Local Government Newsletter

January 2020

Welcome to our first newsletter of 2020 and a belated Happy New Year to you all! I imagine the Christmas break is now a distant memory and you are looking forward to the challenges the new year will bring…

Brexit is now a certainty, but we are no clearer what that will mean in practice. Potential changes to the funding formula may lead to further budgeting issues for some. It is not yet clear what the remedy will be following the McCloud/Sargeant judgement, or if and when changes may be required resulting from the 2016 Cost Management Process. However, despite this, most local funds are in a strong position and well placed to face future challenges. You can all be proud of the excellent work that you have put in to get to where we are today.

Chris

People news

As this is our first newsletter of the new decade we thought we would take a quick look back at how the team and LGPS has evolved over the last 10 years….

At the start of the last decade the 18 strong core Public Sector Team was part of Hewitt Bacon & Woodrow, before the merger with Aon. The team primarily delivered actuarial advice with a little bit of benefits and governance advice, with investment advice provided by a separate team. By the end of the decade the Public Sector Team had grown to 40 core members, with close to 100 colleagues involved in supporting the delivery of advice to public sector organisations, delivering a far wider range of advice, expertise and resource to our LGPS clients.

Our expansion has been driven by increasing client numbers; a greater emphasis on governance (in part in response to the Hutton review, and increased oversight from bodies such as the Regulator and the LGPS Advisory Board); an explosion in the number of employers joining and exiting the Scheme, (largely driven by outsourcing and academisation); the changing needs of administering authorities and the team's access to a greater breadth and depth of expertise by virtue of being part of Aon plc.

There have also been changes in benefits (such as pension increases being aligned to the Consumer Prices Index; changes to GMP indexation; and the introduction of the 2014 CARE scheme whilst retaining the final salary linkage for some); implementation of investment pools; updates and improvements to pensions administration systems; new Fair Deal for central government bodies; changes in taxation rules; auto-enrolment; and numerous changes to accounting requirements to be delivered to ever decreasing timescales.

The list of changes over the last decade may be long but there is still a substantial list of long-awaited regulatory changes with MHCLG and material issues such as McCloud and cost management to be resolved. It doesn't look like the pace of change is going to slow down over the next decade for scheme managers, employers or their advisers!

Talking points

Pension Contribution prepayments

Councils are increasingly asking to prepay pension contributions in return for a discount (e.g. of, say 2% for a payment on 1 April where the discount rate built into the valuation is 4% p.a. or say 6% for payments triennially in advance). This seems to have become accepted practice in relation to deficit payments (secondary contributions) although we'd suggest administering authorities ensure employers understand the investment (and other) risks of prepaying – the discount doesn't mean investment returns are guaranteed – and that the employers check with their auditors if they have any firm views on how any prepayment should be reflected in the Rates and Adjustments Certificate.

We are now also experiencing employers asking to prepay primary (future service) contributions – both annually in advance and triennially in advance - and there is also some evidence of councils borrowing to prepay pension contributions. Administering authorities may wish to take legal advice in relation to prepayment of primary contributions bearing in mind the wording of Regulation 69 – our lay view is that administration expenses must be paid no less frequently than annually and as the primary contribution is defined as a percentage of pay, a "true up" is likely to be needed to ensure the amount paid in each year is at least equal to the percentage rate applied to the actual pensionable payroll over the year.

There is also the need to ensure employers budget for contributions expected to be payable after the end of the Rates and Adjustments Certificate; there is a risk that if contributions are all paid up front, they are somehow "forgotten". Regarding borrowing to prepay pension contributions, on the one hand, administering authorities will not wish to interfere in decisions made by councils in relation to their budgeting and the financing of service provision. On the other, if investment returns were to fall materially short of the interest on any loan, the administering authority could find itself caught up in any negative publicity. We understand there are some concerns about the legality of councils using borrowing to fund revenue expenditure.

Administering authorities may therefore wish to tread carefully and ensure employers are responsible for their own decisions and take their own advice. Given that the Actuary ultimately has to sign off the Rates and Adjustments Certificate he/she will have their own professional obligations to consider so we suggest discussing the issues at an early stage. We don't believe administering authorities have to agree to offer a discount in return for early payment and different funds will have different views on where to strike the balance between flexibility for employers and what they are prepared to administer/agree to.

Section 13 for the 2019 valuation

At the recent SAB committee meetings (Cost Management, Benefit Design and Administration on 6 January and Investment, Governance and Engagement on 14 January) we discussed the content of a draft letter from GAD to MHCLG regarding their forthcoming review of the 2019 valuations under Section 13 of the Public Service Pensions Act (see here).We provided some brief comments on the letter at the meeting and understand that GAD will be finalising it shortly.

In particular GAD set out its intention to add some additional areas for consideration as part of its 2019 valuation review, including:

- Consistency: treatment of age discrimination costs (the McCloud case)
- Long term cost efficiency: age discrimination remedy costs and deficit reconciliation, and, increased focus on long term cost efficiency measures.

GAD is expecting the approach to McCloud/cost management to be clearly stated in the FSS (as set out in the SAB's previous guidance here) or valuation report, and will be looking for evidence of this. They are also expecting any allowance to be "prudent" (although it is not clear what this might mean given the uncertainty).

As in 2016, GAD is also expecting that the end point of the deficit recovery period will not be extended at the same time as employer contributions are reducing. However, the letter doesn't specifically say how/if they will rate recovery periods where there is a surplus.

GAD has also confirmed their requirements in relation to additional outputs from the valuation, some of which are to be included in the formal valuation report. The deadline for provision of the information to GAD is end April 2020, although the information to be included in the formal valuation report will clearly be required in advance of 31 March 2020.

Industry developments

Consultation on Local Valuation Cycle and Management of Employer Risk

Following the consultation by the MHCLG which took place from 8 May 2019 to 31 July 2019 on the changes to the way the LGPS operates in England and Wales, the Scottish Public Pensions Agency have published a consultation on proposed changes to the LGPS (Scotland).

It includes questions on whether to move the valuation cycle for Fund valuations to four yearly from 2024, and if so whether funds should be given powers to take interim valuations (in full or in part) and/or reassess employer contribution rates mid valuation.

The consultation also seeks views on the practical application and effectiveness of the regulation permitting the suspension of an employer's liability to pay an exit payment.

The consultation runs from 22 January to 9 March 2020.

Revised Stewardship Code reminder

The FRC previously published a 'revised and strengthened' UK Stewardship Code, with an extended focus including asset owners such as pension funds. This new Code came into effect from 1 January 2020.

Amongst the changes, signatories to the Code will be expected to take ESG factors, including climate change, into account and explain how they have exercised stewardship across a wider range of assets. The FCA also published feedback on a joint FRC/FCA discussion paper on building a regulatory framework for effective stewardship, which was used in updating the Code.

Veganism is a philosophical belief

A court case recently determined that veganism is a protected philosophical belief under the Equality Act. Some experts think this could mean that pension funds will need to start considering veganism under their ESG policies, while noting that the law permits pension trustees to make investment decisions that are based on non-financial factors, provided that:

- they have good reason to think that scheme members share the concern; and
- there is no risk of significant financial detriment to the fund.

Either way, we expect this may well spark more questions from members in relation to responsible investment! Those interested in learning more on this topic may wish to sign up to this year's Aon Pensions Conferences (see below) where this will be a key item on the agenda.

Employment tribunal makes interim declaration in favour of firefighters

The Fire Brigades Union won a landmark victory which allowed members of the 1992 and 2006 firefighters pension schemes in England and Wales to be treated as if they had remained members of their original pension scheme. The decision was an interim declaration covering immediate cases such as members who have taken ill-health retirement, the final declaration is expected in July 2020 but it may be some time before this part of the remedy can be put into effect for all claimants.

Some members of the Firefighters' Pension Scheme may have been better off in the new CARE scheme and would suffer a detriment if they simply moved back to the old schemes, so the government's intention is to ensure that such persons can keep the benefits they have accrued.

We understand that it is hoped that a consultation will be issued in the Spring on the exact remedy for the unfunded public sector schemes.

The ruling could result in other public sector staff being returned to their original pension schemes. One possible remedy for the LGPS is that the underpin is extended so affected member gets the best of either the CARE or Final Salary benefits. Funds should be preparing a strategy to contact employers and ideally giving them sufficient warning that requests for historical data are likely to be coming their way.

Weather, Climate and Catastrophe Insight: 2019 Annual Report

Aon's latest annual report evaluates the impact of global natural disaster events to identify trends, manage volatility and enhance resilience.

Discussion on assessing the financial impact of climate-related risks can be found on page 32 of the report.

Statutory Parental Bereavement Leave/Pay

Draft legislation has been published in respect of [Statutory Parental Bereavement Leave] and [Statutory Parental Bereavement Pay] – these give parents whose child dies or is stillborn the right to take two weeks leave, which will be paid at a statutory rate if they meet certain criteria.

These regulations still need to be approved by Parliament but it appears the intention is for them to come into force from 6 April 2020.

This may mean that the LGPS regulations need to be amended to cover this element of pay and clarify what happens to pension rights in situations where someone takes the leave but isn't entitled to statutory pay, so something to keep an eye on.

Potential changes to Annual Allowance limits

The Treasury has proposed raising the Threshold Income for Annual Allowance purposes from £110,000 to £150,000, to help reduce the impact of the tapered annual allowance on NHS consultants. This change, if it came into effect, would mean that fewer individuals would be subject to the taper, not just doctors or members of the NHS scheme. However, no change to the complexities of the tapered annual allowance would be made under the proposal.

We will let you know if and when we hear further details.

LGA issues ABS Guidance

The LGA in conjunction with the national Communications Working Group issued a technical guide on the Annual Benefit Statement (ABS). The guidance is aimed to assist Funds in producing an ABS for members and sets what must be included in the ABS along with links to the relevant legislation.

What we've been talking to our clients about

Exit credits

In May 2018 a number of new provisions were added to the LGPS regulations including, most significantly, allowing for the payment of a surplus to an exiting employer (an "exit credit"). Our April 2018 newsletter noted *"There doesn't appear to be any discretion for administering authorities, nor any carve-out for any existing admissions where the parties may have entered into contractual arrangements which aren't compatible with an automatic refund of any surplus"*.

Wider changes to the FSS gives an ideal opportunity for funds to reconsider the approach they take with regard to exit payments.

McCloud/Sargeant

Whilst there is uncertainty over what the eventual remedy will look like for the LGPS, what is more certain is the fact that the major pain is going to be felt in an administrative sense (sorry to be the bearer of bad news if this is news to you!).

It's is almost certain that Funds will need to collect data for virtually all members who joined the scheme prior to 2014 and left after 2014, input that information into the administration system and then deal with any recalculations that are required. We have been discussing with clients about ways that we can help by creating their strategy, assisting with the collection and input of data, and identifying priority cases.

Frozen Refunds

The valuation data is showing an increase in the volume of frozen refunds held per Fund since the previous valuation, which isn't a massive surprise given the change in vesting period from 3 months to 2 years back in 2014.

Some Funds are recognising that it would be prudent to try and pay these to members ahead of the next valuation and more importantly before the McCloud/Sargeant workstream gathers pace. We have been discussing with Funds about how we can carry out the process of contacting frozen refund members and arranging for payments to be made.

SAB's Good Governance Project

We have had various conversations with a range of Funds to ensure they are well placed in relation to the good governance recommendations with particular focus around areas such as setting up and implementing their knowledge and skills and conflicts of interest policies.

We have also been working with a number of Funds in reviewing their staffing structures, linking in with Aon experts who provide analysis on setting appropriate pay levels and focussing on the project's proposal for Funds to have a dedicated LGPS senior officer.

If you'd like to discuss any of these topics and find out more ways in which we can help then please get in touch with your usual Aon consultant.

Recent events

LGA Governance Conference

On 23 and 24 January 2020, Alison Murray, Scott Campbell and Mary Lambe attended the LGPS Governance Conference in York, hosted by LGA. There were a number of very interesting topics, including a reflection on the scheme reforms by Lord Hutton, an update from the Pensions Ombudsman and the Pensions Regulator as well as some topical investment presentations covering responsible investment and ESG issues. In addition, Alison was part of an expert panel to discuss whether the cost cap was fit for purpose. It was good to see so many familiar faces there and hopefully those of you who attended found it useful. If you would like to discuss any of the topics covered at the conference please contact any of the Aon attendees, or your usual consultant.

CIPFA Pensions Panel

On 20 January 2020 Mary Lambe and Karen McWilliam attended the CIPFA Pensions Panel. There were a number of topics covered including discussion of pensions taxation and its impact on senior NHS clinicians, GMP Equalisation, Good Governance and the McCloud/Sargeant judgments.

Upcoming events

CIPFA LGPS Actuarial Summit 2020

On 7 February 2020 Jonathan Teasdale will be presenting at the CIPFA LGPS Actuarial Summit in London, including insights from all the firms involved in the 2019 actuarial valuation as well as an update on the role of the Government Actuaries Department and the next Section 13 review.

CIPFA Pensions Audit and Accounting Workshops

On 10, 18 and 28 February Chris Darby; Joel Duckham and Sam Ogborne will be presenting at the CIPFA Pensions Audit & Accounting Workshops in London and Manchester. The speakers will discuss the implications for pension funds of the 2019 actuarial valuation, including the approach taken in allowing for uncertainties related to the McCloud judgement.

Aon Pension Conferences 2020

Registrations are open for the 2020 Aon Pension Conferences. These are aimed at trustees of pension schemes and pensions, HR and finance professionals who make decisions about schemes.

Attendance is free and offers delegates the opportunity to hear experts' views and ideas on how to manage defined benefit and defined contribution pension schemes. The conferences also provide a platform to learn from and network with peers.

LGC Investment Seminar

Alison Murray will be attending the LGC Investment Seminar on 27th and 28th of February. The event will include a debate on investing for the climate emergency and a hot topics discussion session, where the audience can debate topical areas including the challenge of administration.

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