Empower Results®

Local Government Newsletter

January 2019

Hello and welcome to our inaugural newsletter of 2019.
I hope you all had a good Christmas and New Year and have returned with batteries fully recharged for what promises to be another busy year ahead. January has started the year off with the issuance of another consultation on new Fair Deal regulations and developments on the Cost Management process as it enters full swing in advance of a 1 April regulatory deadline. We have been busy planning for the 2019 valuations, and this edition summarises what we see as being some of the hot topics on the valuation agenda this year.

Joel

People News

Many congratulations to Arek on the new addition to his family. Bernard Harold Gibas was born on 27 December and is proving to be one chilled out little dude – just like his Dad.

We also welcome Imla back to work this month following maternity leave – just in time for the 2019 valuations!

Talking points

Consultation on Fair Deal

After withdrawing draft 2016 regulations, MHCLG has published a further consultation on revised draft regulations to introduce Fair Deal proposals into the LGPS.

In summary the provisions, which apply to England and Wales only:

- introduce the concept of a 'Fair Deal employer' and 'protected transferees' who will retain the right to participate in the LGPS for as long as they are wholly or mainly employed on the outsourced service
- remove the broadly comparable scheme option
- permit employers to be a 'deemed employer' instead of via admission agreement (the legislative provision already exists and is used for Local Authority Schools).
- require Fair Deal employers to have regard to advice provided by the Scheme Advisory Board on matters to be considered, including risk sharing
- set out that transfers back into the LGPS from a broadly comparable scheme will be treated as individual transfers using current GAD factors
- allow automatic transfers of assets and liabilities within and between funds where there are reorganisations or mergers, without triggering an exit valuation.

The consultation closes on 4th April 2019. We will be responding to this consultation in collaboration with our colleagues who advise private sector organisations participating in the LGPS.

Update on employer cost cap

The SAB has confirmed the package of measures they submitted to the Secretary of State to bring the scheme's costs of 19.0% back to the target cost of 19.5%. If agreed by MHCLG, the package of benefit/contribution improvements that will be consulted upon (expected at the end of January or early February) will be as follows:

- Removal of tier 3 Ill Health (instead tier 2 will be extended to cover individuals previously entitled to tier 3)

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- A minimum death in service lump sum payment of £75K (which will benefit members with pay under £25K).
- Improved early retirement factors for active members on or after 1 April 2019, on all service (no details yet on the proposed terms)
- Reduction to employee contributions for the lower paid, and removal of tax relief anomalies

The impact on contributions will be variable at employer-level, largely due to the proposed change to member contribution rates (employers with lower paid staff should expect a greater proportionate increase in employer cost).

The government's objective is for all changes to be made effective from 1 April 2019.

More information is included within our spotlight.

MHCLG publish revised factors following change in SCAPE rate

Following the announcement of the change in the SCAPE rate in the 2018 Budget, from 2.8% p.a. to 2.4% p.a., MHCLG has issued new factors for calculating various member options including non-club transfers, early retirements, trivial commutations and pension credit/debits. These new factors are effective from the date of issue on 8 January 2019. The new factors result in less favourable terms when benefits are being transferred into the Scheme, but more favourable terms on trivial commutation and early retirement.

Post 14 refunds

Funds should ensure they have a process for contacting members with post 2014 frozen refunds. These have to be paid within 5 years of leaving, and hence the first ones will be due in April. This means that funds need to be contacting these members now to allow time to process payment or trace the member if they have moved. Technical Group recently considered this process, and its recommendations to funds are set out in the minutes from the September meeting: http://www.lgpsregs.org/bulletinsetc/tgminutes.php.

Payment of exit credits

The 2018 LGPS Amendment Regulations (England and Wales) introduced a requirement for administering authorities to pay exit credits to employers in surplus who exit the Scheme on or after 14 May 2018.

Many employers and administering authorities have since reviewed and updated existing policies to reflect the regulatory change, but also to ensure they can be administered in line with existing arrangements. For example, in many cases where employers outsourced staff to an admission body before May 2018, letting authorities agreed to contractually indemnify admission bodies against any exit debt on their exit from the Fund. Contractual terms therefore corrected an asymmetry which previously existed within the regulations whereby by the admission body would be required to pay a deficit on exit but not benefit from a surplus. However, unless contracts are renegotiated, the new regulations have potentially created another asymmetry in the other direction, where the letting authority is liable for deficits on exit, but the admission body benefits from a surplus. A further unintended consequence is that contractors may be incentivised not to agree to a contract extension, but instead to re-bid under new terms to enable payment of an exit credit.

We have previously expressed our concerns to MHCLG of the potential consequences of not having a carve out in relation to contracts written before May 2018. We now understand that the LGA is proposing to write to MHCLG in connection with this issue and has recently written to administering authorities asking for information on the number and level of exit credits paid to date.

LGA issue guidance on pension increases

Following government's response on 22 January 2018 to its consultation on the future increases to public service pensions following the end of contracting out on 5 April 2016, and HMT's Ministerial Direction dated 3 December 2018 to implement the outcome of the consultation, LGA has updated and published guidance on the application of increases to LGPS pensions in payment.

Supreme Court grants appeal on banning the imposition of political boycotts

The Palestine Solidarity Campaign (PSC) has won the right to appeal the Court of Appeal judgement which upheld MHCLG's right to restrict the LGPS from divesting contrary to UK foreign and defence policy. These rules would restrict the possibility of divestment, on ethical grounds, from companies on the basis that they trade in products produced in the occupied Palestinian territories.

Delays to implementation of IAS 19 changes into CIPFA Code of Practice

Last year CIPFA consulted on proposed changes to the Code of Practice for 2019/20 including proposed changes to pensions accounting in line with changes to the IAS 19 accounting standard.

The proposals would require employers to remeasure the defined benefit obligation (liability) following a curtailment, settlement or prior service cost. We responded to the consultation to alert CIPFA to the potentially significant additional cost of adopting these changes for employers who account multiple events, such as local authorities whose schools are converting to academy status.

We asked CIPFA to consider providing additional clarification on the implementation of these changes so that auditors do not take an extreme view of what should be undertaken (at additional cost to authorities) when such calculations are unlikely to lead to materially different figures.

CIFPA has since issued an update to confirm that, as the EU has not endorsed the changes to IAS 19 by the time of the effective date (1 January 2019), CIPFA will not be adopting these changes in their 2020 Code. We expect to hear more on these changes in 2019.

Industry developments

Judicial review of female SPA changes

A date has now been set for the judicial review into the raising of the SPA from 60 for females. The review will take place on 5 and 6 June this year and will consider whether women born in the 1950s were sufficiently communicated with on the changes. Depending on the review, it could result in the State Pension Age being put back to 60 for this generation.

Merger of financial guidance bodies

With effect from January 2019 the Pensions Advisory Service, Pension Wise and the Money Advice Service have been merged to form the Single Financial Guidance Body. The new body brings together the provision of government-sponsored financial guidance covering debt advice, money guidance and pensions guidance.

Education Funding Agency's consultation on employer contribution increases to the Teachers' Pension Scheme

The EFA is consulting with employers, teachers and other sector bodies on the impact of proposed increases to employer contributions to the TPS, from 16.48% to 23.6% of Pay from 1 September 2019. DfE has proposed that they provide additional funding to schools which receive public sector funding, Further Education Colleges and other public-funded training organisations. However, funding does not extend to private sector employers, and neither is it guaranteed to extend beyond the 2019/20 financial year, with future funding decisions part of the 2019 Spending Review.

Pensions Dashboard

DWP's consultation on pensions dashboards closed on 28 January.

Whilst DWP's aim is to get dashboards up and running on a voluntary basis in 2019 (noting that DC schemes such as Master Trusts are likely to be their first area of interest) they are seeking views on the phasing of the introduction for schemes such as public sector DB schemes, and how to legislate in a way that supports a phased introduction within a reasonable timeframe.

Other important areas on which comments are being sought include the overall architecture, governance and funding for the project. We have fed in views from a public sector perspective to the Aon response, noting the diversity of public sector schemes and including the additional challenges for multi-employer schemes such as the LGPS in providing data for all scheme members.

Whilst a successfully implemented dashboard would likely bring data improvement and better accessibility for members, we have asked for greater clarity on how frequently data would be required from schemes. If the expectation is to

initially provide Annual Benefit Statement information via the dashboard, how would that align with the current statutory requirements for schemes to provide statements directly? The funding for any inclusion of public sector DB schemes needs to be clarified, recognising that any additional costs will likely fall to schemes; employers, and ultimately tax payers. We also note the challenge in any governance structure to ensure that it is effective, recognising the breadth of schemes (207 public service pension schemes) and members (16.7 million members in public service pension schemes) within the public sector DB world and their respective views.

What we've been talking to our clients about

Planning for the 2019 valuation

With the effective date of the 2019 actuarial valuation on the horizon, we have been working with our clients to plan for the year ahead. Some of the specific areas we have been discussing are:

Employer risk

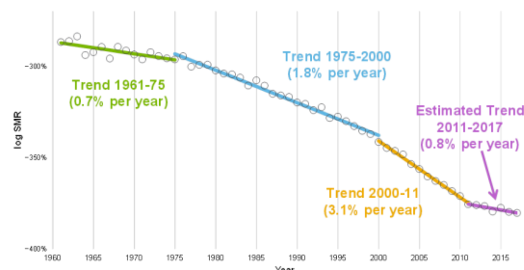
With increasing focus on employer risk from the Pensions Regulator (code of practice 14), CIPFA (guidance on Managing Risk in the LGPS) and the SAB (Tier 3 review), many administering authorities now regularly monitor employer risk and integrate results into their funding strategy.

We are currently undertaking varying degrees of employer financial risk analysis for our clients with the objective of finalising risk categories and communicating potential changes with employers early in the valuation year.

If any changes are to be made to funding strategy, it is important that these are adequately communicated to employers – in our experience changes (even if not popular with the employers affected) can be implemented smoothly as long as employers feel they have been part of the process and understand what the administering authority is trying to achieve.

Mortality

Since the 2016 valuation mortality experience in the UK has been heavier than expected. Whilst life expectancy continues to rise, the rate of improvement has reduced considerably.



We are currently analysing the mortality experience across our clients using data observed to 31 March 2018 using our proprietary longevity model (Demographic Horizons ™). Results will be available in the coming months. The expectation is that the results of this analysis, combined with use of a recent projection model issued by the Continuous Mortality Investigation, will lead to lower life expectancies compared to the 2016 valuation, and as a result reduced Fund liabilities and primary rates (all else unchanged). There are, however, likely to be other factors creating upward pressure on primary rates, including the outcome of the Cost Management process and the risk of lower discount rates.

Data cleaning

Having delivered the results of our 2018 data validation exercise last year we are currently discussing results with clients, with a view to implementing a process of correcting the high priority items (insofar as they impact valuation outcomes) as part of their wider Data Improvement Plans.

We are also discussing the process for submitting, validating, and estimating erroneous data as part of the 2019 valuation timetable, to ensure data is not a barrier to timely and accurate valuation results.

Brighter outlook for contributions?

Despite poor investment performance since the end of September 2018, which has seen falls in UK and overseas equities of in the region of 7%-9% (at date of writing), investment markets have still been very positive since the 2016 valuation.

There is still plenty of water to go under the bridge until the valuation date which, due to being on a Sunday this year, means that market asset values will be measured at close on 29 March (the date the UK is expected to exit the European Union). We would, however, expect market movements in the weeks leading up to this date to be more significant than movements on the day itself as it becomes clear where we are heading.

Discussions with clients to date have generally centred around the likelihood of a more positive outlook at this valuation than the last. Clients are starting to consider how funding and investment strategy may react, including whether de-risking of funding strategy (increasing prudence), and/or de-risking the investment strategy (often leading to reduced expected returns) should be an objective at this valuation. Care is generally being taken not to set expectations of contribution reductions for employers, particularly given uncertainty around changes following the Cost Management process which are likely to increase employer cost (all else unchanged). Indeed, there may be categories of employer in the Fund whose contributions are likely to increase depending on their membership and/or risk profile, or if funding strategy is linked to low risk gilt investments.

Cyber Crime

In conjunction with our Cyber Solutions colleagues, in 2019 Aon are undertaking what we believe is the UK's first simulated phishing exercise for trustees of pension schemes.

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. Simulated phishing exercises are used widely by large companies as a way of testing their cyber resilience, from both a technical and behavioural perspective, and Aon has extensive experience of running these exercises.

This new offering from Aon is designed to be of benefit to trustee, committee and board members, but it can also be used for the wider pensions team. Most LGPS pensions teams are part of a wider organisation so many will be relying on assurances on cyber resilience from their employer. But with pensions so high profile and of potential interest to cyber criminals, it is prudent to look specifically at those in pension roles.

The phishing exercise being launched this year is a group exercise offered to multiple pension schemes at low cost. Alternatively, we can organise Fund-specific exercises which are tailored to their own circumstances.

Our cyber capabilities also go well beyond pension funds, so phishing exercises, or wider cyber training, can also be run for the administering authority or other employers.

If you wish to understand more about how Aon can support you with understanding and tackling cyber risk, please speak to your usual Aon consultant, or contact paul.mcglone@aon.com.

Upcoming Events

LGC Investment Seminar - Carden Park

Catherine Pearce will be attending this event at Carden Park between 28 February and 1 March and she looks forward to seeing many of you there.

Aon's 2019 Pension Conference Series – evolution, solutions, performance

As mentioned in previous editions, our Pension Conference Series is a free event and is designed for trustee, HR and Finance professionals who are responsible for making decisions about their scheme. The conference is held on a number of dates in different locations of the country. Visit our website to register.

Date	Location
5 February 2019	Manchester
26 February 2019	London
5 March 2019	Bristol
12 March 2019	Birmingham
19 March 2019	Leeds
26 March 2019	Edinburgh
2 April 2019	London

Blog spot

The latest articles from the Aon Retirement and Investment Blog

- **Weekly Update – 21 January**
- **Fourth Quarter 2018 Market Review and Outlook**

Contact Information

Joel Duckham
Senior Consultant
+44 (0)117 900 4425
joel.duckham@aon.com

Alison Murray
Head of Public Sector Actuarial
+44 (0)117 900 4219
alison.murray@aon.com

Karen McWilliam
Head of Public Sector Governance and Benefits Consultancy
+44 (0)771 101 6707
karen.mcwilliam@aon.com

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance deliver insights that reduce volatility and improve performance

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Aon Hewitt Limited

Registered in England & Wales No. 4396810

Registered office: The Aon Centre | The Leadenhall Building | 122 Leadenhall Street | London | EC3V 4AN

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