CABINET - 22 JUNE 2021

NATIONAL YOUTH AGENCY – TRANSFER OF PENSION FUND ASSETS AND LIABILITIES

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of the Report

1. The purpose of this report to seek the Cabinet's approval for the transfer of National Youth Agency (NYA) pension fund assets and liabilities to Leicestershire County Council.

Recommendations

2. It is recommended that the Cabinet approves the transfer of the National Youth Agency's pension fund assets and liabilities to Leicestershire County Council.

Reasons for Recommendation

3. To enable the transfer of the NYA's Pension Fund Assets and Liabilities to Leicestershire County Council, thereby enabling the NYA to have concluded all its Pension Fund responsibilities, alleviating it of any future Fund responsibility.

4. The County Council is facilitating a solution for the local charity to successfully exit the Leicestershire Pension Fund which will remove its future costs and limit any detrimental impact on its accounts or ability to raise funding and other finances. Based on the most recent Actuarial evaluation of the NYA's Fund position the assets, which will be added to the County Council share of the Leicestershire Pension Fund, exceed the liabilities by £900,000.

Timetable for Decisions (including Scrutiny)

5. The Leicestershire Pension Committee considered a report on the matter at its meeting on the 4 June 2021. The Committee supported the proposed transfer.

6. The NYA Finance Committee approved the transfer at its meeting in March 2021.

Policy Framework and Previous Decisions

7. The proposal is in line with the revised Local Government Pension Scheme Regulations, which are designed to reduce employer risk.

Resource Implications

8. There are no immediate resource implications for the County Council arising from the proposed transfer. Any actuarial costs arising from the transfer will be met by the NYA whilst any administrative costs incurred are met by the Pension Fund.

9. The proposed transfer of the NYA's portion of the Leicestershire Pension Fund to the County Council would result in the Authority assuming responsibility for an additional £20m assets (and c.£19m liabilities), an additional circa 1% of its current assets.

10. Whilst a transfer would require the Council to undertake additional risk in terms of future inflation, member longevity and future investment returns, the independent valuation ensures that a balanced approach is taken regarding the potential for a beneficial outcome. Based on the most recent valuation of the Fund's expected investment returns, there is a reasonable expectation that the assets (and liabilities) being transferred under this agreement should create a small improvement in the County Council's funding position over the longer term.

Circulation under the Local Issues Alert Procedure

11. None.

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PART B

Background

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

13. 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, and therefore if they go bankrupt their Pension Fund deficit gets spread across all the Fund's employers.

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

15. The National Youth Agency (NYA), which is a national body for Youth Work in England, is the largest remaining CAB in the Fund that does not have a guarantor.

16. They have no remaining active members but have several preserved and pensioner members. As 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 any funding deficit.

17. The NYA have made significant headway in closing their deficit, aided by investment returns. At the 2013 valuation (a statutory Fund exercise provided by the Fund Actuary, Hymans Robertson to assess the Fund's total assets and liabilities and calculate each employers funding position and employer contribution rates) 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.

18. To clear the deficit, using the ongoing basis, the NYA is currently 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 the NYA remain an employer within the Fund, this deficit will fluctuate with investment markets, future inflation and member experience making it challenging for the NYA to manage an exit from the Fund with any certainty.

19. The deficit that the NYA is 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. Without the Council's support, the NYA would exit the Fund on a different cessation calculation basis.

20. 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 for its charitable work.

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

Proposal

22. In September 2020, new Pension Fund Regulations were introduced which focused on reducing employer risk. Since then, the Fund's Pensions Manager has been working closely with the CEO of the NYA to help them reduce their risk. The NYA is keen to clear their deficit and resolve this situation.

23. The Fund proposed to calculate a cessation termination value for the 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 proposal was dependent on there being a guarantee in place. Provided the NYA was able to pay a termination value that returned their ongoing funding position to fully funded (i.e. removing any deficit), Leicestershire County Council (as a Fund employer) had agreed to provide a guarantee to pay the NYA's pension liabilities when they fall due.

24. At the start of the calendar year, Fund Officers were expecting a deficit value in the region of £885,000 however there has been a significant change in government bond yields since January 2021 alongside an improvement in the financial markets, and the Fund Actuary has approximately calculated the NYA's Fund position (on the 'ongoing' funding basis) as a surplus of around £900,000 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 the NYA remain in surplus on the Fund's ongoing basis and therefore there is a nil debt to settle (conditional on LCC taking on the NYA's historic liabilities, hence guaranteeing the payment of future pension benefits).

25. 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.

26. By transferring the assets and liabilities to the County Council, it will mean that 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). The NYA's pensioners and deferred members will not be impacted by the proposal.

27. Taken at face value, this agreement would reduce the deficit of the County Council by around £900,000 (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 lower than they otherwise would have been, due to the exceptional short-term performance.

28. 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 would be transferred to the County Council in full on the cessation date effectively leaving a nil cessation amount, i.e. no surplus or deficit for the NYA.

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

Legal agreement

30. Subject to the transfer being approved, the Fund and the NYA will enter into a legal agreement specifying that the County Council has 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.

31. From the point the legal contract is signed, the 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 resulting in the NYA no longer having any pension liabilities.

Benefits

32. The proposed agreement is intended to be beneficial to all parties. The NYA would be provided with an appropriate and affordable exit from the Fund, removing any future pension costs and limiting any detrimental impact on its accounts or its ability to raise future funding. The Transfer would provide the Fund with a solution which 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).

33. If left unresolved (i.e. if no transfer of liabilities took place) there could be a substantial risk posed to the Fund and County Council if the NYA was to become insolvent in the future and could not meet any future pension costs.

Risks

34. At 31 March 2021, the County Council had approximately £1.5bn assets (held against c.£1.6bn liabilities). Under the proposed legal agreement to fully

underwrite the NYA's pension obligations, 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.

35. 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.

36. 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.

37. 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:

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. All benefits linked to CPI, as the 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.

38. 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).

39. 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.

40. 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.

Conclusion

41. The proposals will enable the County Council to facilitate a solution for the local charity to successfully exit the Leicestershire Pension Fund which will remove its future pension costs and limit any detrimental impact on its accounts or ability to raise funding and other finances.

42. Whilst a transfer will require the Council to undertake additional risk, based on the most recent valuation of the Fund's expected investment returns, the assets (and liabilities) being transferred under this agreement have a reasonable prospect of improving the County Council's funding position over the longer term. The County Council has the ability to take a far longer financial planning horizon (than the NYA) and therefore the risk of any deficit developing over the longer term is at a reasonably low level.

43. Supporting the NYA will ensure that potential risks resulting from the NYA being unable to meet its pension obligations are avoided, thus ensuring appropriate security for the remaining employers in the Fund.

Equality and Human Rights Implications

44. The proposal ensures all the NYA pension scheme members and their dependants will receive full payment of their pension benefits guaranteed and funded by Leicestershire County Council. There are no groups negatively impacted.

Risk Assessment

45. The Local Pension Committee regularly reviews the Pension Fund’s risk register. The Fund also has a specific policy relating to employer risk.

Background Papers

Report to the Local Pension Committee – 4 June 2021 – National Youth Agency
http://politics.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=6524&Ver=4