LGPS CURRENT ISSUES

NEWS IN BRIEF

IN THIS ISSUE

HOT TOPICS

- **LIFE EXPECTANCY UPDATE -** Continuous Mortality Investigation (CMI), whose work underpins life expectancy improvement rates used in our liability valuations for LGPS Funds, have published their most recent Mortality Projections Model "CMI 2017", allowing for 2017 data. At a high level CMI 2017 shows:
    - a slowdown in the impact of future life expectancy improvements
    - this is equivalent to a reduction in life expectancy of around 2 months on average compared to last year's model, CMI 2016
    - this continues a recent trend, as last year's model also saw a (larger) reduction in life expectancy compared to the 2015 model, CMI 2015
    - there is increasing evidence that the low level of recent mortality improvements may be due to medium / long-term influences (rather than just short-term events such as influenza in early 2015)

  For our funds, whose valuations used the CMI models, in isolation the impact of moving to the latest projection model would be to improve overall funding levels by 1-2% and reduce average future service contributions by around 0.3% of pensionable pay. Other factors will affect the life expectancy assumption used in the valuation (including where employers cease participation) and the level of future improvements is something to consider over 2018 for Funds given the evidence that the improvement rates are showing a further tailing off than was previously expected.

- **GDPR** replaces the Data Protection Directive and applies in all EU member states from 25 May 2018. Work is well underway in many Funds; however meeting the requirements of the GDPR remains a challenge for some. A lot of activity is expected in the early part of 2018. The Secretariat (acting on behalf of Administering Authorities) has commissioned Squire Patton Boggs to produce the following documents
    - Template privacy statements for administering authorities to use
    - A memorandum of understanding document for employers setting out that participating employers can share data with the administering authority without a data sharing agreement being in place

- The DWP has responded to its 2017 consultation on DEFERRED DEBT ARRANGEMENTS (DDAs). DDAs will be introduced from 6 April 2018 and will apply to all multi-employer DB schemes in the private sector, although will most likely be of interest to non-associated multi-employer schemes. They allow an employer that is ceasing to employ active members to defer the debt trigger and continue to be treated as an employer in relation to the scheme.

  Whilst not affecting the LGPS currently, it's likely this will support a move to afford the flexibility to employers to be incorporated into the LGPS Regulations in similar way in the future. We think it would beneficial for administering authorities to be able to exercise this power should the circumstances warrant it to manage liabilities and protect the Fund from future unrecoverable debt. We have already commented on our support for this change as part of the recent Tier 3 review.

- Work on the "PENSIONS DASHBOARD" is expected to continue during 2018. The Government has accepted the need for a single platform holding information for individuals on all their pension savings, and the Department for Work and Pensions (DWP) will take the project forward.

- Following its "REVIEW OF RETIREMENT OUTCOMES" in 2017, investigating how to provide additional protections for consumers and to help consumers make good choices, the Financial Conduct Authority intends to publish its final report on whether it should intervene and how in the first half of 2018.

SCOTTISH INCOME TAX

The Scottish Government recently announced tax changes that result in moving to a five-band income tax system. This means that any Funds that have pensioners residing in Scotland will need to ensure that the administration systems are able to cope with the changes before they are introduced on 6 April 2018. HMRC have issued Pension Schemes Newsletter 96 which focuses on the impact of the Scottish Budget on the taxation of pension income – in particular the effect on fixed rate charges (e.g. Lifetime Allowance charge), marginal rate charges, PAYE and taxable Lump Sum Death Benefits. It also covers relief at source for Scottish Tax payers.

WELSH INCOME TAX

From April 2019, the National Assembly for Wales will have the power to set the basic, higher and additional rates of income tax for Welsh taxpayers, although the bands of income to which they will apply will remain the same as those for England and Northern Ireland. Broadly speaking, Welsh taxpayers are taxpayers for whom the majority of their time throughout a tax year is spent residing in Wales. Systems will need to be upgraded before April 2019 to cope with potentially different income tax rates for Wales than currently.

GMP RECONCILIATION

The Scottish Public Pensions Agency ("SPPA") has published Q&As regarding how GMP overpayments to pensioners will be dealt with (treatment will vary depending on the public service scheme, as for certain schemes HM Treasury consent is required). In common with public service schemes across the UK a number of overpayments are expected to be identified from the reconciliation exercise where current GMP data held by schemes is incorrect.

EQUITIES COOLING OFF?

Following the sell-off, US equities have experienced a substantial increase in volatility, showing their biggest percentage drawdown since January 2016; these drops were consequently echoed around the globe with other developed markets feeling the full force of the events in Wall Street.

The apparent source of this decline was a higher than expected wage growth report which, coupled with a sustained increase in interest rates over the last month, sparked concerns of a continued move higher in nominal interest rates.

We do not believe there are any urgent actions for investors to take. We believe there is a potential for higher volatility over the next few years as monetary support is withdrawn, and we should be prepared for the potential for sharp drops from time to time. Many LGPS Funds have implemented or are considering equity protection strategies to remove the downside risk of a significant correction in the markets which could impact on employer contributions at the next valuation. As LGPS Funds are long term investors, it is important to maintain discipline and focus on the long term and protection strategies can form part of that focus..

CRYPTOCURRENCIES: FOOL’S GOLD OR THE FUTURE?

Eye-watering cryptocurrency price appreciation was the speculator’s delight of 2017. Two of the major cryptocurrencies, Bitcoin and Ether, rose by around 1,400% and 9,000% respectively over the calendar year, while an index of leading cryptocurrencies rose by approximately 2,800%. Rapid price appreciation, the proliferation of new coin launches (initial coin offerings, or ICOs) and widespread excitement around cryptocurrencies suggest the existence of a speculative bubble.

We do not view cryptocurrencies in their current form as an investable proposition or store of value (either directly, via futures or via hedge funds set up to speculate on cryptocurrency price movements). They offer no income to the passive holder of coins (“non-miners”), and assessing fair value is close to impossible. In addition, the wave of cryptocurrency launches and the spectacular price increases seen over 2017 exhibit many of the hallmarks of a speculative bubble. We suggest that investors sit it out.

Although the blockchain technology underlying cryptocurrencies holds significant promise in areas such as trade processing and settlement, cryptocurrencies have yet to prove that they offer much more than the benefit of anonymity and the potential for large price fluctuations.

EMPLOYER RISK

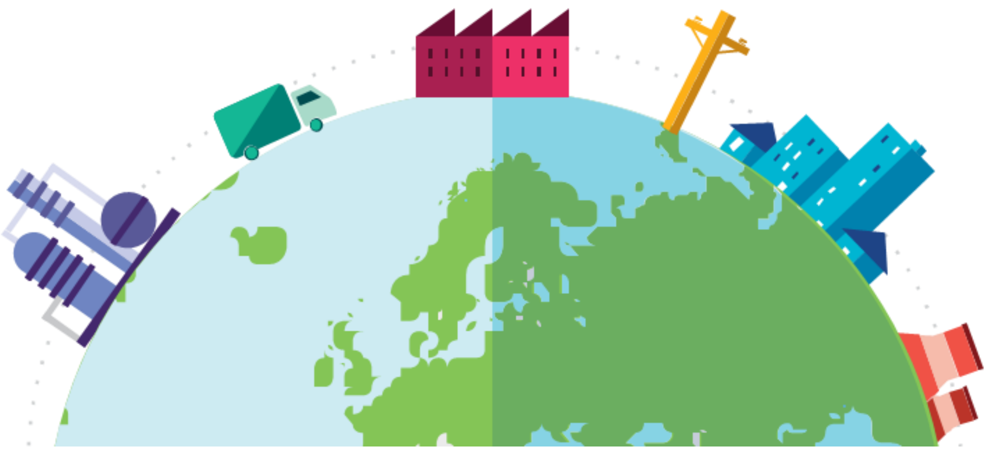
SECTION 114 NOTICE

WHAT DOES IT MEAN FOR THE PENSION FUND?

The recent issue of a Section 114 Notice by Northamptonshire County Council received a good deal of press coverage. The issuing of a section 114 notice imposes immediate spending controls on the Council. In effect it means that any new spending on non-statutory services are put on hold, whilst any statutory functions are maintained. It remains to be seen whether any further notices will be issued by other Councils given the continued pressure on budgets and services.

This event shows that even the apparently most secure employers can run into difficulty in meeting some obligations without significant action. Whilst we would expect pension costs to form part of the statutory obligation of a Council (in the same way as paying staff wages), there is no doubt that contribution affordability will be paramount to Councils who find themselves in this situation. It is therefore important that Funds consider employer covenant for all employers and put in place the appropriate frameworks to manage these one off events especially if it affects the ability of the employer to maintain the level of contributions due under the valuation certificate and/or the likely contribution requirements at future valuations.

HOW CAN WE HELP – We will be supplying a more comprehensive note on the implications of section 114 and the considerations for funds. In the meantime please contact Tim Birkett on 0161 837 6672 or tim.birkett@mercer.com, or your usual Mercer consultant if you would more information on monitoring covenant and the actions that can be taken.



OTHER DEVELOPMENTS ON REGULATIONS AND CONSULTATION

WHAT HAPPENED TO THE PROPOSED CHANGES TO PUBLIC SECTOR REDUNDANCY PAYMENTS?

The Government has consulted on various ways to reduce redundancy pay outs to public sector staff, including early retirement pensions.

The intention to cap redundancy payments by law (at £95,000), and to recover payments made to higher paid employees who return to public sector employment, were policies mooted under David Cameron's administration. Our understanding is that this remains Government policy and that HM Treasury may consult on draft regulations and guidance regarding the cap this year. We also expect the recovery provisions to be implemented this year.

A third aspect of public sector reform is HM Treasury's overall framework for reducing the cost of exit payments, which is to be implemented for each workforce by the relevant Government department. The Civil Service moved quickly to implement its reforms in line with the Treasury framework, although these were subsequently challenged in the High Court. Our understanding is that the Department for Communities and Local Government will consider its proposals for the framework reforms applying to local government, and publish these for consultation.

NEW FAIR DEAL PENSION PROTECTIONS

WILL PENSIONS RISK BE TAKEN OUT OF THE OUTSOURCING EQUATION?

The Government is to consult again on its approach to introducing New Fair Deal pension protections for the LGPS, with new proposals expected in the coming months. In its original consultation, the Government proposed that contractors would be required to join the LGPS when local authority services - and staff – are outsourced (the option of using their own schemes, which are certified as broadly comparable to LGPS, would be removed). Interestingly, it was proposed that there would be no requirement to provide pension protections at all on second generation contracts where the staff involved were already in a broadly comparable scheme.

GMP INDEXATION AND EQUALISATION

Following the introduction of the new State Pension system in 2016, the Government effectively ceased to provide cost-of-living increases on GMPs for members of both private and public sector schemes who reach state pension age (SPA) after 5 April 2016. As a result, the public service schemes are required to step in and pick up the cost of fully indexing GMPs (over and above the statutory increases that all schemes are required to pay) – at least in respect of members who reach SPA before 6 December 2018.

HM Treasury has consulted on options for how GMPs should be indexed from December 2018; Treasury has been clear that the solution must also ensure that equal benefits in relation to GMP are paid to men and women. The Government announced its response to the consultation on 22 January. The responses received were broadly in favour of the Government's objectives. The Government had been implementing an "interim solution" between 6 April 2016 and 5 December 2018. The outcome of this consultation is to extend this for a further two years and four months covering those members who reach state Pension Age on or after 6 December 2018 and before 6 April 2021. During this time, the Government will investigate the possibility of converting GMP in the longer term.

THE LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND) REGULATIONS 2018

The Scottish Public Pensions Agency (SPPA) has consulted on a set of draft regulations for the Local Government Pension Scheme (Scotland). Following the implementation of the reforms from 1 April 2015, work has continued to identify areas in the regulations that require further clarification and correction. The consolidated 2018 Regulations have been designed to clarify these existing provisions and to make some suggested changes from stakeholders that have been agreed by SPPA. The deadline for the consultation ended on 15 January 2018 and our understanding is that some changes will be made before the final regulations will be presented to Parliament in April. Further information can be found here and we will include a summary of the main changes in future Current Issues.

SCHEME ADVISORY BOARD UPDATES

- **TIER 3 EMPLOYERS** – As part of the review of tier 3 employers, three surveys were issued to Administering Authorities, members and tier 3 employers during November 2017. The closing date for the surveys was 31st January 2018 and the results are currently being analysed.

- **ACADEMIES** – As discussed in previous issues, the GAD collected some further information from actuaries under the umbrella of their section 13 work. The two working groups tasked with this met in January. The administration working group agreed that a standard template for data consistency would help improve administration efficiency. The funding working group has initially explored the concept of a single contribution rate for academy 'pools' or Master Academy Trusts (MATS). The working groups are expected to meet monthly.

- **50/50 OPTIONS** – A member survey performed in July 2017 indicates that the low take up rate of the 50/50 scheme may be due to poor communication. The SAB are therefore considering whether improving awareness of the option would result in an increase in the take up rate.

MINISTRY OF HOUSING, COMMUNITIES AND LOCAL GOVERNMENT

In the recent cabinet reshuffle, the Department for Communities and Local Government (DCLG) has been renamed as the Ministry of Housing, Communities and Local Government (MHCLG). In addition, Rishi Sunak will replace Marcus Jones as the minister responsible for the LGPS.

ELMES V ESSEX

Between 1 April 2008 and 31 March 2014, it was a requirement for the members to complete a nomination form setting out who benefits should be paid to in the event of their death (for England and Wales). A case in respect of Nicola Elmes and Essex County Council was recently heard in the High Court about this requirement.

The outcome of this case indicates that the nomination form is no longer required in order for cohabitees to be eligible for a partner's pension in the LGPS. Funds will now need to decide how to rectify this issue in respect of historic members who were refused a partner's pension due to the nomination form not being completed. The impact on the LGPS regulations will be confirmed by MHCLG in due course.

AUTO-ENROLMENT REVIEW

Following a full review of automatic enrolment during 2017, the Government published its report and proposals on how to build on its success.

The report contains surprisingly few firm recommendations, but the proposals are:

- To reduce the minimum eligibility age from 22 to 18 (with the £10,000 earnings trigger for eligibility remaining unchanged);
- To remove the lower earnings contribution threshold, so that contributions are payable from the first pound earned. This will mean that the "entitled worker" category will disappear and anyone opting in will be entitled to an employer contribution.

However the review does not intend these changes to come into force until the mid-2020s, to allow for a period of consultation and advance planning given the associated cost increases.

Although no specific changes are being proposed in relation to individuals in multiple part-time jobs who earn more than £10,000 in combination, but who don't get auto-enrolled because they don't earn over £10,000 in any single employment, the Government considers that the removal of the threshold will be an increased incentive for these individuals to opt-in.

The review also calls upon the pensions industry, employers, and the wider advisory and intermediary community to work with Government on improving member engagement through a variety of strategies. These include simplifying messaging and language, using rules of thumb and nudges, identifying specific life events as "teachable moments", and making use of technology, including the ongoing development of the Pensions Dashboard.

DATES TO REMEMBER

DATE	ISSUE	THE LATEST
3 January 2018	MiFID II	MiFID II became effective from this date.
15 January 2018	Scottish Regulations 2018	Deadline for response to the Consultation
31 January 2018	Tax	Voluntary Scheme Pays Deadline
1 February 2018	Auto-enrolment	The final staging date for employers to enrol workers into a workplace pension. This completed the phased rollout of auto-enrolment.
8 February 2018	Base rate	The Bank of England's Monetary Policy Committee met and voted unanimously to keep interest rates at 0.5%
13 March 2018	Spring Budget	Chancellor of the Exchequer Philip Hammond will deliver the 2018 Spring Statement.
31 March 2018	Actuarial Valuation	Deadline for the 2017 Scottish actuarial valuation exercises to have been formally signed off by the Fund actuary.
April 2018	Asset Pooling	LGPS funds must begin transitioning assets to the new investment pools
5 April 2018	Lifetime Allowance	Increase from £1m to £1.03m to match the Consumer Prices Index.
25 May 2018	Data protection	Date by which EU member states must comply with the new General Data Protection Regulation.
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 this month.
2018	Tier 3 Employers	Outcome of the Tier 3 employers review
2018	Academies	Outcome of the academies review
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: Barbara Forbes
Role: Actuarial Technician
Joined Mercer: 1990
Place of Birth: Leigh
Favourite Film: As Good As It Gets
Dream Holiday Destination: New York
Favourite Easter Chocolate: Any Dark Chocolate
Which Winter Olympics sport would you choose to do: Après Ski!

Name: Clive Lewis
Role: Actuarial Consultant
Joined Mercer: When rainbows were black and white
Place of Birth: Liverpool
Favourite Film: Saw, Saw iii, Saw iv, Saw ii, Saw vii, Saw vi, Saw v, Jigsaw (in precisely that order), oh and the Shawshank Redemption
Dream Holiday Destination: Not bothered as long as it's with friends and family.
Favourite Easter Chocolate: Anything that the kids forget to eat
Which Winter Olympics sport would you choose to do: Got to be the Ski Jump after the inspirational Eddie

Name: Adam Lane
Role: Investment consultant
Joined Mercer: 2010
Place of Birth: Birmingham
Favourite Film: Star Wars
Dream Holiday Destination: Barbados
Favourite Easter Chocolate: Dairy Milk
Which Winter Olympics sport would you choose to do: Curling

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