MARCH, 2016

LGPS CURRENT ISSUES

NEWS IN BRIEF

PENSION INCREASES / REVALUATION OF CARE BENEFITS

Given that UK inflation, as measured by the Consumer Prices Index (CPI), fell by -0.1% in the period September 2014 to September 2015, those members in the LGPS who have retired/left service, will receive no increase to their benefits with effect from April 2016.

With regard to members in service, on 1 February 2016, a draft of The Public Service Pensions Revaluation (Prices) Order 2016 was published, which specified that a decrease of -0.1% should come into effect from 1 April 2016. Therefore, whilst this has yet to be laid, it is looking likely that HM Treasury will choose to use their powers under the legislation and apply a reduction to post 2014 CARE benefits.

The very low CPI figure will also have an effect on the 2016/17 Annual Allowance calculations.

IN THIS ISSUE

EQUITABLE LIFE DEVELOPMENTS

There have been a number of recent developments at Equitable Life with regard to the various investment Funds available to members. A number of changes have already taken place.

In short, Equitable Life is increasing the annual management charges it applies to various funds, and also halving its overall fund range, with assets being disinvested and reinvested in one or more of the remaining funds. Whilst we would expect that the majority of LGPS members with Equitable Life policies to not be affected (given they will be invested in With-Profits funds which are not subject to any of the changes announced), LGPS Funds, which have members with Equitable Life Policies, still need to consider what action they should take.

In particular, administering authorities need to be aware that any automatic reinvestment performed by Equitable Life, could be deemed to be an investment decision by the administering authority on behalf of members.

We will be producing a separate note on the options available and what steps should be taken.

SINGLE FRAUD INVESTIGATION SERVICE BULK TRANSFERS

The Single Fraud Investigation Service (SFIS) involves the transfer of a handful of local authority staff from each LGPS Fund to the PCSPS.

We understand that members are currently being provided with the details of their options on joining the PCSPS and in some cases the transfers will be paid shortly. For other funds, once members have made their decisions we will be in touch with Funds to agree the amounts of any transfers to be paid.

EUROPEAN UNION REFERENDUM

The Prime Minster has announced that the European Union (EU) Referendum will be held on 23 June 2016.

The most important immediate impact that the EU Referendum will have on pension schemes will be the impact on the financial markets (e.g. potential volatile equity prices and bond yields) both before the Referendum, depending on how close the vote is predicted to be, and afterwards, should the vote be to leave the EU. Markets are currently expecting the UK to stay in the EU, so if there is an exit, it is difficult to predict the outcome.

Such volatility and uncertainty in the markets will have a knock-on effect on funding positions and for LGPS Funds in England and Wales, this may need to be considered carefully as the outcome of the referendum will be announced right in the middle of the 2016 valuation process.

In addition to market volatility, given that UK pension law has been brought into line with various EU directives e.g. gender/age discrimination etc, in theory a vote to leave the EU could pave the way for the UK to change its legislation in certain areas, although whether any major changes will be brought in is perhaps doubtful.

2016 ACTUARIAL VALUATION (ENGLAND AND WALES)

We are now less than a month away to 31 March 2016, the effective date of the next round of actuarial valuations for English and Welsh Funds. There will be a number of challenges facing Funds, Employers (and advisors!) in relation to this exercise, in particular given it will be the first valuation in the Post 2014 environment, and also with regard to the greater level of scrutiny that the LGPS is now under.

Preparatory work is already underway on a number of fronts and we will be producing a separate note to consider some of these in more detail.

INFRASTRUCTURE AND INVESTMENT POOLING IN THE LGPS

The Chancellor made a statement back in October that referred explicitly to infrastructure investment and investment pooling in the LGPS. The statement provided the clearest sign yet of the scale of ambition that the LGPS has been tasked to achieve.

Alongside the deadline for responses to the Consultation on the Investment Regulations (as referred to below), LGPS Funds had to submit by 19 February 2016 details of what progress they had made to date in terms of pooling with other authorities. As we understand, there are now 7 pools in the process of being established.

The next deadline for Funds to consider is 15 July 2016. By this date, Funds will have had to make a final submission to the government describing the proposed structure and governance of any pooling arrangement, what costs (and importantly savings) are expected, and also how this will be implemented e.g. transition profile for the assets involved. Unlike the initial submissions (which could have been submitted jointly by Funds), final submissions need to be on an individual basis.

If done in the right way, pooling could have significant investment and governance benefits to the LGPS and wider society. However, we should not lose sight of the LGPS's ultimate objective of providing pensions in a cost effective manner, which requires a holistic approach encompassing credible and transparent funding plans, effective cost management, best in class governance, return generation and risk management. There is no silver bullet therefore and continuous effort on all these fronts is needed.

INVESTMENT REGULATIONS' CONSULTATION

The deadline for responses to the Government's consultation on revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ended on 19 February 2016 and responses are now being considered.

In summary the main changes proposed centred around:

- Pooling of assets to increase scale and reduce costs possibly through more internal management e.g. the Common Investment Vehicle being implemented by the London Boroughs.
- Improving governance by ensuring strategies are adhering to regulation and guidance
- Increasing flexibility for Administering Authorities to determine an appropriate risk based investment strategy
- Allowing the Secretary of State to intervene where Funds are not taking advantage of pooling and/or not delivering appropriate risk based investment strategies

Mercer has responded to the consultation, please contact your usual Mercer contact if would like a copy.

UPDATE ON IMPLICATIONS OF THE STATE PENSION REFORM

Time is potentially running out to prepare for state pension reform, and actions need to be taken before 6 April 2016.

There are a number of implications for LGPS funds and employers as a result of the reform and we have considered this in more detail later in this edition.

MARCH 2016 BUDGET AND RESULT OF PENSION TAX CONSULTATION

The current pensions tax system is under review and the government issued a consultation on pension tax relief in July 2015. Mercer understands that the four structures most likely to be seriously considered by HM Treasury are: the current system; an amended version of the current system; an ISA-style structure with additional incentive to make long term saving; and a flat rate of tax relief.

The result of the consultation is likely to be announced in the March 2016 Budget and there are many issues that this could potentially create including further upheaval for employers and Funds who have already had to address issues caused by auto-enrolment, the new pensions freedoms and the end of contracting-out in April 2016.

All the time of writing , Press reports strongly support that Chancellor will make no changes to the current system, but we cannot be certain until after the Budget and even then it may only be a deferment of the decision.

PUBLIC SECTOR EXIT PAYMENTS

As trailed in the Chancellor's Spending Review and Autumn Statement, the government has issued a consultation on further reforms to public sector exit payments. This is the third in a series of reviews in this area, the other two being:

- the "Recovery Regulations" (whereby higher earners have to repay part or all of their exit payment if they rejoin the public sector within a year), effective from April 2016.
- the proposed overall limit on exit payments of £95,000, which is expected to become effective in Autumn this year (date not yet confirmed)

The latest consultation is aimed at reducing the overall cost of exit payments and achieving greater consistency with the private sector. Once again, the costs of any pension enhancements awarded are within the government's sights. In brief, the proposals are to:

- Set a maximum tariff (three weeks' pay per year of service) for calculating exit payments.
- Cap the maximum number of months' salary that can be used when calculating redundancy payments to 15 months. Some minor variations on this general policy might be allowable.
- Set a maximum salary (possibly £80,000) on which an exit payment can be based.
- Taper the amount of compensation as an individual gets closer to their pension retirement age.
- Require employer-funded early access to pension to be limited or ended. The consultation puts forward a number of options, including meeting any cost out of the remainder of the exit package, limiting the ages at which employer-funded early access might be made available, or even abolishing the practice completely and allowing the cost of any top-up to be met entirely by the individual.

At the same time, HMT has written to all government departments setting out new guidance on the rules they must follow on pay and terms for public sector workers.

In practice, this seems to be little more than a consolidation of existing guidance, including the requirement for approval of the Chief Secretary to the Treasury for civil service appointments with a remuneration package is above £142,500 and for bonus arrangements worth over £17,500. For local government appointing staff on salaries of £100,000 or more should be subject to a vote of full council.

Clearly the government still has the overall area of public sector pay and exit packages well in its sights, and more can be expected (e.g. the promised review of sickness absence has yet to emerge). For the LGPS it could well mean the removal of access to unreduced pensions for all on exit from the sector.

We will be responding to the latest consultation, and will update you with any further developments.

CODE OF PRACTICE ON INCENTIVE EXERCISES

The Incentive Exercises Monitoring Board has published Version 2 of the Incentive Exercises for Pensions code of good practice. The code applies to all new incentive exercises made available to members on or after 1 February 2016. Exercises made available to members prior to this date will continue to fall under Version 1.

Version 2 introduces a proportionality threshold under which there is no requirement to provide advice or for a member to take guidance. The threshold is £10,000 for transfers and full commutation exercises, and £500 p.a. of pension affected by a pension increase exchange.

This proportionality threshold is a useful mechanism for Funds and employers wishing to conduct bulk trivial commutation exercises to reduce liabilities and administration costs, as it potentially removes the requirement to pay for financial advice for the member, where the member's pension is trivial, which significantly increases the appeal of such exercises.

The 2016 valuations mark an ideal time for Funds which have not yet previously considered such exercises to assess the liabilities that can be extinguished through trivial commutation and we are able to incorporate such analysis in our valuation calculations.

STATE PENSION REFORM, THE DETAILS AND THE ACTION REQUIRED

As a result of the reforms to state pensions, there are a number of actions required by LGPS Funds and Employers and we have summarised these in the table, with further details provided below:

ACTION	FUND/ EMPLOYER?	DEADLINE
Ensure payroll function notified of national insurance and any other contribution changes.	Employer	5 April 2016
Notify members: Of any change in contractual terms (because of change in contracting-out status) by 6 May 2016. Consider notifying employees of impact on take home pay from 6 April 2016.	Employer	6 May 2016
Update booklets and communications to reflect changes to state benefits.	Fund / Employer	n/a
Commence GMP reconciliation exercise before April 2016.	Fund	5 April 2016
Notify active members of the end of contracting-out by 6 July 2016.	Fund	6 July 2016
Respond to government consultation on solutions to indexation for public service pension schemes and their members	Fund / Employer	Expected later in 2016

GMP RECONCILIATION EXERCISE

The National Insurance Contributions and Earnings Office (NIC&EO) of HMRC has issued its latest update on the abolition of contracting-out for DB schemes, which will come into effect in April 2016.

HMRC key messages remain:

- The cut-off date for expressions of interest (EOI) for the Scheme Reconciliation Service SRS is 5 April 2016
- No action by Trustees / Funds, who have received SRS data, will result in an assumption that the data held by HMRC is accurate
- Failure to reconcile this with the Fund's records could result in Funds being assigned pensions that they were not previously aware about, or had previously been extinguished but not notified to HMRC.
- All funds therefore need to register an EOI by 5 April 2016 to avoid this potential liability

LGPS TO PICK UP THE COST OF FULLY INDEXING GMPS

On 1 March, Government issued a Press Notice, announcing that public service schemes would be required to pick up the cost of fully indexing GMPs in respect of members who reach State Pension Age from 6th April 2016 to 5th December 2018.

For members reaching State Pension Age from 6th December 2018, HM Treasury intends to consult later this year on a solution to the indexation issue and GMP equalisation for the public service schemes and their members.

What is the financial impact?

If full indexation had been implemented for all members who reached State Pension Age from 6 April 2016, we had estimated that the burden for the LGPS would have been additional liabilities of around £1 billion which equated to around 0.5% of the Scheme's total liabilities. Based on this initial shorter window of pensioners, we estimate that the current impact on the LGPS will now be additional liabilities of the order of £225 million, which will have to be reflected in the forthcoming 2016 valuation: The impact will vary for individual employers, depending on their membership profile, and again this is something to be costed in the valuation.

Practical impact?

From an administration/pensioner payroll perspective there will be a need to identify affected members and set up processes for them in order to apply the correct increases going forward when they reach State Pension Age with potentially different treatment again from 2018.

It remains to be seen how this will play out in the longer term. We are aware that private sector companies who operate public sector style "mirror" schemes have been lobbying government to prevent the full requirement from being imposed on public service schemes and therefore their own as well. We anticipate that they will respond strongly to the consultation on this.

We will be touch again once the consultation details are published and will remain in close contact with HM Treasury in the meantime.

COMMUNICATION WITH EMPLOYEES

Funds and employers will need to notify members about the change to their contracting out status. Further information and example communications can be found here: http://lgpsregs.org/images/Bulletins/Bulletin140.pdf

STATE PENSION REVIEW BEGINS

In addition to the above reforms, a review of the State Pension Age has begun that may mean people joining the workforce today having to wait until their mid-70s before they can retire.

The review will make its recommendations by May 2017.

Whilst directly affecting members' state pensions, this could also have implications for LGPS benefits as the Scheme's Normal Retirement Age is linked to State Pension Age.

DATES TO REMEMBER

DATE	ISSUE	SUMMARY
31 March 2016	Actuarial valuation	Effective date of the 2016 actuarial valuation exercise for English and Welsh LGPS funds
1 April 2016	Pension increases	Effective date of the annual pension increase for the LGPS / application of care revaluation rate
6 April 2016	Lifetime allowance	The lifetime allowance will reduce to £1 million, subject to legislation. Fixed and individual protection will be made available to impacted inviduals.
6 April 2016	Annual allowance	The annual allowance will be reduced from 2016/17 for high earners, tapered down to £10,000 for the highest earners. All pension input periods will be aligned with the tax year.
6 April 2016	State pensions	The government will introduce a single-tier state pension. Contacting out for defined benefit schemes will be abolished.
6 May 2016	Abolition of contracting out	This is the deadline for employers to have notified employees of change in contractual terms (as a result of the abolition of contracting-out)
23 June 2016	European Referendum	The referendum on whether the uk will opt out of the EU will take place on this date.
5 July 2016	Abolition of contracting out	This is the deadline for administering authorities to have notified active members of their change in contracted-out status.
15 July 2016	Investment pooling	Deadline for funds to have formally submitted their proposals to the government for investment pooling with other funds.
30 September 2016	Actuarial valuation	Deadline for membership data to have been submitted to GAD as part for the LGPS cost management analysis.
31 March 2017	Actuarial valuation	Deadline for the 2016 actuarial valuation exercises to have been formally signed off by the fund actuary.

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