Agenda Item 16

Leicestershire County Council

LOCAL PENSIONS COMMITTEE - 4 JUNE 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

NATIONAL YOUTH AGENCY

## Purpose of the Report

1. The purpose of this report to request Committee support the transfer of National Youth Agency pension fund assets and liabilities to Leicestershire County Council.

2. If Committee support this, it will then be taken to Cabinet to approve on behalf of the County Council as Fund employer.

## Background

3. The Leicestershire Pension Fund (the Fund) has a small number of historic scheme employers known as Community Admission Bodies (CABs).

4. CABs tend to be small to medium sized charities that joined the Fund in the 1970's or 1980's, before the full extent of the employer risk associated with a defined benefit scheme was known. Because of this, CABs often do not have an employer guarantor or security sat behind them, so if they go bankrupt their Pension Fund deficit gets spread across all the Fund's employers.

5. The Fund closely manages employer risk and tries to mitigate this wherever possible.

6. The National Youth Agency (NYA) is the largest remaining CABs in the Fund that does not have a guarantor.

7. They have no remaining active members but have several preserved and pensioner members. Because they do not have any active members they do not pay "standard employee and employer contributions" to the Fund. Instead the Fund Actuary assesses their assets and liabilities at each valuation and the NYA make fixed payments each year to the Fund towards their funding deficit.

8. The NYA have made significant headway in closing their deficit, aided by investment returns. At the 2013 valuation, the deficit was £2.8 million, on liabilities of £15.8 million on the Fund's 'ongoing' funding basis. This had improved to a deficit of £0.5 million on liabilities of £18.5 million at the 2019 valuation.

9. To clear the remaining deficit (on the ongoing basis), the NYA are paying £155,000 per annum into the Fund, a level that tries to balance affordability for the NYA with security for the Fund. However, while NYA remain an employer within the Fund, this deficit will fluctuate with investment markets, future inflation and member experience making it challenging for NYA to manage an exit from the Fund with any certainty.

10. The deficit that NYA are currently funding towards (i.e. on the 'ongoing' basis) is appropriate for employers who continue to participate in the Fund or for exiting employers where there is some form of security or guarantor in place to safeguard the remaining employers within the Fund against any longer term pension risks in respect of the exiting employer's liabilities. If no security or guarantor existed, NYA would exit the Fund on a stronger cessation basis.

11. As the NYA are no longer an actively participating employer in the Fund, the Fund and NYA are keen to explore options to manage an appropriate exit.

12. Furthermore, in the NYA's accounts the pension deficit is valued assuming fund assets will achieve returns in line with investment grade bonds, as per the accounting standard. This calculation method shows a far higher deficit, than the funding deficit, due to the lower expected returns of bonds (than the Fund's investments). This is likely to be an impediment for the NYA when trying to access certain funding sources.

13. The pension deficit is NYA's most significant liability and results in a negative balance sheet.

**Proposal**

14. In September 2020 new Pension Fund Regulations were introduced dealing with employer risk. Since then, the Fund's Pensions Manager has been working closely with the CEO at NYA to help them to reduce their pension fund risk. NYA are keen to clear their deficit and resolve this situation.

15. The Fund proposed to calculate a cessation termination value for NYA on the Fund's ongoing basis which creates a fixed target for them to work towards. To ensure appropriate security for the remaining employers in the Fund, this is dependent on there being a guarantee in place. Provided the NYA are able to pay a termination value that returns their ongoing funding position to fully funded (i.e. removing any deficit), Leicestershire County Council (as a Fund employer) have agreed to provide a guarantee.

16. At the start of the calendar year, Fund Officers were expecting a deficit value but there has been a significant change in gilts since January 2021 alongside an improvement in the markets, and the Fund Actuary has approximately calculated NYA's Fund position (on the 'ongoing' funding basis) as a surplus of around £900k as at 31 March 2021. While there are some approximations adopted in the actuary's method to provide this estimate, the Fund and the actuary are satisfied that a full valuation based on the NYA's specific

membership at 31 March 2021 would yield broadly the same result, specifically that:

17. NYA are in surplus at 31 March 2021 on the Fund's ongoing basis and therefore there is a nil debt to settle (conditional on LCC providing a guarantee).

18. As described above, this calculation is on a set of assumptions that is consistent with the funding basis set out in the Fund's current Funding Strategy Statement, for employers who continue to participate in the Fund, or is appropriate for a termination valuation where some form of security is in place for the exiting employer's liabilities.

19. From 31 March 2021, the NYA would have no further obligation to the Fund and all their assets and liabilities would become the sole responsibility of Leicestershire County Council (as a Fund employer) from this date under this proposed agreement. NYA's pensioners and deferred members will not be impacted by the proposal.

20. The calculation of the surplus is at a point in time and is likely to be variable due to the volatility in financial markets. For example, had the transfer occurred earlier in the year it was anticipated that the deficit had grown since the 2019 valuation. Taken at face value this agreement would reduce the deficit of the County Council by around £900k (based on the surplus at 31 March 2021 being subsumed into their funding position). However, it is likely that future investment returns will be marginally smaller than they otherwise would have been.

21. For the avoidance of doubt the NYA do not qualify for any refund of the surplus as calculated on the ongoing basis (i.e. an exit credit), as the assets and liabilities are being transferred to the County Council in full on the cessation date effectively leaving a nil cessation amount, i.e. no surplus or deficit for NYA.

22. For completeness, the Pensions Manager has checked with NYA to ask if there was any pension sharing risk in place at the start of their admission to the Leicestershire Fund. NYA have confirmed there was not and have confirmed they do not expect any of the surplus back.

**Legal agreement**

23. The Fund and the NYA will enter into a legal agreement specifying that the County Council have agreed to fully underwrite the NYA's pension obligations and, from 31 March 2021, the assets and liabilities of the NYA will be subsumed into the County Council's funding position.

24. From the point the legal contract is signed NYA will then no longer form part of the Fund valuation for future assessment of their contribution rates or cessation amount. From 31 March 2021, all assets and liabilities will fall under the County Council for valuation purposes allowing NYA to "walk away".

**Benefits**

25. The proposed agreement is intended to be beneficial to all parties. The NYA successfully manage an appropriate and affordable exit from the Fund. The Fund resolves a long-standing employer risk and provides an added layer of protection for its remaining employers (based on the County Council's strength of covenant). The County Council is facilitating a solution for a local charity to successfully exit the pension fund which will reduce NYA's future costs and limit any detrimental impact on its accounts or ability to raise funding and other finances.

26. If left unresolved (i.e. if no guarantee was provided) there could be a reputational risk posed to the Fund and County Council if the NYA were to become insolvent in the future and could not meet any future pension costs.

**Risks**

27. At 31 March 2021 the County Council have approximately £1.5bn assets (held against c.£1.6bn liabilities). Under the proposed legal agreement to provide a guarantee in respect of the NYA's portion of the Fund, the County Council would be assuming responsibility for an additional £20m assets (and c.£19m liabilities), i.e. an additional circa 1% of their current assets.

28. The most significant pensions risks being assumed under this agreement (and in general to any participating Fund employer) are future inflation, member longevity and future investment returns. Of these three risks, future investment returns are the least predictable and can lead to greater volatility.

29. The valuation (on the 'ongoing' basis) of the NYA's pension liabilities at 31 March 2021 has been carried out using an assumption that future investment returns will be 3.6% p.a.

| | | |
|---|---|---|
| **Investment Return** | Risk | The Fund's assets are primarily debt and equity investments, which do not have guaranteed return. The assumption is set at a level that assumes the target return is met or is greater in 80% of future economic scenarios modelled. |
| | Mitigation | LCC will hold the assets for decades increasing the probability that the target return will be exceeded (i.e. any short term market volatility has less impact) |
| **Pension Benefit** | Risk | Salary increases, or redundancy costs increase the liabilities. |
| | Mitigation | All NYA members are either retired or no longer accruing LGPS pensionable service. This removes this risk which only pertains to active members of |

| | | |
|---|---|---|
| | | the scheme. NYA no longer have the ability to make any decisions that impact the liability. |
| **Life Expectancy** | Risk | Increases result in higher liabilities |
| | Mitigation | Mortality experience is monitored regularly which informs funding assumptions. |
| **Inflation** | Risk | Higher inflation increases benefits payable |
| | Mitigation | Fund investments are structured to account for the inflation linking of liabilities.<br>All benefits linked to CPI, as Government's headline measure it is usually controlled (or changed.) |
| **Legislation** | Risk | Unforeseen changes increase pension benefits |
| | Mitigation | Historically changes have been focused on new pension entitlement rather than already earned. Recent changes have focused on reducing the cost of pension schemes. |

30. To put the investment risk into context, at the latest formal valuation in 2019, the Fund's assets were likely to achieve an annualised return of 3.6% on average over the next 20 years in around 80% of the scenarios modelled by the actuary (using their economic scenario modeller which projects 5,000 different future economic scenarios under varying investment and inflationary environments).

31. In simple terms (and taken in isolation), this means that there is around a 20% chance that a deficit could emerge over the next 20 years in respect of the liabilities being subsumed under this agreement.

32. For reference, at the 2019 valuation the 'best estimate' return over the next 20 years (i.e. a 50/50 chance of being achieved) was around 5.9% p.a. Therefore, on average, the assets (and liabilities) being transferred under this agreement should improve the County Council's funding position over the longer term.

33. The actuary's valuation inevitably relies upon a set of assumptions about future events. The risks (and mitigations) of the main assumptions are set out below:

## Summary

34. The proposal is recommended because with the ability for County Council to take a far longer financial planning horizon (than the NYA), the risk of any deficit developing over the longer term is at a reasonably low level.

35. Supporting the NYA in this way ensures there is no reputational damage caused for either NYA or the County Council if the existing situation remains unresolved, which could create a future financial problem for NYA and the Fund.

36. With no formal guarantor in place it is difficult for the Fund to reduce NYA's annual repayments, should they have financial difficulties, due to the increase in counterparty risk. Similarly, if asset values were to drop over the shorter term then higher payments from NYA would be expected to close any emerging/increasing deficit over their shorter time horizon - whereas the County Council's strength of covenant and longer funding time horizon allows the actuary to stabilise their contributions to ride out any market fluctuations.

37. Unlike other bodies within the Fund, the NYA have no ability to raise taxes. By putting a final end date for NYA's future participation in the Fund, this proposal reduces the chance of an adverse event impacting on the NYA whilst it is a member of the Fund.

38. NYA are a strong supporter of the Fund and have always made payment of the monies due, on time and in full.

## Next Steps

39. If the Committee is minded to support the proposals a report will be taken to Leicestershire County Council's Cabinet for approval on behalf of Leicestershire County Council as Fund employer.

## Recommendation

Members of Committee are asked to support the proposals as set out in the report.

## Equal Opportunities Implications

None specific

## Officers to Contact

Ian Howe
Pensions Manager
Telephone: (0116) 305 6945
Email: Ian.Howe@leics.gov.uk

Declan Keegan
Assistant Director of Strategic Finance and Property
Telephone: (0116) 305 6199
Email: Declan.Keegan@leics.gov.uk