LGPS CURRENT ISSUES

NEWS IN BRIEF

IN THIS ISSUE

- News in Brief
- Other Developments on Regulations and Consultations
- Dates to Remember
- Meet the Team
- Contacts

APRIL 2019 PENSION INCREASE

On 17 October 2018, the Office for National Statistics (ONS) announced that the Consumer Price Index (CPI) rate of inflation for the year to September 2018 was 2.4%. This increase will be applied to LGPS pensions with effect from 1 April 2019.

AUTUMN BUDGET

With a post-Brexit “average-type free trade deal” in mind, the Chancellor Philip Hammond delivered his Budget on 29 October. It was relatively quiet from a general pension and savings perspective but there were a few points of interest in relation to public sector pensions. The main pensions headlines were:

- No changes to the Annual Allowance, Tapered Annual Allowance or Money Purchase Annual Allowance.
- The Lifetime Allowance will increase in April 2019 from £1,030,000 to £1,055,000, based on the September 2018 CPI increase.
- A ban on pensions cold calling is expected to be passed into legislation later this year.
- The detailed design for the Pension Dashboards will be subject to a DWP consultation, later this year. The Budget has specifically allocated funding over 2019/20 to help make the dashboards a reality.

'SCAPE' DISCOUNT RATE

Buried away on page 32 of the Chancellor's budget was confirmation that the SCAPE discount rate for calculating employer contributions in unfunded public service pension schemes will be reducing to 2.4% plus CPI - this is in line with established methodology to reflect the Office for Budget Responsibility (OBR) forecasts for long-term GDP growth. This will mean significantly increased costs for employers in the unfunded schemes, not all of whom are likely to receive additional funding or funding for a sufficient period of time to cover the increased costs.

The change in the discount rate becomes effective from April 2019 for the purpose of assessing the cost of the unfunded schemes. However, as we understand it the change takes immediate effect for individual member calculations being performed, for example transfer values. In accordance with guidance from the MHCLG as published by the LGA, some calculations in the LGPS had been suspended until the Government Actuary's Department (GAD) provided new sets of actuarial factors, albeit some of the new factors have now just been issued.

Finally here, it is clear that the Government's preferred inflation measure will, over time, move to CPIH (which includes owner occupied housing costs). This means that public sector pensions could start to uprate in line with CPIH rather than CPI in the future. We await further details on this.

4-YEAR VALUATION PROPOSAL

September's statement to Parliament by Chief Secretary to the Treasury Liz Truss MP saw the first hint of a proposal to move all the LGPS Funds in the UK onto a "quadrennial" valuation cycle starting in 2020 in line with the unfunded schemes. The stated reasons for the change are that it "…should minimise complications … will assist with comparisons…" and that "…the outcome of the employer cost cap mechanism test may have significant implications and it is difficult to justify why the valuation cycle should differ for the LGPS". Full details of the proposals can be found in the supplementary documents on the government's website. Whilst the formal announcement technically referred to the valuations carried out by GAD for HM Treasury's Cost Management process, informal briefings have confirmed that the main funding valuations will also be moved to a four-year cycle. With regard to transition to the new cycle, we fully expect that the 2019 E&W valuations will go ahead. Consideration is being given towards a mid-cycle review of contribution rates before aligning fully in 2024. For the LGPS in Scotland the next actuarial valuation is in 2020 in any event so there are less issues of transition for Scottish Funds.

NATIONAL INITIATIVES

- **SECTION 13 -** On 27 September 2018, we saw the publication of GAD's "Section 13 review" of the 2016 actuarial valuations of the LGPS in England and Wales. A copy of the report, whose 3 sections total more than 130 pages, can be found here. We had a number of concerns about the report, the engagement process leading up to it and the final recommendations. In collaboration with the other actuarial firms we wrote to the MHCLG and SAB formally to express those concerns.

  Our view is that the GAD analysis should be primarily focused on identifying those "outlier" funds in the LGPS who are for whatever reason, not putting in place long term robust funding plans. This might be funds whose employers are avoiding paying in contributions, whether through overly optimistic funding assumptions, long recovery periods and/or risky asset strategies which cannot be supported by the strength of covenant backing the risk. In our view, a more appropriate approach should be to take a holistic view of the funding strategy and recovery plan taking account of the supporting level of employer covenant and the investment strategy adopted, with a view to intervening with those Funds which pose significant concerns. This is the funding approach we have advised our clients to adopt over many years.

- **COST MANAGEMENT PROCESS –** There are clearly some conflicting pressures arising from the latest valuations of the unfunded schemes. It seems that employer contribution rates are likely to have to increase, largely as a result of the previous reduction in the SCAPE discount rate to 2.8% in 2016. On the other hand, the cost cap mechanism is triggering either a benefit improvement or a contribution reduction for members in a number of the schemes. Whilst HMT will follow through with implementing the changes required by the cost cap process for the current round of valuations, there is clearly some disquiet that these results are not following the general policy intention so they have commissioned a wider review of the process to take place in time for the next round of valuations.

  A number of changes are being made to the actuarial assumptions used in the cost cap process. These include a change in the assumed future mortality improvements to tie in with the latest ONS projections, an increase in the assumed rate of commutation (from 15% to 17.5% of the member's pension), and a small change relating to pay growth.

  For the cost cap process for the LGPS, HMT will await the outcome of the Scheme Advisory Board's process before deciding whether to invoke HMT's own process for the Scheme.

ACADEMIES' LGPS PENSION ARRANGEMENTS

The report on the analysis of pensions arrangements for academies within the LGPS was published on 14 September 2018 by the Government Actuary's Department (GAD). A copy of the report can be found here but, in summary, the data collected by GAD indicates that, on the whole, academies are treated consistently with Local Authorities with regard to the 2016 valuation funding assumptions, suggesting that the DfE guarantee is currently being recognised by Funds. This is consistent with the approaches followed by the Funds we advise and this report will be a useful reference point for ongoing funding discussions with academies.

EQUALISATION OF GUARANTEED MINIMUM PENSIONS

On Friday 26 October, the High Court made a landmark judgment confirming that pension schemes are required to equalise male and female members' benefits for the effect of Guaranteed Minimum Pensions (GMPs). This will increase the liabilities of affected schemes, a cost that will ultimately need to be met either from additional asset returns or from additional contributions from employers. The ruling potentially affects GMPs accrued after 17 May 1990.

The impact of the judgment on overall liabilities in UK pension schemes is likely to be significant, with some estimates quoting an increase in liabilities for FTSE100 companies as £15billion.

The impact for the LGPS will vary by scheme depending on the profile of the members. However, based on our initial interpretations and taken in conjunction with the Government's recent consultation on GMP indexation in public sector schemes which proposed ways to address equalisation (as well as indexation) it is possible that the impact for the LGPS could be much less significant versus that reported for pension schemes generally. This is on the basis that they implement one of the options put forward in the consultation e.g. full indexation on all GMP for members. It is recognised however (see para 4.14 of the response to the consultation) that the Government will need to consider the implications of the Court case before coming to a final conclusion.

Whilst this potentially removes the need to consider a separate equalisation exercise, there will be a cost associated with whichever option the Government implements in response to its separate GMP indexation consultation for public sector schemes. We will provide further details once this is known.

OCTOBER EQUITY CORRECTION – ARE THERE ANY LESSONS?

Rising US Treasury yields and concerns about pending US Q4 earnings have prompted significant asset volatility in October – this felt stark given the low volatility world we have been living thorough in recent times. We should see this shot across the bows as a reminder that risks are real and can be painful:

WHAT ARE THE LESSONS?

- Markets are stretched and vulnerable to shifts in sentiment at short notice
- Large movement are non-discriminating - correlations between asset classes rise in stress event
- Rate hikes and rising yields have consequences for other asset prices, not just bonds!

WHAT TO DO?

- Stress test portfolios for different downside outcomes
- Think about correlation between "tail risks" – diversification can fail when correlations spike
- Consider direct hedging strategies to give more tools to manage downside risk.

OTHER DEVELOPMENTS ON REGULATIONS AND CONSULTATIONS

TIER 3 EMPLOYERS

The report on the review of Tier 3 employers in the LGPS was published on 24 September. It summarises the findings of engagement with stakeholders and sets out a wide range of possible options to address the issues raised. However, it doesn't include any recommendations!

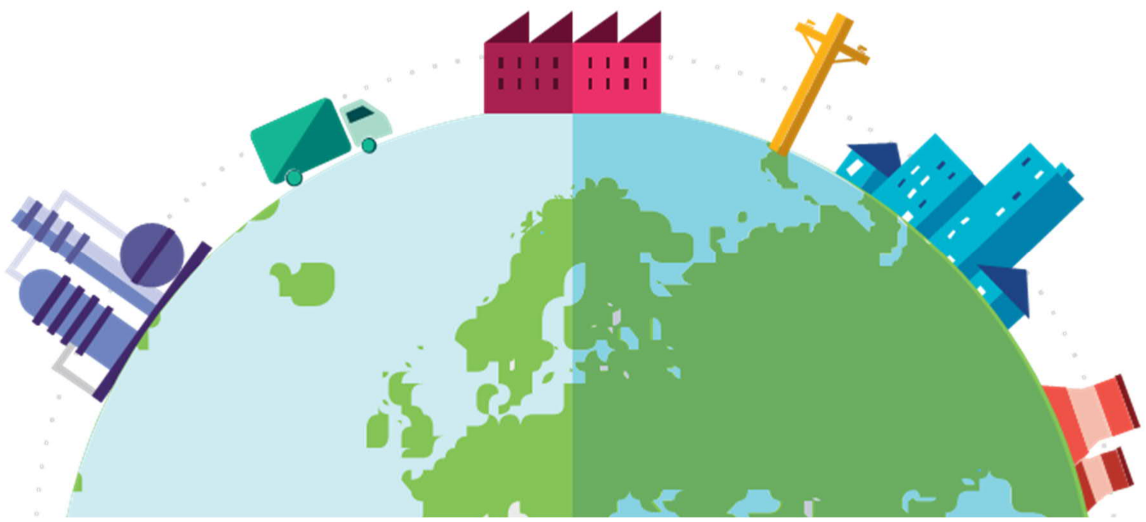
A small working group, made up of Scheme Advisory Board members, will produce a set of recommendations based on concerns expressed by third tier employers and will report back later in the year. Stakeholders will then be given the opportunity to comment on these recommendations. More information will be provided as it becomes available and further details on the project along with a copy of the report can be found here.

TECHNICAL AMENDMENTS TO BENEFITS CONSULTATION

On 4 October the MHCLG issued a small consultation, running for 8 weeks, on a number of minor amendments to the provisions of the LGPS. The changes relate to survivors' benefits (in particular the payment of survivors' pensions, calculated on the same basis as widowers' pensions, in respect of civil partnerships and same-sex marriages), the ability for MHCLG to issue statutory guidance on the interpretation of the provisions of the LGPS, and a provision for deferred members of the 1995 Scheme to take their benefits before age 60.

In practice, we don't regard the above changes as being substantial for any LGPS Fund. There may be a cost in relation to some small employers if new cases of survivors' pensions emerge, and there will undoubtedly be some cost of administration in terms of reviewing past cases where a partner in a same-sex marriage or civil partnership has died, but the proposal seems to be part of a consistent approach for government across all the public service schemes. We therefore expect all the proposed changes will go ahead as proposed in the consultation.

.



DATES TO REMEMBER

DATE	ISSUE	THE LATEST
H2 2018	DB Consolidation	DWP consultation on developing legislation and an authorisation regime to facilitate commercial arrangements for consolidating DB schemes.
Autumn 2018	CDC consultation	DWP consultation on the framework for CDC schemes
Autumn 2018	DB superfunds consultation	DWP consultation on the facilitation and consolidation of DB pension funds
2018	Tier 3 Employers	Outcome of the Tier 3 employers review
2018	Academies	Outcome of the academies review
2018/2019	Regulator powers	Consultation on changes to the Pensions Regulator's Funding Code of Practice and strengthening its scheme funding and anti-avoidance powers has now started.
1 January 2019	HMRC brief on VAT and treatment of pension fund management services provided by insurance companies.	Date by which, where an insurance company provides pension fund management and administration services, only the services for schemes classed as "special investment funds" will continue to be treated as VAT exempt.
1 January 2019	Plan Amendment, Curtailment or Settlement (IAS19)	Date after which if a plan amendment, curtailment or settlement occurs, a full remeasurement is mandatory under IAS19/
13 January 2019	IORP II	Date by which member states must adopt the new EU directive covering occupational pensions
March 2019	Brexit	It is expected that the UK will formally leave the EU by the end of March 2019.
31 March 2019	Actuarial Valuations	For all LGPS Funds in the England and Wales, the next actuarial valuation effective date will be 31 March 2019.
6 April 2019	Auto-enrolment	The minimum contribution rates for auto-enrolment will rise to 3% employer, 5% employee on this date.
6 April 2019	Enhanced DC investment disclosures	New requirements around the disclosure of investment information to members of trust-based schemes providing money purchase benefits take effect.
2019	Pensions Dashboard	These are expected to go live some time in 2019

MEET SOME OF THE TEAM

THINGS YOU MAYBE DIDN'T KNOW

Name: Laura Evans
Role: Actuary
Joined Mercer: 2001
Place of Birth: Liverpool
Favourite Christmas film: *Die Hard* (definitely a Christmas film)
What is the worst present you ever received for Christmas? Shiny purple tissue packet cover (for the small handbag sized tissue packets)
Favourite Christmas cracker joke: How did Scrooge win the football game? The ghost of Christmas passed!
Thoughts on Christmas decorations in November: Too early, last week in November at a stretch!

Name: Paul Bottone
Role: Wealth Analyst
Joined Mercer: 2005
Place of Birth: London, but I moved after a couple of years.
Favourite Christmas film: Well I could start a whole debate on whether Die Hard is a Christmas film but instead I will say *It's a Wonderful Life*
What is the worst present you ever received for Christmas? I can't remember if it was for Christmas but once someone got me a Manchester United mug because "everyone from up north supports them"! Errrrrrr no!
Favourite Christmas cracker joke: Why is it getting harder to buy Advent calendars? Because their days are numbered!
Thoughts on Christmas decorations in November: I've usually taken them down by then.

Name: Victoria Kushchak
Role: Wealth Analyst
Joined Mercer: July 2017
Place of Birth: Llandudno, North Wales
Favourite Christmas film: It has to be two - *It's a Wonderful Life* and *Home Alone*
What is the worst present you ever received for Christmas? An Elvis Presley calendar (don't even ask…)
Favourite Christmas cracker joke: Why did the orange take a prune to the Christmas party? Because he couldn't find a date!
Thoughts on Christmas decorations in November: November is way too early to be putting up Christmas decorations or to be asking about favourite Christmas cracker jokes and films!

CONTACTS

Paul Middleman
paul.middleman@mercer.com
0151 242 7402

Leanne Johnston
leanne.johnston@mercer.com
0161 837 6649

Ian Kirk
ian.x.kirk@mercer.com
0151 242 7141

Nigel Thomas
nigel.thomas@mercer.com
0151 242 7309

John Livesey
john.livesey@mercer.com
0151 242 7324

Clive Lewis
clive.lewis@mercer.com
0151 242 7297

Charlotte Dalton
charlotte.dalton@mercer.com
0161 837 6660

Jonathan Perera
Jonathan.perera@mercer.com
0151 242 7434

This edition of LGPS: Current Issues is for information purposes only.
The articles do not constitute advice specific to your Fund and you are responsible for obtaining such advice.
Mercer does not accept any liability or responsibility for any action taken as a result of solely reading these articles.
For more information about other training or advice about how any article in this issue relates to your Fund, please contact your usual Mercer consultant.

Visit us at www.uk.mercer.com

MARSH & McLENNAN
COMPANIES