pending career as a chartered (!) meant I missed out on the Interrailling rite of passage.

Can you speak a foreign language / do you try to when overseas? My wife is fluent in French and Spanish and so she regularly despairs at my mangling of these beautiful languages. However, she speaks no German so I have the opportunity to exploit my O level German to my heart's content!

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For further information on how Mercer can help LGPS Funds and their stakeholders, please visit our website at www.uk.mercer.com/lgps