Summary
• LGPS funds have faced several obstacles stemming from the pandemic, including ongoing challenges around remote working.
• Key legislative and regulatory changes present a significant and unique hurdle for LGPS schemes, with the McCloud judgment expected to present a key concern in particular.
• LGPS funds must prepare now to ensure they have the capacity to manage these regulatory and legislative challenges, or else they could face an administrative overload.

Localised changes

Amid an already challenging year, the LGPS has faced a torrent of unique legal and regulatory changes. Sophie Smith takes a closer look at the issues facing the funds and whether they can cope with the hurdles ahead

2020 has no doubt been a year of challenges for everyone, and the pensions industry has been no exception, with the Local Government Pension Scheme (LGPS) facing a number of hurdles in particular. Just as the rest of the country had to pack up and move operations to dining tables across the country, so too did pension schemes, with Hymans Robertson partner, Richard Warden, highlighting the shift to remote working as "unprecedented" for the LGPS.

"Without doubt the greatest challenge that we've faced has been protecting our mission-critical services during the disruption caused by the global pandemic," agrees Lothian Pension Fund CEO, Doug Heron, explaining that this has required the quick adoption of new technology and shifting resources to meet growing demand from channels such as email, all whilst also ensuring member payments are made on time.

However, Warden adds that although funds are generally functioning well with working remotely, the backlog of non-priority cases from pre-Covid could present a future challenge. These concerns are echoed by Aon senior benefits and governance consultant, Catherine Pearce, who states that whilst funds do seem to have managed quite well, in many cases pensions staff have still had to travel to central offices to check for post, especially as LGPS member portals traditionally report lower take up.

A market in crisis

The pandemic also brought unprecedented market volatility, with Warden highlighting this as a key concern amongst funds with dividend cuts and the availability of payment benefits. "Many funds undertook cashflow analysis to ensure that they had sufficient liquidity to cope with the market reaction," he explains, clarifying that much of this value has since been recovered.

This economic impact was also felt by LGPS employers, prompting the Ministry of Housing, Communities and Local Government (MHCLG) to publish proposals on flexible employer contributions between valuations, which were backed by 73 per cent of consultation respondents.

This in turn has placed more onus on LGPS funds, as Pearce explains that they will now need to develop policies to enable the use of these new flexibilities on employer exit and amending contributions between valuations. Furthermore, she notes that whilst the MHCLG is expected to issue statutory guidance, this will not be available until 2021, despite regulations having been in force since 23 September and a number of employers already pressing funds to make use of the new provisions.

However, Warden says that whilst the diverse range of employers encompassed by the LGPS has presented a challenge, with some revenue streams were more disproportionately affected than others, the vast majority of LGPS employers have managed to continue to pay contributions. "Where payment problems have arisen, funds have generally been flexible on repayment terms subject to legislative restrictions and receipt of evidence showing the employer's financial circumstances," he says.

Adding to this, Aon partner, Alison Murray, argues that the flexibilities could also help administering authorities better manage employer risk as well as offering not-for-profit organisations a route out of the scheme. "We expect that use of these new powers may also see greater use of security and other alternative financing arrangements, adding new tools to the administering authority and its actuary's toolbox in seeking to balance the needs of employers and taxpayers in setting funding strategy," she says.

Good governance

Good governance is key for any pension scheme, but it is often an area of increased scrutiny for the LGPS, with Aon senior consultant, Mary Lambe, predicting a further increase in focus on governance next year. In particular, Lambe notes that recommendations from the Scheme Advisory Board's Good Governance review are due to be formalised in regulations, as well as potential changes to the 12-year-old Governance Compliance Statements Statutory Guidance from MHCLG, and a new single code from The Pensions Regulator.

However, Warden warns that requirements of the project, such as the publication of an annual governance compliance statement, will place a further onus on funds, as in order to benefit from governance reform, funds will need to consider how to implement these new requirements into their working arrangement. Furthermore, Warden also warns that recent changes to climate related disclosures could also add to the governance burden facing LGPS.

Despite this, sentiment amongst pension schemes remains optimistic, with Heron stating that whilst a Local Government Association report showed that many LGPS funds were forced to let their governance frameworks lapse due to pandemic disruption, most, if not all, should now be back to normal cycles and be operating with dedicated committees and pension boards.

"At the end of the day, the LGPS across the UK today is generally well-funded and members can be confident their benefits are protected, but maintaining that position will not be easy in the years ahead and strong governance that protects members' interests is essential," he states.

Supporting a greener tomorrow

Even amid a global pandemic, an increasing focus on climate initiatives has emerged, with the government's recent roadmap for the Taskforce of Climate-related Financial Disclosures implementation confirming that greater environmental disclosures will be expected from LGPS funds from 2023. "This will create added focus on funds' approaches to climate issues and is an area where the LGPS has a hugely positive story to tell about its work on engagement and responsible investment," Tsang says. This is echoed by the Heron, who emphasises that this momentum on ESG developments has not been slowed by the pandemic, and that whilst there will be pressure for pension funds of any type to do more to tackle climate change, funds such as the LPF are already doing a great deal.

However, Warden warns that funds are still being targeted by climate change activists, stating that although remaining invested may achieve better results, activists may not agree with solutions that don't involve immediate disinvestment from fossil fuel. Considering this, he says that clear communications are required to explain that the transition to lower carbon investments takes time.

Keeping up with the courts

Although the pandemic may have dominated day-to-day life during the past year, other challenges have persisted in the background. "2020 will be clearly be remembered for the Covid-19 pandemic, but for LGPS it will also be remembered as a year of legislation and court rulings," Warden argues, explaining that LGPS funds have faced a "torrent of changes" that will require significant resources and will feature heavily in business plans for 2021 and beyond. This includes, according to Pearce, reviewing policies in light of changes and the exit credit provisions introduced in 2018, all whilst responding to ongoing concerns around McCloud and exit reform.

Indeed, Warden highlights the exit payment as the "toughest challenge" for funds in 2020 since coming into force on 4 November, explaining that whilst in England and Wales the cap includes early retirement pension strain, current LGPS regulations require funds to pay full unreduced pensions when employees are made redundant aged 55 or over. Considering this, he stresses that funds are caught in a legal minefield until regulations are changed to encompass wider reforms that are being made to exit pay, also warning that pension strain will likely become a key feature of an employee's redundancy package once regulations are in place.

"Members will face tough decision-making comparing redundancy cash versus pension benefits, and funds will be more involved than before by providing information to employers on the pension options that are available," he states.

One hurdle at a time

Whilst there are many hurdles on the horizon, Tsang notes that much of the work may overlap, highlighting data as an area that funds will get the greatest return on their efforts in coming year.

"Having this in order will become crucial not just the McCloud judgment implementation," she explains, "but also for GMP equalisation and for the dashboard works coming down the track."

Pearce agrees, stating that many funds have already started planning exercises, such as gathering data from employers. "However," she continues, "we urge any funds who haven't yet started their discussions to do so as soon as possible as there is a lot of work involved and the sooner funds start planning the work and the resources, the better."

Indeed, it seems crucial that LGPS funds begin handling the challenges proactively, as Aon senior consultant, Virginia Burke, warns that although the McCloud judgment is likely to present a "significant challenge" alone, it could risk overwhelming administering authorities if taking place at the same time as the cost management, the £95,000 cap, GMP equalisation and the introduction of the pensions dashboard.

This is echoed by Heron, who warns: "At some stage in the future, if we're not already there, the LGPS will become so complex the costs and risks of administration will lead to a case for complete redesign."

Written by Sophie Smith

Storm (Mc)Cloud on the horizon

The McCloud judgment is perhaps the largest challenge facing LGPS currently, and as Heron explains, it also remains a problem that is hard to plan for. "We know we'll need access to historical data that might or might not be available and we know we'll need to explain to a group of members that they have a choice to make," he explains, "but we don't yet know how large this group will be, how we'll calculate their parallel benefit entitlement and when they'll be asked to make a final decision."

Estimates from Hymans Robertson suggest that around 25 per cent of all current active LGPS members are entitled to the underpin, equal to well over a million people, whilst predictions from Aon place this closer to 1.5 million members. Warden explains however, that for most employers, the actuarial cost of the underpin is likely to be fairly immaterial, perhaps adding only 0.2 per cent to existing liabilities. Furthermore, whilst recent proposals from MCHLG place the potential cost to LGPS employers at around £2.5 billion in additional pension payments over the coming decades, Burke states that this is based upon conservative assumptions, and that actual cost will likely be minimal on a fund level.

The bigger issue instead, Warden warns, will be gathering historic data and testing if the underpin bites for the eligible members. "We believe that a typical LGPS of 75,000 members fund will need to devote up to five FTE staff to tackling these challenges during 2021," he says, estimating that the final administration cost may well run into seven figures for a large fund.

This is echoed by Burke, who argues that the administrative burden of the changes will far outweigh the costs, stating that significant changes will also be needed in administrative processes, systems and communications. "Implementation costs will be incurred in relation to additional administration resources, software changes and other external support", she adds, stating that employers may also incur additional cost through additional resourcing to extract data or from fees to payroll providers to do this for them.

Adding to this, Heron states that the best funds can do is ensure they reach the implementation period with additional trained resources, cleared backlogs, and ready to work with providers, sponsoring employers and actuarial advisers to make sure members get the clarity and assurance they need. However, he warns that there will be further 'stress points', such as whether the LGPS moves into a period of benefit change, from upper or lower breaches of the cost cap, or not.