Local Government Newsletter

September 2020

Hello and welcome to the latest edition of our newsletter.

As schools have started and nationwide social restrictions are stepping back up, we are reminded that it is important that we adapt quickly to changing conditions and keep our colleagues' and clients' wellbeing at the forefront.

This month we look in more detail at the status of the pandemic and the impact on our assumptions for life expectancy, and updates on the various ongoing government consultations which will impact the LGPS. Sit down with a cup of tea and enjoy a bumper edition this month!

Laura

People news

Many congratulations to Scott for the arrival of Elliot George Campbell who was born on 26 August weighing 7lb 4oz. Mum, Dad and Elliot are all doing well and Elliot has already enjoyed his first client meeting (virtual of course!)

COVID-19

Status update

Our colleagues at Aon have produced an update on the current status of the pandemic in the UK and its implications. We have summarised this below.

(a) Mortality to date

- There have been around 60,000 more deaths than expected in England & Wales during 2020 to mid-September (against a typical backdrop of around 550,000 deaths annually).
- The peak of excess mortality from the first wave of the pandemic has now clearly passed.
- Overall mortality rates have been slightly *below* typical levels since early June.

(b) It is still too early to assess the timing and success of a possible vaccine.

- We understand that there are currently six vaccines in Phase III trials (i.e. a large population test using blind trials of the vaccine against either a placebo or existing therapy).
- But it is important to note that vaccines *do* fail Phase III trials and, given the speed of development of these COVID-19 vaccines, the failure rate may be higher than usual.
- Even if a vaccine passes its Phase III trial, that doesn't necessarily mean it's very effective, it simply means (a) it's (relatively) safe and (b) it's more effective than the existing treatment (and given that this is a new virus, there are no existing treatments).

(c) *No-one* knows how this winter is going to pan out:

- The UK is now much better prepared compared with the outset of the pandemic and is generally taking sensible precautions.

- The Government is seriously considering population-wide mass COVID-19 testing (so-called 'moonshot') using yet-to-be-proven saliva tests and/or yet-to-be-developed rapid antigen tests. Although this would likely be an effective strategy to bring the economy back on stream while we await a vaccine, it is enormously expensive and depends on as yet unproven technology.
- There may be a material uptick in COVID-19 during the winter, as is the case with other airborne pathogens. If this coincides with seasonal flu it could cause significant pressure on the NHS. On the other hand, with the precautionary measures we now have in place, both the 'second wave' and the next flu season may have a subdued impact.

(d) We believe the more relevant impacts for longer-term longevity are:

- the knock-on impact of recession (which itself depends on the severity and length of the recession), and
- different attitudes to health and welfare spending (possibly combined with more robust hygiene practices)

But again, we can't call the magnitude (or even, with certainty, the direction) of this.

Consultation on new CMI Model in light of COVID-19 and high 2020 excess mortality

The Continuous Mortality Investigation Board (CMI) has just released its consultation on its mortality projections model (the 'CMI Model'), which is the de facto industry standard.

Although the model has proved reasonably robust since its introduction in 2009, it was simply not designed to cope with the 60,000 excess deaths we have had so far in 2020 in the UK. In the CMI's own view, if 2020 is incorporated without adjustment, then the model is likely to produce unrealistic falls in predicted life expectancy.

As far as we at Aon can assess, the 2020 pandemic has not (yet) changed consensus estimates of mortality improvement. The reason for this is that, for both near and longer term mortality, the data from 2020 cannot be used to predict future changes to mortality trends reliably. Even predicting the direction of any change is difficult, let alone its magnitude:

- Although mortality in 2020 has been much heavier than expected, it is possible that future mortality may actually be lighter than expected in the short term. This is because some of the individuals who would otherwise have died in the years immediately following 2020 were also more vulnerable to COVID-19, meaning that some of their deaths were brought forward to 2020. Indeed, data emerging following the first wave of COVID-19 deaths, suggests we may already be seeing this effect in action.
- The pandemic has already caused the UK to go into economic recession, which tends to be viewed as negative for future mortality improvement. But, conversely, the huge attention focused on healthcare and social care because of the pandemic may lead to greater public spending on these areas, which typically is positive for future mortality improvement.

The CMI is proposing that the core model should place no weight on 2020 data, which is a sensible option. Although there will be some variation compared with the previous version (partly because the CMI is proposing to change another aspect of the model), this is broadly the same thing as not having a new model at all.

Aon will of course play an active role in the consultation, with a particular concern to help the industry avoid overreacting to this potential skipped beat in the cycle of CMI Model updates.

COVID-19 has probably increased short term uncertainty over mortality improvements and the outcome over the winter remains a concern, but longevity has been defying reliable long-term prediction for decades. COVID-19 is just one of many unknowns that make future longevity uncertain.

Industry developments

£95K Exit Cap

After a long lead in period, there has been a lot of recent activity regarding the implementation of the cap of £95,000 on exit payments to public sector workers. The main legislation on this, the draft Restriction of Public Sector Exit Payments Regulations 2020, was approved in the Lords on 23 September, and it is now due to go to the Commons for a vote (date yet to be scheduled). If approved in the Commons it will become effective within 21 days.

As these new rules restrict the total of redundancy payments and the early retirement strain costs of immediate payment of unreduced pension for those members of the LGPS made redundant over the age of 55, changes to the LGPS regulations are required. To that end, MHCLG released a consultation on potential changes to the regulations, and we commented on this shortly after release highlighting the main proposals and areas of uncertainty.

The consultation goes further than simply restricting payments to the 95k cap, proposing:

- a change in redundancy payment calculation limits
- for all members where an early retirement strain payment is payable:
  a) no discretionary redundancy payment would be able to be made (unless the discretionary redundancy pay is higher than the strain cost - in which case the difference can be paid), and
  b) the limit on the strain cost is further reduced by the amount of statutory redundancy payment leading to a reduction in pension to cover this reduction
- introducing flexibility for members to take their full redundancy payment and defer taking their pension or take a fully reduced immediate pension.

The consultation which runs to 9 November is relatively high level and does not include draft regulations. On 29 September GAD issued a draft impact assessment and draft strain cost guidance containing the standard factors to be used to calculate the pension strain for all exits subject to the exit payment cap, and accompanying guidance to demonstrate how these factors should be applied.

The expectation is that new regulations will be in place by the end of the year. The Exit Payments Regulations may therefore be passed before amending LGPS regulations are available, and in this case it is not clear how the potentially competing requirements for redundancies for members over age 55 of paying an immediate unreduced pension but not paying more than £95k would be reconciled. We are aware that LGA has sought urgent clarification from Government on this matter.

It is also possible that there will be further delays implementing the necessary changes to administration systems once the methodology is agreed and so manual calculations may be required in the interim. We are working on a model that can be provided to administering authorities that can carry out these calculations to plug this gap. If you have any questions or are interested in this model please contact Becky Durran or your usual Aon contact.

New Regulations on Employer Flexibilities

Following MHCLG's partial response to the review of employer contributions and flexibility on exit payments consultation, Regulations have been published which give new flexibilities to administering authorities in England and Wales to:

- review contributions for employers between valuations
- allow employers to defer their exit valuation and instead continue ongoing contributions to the fund.

The regulations came into force on 23 September. However, funds will not be able to take advantage of these new flexibilities unless they have a policy set out in their Funding Strategy Statement (FSS). Funds will therefore need to amend their FSS appropriately.

The deferred debt agreement allows an administering authority to defer the exit valuation, and the employer is treated similarly to an employer with active members with liabilities reviewed and contributions set at triennial valuations. Employers are likely to welcome this additional flexibility, but funds will need to consider under what circumstances they would be willing to enter into such an arrangement. In some cases it could be beneficial to have a secure employer continue to bear funding risk and contribute to the fund rather than exiting once the last active member leaves/retires.

The new regulations also make it clear that the administering authority is allowed to spread payment of an exit debt over a number of years, and that this can be set out in the Rates and Adjustment Certificate.

The ability to review contributions for employers between valuations is subject to a list of conditions, one of which must be met:

- it appears likely to the administering authority that the liabilities arising or likely to arise have changed significantly;
- it appears likely to the administering authority that there has been a significant change in the ability of the employer to meet their obligations, or;
- the employer has requested a review.

The middle criterion would cover a change in the covenant of the employer, so could be quite pertinent given the potential fall-out from the response to the COVID-19 pandemic in some sectors. Importantly, we understand that the new Regulations are intended to facilitate employer contribution reductions as well as increases if circumstances permit. In order to stop employers taking advantage of market conditions to request a review, MHCLG specifically states in the consultation response that *market volatility or changes in asset values would not be a proper basis for a change in contributions outside a full valuation*.

We are expecting statutory guidance to be released by MHCLG which funds will need to consider when changing their FSS. We are also expecting the Scheme Advisory Board (SAB) to release more detailed guidance for administering authorities.

Withdrawal of Schools from TPS

According to a recent Freedom of Information request 177 private schools have left the Teachers' Pension Scheme (TPS) over the past year (there were 1,171 independent schools in the TPS in March 2019, so this represents more than 15% of those). The majority of these exits took place following the contributions hike of over 40% in September 2019.

The TPS guarantees retirement benefits that are linked to the teacher's salary and offers teachers a secure retirement. Though the government has promised to cover the increase in contributions for state schools over the 2019/2020 year, private schools have been asked to raise their own funds to match these costs.

We are aware of a number of private schools with staff in the LGPS considering their options in light of the changes to regulations (in particular deferred debt arrangements) set out above. This is another area where funds should ensure they have their FSS amended to set out the approach should a school make such a request.

USS Consultation

On 7 September 2020 the Universities Superannuation Scheme (USS) released their consultation with proposals on how to tackle their growing deficit.

With universities being hit heavily by disruption due to the coronavirus – both by way of drastically fewer overseas students enrolling as well as the impact of market volatility – their pension costs will increase markedly in order to maintain the benefits promised to members.

The options set out in the consultation see some employer contributions increasing to 68% of employee salaries. USS have also advised universities that this increase in contributions can be limited if they agree to a list of conditions, including giving USS pension priority over any new debt.

We suggest, as previously, that all LGPS funds with university employers take note of the proposals, consider their exposure to employers who also participate in USS, and make an informed decision as to whether they should contact their university employers to ensure fair and equal treatment with USS.

Aon’s specialist covenant team have been involved in advising USS employers on the proposed risk management framework and would be happy to discuss the potential impacts and considerations for LGPS funds. If you would value such a discussion, please get in touch with Alison Murray or your usual Aon contact.

Increase in minimum early retirement age

The Government announced on 3 September that the minimum retirement age will be increased from 55 to 57 by 2028. The government plans to legislate for this change "in due course".

The drivers for this change are to recognise the continued longevity improvement in the population and to encourage the workforce to remain in employment for longer, so that member pensions can be funded for two additional years.

It will be important to keep members informed when the changes are made in legislation so that they can plan for their retirement accordingly.

TPR Single Modular Code Delay

TPR's new single modular code of practice - where existing codes including Code of Practice 14 (relating to the governance and administration of public sector schemes) will be consolidated and brought into an interactive online facility - was expected earlier in 2020. This month TPR issued a statement indicating that the formal consultation is planned for late 2020/early 2021 and that before it is issued TPR will engage with stakeholders for feedback.

This pre-consultation engagement will be important for LGPS funds given the potential challenges arising from moving from a distinct Code of Practice for Public Service Pension Schemes to a merged new single Code. Aon are engaging with TPR about developments in this area and if you wish to discuss further do contact Mary Lambe or your normal Aon contact.

SAB publish draft response to MHCLG consultation

On 28 September the Scheme Advisory Board for England and Wales published its draft response to MHCLG's consultation on amendments to the statutory underpin. The response outlines several policy and technical considerations in relation to the proposed regulatory amendments and includes very detailed comments on the draft regulations in Annex A.

DWP's consultation on climate change risks

The Department for Work and Pensions (DWP) has published a consultation with proposals that would require trustees of larger occupational pension schemes (amongst others) to meet climate governance requirements which underpin the 11 recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and to report on how they have done so on an annual basis.

The scope of the consultation states that MHCLG will make provision for the LGPS, in line with their responsibility for the investment and governance of the LGPS more broadly. We understand that MHCLG are considering what this might mean for LGPS on climate disclosures, noting the wider government commitments in relation to pensions by 2022.

LGA latest Bulletin

The Local Government Association (LGA) has published its latest bulletin here. In summary (where not addressed elsewhere in this newsletter),

- SAB will be responding to the McCloud consultation and will be starting work on central guidance for implementation of rectification. SAB have also agreed in principle to un-pause the cost cap process but will not take further action until more details about the Treasury cost management process are known.
- The Regulator will be issuing its "warm-up" email for the LGPS scheme return in the next few weeks – so the deadline for completion is likely to be sometime in November.
- MHCLG recognises that SF3 returns may be based on provisional data. MHCLG aims to publish the usual statistical report on 4 November 2020, so if audited data is provided later than 25 September it may not be included.
- GAD have now closed its GAD factors guidance feedback survey for the LGPS in Scotland. GAD is developing a website designed to hold all relevant factors and guidance for each scheme. This website is scheduled for release next year.

Police Pensions for Survivors

The 1987 Police Pension Regulations set out that when a police widow/widower remarries, they forfeit their dependant police pension.

This rule is currently being challenged in the High Court in Manchester by four widows and one widower, on the basis that this regulation breaches their human rights.

A Home Office spokesperson stated "The government is committed to providing public sector pensions that are fair to both workers and taxpayers. Due to similar provisions in the majority of older schemes, any changes to police pensions would create a pressure for changes across all public service pensions pre-2006."

Compensation awarded due to transfer delays

The Pensions Ombudsman awarded an individual ("Mr T") compensation for investment losses due to significant delays by their pensions administrator in processing their transfer request.

In this particular case, the individual had lost the opportunity to make a profit in the stock markets following the Brexit referendum. He had made a request from his administrator on 24 March 2016 in the hopes that he would receive the funds by the time of the referendum in June 2020. Despite numerous chasers, the final funds were only transferred in October 2016, which meant that the member could not make the investment as planned.

This ruling is especially significant as during these times, we see that requests are taking longer due to increased requests and administrative difficulties arising from COVID-19. It is important that administrators are aware that they may face complaints and legal action seeking compensation for any investment losses that may result from these delays.

What we've been talking to our clients about

McCloud consultation

The MHCLG consultation on amendments to the statutory underpin is drawing to a close and we have been helping a number of clients draft their responses, with emphasis on the need for guidance on issues such as data collection and annual benefits statements. The impact on administration has been raised but it is recognised as inevitable that a great deal of work will be required to implement the proposals and remove the discrimination found in the McCloud and Sargeant cases.

We continue to raise awareness amongst LGPS administration teams about the work involved in implementing the McCloud proposals, with a particular focus on the importance of good programme management, given the large number of workstreams required to implement the changes: data collection, leavers' benefits review, employer and member engagement, finance and accounting, systems, changes to ongoing administration to name but a few!

If you haven't already started your McCloud programme, here are the key steps to get you started:

1. Identify your core McCloud programme team, including a Programme Manager, and set up the programme
2. Identify which of your members are in-scope
3. Engage with your employers to determine what data you need to collect and how you will go about it

If you would like to discuss how we can help you get started, or to discuss the support we can offer all the way through to completion, please get in touch with Virginia Burke or your usual contact.

Annual Allowance and Pension Savings Statements

With the regulatory deadline for issuing Pension Savings Statements arriving next Tuesday (6 October), we have been in discussions with administering authorities around both annual allowance and lifetime allowance, including providing high earner workshops and benefit reviews. If you would like more information on this, please contact your usual Aon consultant.

GAD data submission

We mentioned in our August newsletter about the upcoming GAD data submission and our data validation offering. We understand the request from GAD will be arriving with Funds imminently (around the end of September), so a likely deadline may be around the end of October (although this has not been confirmed). We have also sought clarification from GAD regarding the number of years' history to include in the data extracts. GAD have confirmed that 4 years' history is required i.e. going back to a "previous valuation date" of 31 March 2016. This is so they can do a full reconciliation with the data provided for the previous Cost Management process.

Cyber security

This is an area we and our Cyber expert colleagues can support in a variety of ways, from testing your cyber-resilience, (and that of the wider local authority and any third-party suppliers/advisors), to data mapping and helping draft policies and incidence response plans.

Please keep an eye out in the coming weeks for our new LGPS Cyber Scorecard which is a high-level assessment of the actions your fund has taken to cyber resilience, the results of which can be benchmarked against other pension funds. Alongside this we will also be running a webinar to educate officers, committee members and board members on cyber risks. Watch this space!

Please let me know if you would like any further details on this.

Upcoming events

Mary Lambe will be attending the next virtual Scheme Advisory Board Investment, Governance and Engagement Sub-Committee meeting which takes place on 12th October.

Research and Publications

The latest research and publications by Aon Thought Leaders:

- September COVID – 19 investment market update
- Aon's Investment Research and Insights: A 2020 guide to Cryptocurrencies
- Aon's Global Asset Allocation team: What to make of current market conditions
- Aon's Global Asset Allocation team: As Good as Gold?
- Capital Market Assumptions as at 30 June 2020

Contact information

Laura Caudwell
Senior Consultant
+44 (0)117 948 5020
laura.caudwell@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
+44 (0)7884374550
karen.mcwilliam@aon.com

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Registered in England & Wales No. 4396810
Registered office:
The Aon Centre | The Leadenhall Building | 122 Leadenhall Street | London | EC3V 4AN