



**LOCAL PENSION COMMITTEE - 22 JANUARY 2021**

**REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

**FUNDING STRATEGY STATEMENT – EMPLOYER RISKS AND EXITS**

**Purpose of the Report**

1. The purpose of this report is to advise the Committee of proposals to amend the Fund's Funding Strategy Statement following regulation changes on employer risks and exits and to seek approval to undertake consultation with the Fund's Employers on the proposed changes.

**Background**

2. Pension Fund Officers already monitor employer risk, and these were considered at the last Pension Fund Valuation.
3. At the valuation employers were grouped by risk and this was used to determine some factors when assessing their contributions and deficit recovery repayment terms.
4. The Pension Fund also manages the risk of higher risk employers having to fund unexpected costs by requiring them to have a bond to cover potential redundancy situations, and also having ill health insurance in place. In the event that an employer is in serious financial failure and unable to pay pension strain costs the Fund can call upon the bond. The bond will then be paid to the Fund to cover the value required. This acts as a security for the Fund.
5. Officers monitor the bond values and their termination dates and arrange extensions or changes to the bond values, as required.
6. When an employer exits the Fund, Officers request a cessation termination value from the Fund Actuary and the employer usually pays the value as a single payment. However, there are some occasions when this is not possible, and the employer and Officers work together to form a repayment plan.
7. Currently there are five closed Community Admission Bodies (CABs) in the Fund. These tend to be older Fund employers without a guarantor or security, with either none or a very small number of active members, but still retain a Fund deficit.

8. At the last valuation the CABs were offered opportunity to crystallise their deficit positions and set up repayment plans with the Pension Fund. One CAB chose to do this and is making its repayment contributions. On receipt of the final payment, this employer will then be able to “walk away” from the Fund having fully met its Fund responsibilities.
9. The CABs that did not chose to crystallise their deficit plans will be assessed again at the next valuation, or earlier if the employer requests it.

### **Changes**

10. On the 23 September 2020 new Regulations regarding employer risk came into force. These Regulations are named - Local Government Pension Scheme (Amendment) (Number 2) Regulations.
11. Whilst there is no requirement for the Fund to use any of the new powers, however it is useful to note that some of the Regulations changes support what the Fund already does. These Regulations effectively fall into three areas;
  - i. **Review of employer contributions** – Currently officers monitor the risk of the Funds employers. However, the Regulations now require the Fund to have a policy on when a review of employer contributions is necessary (outside of the formal Fund valuation process) and the process the Fund will take in doing so.

Areas that should be included are;

- a. Factors the Fund will use to determine whether a contribution review for an employer or a group of employers should take place, taking into account actuarial advice.
- b. How the Fund will assess the risk/impact of an employer contribution on other fund employers.
- c. How an employer will be involved in a contribution review and the Fund’s procedure on consulting other potentially impacted employers.
- d. The periods in the triennial valuation cycle during which the Fund considers it may be inappropriate to conduct a review.
- e. That the Fund will take actuarial advice on the calculation of an employer’s revised contribution rate considering the following;
  - i. The scale of the liability change
  - ii. Changes in the employer’s covenant and their ability to meet obligations to the Scheme
- f. The process required for an employer to apply for a review, the evidence they are required to submit, and how the cost to the employer will be calculated.

Other areas that should be covered are;

- g. Timetable for the review, noting this may vary.

- h. How any change in contribution rate and the employer's circumstances may be monitored after implementation and a statement that employers will be required to support any reasonable information requests in order to allow effective monitoring of the changes in covenant.

#### The Fund's approach to a Review of Employer Contributions

12. The Fund is not minded allowing reviews of employer contributions as this is the purpose of the Fund's valuation. However, in one exceptional circumstance the Fund may consider it if an employer contacts the Fund in writing.
13. The exceptional circumstance is if an employer is in genuine financial difficulty and this option increases the chance of repayment. The employer will need to provide evidence of the reason within six months of the change.
14. The Fund would only consider this if this was the least risk option to other Fund employers, and if the original outsourcing employer (if applicable) agrees, and acts as guarantor. The Fund would also assess the potential to put additional security in place and seek actuarial advice in all cases.
15. Ideally the Fund would not consider requests if it is within 12 months of the next valuation the Fund, however if the employer can prove their financial difficulty is imminent, the Fund would consider allowing the review.
16. The Fund proposes a legal document would be prepared by the Fund and must be signed by all relevant parties prior to allowing a change in rate. The document would include how future assessments of the case would be made, but ideally the employer would resort back to the standard actuarial assessment and employer rate setting, at the next valuation.
17. If there is no guarantor, the Fund would seek a clause in the legal document acting as priority over security of the employer's assets, effectively acting as though the Fund is a secured creditor.
18. All costs of the arrangement to be met by the employer, such as the cost of advice to the Fund.
19. All cases will be taken to the Local Pension Committee for consideration and each case will be considered on its individual merit. Decisions may be made by the Chairman in consultation with Officers if an urgent decision is required between Committee meetings.
20. The Fund's approach to this change is included on page 14 in the Fund's proposed Funding Strategy Statement – see Appendix A.

**ii. Spreading exit payments** – When an employer last active member leaves the scheme the cessation termination value is calculated. Usually the exiting employers pays the value as a single amount. However, there are rare occasions when the employer requests the payment is spread over a period of time. Officers already allow this to happen in exceptional circumstances and this Regulation change supports this action.

21. The Regulations now require the Fund to have a policy on when the Fund will allow spreading exit payments and the process the Fund will take in doing so.

Areas that should be included are;

- a. Factors the Fund will use to determine whether an employer's exit payment should be spread (taking account of actuarial advice, covenant, legal and other advice as necessary).
- b. Circumstances the Fund considers it will not be appropriate to spread an exit payment.
- c. The appropriate length of time for an exit payment to be spread, including its maximum period.
- d. The process the Fund will adopt for consulting the Fund employer.
- e. Evidence the Fund will require from an employer to consider spreading an exit payment.
- f. How the Fund will inform an employer of its decision and matters such as
  - i. The spreading period
  - ii. Annual payments
  - iii. Interest rates
  - iv. Other costs payable
  - v. Responsibility of the employer during the repayment period
- g. The Fund's approach to monitoring the exit period and circumstances which could trigger a review.

Other areas that should be covered are;

- h. Timetable for the review, noting this may vary.
- i. The Fund will take actuarial, covenant, legal and other advice as necessary in considering a case, and,
- j. The process for employers to share updated information if/when their circumstances change to allow effective monitoring of the arrangement.

#### The Fund's approach to a Spreading Exit Payments

22. Whilst the Fund still prefers payment of the cessation amount as a single value the Fund is willing to allow this in exceptional circumstance if the employer requests this in writing.
23. The exceptional circumstance is if an employer is in genuine financial difficulty and this option increases the chance of repayment.

24. The Fund proposes spreading the amount by no more than three years, but this could be extended in extreme circumstances.
  25. The Fund would consider written requests from exiting employers within six months of exiting the Fund and would require detailed financial information from them to support their request for spreading.
  26. The fund would take into account the amount of any security offered and seek actuarial and legal advice in all cases.
  27. The Fund proposes a legal document would be prepared by the Fund and must be signed by all relevant parties prior to allowing a spreading of the exit payment. Interest would be added to the cessation value to account for the period the spreading covered, and payments would be made on a monthly basis until full payment is received. The first payment would start as quickly as possible after confirmation of the cessation value and the repayment plan would be written into the legal document.
  28. The Fund would monitor payments from the employer and if any payment was breached the full remaining cessation amount would be requested.
  29. All cases will be taken to the Local Pension Committee for consideration and each case will be considered on its individual merit. Decisions may be made by the Chairman in consultation with Officers if an urgent decision is required between Committee meetings.
  30. The Fund's approach to this change is included on page 18 in the Fund's proposed Funding Strategy Statement – see Appendix A.
- iii. Deferred Debt Agreements (DDA)** – This introduces a new “deferred employer status” and deferred debt agreements for exiting employers. This formally allows Secondary contributions to be certified for employers with no active members who have not paid their cessation termination value in full.
31. The Regulation allows the Secondary contributions to be subject to review at formal Fund valuations and the DDA must set out the period over which the arrangement will run. This offers similar employer flexibilities to spreading exit payments, but without crystallising the debt. However, the key difference is that the employer remains invested within the Fund and its funding position will ultimately change at subsequent valuations – which may positively or negatively affect the employer. Given the level of prudence established in all funding plans, the expectation is that this arrangement would benefit the employer through positive investment performance and the ability to wind down some of its liabilities over time.

32. Areas that should be included are;

- a. Factors the Fund will use to determine whether to enter into a DDA with an employer (taking account of actuarial advice)
- b. Circumstances the Fund considers it will not be appropriate to enter in a DDA
- c. The process the Fund will adopt for consulting with the exiting fund employer
- d. Evidence the Fund will require from a Fund employer to consider a DDA, including the cost and timing of an application, noting the requirement for actuarial advice and covenant, legal or other advice as applicable.
- e. Matters the Fund expects to include in the DDA, including;
  - i. Responsibilities of the deferred employer
  - ii. Conditions triggering the implementation of a recovery plan
  - iii. Circumstance triggering a cessation of the arrangement leading to an exit payment becoming payable
- f. Fund's approach to monitoring a DDA and the circumstances in which the Fund may consider;
  - i. Approaching the employer to seek to agree a variation to the length of the agreement, and,
  - ii. Serving notice on the fund employer that it is reasonably satisfied that the deferred employer's ability to meet the contributions payable under the arrangement has weakened or is likely to weaken materially in the next 12 months.

33. Other areas that should be covered are;

- g. Timetable for the review, noting this may vary.
- h. The Fund will take actuarial, covenant, legal and other advice as necessary in considering a case, and,
- i. The process for employers to share updated information if/when their circumstances change to allow effective monitoring of the arrangement.

#### The Fund's approach to a Deferred Debt Agreement

34. By virtue of the old CABs in the scheme that have not crystallised their debts the Fund already provides for this. However, the Fund would not wish to allow new cases to arise, instead using the "spreading exit payment" route for future cases.
35. The only time the Fund would consider a DDA is if payment of the crystallised cessation value, even with spreading payments, was to create a high risk of bankrupting the exiting employer.
36. If this was to occur the Fund would work closely with the exiting employer, Fund Actuary, Fund and employer's Legal Teams and any other relevant parties, to sign a legal document produced by the Fund

detailing repayment terms based on an ongoing basis. The Fund would still wish to move the employer to the spreading exit payment route as soon as this became viable and the cessation termination was suitable.

37. The Fund would wish to have some form of security in place, e.g. a bond that the Fund could call upon if the employer became bankrupt. Fund Officers would monitor the financial position and review the DDA arrangement annually, working closely with the employer. If the financial position improved significantly the intention would be to end the DDA, crystallise the debt and move over to spreading exit payments.
38. All costs of the arrangement to be met by the employer, such as the cost of advice to the Fund, ongoing monitoring of the arrangement and correspondence on any ongoing contribution and security requirements.
39. All cases will be taken to the Local Pension Committee for consideration and each case will be considered on its individual merit. Decisions may be made by the Chairman in consultation with Officers if an urgent decision is required between Committee meetings.
40. The Fund's approach to this change is included on page 19 in the Fund's proposed Funding Strategy Statement – see Appendix A.

### **Consultation**

41. It is proposed that the Fund consult with employers over four weeks following approval from the Committee. A further report detailing the outcome of the consultation and presenting a final version of the Funding Strategy Statement will be brought to the Committee at a later date.

### **Recommendation**

42. It is recommended that Committee;
  - a. Approves the draft Funding Strategy Statement, in relation to changes on employer risks and exits, for consultation with the Fund's Employers.
  - b. Notes that a further report will be submitted to the Committee presenting the outcome of the consultation and seek final approval for the Fund's Funding Strategy Statement

### **Equality and Human Rights Implications**

None specific

### **Appendix**

The Fund's proposed Funding Strategy Statement

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