Local Government Newsletter

March 2020

Hello and welcome to the latest edition of our newsletter.

First of all, we would just like to send our best wishes to you all at this difficult time. We appreciate that many of you will be key workers, and most of you are critical to ensuring your fund or organisation's services are continuing despite the many challenges that are being faced. We hope you can keep safe, and are thinking about all of you, your families and work colleagues.

As you might expect, this month's topics include the ongoing impact of COVID-19, but we are also keeping on top of other business with an update on McCloud, the recent exit credits regulations, and the Budget (which seems like a distant memory now!), all of which should be useful in the coming months.

If you would like any further information on the above or anything else covered in this month's Local Government Newsletter, please get in touch.

Chris

Response to COVID-19

We are all experiencing unprecedented times with the outbreak of COVID-19, the illness caused by the new coronavirus. At point of issue, the impact of this virus continues to grow in the UK and it looks set to worsen in the coming weeks.

The Government had provided a list of key workers in their advice to schools, who are considered critical to the COVID-19 response. This list included local government administering staff "delivering essential public services, such as the payment of benefits". On 23rd March, the Prime Minister asked that everyone stay at home except for a few restricted activities one of which is "travelling to and from work, but only where work absolutely cannot be done from home".

The Pensions Regulator (TPR) has stated that schemes, employers and administrators should focus on:

- Payments of benefits,
- Minimising the risk of scams,
- Employer contributions, and
- Supporting good decision making

TPR has also acknowledged that COVID-19 is placing a huge additional pressure on scheme administration and noted that they "understand that many non-critical trustee and member services may be affected". They go on to state that "trustees and administrators should report to us immediately if they believe they will be unable to pay member benefits". In addition, they state reporting of other breaches should be as normal, but they will take a "pragmatic approach in our response". For more details see TPR's update issued 20 March.

The Local Government Association (LGA) has requested that administering authorities provide feedback on any issues with resourcing, their ability to process data and any local challenges. This will help raise awareness with Government, along with the aim of issuing guidance and advice as necessary. LGA also confirmed that pension managers will have received a message about minimum levels of service provision and the measures that they are taking to support administering authorities during this time. For more information visit the Scheme Advisory Board's dedicated page relating to impact of COVID-19.

LGA and MHCLG have also been in discussions with Fund Actuaries regarding the 2019 valuations and the possibility of employers asking for contribution holidays or being unable to make contributions. There has been general agreement to try to make best use of whatever flexibilities we can find within the existing regulations. However, whilst Ministerial time is likely to be difficult to secure, MHCLG has requested that funds and their actuaries provide evidence and examples to support any regulatory changes which might also be useful in the circumstances. We have suggested some possible solutions, including the bringing forward of the deferred employer provisions which might be of use for community admission bodies and will be in touch with funds we advise to discuss what other options, if any, they would like to see implemented. The Pensions and Lifetime Savings Association have also issued a document which sets out some top tips for DB schemes and LGPS funds to deal with short and long-term impacts of the pandemic.

Moving on to Aon's response, at the start of March, Aon began implementing travel restrictions and colleagues moved to primarily working from home, to protect the health and safety of our colleagues and their families, and to ensure Aon's capability to serve clients continues. Due to the advances in technology, we are finding that it's much the same as being in the office, if a bit strange. So we are here as normal if you need any help in delivering your services, or just even to discuss the approaches you are taking to provide a bit of independent input. We've been enjoying seeing so many of you during meetings that have gone ahead using our Webex functionality (and very grateful that the lack of business attire is being accepted)!

Aon has created a website dedicated to COVID-19 related communications and provides a single source of information for all clients. We hope you will find this useful.

People news

We are delighted to report that James England has recently passed his actuarial apprenticeship. James' hard work means he has reached a significant milestone in his career.

In addition, congratulations to Sam Ogborne and James Haysom on their recent promotions.

We'll have to celebrate later in the year when we can!

You will also see in our McCloud update later that we are delighted to be welcoming Virginia Burke to our team this week! Many of you will know Virginia from her time at Hymans and ITM.

Talking points

Exit Credits

On 27 February the Government partially responded to the consultation on changes to the valuation cycle and management of employer risk. The response focused on employer exit credits, and the other proposals in the consultation will be responded to at a later date.

On the same date, regulations were laid, which came into force on 20 March 2020 but the effects are backdated to 14 May 2018 (the date the exit credit regulations were originally introduced).

The regulations give administering authorities the discretion to pay an exit credit after taking into account factors such as the level of risk that the employer was exposed to during their participation in the fund and the value of the contributions paid to the fund. Where an exit credit is due, it must normally be paid within six months of the employer leaving the fund (this is an extension on the three-month deadline in the earlier regulations).

Any exit credits already paid to employers between 14 May 2018 and 20 March 2020 will stand and cannot be revisited, but any that have not been paid can now be dealt with under the new rules.

Fund actuaries are required to state the excess value of assets over the value of the liabilities in a revised Rates and Adjustments Certificate, and it will then be down to the administering authority to determine how much, if any, of that surplus is to be paid back to the exiting employer. This means that administering authorities will need a robust policy on dealing with exit credits, set out in the Funding Strategy Statement, to avoid the risk of challenge from exiting employers.

These regulatory changes will be welcomed by many administering authorities, meaning that exit credits no longer have to be paid to employers with pass-through agreements or other risk-sharing mechanisms. However, this does now make the exit process more complicated for administering authorities who will now have to decide the amount that should be paid after having regard to any representations from the exiting employer and (where relevant) the original outsourcing employer, and any other relevant factors, such as the value of the employer's contributions.

If you would like any advice on this, whether about a particular case or updating your Funding Strategy Statement, please get in touch with your usual Aon contact.

Cyber Phishing

In 2019, Aon ran a simulated phishing email exercise to test the resilience of UK pension schemes. This exercise is being undertaken again in 2020. A large proportion of cyber-attacks start out with a phishing email, which is an attempt to trick the recipient into following a link or providing data to the cyber-criminal. This risk is even greater due to the COVID-19 situation where work from home is required. Simulated phishing exercises are a way of testing the resilience of people and organisations, from both a technical and behavioural perspective.

The 2019 exercise was aimed at approximately 250 people, primarily trustees and others involved with pensions, across a selection of Aon clients. Over 25% didn't recognise the email as a phishing attempt and followed the link.

The 2020 exercise will involve a simulated phishing email sent to all participants sometime between 1 July and 31 December 2020. A report will be provided to your Pension Committee/Board on the results of the exercise both for your Fund (on an anonymous basis) and across the group of pension schemes as a whole. If you are interested, please do get in touch with your usual Aon contact to discuss further.

For more information about potential cyber resilience components administering authorities can consider please read our new leaflet "Pensions: Cyber Risk in the Public Sector".

Pension Age Awards

Congratulations to all the winners of the 2020 Pension Age Awards. In particular, congratulations to those Funds that administer the LGPS:

DB Pension Scheme of the Year: West Yorkshire Pension Fund.

Best Risk Management Exercise: Essex Pension Fund

Industry developments

Willis Towers Watson Merger

On 9 March, Aon announced that we have agreed to combine with Willis Towers Watson to accelerate innovation on behalf of clients. The combined company, to be named Aon, will be the premier, technology-enabled global professional services firm focused on the areas of risk, retirement and health. You can read the press release, listen to a replay of our Investor Relations call and find more information here: www.aon.com.

It is important to keep in mind that this announcement is just the first step in this process. Until the transaction closes, which is expected in the first half of 2021, Aon and Willis Towers Watson must act as separate and independent companies. That means it is business as usual at

Aon. We won't begin interacting with Willis Towers Watson or sharing client information at this time, and there will be no changes to our current relationship, team or our commitment to providing the exceptional service that clients have come to expect from us.

UK Budget

Our in depth look at the UK Budget provides details of the economic implications of the Budget as well as the announcement that the tapered annual allowance would change with effect from the 2020/21 tax year. This change, primarily driven by issues arising in the NHS pension scheme with some senior doctors refusing to work overtime shifts due to the negative impact on their annual allowance, applies to all pension savers.

In summary the changes to the tapered annual allowance are as follows:

- Previously, the annual allowance tapered down from £40,000 to £10,000 for those with 'adjusted income' (which includes pensions savings) between £150,000 and £210,000;
- Now with effect from 2020/21, it will taper down from £40,000 to £4,000 for those with 'adjusted income' between £240,000 and £312,000;
- 'Threshold income' (which excludes most pensions savings and below which the tapered annual allowance does not apply) is also increased from £110,000 to £200,000.

Effectively, the change means that those with adjusted income between £150,000 and £300,000 will see an increase in their Annual Allowance, but for those with adjusted income above £300,000 their Annual Allowance will decrease (to as low as £4,000 for some individuals).

For the LGPS this is expected to remove the need to consider the taper for the majority of people, with only the very highest earners being affected. However, the change is only effective from April 2020, so for the Pensions Savings Statement exercise later this year, which covers the 2019/20 Pension Input Period, the previous taper will still be a consideration.

Accounting deadlines

On 16 March the government announced an extension to the deadline for publication of local government financial audits from the end of July to 30 September 2020. Since then LGA have sought further clarification on this and whether this also affects the other deadlines such as the sign off for the accounts. MHCLG have confirmed that they will be amending the whole chain of publication requirements in the Accounts and Audit Regulations 2015, not just the final publication date for accounts. The intention is that the date for the public inspection of draft accounts will move to the first 10 working days of July, which will mean that the accounts themselves will not need to be signed off until 30 June. It remains to be seen if these changes will be extended to other parts of the UK.

The Scheme Advisory Board have asked MHCLG to confirm if it is their intent to apply a similar delay to the publication of scheme annual report and accounts, and we await further update.

Update on McCloud

The Government has confirmed that there will be changes to all public sector schemes to remove age discrimination, that was introduced when public sector pension schemes were reformed in 2014 and 2015.

Government recently announced that members of the unfunded schemes will have the option as being treated as members of the old scheme or the new reformed career average scheme. Thankfully this complication won't arise in the LGPS since all members moved to the new scheme with effect from 1 April 2014 (2015 in Northern Ireland and Scotland) and the transitional protections were effected via an underpin.

The E&W Scheme Advisory Board and Government are in ongoing discussions on what this means for the LGPS. It is expected that the outcome will be to provide younger members of the Scheme with protections that were introduced for older members. The protection will enable benefits to be paid under the rules which applied before 2014 or 2015, if this resulted in higher benefits. Otherwise, benefits would be payable in line with the current rules.

It is expected that these protections will apply automatically. Any changes to the Scheme will be backdated to 1 April 2014 (or 2015), and will apply to qualifying members who left the Scheme after this date.

Further details of the scope of any changes to the LGPS are likely to be available later in the year but some administering authorities are already seeking our advice on which members might be affected. It will be really important to plan the project, considering communications to members and employers and ensuring resources are in place to implement any agreed changes. There will be multiple strands to the project including software updates for future cases and recalculating benefits for members affected to date. We are developing tools and materials to support administering authorities across all aspects of this work. In order to ensure you are best placed to deal with McCloud we can support you by running educational sessions (via interactive webinars) for officers, committee and board members as well as supporting with planning which we think will be vital. Virginia Burke will be leading on this so please do get in touch with her, Alison Murray, or your usual Aon contact if you would like to discuss.

Cap on public sector exit payments

On 13 March, the Chief Secretary to the Treasury (Steve Barclay MP) advised that the Government intends to publish the response to last year's consultation on the implementation of a cap (expected to be £95K) on public sector exit payments in April. He also said that the Government will ensure legislation is brought forward before the summer recess "providing parliamentary time allows". However, we now understand that the second reading of the Bill has been delayed until September.

Once any cap is in place our expectation is that national strain factors, set by the Government Actuary's Department, will need to replace the current approach of local factors to ensure consistency for members across the Scheme for the purpose of comparing redundancy costs with the cap. It will be important for any changes to the methodology which may require the administration systems to be updated to be made in advance of the cap being implemented to avoid administering authorities having to process manual calculations or stockpile cases whilst the systems upgrades are being developed. The timing may also prove to be unhelpful for administering authorities if it sparks a flurry of redundancies before the cap is implemented (our assumption is that there will be a lead-in time although that is not guaranteed) when pensions teams are still adjusting to off-site working and potentially under-staffed due to illness, never mind the additional workload which McCloud may bring.

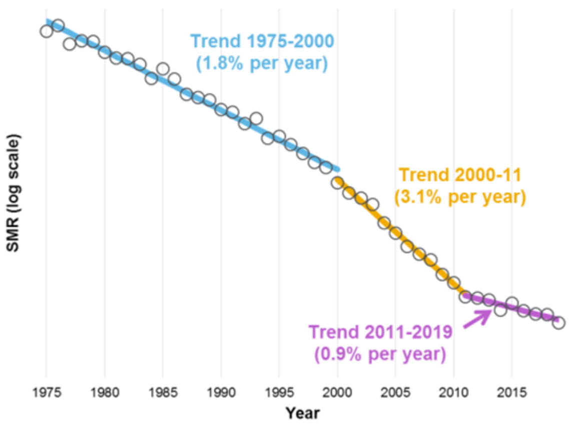
Increasing mortality improvement rates - CMI 2019 published

The CMI ('Continuous Mortality Investigation'), has published its updated standard mortality projections model, 'CMI_2019'. The updated model reflects an additional year of England & Wales mortality data. Because 2019 saw the strongest full-year improvement in a decade with a standardised mortality improvement of 3.8%, the new model will (all else being equal) increase liabilities compared to the previous version ('CMI_2018').

The CMI noted that mortality improvements are not the same for everyone, with people living in less-deprived areas of England and Wales experiencing mortality improvements around 1% a year higher than people living in the more deprived areas in recent years.

For males aged 50 to 89, improvements have been on average 0.9% per year over 2011 to 2019, compared to 3.1% per year over 2000 to 2011 and 1.8% over 1975 to 2000.

The chart below shows these mortality trends.



Standardised mortality rates for England & Wales males aged 50 to 89 inclusive

We will continue to monitor mortality trends and note that there is a great deal of uncertainty given the outbreak of COVD-19 so we will see how this develops in the coming months.

Cost Management

The Government Actuary's Department has confirmed that they will be sending funds a short report on the 2019 data that was provided for the purpose of the cost management exercise.

It is expected that data for 2020 will be requested in September 2020.

RPI Consultation

HM Treasury and the UK Statistics Authority (UKSA) published their anticipated consultation on the Reform of the Retail Prices Index Methodology on 11 March, the same day as the Budget. There were no major surprises, the consultation confirmed that "from the implementation date (a date between 2025 and 2030 subject to consultation) the RPI index will be calculated using the same methods and data sources as are used for CPIH".

The consultation made no mention of any compensation for holders of RPI-linked gilts affected by the changes. There was no clear market reaction, although as the consultation was launched on the day of the Budget (and amid market uncertainty due to COVID-19) there was a significant amount of news for the market to digest at around the same time. The consultation runs until 22 April.

In relation to the LGPS, where pensions are CPI-linked, the position remains that for funds holding index-linked gilts (or other assets such as swaps that provide a hedge to RPI), this change to RPI is potentially unfavourable. Any funds with material index-linked holdings (current or planned) should consult with their actuary and investment consultant.

The change will also impact on the way many Funds determine their inflation assumption which typically has regard to index linked yields.

There are also still some LGPS benefits that use RPI that will be affected by this consultation (e.g. the calculation of councillors' career average pay, and the increases to pre-2012 additional pension contracts).

TPR Single Modular Code

A consultation was expected in late March but given the COVID-19 situation TPR have confirmed that they are suspending all their regulatory initiatives at present. That includes postponing their consultation on bringing together their codes of practice – including Code of Practice 14 for Public Service Pension Schemes.

What we've been talking to our clients about

2019 Actuarial Valuations

Most of you will be aware that the statutory deadline for signing off the 2019 valuation is 31 March 2020, so we have been busy making final changes to our report and tying up loose ends. This has included discussions on market volatility (worthy of a special mention so covered further below) and ensuring documentation has been through appropriate governance processes.

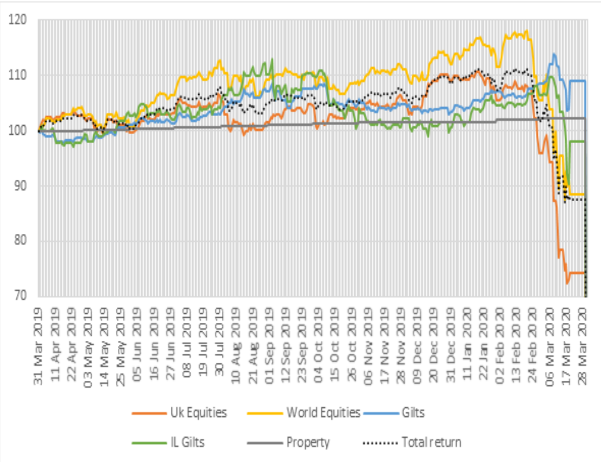
Market Volatility

It will have escaped no-one's attention that Covid-19 has caused a major shock to investment markets – see chart below on recent market movements.

In general, growth assets have been falling materially in value during March 2020, albeit with major swings in both directions from day to day and even during the same day, and all of this after what had up to that point been, for most funds, a reasonably good previous 11 months since the 2019 valuation date.

In addressing this with our clients, the general conclusion for the valuations has been that there is no need to make last-minute changes to employer contributions, given the level of prudence in funding strategies and the long-term nature of the LGPS. Having said that, given ongoing uncertainty as to whether there may be a more enduring downturn in performance, some administering authorities have shown an interest in certifying "conditional" contributions over the period 2021-23.

We have also been suggesting that consideration could be given to revisiting contributions between now and the next valuation under Regulation 64(4), for employers that an administering authority believes are likely to exit the Fund in advance of the next valuation. In any event, managing the expectations of employers regarding the potential outlook for contributions after the next valuation should remain on fund agendas.



Financial and Emotional Wellbeing

There can be many upsides from working from home which many employees are benefiting from because of the COVID-19 outbreak, such as increased flexibility of working arrangements. However, there can be downsides too – for example employees may feel isolated in their new working environment.

Employers have an important role to help their employees thrive in the home-working environment, however temporary. We have produced a document which provides suggestions on how employers can support their employees through this potentially challenging time.

Recent events

LGC Investment Seminar

Alison Murray and Karen McWilliam attended the seminar at Carden Park. The sessions were very varied with a focus on the climate emergency and ESG. As always, it was great to catch up with so many of you.

National LGPS Technical Group meeting

Due to our travel restrictions that came in to effect before this meeting on 6 March, we were unable to attend. However, the minutes are available online.

Upcoming events

Knowledge and Skills

It is extremely challenging in the current environment to prioritise and provide the required training to committee and board members to ensure appropriate knowledge and skills.

However induction training, or training on topical issues (such as McCloud) is still important. In addition, being able to train and support staff is more difficult given the prioritisation of key work during the COVID-19 situation, but it may be necessary to think about expanding the skills of existing staff to plan for potential staff shortages. We are supporting clients through online learning facilities to provide Webex training in shorter, bite size sessions on topic specific items. If this is something you would like to discuss further please contact your usual Aon contact.

Aon's 2020 Conference Series

As a precautionary measure, Aon Leadership made the decision to cancel the 2020 Pension Conference Series to help mitigate the spread of the COVID-19 disease caused by the Coronavirus.

To ensure you are still able to access the great content that our teams of industry experts have worked so hard to produce for you, we have put together a schedule for those registered for the Conferences; some content will be offered to you over the coming weeks via webinars. We currently plan to deliver the remaining content at a half day conference later in the year. Look out for further information on this in due course.

You can register for the webinars here. We have added details of webinars that may be of interest to public service pension schemes below. Simply **select all the webinars you wish to attend and** we will send you joining instructions for each event.

Session	Format	Timings
Trustee governance at this changing time What changes are we expecting in governance and trusteeship over 2020 especially in the light of the Coronavirus pandemic? How is this likely to impact how you run your pension plans and what are the actions that trustees and corporates are already starting to take?	Webinar	31 March 2:30pm – 3pm
GMP Equalisation The team will look at the key decisions of GMP Equalisation, how far other schemes have got and discuss the big question - is it harder or easier than expected!	Webinar	7 April 10:30am – 11:15am
Responsible Investment - a member's vision In this discussion and Q&A session, Aon's experts will consider the growing demand from regulators, the industry and scheme members for more action from trustees on responsible investment and good stewardship. We will explore how trustees can respond to these new demands, and ask what opportunities this offers for engagement with members.	Webinar	7 April 1:30pm – 2pm

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About Aon

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