Local Government Newsletter

March 2021

We have a bumper newsletter for you this month!

As we enjoy the lighter evenings and the long-anticipated return to lido swimming, we bring you news on **the Pensions Regulator's new Code of Practice**, information about **RPI reform** and discussions we've been having with administering authorities around **business continuity**… and something we are very proud to announce, our commitment to "net zero"!

We hope you enjoy reading it.

Aon News – net zero

We're delighted to announce that Aon has stated our commitment to net zero emissions by 2030. The commitment comes as we publish our 2020 social impact report, which showcases the many ways in which our firm demonstrated ingenuity and resilience during one of the most challenging humanitarian and economic times in living history.

In announcing this ambitious target, Aon CEO Greg Case said "We believe this is a necessary step to take as a global corporate citizen to ensure we are doing our part to reduce our carbon footprint and help mitigate the significant and catastrophic impacts of climate change. Since 2015, we've reduced our greenhouse gas emissions by 60%+, but we recognise there is much more work to be done to have a lasting impact."

"In alignment with science-based targets, we will adopt achievable objectives and set action plans focusing on sustainable sourcing, energy efficiency, business travel and renewable energy. Taking these actions will make our firm more effective, efficient and resilient."

Industry developments

TPR new Code of Practice

The Pensions Regulator (TPR) has issued its consultation on a new **Code of Practice** which runs for 10 weeks to 26 May 2021. We ran an educational webinar on the new Code along with the Pensions Regulator on 25 March, and you can find the link to the recording and the slides at the end of the newsletter under "recent events".

The new code brings together 10 existing codes of practice, including Code of Practice 14 (Governance and Administration of Public Service Pension Schemes), into a single modular (on-line) code which will apply to all UK pension schemes.

TPR's reasons given for replacing the existing codes included a need to update the requirements arising from the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018, although those regulations don't apply to public sector schemes. In addition, some codes were outdated and did not reflect TPR's current expectations, and the new Code aims to address some inconsistencies between the codes which had not been helpful to users or to TPR's enforcement activity.

In relation to public sector schemes, the Regulator now has a better understanding of the public sector arrangements having had oversight since 2015 and it was felt much of the wording in the public sector code would actually be useful for application to private sector arrangements. Finally, the Regulator is mindful of the fact that all schemes will need to provide data to the Dashboard arrangement in the future and the new Code aims to align with those requirements (see below article for more information on Dashboards).

Not all parts of the new code apply to the LGPS, and some others are recommended best practice and not strictly required by law. Appendix 1 of the consultation document helpfully summarises which parts of the code apply to the LGPS and which are new. Caution is needed however as there is new guidance within the modules listed as 'existing', and some of the new modules don't contain any new legal requirements but contain "best practice" recommendations. Administering authority officers and pension boards will therefore need careful interpretation of the guidance to determine which parts they need to comply with; to what extent they wish to adopt the recommended best practice guidance, and to identify where changes will need to be made to existing policies and procedures.

New and best practice modules applying to the LGPS include:

- **Administration modules**. There are seven new administration modules for the public sector schemes, and these cover all the main operational procedures. Most of the requirements here were already set out in the previous code of practice but the key will be making sure everything is appropriately documented. Some areas may need more work than others, such as documenting the policies for maintaining IT systems. One of the new modules is 'Cyber controls' which brings separate guidance into the Code and therefore ensures cyber security measures and controls are in place as part of internal controls legislation.
- **The Governing Body modules.** The first of the two new modules in this area is 'Recordings of meetings and decisions made'. There may be some points of detail in existing policies which need to be reviewed, for example documenting any decisions taken outside of meetings within the minutes of the next meeting. The second new module here is 'Managing advisers and service providers', which includes expectations on selection, appointment, and performance monitoring. We would expect this is broadly well followed by procurement teams already. The Regulator has set some additional expectations around obtaining external assurance reports outside of the statutory audits (which could be limited in scope), and assurance from external providers, in order to critically assess the internal audit function and other internal controls.

  The first of two "best practice" modules introduced under the Governing Body section is 'Remuneration policy', which recommends that there is a written and published remuneration policy covering key personnel involved in running the scheme, which is reviewed at least every 3 years (ideally annually). The second is 'Continuity planning' which sets out that each fund should have its own continuity plan to document the key actions that would be undertaken under a range of events, to ensure data and administration are not disrupted. This would consider suppliers too. We have provided more details about this in a separate article below.
- **Communications and disclosure modules**. There are new requirements here on the principles for member communications (accurate, clear, concise), use of technology, and accessibility, as well as steps for mitigating the risk of scams.
- **Investment governance and monitoring modules.** These best practice modules cover documenting objectives, maintaining knowledge and skills and obtaining advice, processes for decision making and implementation, monitoring risks, monitoring performance of advisers, and procedures for monitoring investments.
- **Stewardship and Climate Change modules.** These two modules in the Code are listed as new for private sector schemes. The consultation document doesn't identify these as best practice for public sector schemes, but the wording of those modules is clear that LGPS funds should follow the principles. In any case, at the very least funds should be assessing the risks and opportunities associated with climate change in both the assets and the liabilities.

If you would like help responding to TPR's consultation, or to start planning for a review of your fund's compliance in anticipation of the new code going live, please contact your usual Aon consultant.

£95K cap update

You may recall that on 25 February Government laid regulations revoking the Public Service Exit Payments Regulations 2020, following HMT's announcement on 12 February. The Revocation regulations came into force on 19 March. Whilst the revocation is not retrospective, the new regulations provide for relevant authorities to pay the difference between the capped exit payment and the uncapped exit payment for exits after 4 November 2020.

On 4 March, MHCLG withdrew its 28 October 2020 letter which had advised LGPS administering authorities not to pay unreduced early retirement benefits on redundancy under Regulation 30(7) where this would breach the £95K limit set out in the Public Sector Exit Payments Regulations 2020. This, together with the revocation regulations, paves the way for administering authorities to revisit exits after 4 November 2020 and put into payment benefits under Regulation 30(7) where these had previously been withheld. As discussed in our February 2021 newsletter, employers who paid an alternative compensation payment will need to seek to recover those payments from the member to avoid paying twice.

New mortality projection model (CMI_2020)

The CMI ('Continuous Mortality Investigation'), owned by the Institute and Faculty of Actuaries, has recently published its updated standard mortality projections model, 'CMI_2020'.

As you'll be aware, the COVID-19 pandemic has led to significantly increased mortality. Weekly death registrations for England and Wales released by the Office for National Statistics indicate that around 601,000 deaths were registered for the ages represented by the CMI model in 2020. This compares to 523,000 in 2019. This translates into a mortality 'improvement' of −10% for 2020 which is a long way outside the range of the last 4 decades. Consequently, the CMI Mortality Projections Committee has decided that no weight should be placed on the 2020 data within the core CMI_2020 model. This is principally intended to ensure that the model reacts in a sensible way to 2020's experience. The model does however contain flexibility to place non-zero weight on 2020 data.

The CMI model typically projects that life expectancy will increase year on year, but life expectancies in 2021 under CMI_2020 are very similar to life expectancies in 2020 under the previous version of the model (CMI_2019). This means that the life expectancy in 2021 is slightly lower than would previously have been projected – we estimate that, all else being equal, using CMI_2020 instead of CMI_2019 should lead to a small reduction in liabilities (less than 0.5%) for a typical pension scheme. However, Aon advised LGPS Funds adopted CMI_2018 in the 2019 valuations. All else being equal, CMI_2020 is likely to be very similar to the 2018 version of the projection model, with very small impact on liabilities.

Please click here for more information in Aon's "In-Touch" technical update on CMI_2020.

GMP indexation

On 23 March HMT responded to its consultation on the indexation of Guaranteed Minimum Pensions (GMPs) in Public Service Pension Schemes.

In summary, HMT has discounted conversion (of GMP into main scheme benefits) as their long-term policy solution and instead will make full GMP indexation the permanent solution for public service pension schemes. Currently, all members whose State Pension Age is between 5 April 2016 and 6 April 2021 have their GMP pensions fully uprated by their scheme in line with CPI. The new policy will extend this to members whose State Pension Age (SPA) is on or after 6 April 2021.

From an administration point of view administering authorities will be relieved there is no longer the prospect of a full GMP conversion exercise being needed over the next couple of years (or indeed, ever). Software suppliers will need to ensure the extension is appropriately allowed for, and transfer terms will also need to be reviewed centrally. Otherwise this can be seen as business as usual for administration teams.

However, we are expecting further guidance (to an undefined timetable) on how HMT propose to deal with the sex inequalities which will persist for a minority of members, which will have implications for benefit calculations.

It is also worth noting that this consultation does not address the second Lloyds Bank ruling in November 2020 which found that transfers paid in relation to service between 17 May 1990 and 6 April 1997 containing GMP would need to be revisited to address any sex discrimination. We are still waiting for Government guidance on this issue.

The implications for funding will depend on the approach taken in the 2019 valuations. Funds which provisioned for the interim solution ending 5 April 2021 may see total liabilities increase by approximately 0.1% to 0.2%, however the impact will vary by employer. Policies relating to the valuation of liabilities of new employers and in employer exits will also need to be reviewed.

UK Pension Schemes Act update

In a parliamentary statement on 2 March, the Pensions Minister Guy Opperman set out a timetable for secondary legislation to bring into force the provisions of the 2021 Pension Schemes Act. The statement confirmed the Government will consult on proposed regulations for the Pensions Dashboard later this year and will table draft regulations in 2022, with delivery in 2023.

Pensions Dashboards Programme (PDP)

What is the dashboard?

In the 2016 Budget, the Government tasked the pensions industry with ensuring that by 2019 it had designed, funded and launched a pensions dashboard to enable individuals to view all of their retirement savings in one place. The idea is that this will improve member engagement and make it easier to plan for retirement.

In April 2019, following consultation, the government confirmed that multiple industry dashboards should exist alongside a non-commercial dashboard hosted by the Money and Pensions Service (MaPS).

In 2019 MaPS set up the Pensions Dashboards Industry Delivery Group (IDG) to lead the delivery of the initial phase of the pensions dashboards programme. The IDG was subsequently renamed the Pensions Dashboards Programme (PDP).

What are the latest developments?

In February 2020, the PDP launched a call for evidence from pension providers and schemes. The deadline to this was originally 16 March 2021 but this has been extended to the close of play on 2 April 2021. LGA, who encourage all administering authorities to respond, responded with their views earlier this month.

The Pension Schemes Act 2021 (PSA 2021) provides a legal framework for pensions dashboards, including new powers to compel schemes to provide information to dashboard providers. Detailed requirements of what must be provided, when and how will be set out in regulations.

Schemes and providers are expected to have their data 'dashboard' ready from 2023 but the development and testing phases will be happening throughout 2021 and in 2022.

In March, PASA issued guidance for schemes and providers on how to start getting ready for dashboards. It outlines the expected timescale for compliance, and summarises the initial data standards recently published by the PDP.

We suggest that all administering authorities have Pensions Dashboards as an item on their business plans and engage with software suppliers/third party administrators to clarify actions and responsibilities. They should consider issues such as:

- is member data accurate?
- is it available digitally?
- do they have suitable IT and software to provide data to dashboards?

The PDP is publishing six-monthly updates and the next one is due in April 2021.

Spring Budget

On 3 March the Chancellor delivered his spring budget, which was relatively 'light' on changes impacting pensions. Of interest to the LGPS was:

- A **freeze of the lifetime allowance for 5 years** (at £1,073,100, until April 2026). This will affect high earner members who previously made decisions about their benefits based on the assumption that the Lifetime Allowance would increase annually in line with CPI.
- An announcement of the introduction of **a new UK infrastructure bank**, which will be offering loans to local authorities at a rate of gilts + 0.6% for strategic infrastructure projects (from the summer). The Bank "will work closely with pension funds and the institutional investor market to explore opportunities for further expansion of investment into UK infrastructure"

Wider changes to tax may have indirect impact on pensions – such as the increase in corporation tax to 25% from April 2023, the freezing of income tax thresholds (and the national insurance upper earnings limit) after 2021/22, until April 2026, and the freezing of the inheritance tax threshold until 2026.

MoneyHelper

The Money and Pensions Service has announced a re-branding which will bring together their three separate brands (of the Money Advisory Service, the Pensions Advisory Service and Pension Wise) into a new single brand called MoneyHelper. This will be rolled out from June this year.

What we've been talking to our clients about

RPI Reform and LGPS valuations

Administering authorities have been asking us whether the move to align RPI with CPIH with effect from 2030 will affect the assumptions we adopt for funding purposes for future pension increases and revaluation of pension accounts, which are linked to CPI. Whilst this can be really complicated for private sector schemes, we think it's actually quite simple for the LGPS funds we advise.

It's simple because for long-term secure employers our CPI assumption is set based on the long-term best estimate of CPI inflation from our Capital Market Assumptions. These are the product of an extensive data gathering exercise every quarter by Aon's Global Asset Allocation specialists. For inflation, they take the views expressed in a biannual survey of long-term forecasts as well as other more frequent forecasts by economic institutions to derive where they think the true market consensus forecast for CPI inflation is.

This approach has generally led our LGPS Actuaries to recommend a lower CPI assumption than adopted by other LGPS advisers because it isn't distorted by supply and demand factors that impact the alternative approach of comparing the yield on index-linked gilts with the yield on fixed interest gilts (so-called market-implied breakeven RPI inflation).

Our approach is also appropriate because it means our CPI assumption is consistent with the long-term investment returns which underpin the choice of discount rate.

Thus, given CPI itself isn't changing, the only change to our CPI assumption for long-term secure employers is to reflect updated views of future best estimate CPI, which isn't influenced by RPI reform.

There are of course situations when it might not be quite so simple and the valuation may be affected:

- *if you are holding a substantial proportion of assets in index-linked gilts as a matching asset/to "hedge" CPI inflation.*

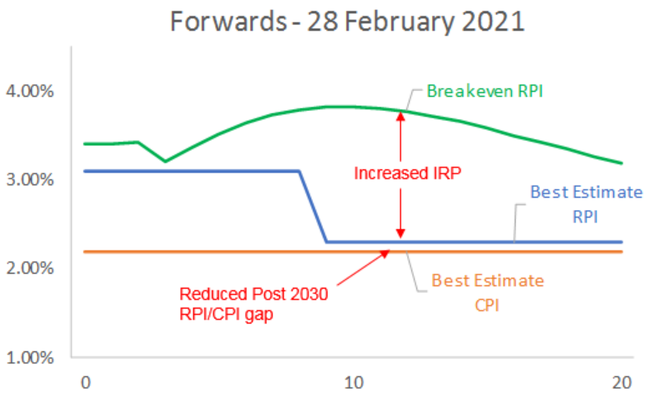
As the Government will not offer compensation to index-linked gilt holders, your liability to pay CPI-linked benefits is unchanged but from 2030 payments from your index-linked gilt holdings will be linked to CPIH not RPI and CPHI is expected to be lower than RPI.

- *if your financial assumptions are linked to gilt yields (e.g. for exit valuations and potentially for ongoing funding purposes for employers where a gilt based discount rate would be adopted at exit); in particular your inflation assumption is derived from breakeven RPI with allowance for a RPI/CPI gap ("wedge")*

As the chart below shows, despite the Government announcement that holders of index-linked gilts won't be compensated for the change in RPI, there is not a steep fall in forward levels of breakeven RPI after 2030 (the green line in the chart). This is despite the fact that RPI itself is expected to fall when it is aligned with CPIH (the blue line in the chart). There are many reasons for this, but from a practical perspective it means that the price investors are prepared to pay for inflation protection (the inflation risk premium, or "IRP" as shown in the chart) has increased.

As the RPI/CPI wedge is expected to be materially lower once RPI is aligned with CPIH (down from c.0.8% to c0.1% from 2030) if you're using long-term breakeven inflation (the green line) as the starting point for your inflation assumption, together with a lower long-term RPI/CPI wedge (the difference between the blue and orange lines), you're inevitably going to end up with a higher CPI assumption even though your liability to pay CPI-linked benefits is unchanged.

Whilst in our view this is largely an issue for Trustees of private sector schemes, particularly where CPI-linked liabilities are hedged (via index-linked gilt investments), it may have some relevance for the LGPS, e.g. in relation to orphan liabilities where these are assumed to be matched by index-linked gilts.



Source: Aon and Bank of England (fitted/smoothed RPI break-even curve)

In summary though, whilst funds whose actuary bases their CPI assumption on breakeven RPI are likely to see an increase in the CPI assumption in current market conditions, using the approach we take for setting the assumptions for the long-term secure employers, there should be no change – our assumption will continue to be based on long-term estimates of CPI (the orange line in the chart above), albeit recalibrated each quarter.

Employer flexibilities

On 2 March 2021, MHCLG issued their statutory guidance for administering authorities developing their policies on how to use these new flexibilities introduced by the Local Government Pension Scheme (Amendment) (No.2) Regulations 2020. The Scheme Advisory Board (SAB) have also released more detailed guidance at the same time.

By way of recap, these flexibilities allow administering authorities (AAs) to:

a) review employer contribution rates between valuations under more circumstances (before now this has been very limited),

b) spread exit payments over a period rather than require immediate payment from an exiting employer, and

c) enter into Deferred Debt Agreements with an employer who would otherwise be exiting the Fund, which in effect postpones an exit valuation to a later date.

AAs are unable to use the new provisions unless their policies are set out in their funding strategy statement. The publication of statutory guidance now allows those policies to be developed and finalised.

There is a lot of information AAs will need to include in their policies. We believe clarity is important and AAs must treat employers consistently but inevitably policies cannot (and should not) be too prescriptive nor try to cater for every eventuality.

We have been working with our clients to navigate both the statutory and SAB guidance in developing their policies including setting out the increased monitoring requirements and the role of the covenant adviser.

Business continuity

Those of you who have read the Pension Regulator's draft new Code of Practice or attended our webinar on 25 March will be aware that it includes a module on business continuity which is identified as best practice for public service pension schemes. Integral to this module is the provision that the governing body (read administering authority for the LGPS) should *'have a resilient business continuity plan (BCP) that sets out key actions in case of a range of events occur that impact the scheme's operations'.*

A poll we ran during our webinar (covering over 170 participants) found that whilst over half of respondents do have a fund-specific business continuity plan, around 30% of respondents are relying on the business continuity plan of the host authority and a further 15% don't know if the fund has a plan at all. Around 8% of respondents said they are developing a fund-specific plan. Our public sector team has already been working with experts in our Enterprise Risk & Resilience practice to deliver training on business continuity to LGPS fund officers, committee and local pension board members as well as providing advice and support in the development of fund-specific business continuity plans.

Whilst developing a fund-specific plan is an invaluable outcome, business continuity management can no longer be considered as a single business recovery document, rather it is just one component in a fund's overall reaction, response and resilience capability, and should be part of its established governance and risk management framework. As set out in ISO22301, business continuity management is a *'holistic management process that identifies, in advance, the potential impacts of a wide variety of disruptions to the organisation's ability to function, allowing that organisation to tolerate the loss of part or all of its operational capability'.* The ongoing Covid-19 Pandemic has demonstrated that it's more critical than ever that administering authorities ensure their business continuity management arrangements, across all areas of scheme management, are fit for purpose, formalised and aligned to best industry practice. This will help to ensure that if a significant business disruption event were to occur, they are ready to react, respond and recover. It is important that administering authorities don't just focus on the next pandemic but they clearly identify their critical processes, consider the impact of a range of scenarios (covering supply, environment, equipment and people) on those processes, and plan appropriate business recovery strategies accordingly. As Sun Tzu said *"To…not prepare is the greatest of crimes; to be prepared beforehand for any contingency is the greatest of virtues."*

If your fund would benefit from the expertise of colleagues in our Enterprise Risk & Resilience practice whether this is training, help in developing, reviewing or implementing your business continuity management arrangements please get in touch with Alison Murray or your usual consultant.

Section 13 update

GAD have now shared with each of the administering authorities in England and Wales and their fund actuaries the Section 13 summary of the 2019 valuation.

GAD's purpose in sending these draft results is to give funds an opportunity to examine the results and let GAD know if there are any unexpected results. GAD has requested feedback by 16 April so that comments can feed into the final Section 13 report.

It appears that GAD have introduced a new “white flag” which denotes where the test would have been flagged either amber or red under the criteria that would have applied under the 2016 review, but where we understand that GAD will not be recommending any particular action for such flags in their report, although there may be a risk present that the administering authority should consider. GAD has commented they have not finalised how these white flags will be presented in their report, but are considering listing them in an appendix with a short description of what it means.

Recent events

Webinar on the Pensions Regulator's new Code of Practice

We were pleased to see more than 160 of you attend our webinar on 'The Pensions Regulator's new Code of practice and the LGPS' on 25 March.

This is clearly an area which is rightly getting a lot of attention from officers, pension Committees and Local Pension Boards. We carried out a live poll during the webinar and we found that around half of you are concerned it will be a lot of extra work and only half believe the new Code will materially improve their governance.

If you missed it, the link to the webinar recording is here and the slides are here. We hope you find them useful.

Research and Publications

The latest research and publications by Aon Thought Leaders: -

- Aon's guide to ESG investing
- Incorporating diversity & inclusion in investment decisions (PMI article)

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