Local Government Newsletter

January 2021

Happy new year, and welcome to the January 2021 edition of our monthly newsletter.

Whilst society has entered 2021 learning to adjust to increased restrictions on our daily lives, the pace of change in local government pensions is unrelenting, and many of us have returned from the festive break with overflowing agendas for the year ahead. We are working with many of our clients to help pull together their business plans and priorities for 2021.

In this issue we bring you a further **Covid 19 update** including how Aon is reflecting the pandemic in our mortality analysis ahead of the 2022 LGPS valuations; a discussion on the **Taskforce on Climate-related Disclosures** (TCFD), and planning for the 31 March **employer accounting exercises**, alongside a number of regular industry developments.

Joel

People News

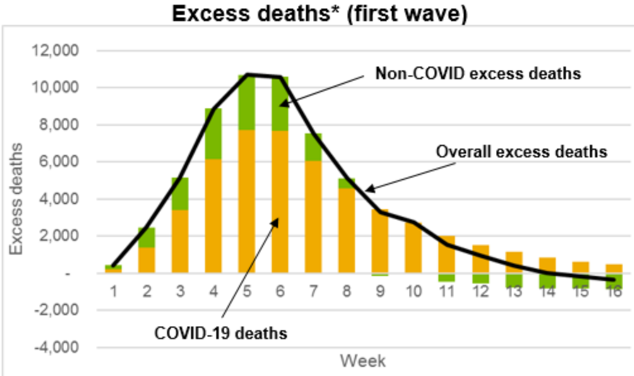
Congratulations to Loren Wynn who gave birth to baby James on 19 January, weighting in at a healthy 8lb 15oz. To break with the tradition of bringing the baby into the office, we have invited Loren to personally visit each and every one of our doorsteps to show him off.

COVID-19 Update

The UK has recently reached the tragic milestone of 100,000 "COVID-19 deaths" (deaths for any reason within 28 days of a positive COVID-19 test), with more than half of these deaths during the second wave (which started in September 2020). And it's important to recognise that the second wave is still in progress – the charts below use data from the Office for National Statistics up to the week ending 8 January 2020; more recent data on COVID-19 deaths suggest that the toll remained high throughout January, with indicators starting to improve at the very end of the month.

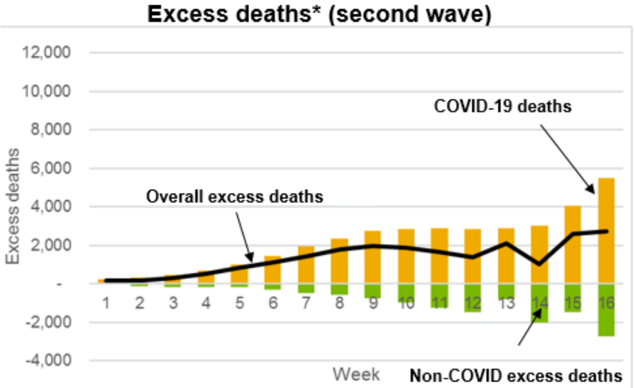
From the perspective of pension scheme funding, it is total deaths from all causes (not just COVID-19) that is the key statistic. The charts on the next page illustrate the "excess deaths" each week during the two waves so far - that is, the number of additional deaths relative to the same period in previous years.

Excess deaths* (first wave)



Weeks ending 13 March to 10 July 2020

Excess deaths* (second wave)



Weeks ending 18 September 2020 to 8 January 2021

The charts reveal a very different pattern between the two waves. During most of the first wave, excess deaths (the black line) were higher than COVID-19 deaths (the gold bars), which may be because some COVID-19 related deaths may not have been recorded as such, given the limited testing early in the pandemic.

In contrast, during the second wave, excess deaths have been *lower* than COVID-19 deaths. This is likely to be because:

- some (but by no means all) of those who died in the first wave were people who might have died relatively soon afterwards; and
- other infectious diseases such as flu are not circulating to anywhere near the same extent as usual (as noted in our November newsletter, this mirrors the experience of Australia during their winter).

The UK have now provided first vaccines to around half of the individuals in the Government's priority groups (care home residents and their carers, frontline medical staff, clinically extremely vulnerable individuals, and those aged over 70). It's estimated that almost 90% of excess deaths in the first wave were individuals in these groups, so an effective vaccination rollout could have a significant impact on future mortality.

The exceptional nature of recent mortality experience was recognised by the Institute and Faculty of Actuaries' Continuous Mortality Investigation (CMI), who have confirmed that they will not take 2020 experience into account when preparing the next industry standard mortality projection model (CMI_2020). Aon have been strongly supportive of this approach to setting mortality improvements.

Looking ahead to setting mortality assumptions for 2022

When setting base mortality assumptions for individual pension funds however, we will use all available data, including mortality experience across the pandemic period. This is possible because we have a pattern of pandemic mortality to compare against, based on experience in the national population. Aon's approach to setting mortality assumptions for the 31 March 2022 funding valuations will be to assess each pension fund's own mortality experience compared to national data, making allowance for the impact of the COVID-19 pandemic over time and by geographic region (London being much harder hit in the first wave than the South West, for example). This will allow us to come up with fund specific assumptions using all available data that are not distorted by the exceptionally heavy mortality during the pandemic. Pension funds should therefore plan to provide up to date mortality experience data later this year to feed into the assumption setting process, as they did three years ago.

TCFD – considering climate risk

Climate risk has been on many of your agendas for some time now – but, research conducted by the PLSA in mid-2020 suggests that many schemes have not yet determined how they will approach this complex and important issue. Meanwhile, over 50% of LGPS funds have either had climate change proposed as a meeting agenda item, or have received enquiries from members or constituents about climate change considerations within the pension scheme. With an increasing number of local authorities declaring climate emergencies, it is clear that momentum is building and that action should be taken now.

What can you do to understand climate change risks and how they may affect your fund? On the horizon is a consultation, expected to be launched imminently by MHCLG, regarding the TCFD. Another set of initials, we hear you say? TCFD is likely to become very familiar to many of you over the coming months – it stands for the "Taskforce on Climate-related Financial Disclosures" and is a globally-recognised initiative launched by former Bank of England Governor, Mark Carney. The TCFD is a set of recommendations – 11 in total – which, taken together, provide a framework for making consistent and comparable disclosures regarding climate change related financial risks. The PLSA's research suggests that over 60% of schemes were not yet familiar with TCFD, whilst only 20% had begun to consider climate risk and were aware of TCFD's existence.

Use of the TCFD framework is expected to be made mandatory for corporate pension schemes from October 2021, and MHCLG intends to consult this year on the introduction of mandatory TCFD-aligned disclosures across the LGPS in England and Wales by 2023. Whilst that may seem some time away, TCFD is a significant undertaking and one that will require careful planning and structure in order to fulfil each of the four 'pillars' of the TCFD framework. These 'pillars' span from scheme governance arrangements through to assessment of financial risk – including through scenario modelling, in which Aon has significant expertise (indeed, our scenarios – which are fully aligned to the TCFD – were highlighted by the Institute and Faculty of Actuaries as being "the most useful to date"). Scenario analysis can help in assessing the potential impacts of climate change on a scheme's assets and liabilities over the short, medium, and long term.

We're working with a number of schemes at the moment who, whilst not required by law to disclose under TCFD at this stage, are seeking to have a 'dry run' over 2021 so that they are well-positioned to deliver this come the expected deadline. We believe this is a sensible and appropriate way to approach this – from a good governance and overall 'readiness' perspective, our suggestion would be to consider planning for and undertaking a similar exercise over the course of 2021 to ensure that the structure is in place to deliver this effectively in 2022/2023. For many schemes, the first step will be understanding more about climate risk and how this applies to pension schemes, and learning more about TCFD and what the framework delivers. If you'd be interested in learning more, please get in touch with Alison Murray, or your usual Aon contact.

Industry developments

Prudential closing their property fund

Prudential has announced it is closing its UK Property Fund in mid-2021. This Fund had been suspended since June 2019. No alternative property fund will be offered so Prudential is proposing the Prudential Dynamic Growth Fund as the default replacement. Administering authorities that have prudential as a provider will need to decide whether members should be offered an alternative replacement fund rather than accepting Prudential's default, and consider the communication with employees around this. Please get in touch with your usual Aon contact if you'd like advice in this area or if you'd like to review your current AVC offering.

Section 13 update

GAD are currently undertaking their review of the 2019 valuations under Section 13 of the Public Service Pensions Act: We understand their calculation work is now complete and they are planning for their engagement with the funds and their actuarial advisers in the coming weeks, ahead of a timetable for finalising their report this summer.

Exit Cap update

We understand that the MHCLG Regulations are likely to be delayed until after the Judicial Reviews have taken place, which could be towards the end of March, or later if there is an appeal thereafter.

The Pensions Ombudsman has said that where an administering authority has made a decision to follow MHCLG's letter it should say so in the documentation to members, i.e. that benefits are not being paid in line with Regulations as they stand but in line with instructions from Government. LGA/SAB has issued guidance on Strain cost caveat wording for use alongside quotes provided for exits that occur from 4 November 2020 until the revised LGPS regulations and GAD guidance are in place. Administering authorities should review their communications with members.

It is also our understanding that any cases referred to the Pensions Ombudsman need to go through IDRP first. However, it should be noted that the Ombudsman is prevented by the Pensions Act from considering anything where there is ongoing legal action on the same matter and as the Judicial Reviews include the question: 'what effect do HMT exit cap Regulations have on the existing LGPS Regulations?' the Ombudsman can't currently make a direction. Cases should still be sent to the Ombudsman since there may be other parts of the process on which the Ombudsman can take a view.

McCloud update

Whilst the date the remedy will come to an end appears to be fixed as 31 March 2022, we understand there is a possibility that implementation will be delayed until 2023 in the unfunded schemes. A Treasury response to the consultation is expected this month, or early in February; with MHCLG planning a Ministerial statement by the end of the February. Whilst we await more details on the timing of regulations for the LGPS, we continue to help clients with all the work associated with McCloud data collection and planning their implementation projects.

SAB Guidance on new employer flexibilities

The SAB consultation on the guidance for the new employer flexibilities in the LGPS closed on 9 January 2021, and we await the publication of the final guidance. Given the Regulations have been in place for some time, many Funds are already considering changes to their policy documents based on the draft guidance, so that policies can be agreed and consulted upon without significant delay once the final guidance is published.

Pensions Increase/Revaluation for 2021

It has been confirmed that the CPI increase in the year to 30 September 2020 was 0.5%. The chief secretary to the Treasury has also confirmed this to be the 2021 rate of pension increases and revaluation of pensions accounts for public service pension schemes. The CARE revaluation rate in the LGPS was also confirmed as 0.5%.

What we've been talking to our clients about

Planning for 31 March accounting

Administering Authorities will need to start engaging with employers to collect their requirements for pensions accounting this year.

In some respects, the 2021 exercise is likely to be more straightforward this year for the England and Wales Funds, as we are not updating figures for a new valuation, and assuming we have no last minute 'surprises' on the proposed McCloud remedy (although we await MHCLG's response to their consultation, so there is no guarantee!).

However we are expecting some bumps in the road, such as:

- The 2020/21 CIPFA code of practice has adopted the amendment to IAS 19 which requires the remeasurement of the net pensions asset (liability) following a plan amendment, settlement or curtailment. This potentially affects employers who account for redundancies, or local education authorities accounting for academy conversions for example. Whilst in many cases the remeasurement can be ignored on materiality grounds, we expect auditors to seek evidence of the materiality judgement, noting that the application of the remeasurement could be more significant than the event itself. We are encouraging employers to discuss this with their auditors at an early stage, ideally before actuarial advice is commissioned, and we can provide a materiality report to help with these discussions.
- The higher number of auditor queries in relation to the pensions note experienced by many employers is expected to continue this year. This is largely due to audit firms reacting to a report from the Financial Reporting Council in 2018 which highlighted failings in some aspects of the quality of pensions audit and which set out areas for improvement covering areas such as greater consideration of the significance of the chosen assumptions, stronger evidencing of auditor conclusions supported by in-house actuarial teams, and greater scrutiny of the accuracy of source data. We are constantly investing in our reporting to help employers answer as many queries without recourse to us, but this is not always possible. This year we are proposing to run training sessions for employers to help them to understand how national developments are likely to impact the figures and disclosures in their accounts.

Recent events

Hopefully many of you were able to attend our first investment webinar of 2021 titled **'Vaccines, volatility and value – charting the course for 2021'**. Our investment experts discussed the impact of the ongoing pandemic on markets and valuations, the EU trade deal, Joe Biden's first 100 days and the implications for markets, and accelerating the journey to decarbonisation and expectations of investors. For anyone who missed this session or who would like to listen again, the link to the replay is **here.**

Mary Lambe attended **the CIPFA Pensions Panel on 18 January.** The Panel discussed the revised framework on Knowledge and Skills competencies for Pension Committee members and Senior Officers and the updates to the Knowledge and Skills Code of Practice. It is anticipated that these revised documents will be ready for publication in Spring 2021.

Mary also attended the **Investment, Governance & Engagement committee on 18 January 2021** where the Committee received a presentation from Dr Anna Tibla (Durham Business School) on corporate actions (scrip dividends) and asset managers fiduciary duty to maximise the value for the asset owners. There was also an update in the area if Responsible Investment (RI) including the development of a new RI database and also the configuration of a new RI Advisory Group to inform the Scheme Advisory Board.

On 14 January I attended a meeting with the **National Audit Office**, PwC (as adviser to the NAO), and representatives of the actuarial firms, to discuss NAO's guidance to auditors of local authority pension figures ahead of the 2020/21 exercise. The aim is to smooth the audit process by providing auditors with detailed information on the actuaries' methods and assumptions, and discussing potential areas of audit focus in advance of the exercise. Hot topics this year are likely to be IAS 19 remeasurement requirements; the impact of RPI reform on assumptions made for future inflation, and focus on the data supplied to the actuary.

Research and Publications

The latest research and publications by Aon Thought Leaders: -

- 2021 Outlook - a vaccine bridge over troubled water
- A blue wave for Biden - bit it won't be a free rein
- US dollar weakness has further to run
- Market update – Covid 19

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