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CITY OF WOLVERHAMPTON COUNCIL	**Pensions Board** 30 April 2019

Report Title	Funding Management Update	
Originating service	Pension Services	
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Recommendation for noting:

The Pensions Board is asked to note:

1. The proposed changes to the Funding Strategy Statement and attaching Termination Policy, subject to finalisation following consultation closing 30 April.

1.0 Purpose

1.1 To provide the Board with an overview of the proposed changes to the funding strategy statement (FSS) following the release of LGPS Amendment Regulations.

2.0 Background

2.1 As required under regulation 58 (3) of the Local Government Pension Scheme 2013 Regulations, the administering authority must keep its Funding Strategy Statement (FSS) under review between triennial actuarial valuations. This ensures it remains appropriate in the event of changes to the Investment Strategy Statement or overarching legislation.

2.2 The LGPS (Amendment) Regulations 2018 introduced the provision to refund a surplus to an employer, defined as an “Exit Credit” with effect from 14 May 2018. As this is a material change in scheme regulations which could impact funding arrangements it is necessary to review the Fund’s termination policy and consider making changes to the FSS.

2.3 A report was taken to Pension Committee as part of the 27 March 2019 meeting to provide an overview of the proposed changes and the consultation process with employers.

2.4 The revised draft FSS is attached as an appendix to this report (incorporating the updated Termination Policy as an appendix).

2.5 Due to the scope of the proposed changes to the FSS and Termination Policy, the Fund is required to consult with a wide range of stakeholders. More detail is provided on the consultation process below, with the final version to be effective from 1 April 2019.

3.0 Arrangements prior to 14 May 2018

3.1 Prior to change in 2018, the LGPS Regulations did not allow a surplus of assets over liabilities to be paid out of the Fund when an employer terminated participation within the Fund.

3.2 The current funding arrangements on exit for employers with a guarantee from another Scheme Employer, also participating in the Fund are as follows:

- Where a deficit exists, the exiting employer will be required to pay the termination debt, as assessed by the Fund actuary in line with the assumptions consistent with the most recent valuation basis (i.e. the “ongoing basis”). The guarantor subsumes all assets and liabilities (in respect of active, deferred and pensioner members) for the exiting employer. As a result, where the exiting employer is unable, for whatever reason, to pay all or any of the outstanding termination debt, then the guarantor assumes responsibility for this.

- Where a surplus exists, the assets and liabilities of the exiting employer are again subsumed by the guarantor, and hence any surplus is credited to the guarantor accordingly.

3.3 As a result, under arrangements prior to 14 May 2018, the guarantor was exposed to the downside risk of absorbing potential outstanding deficit, but equally had the upside benefit of absorbing any surplus. In the event there is no guarantor, the exit valuation is assessed on a 'least risk' funding basis (assuming a low risk future investment strategy) as the outstanding liabilities become orphaned across all other participating employers.

4.0 Introduction of Exit Credits on 14 May 2018

4.1 Following the introduction of Exit Credits, under current arrangements, a guarantor retains the downside risk of absorbing potential outstanding deficit, however it no longer benefits from any surplus, as the amended LGPS Regulations determine that should be paid to the exiting employer.

4.2 The changes proposed to the Funding Strategy Statement and associated Termination Policy, as set out in the section below, therefore seek to redress the balance in terms of a guarantor's risk exposure. Where there is no guarantor present this can result in acceleration of the ultimate funding requirement if the employer is in deficit, with advanced payment of any surplus, leaving no recourse for the future if the position changes and therefore increasing the risk of calling on other employers in the Fund.

5.0 Revised Policy for Employers who have a guarantor participating in the Fund

5.1 The default policy of the Fund will be for the exit funding position to be based on a least risk basis, with the discount rate as advised by the Fund actuary from time to time (noting that it is currently based upon government gilt yields of appropriate duration to the liabilities).

5.2 The Scheme Employer providing the guarantee will subsume all assets and liabilities from the exiting employer. No exit credit will be paid to, or any exit debt required from, the Scheme employer, but instead the assets and liabilities will be added to those upon which employer contributions are calculated with each actuarial valuation.

5.3 As an alternative to the default, for Schedule 2, Part 3 employers (admission bodies, for instance Transferee Admission Bodies such as private sector contractors, or Community Admission Bodies such as not-for-profit organisations and charities), where the service or contract is due to be transferred to another Scheme Employer participating in the Fund, subject to agreement from the guarantor, the Fund will consider the transfer of active member liabilities to the new employer based on the funding level of the exiting employer. These liabilities will be assessed in line with the assumptions consistent with the most recent actuarial valuation basis (i.e. partially-funded upon inception). This is based on the premise that the new employer has a reasonable prospect of retention of contributing employees and/or there is likely to be a succession employer to inherit liabilities.

5.4 In this instance the exiting employer will not be required to pay any exit debt and the Scheme Employer providing the guarantee subsumes all deferred and pensioner liabilities in respect of the exiting employer.

6.0 Revised Policy for Employers who do not have a guarantor participating in the Fund

6.1 Where the exiting employer does not have a guarantee, this means that there may not be any future Scheme Employer or guarantor to make good any shortfall between assets and liabilities. In order to protect other employers from having to meet these liabilities in the future, the Fund will need to ensure that there are enough assets in the Fund over the long term to pay member benefits.

6.2 The assessment of the exit funding position (cessation basis) is set by the Fund actuary, which is currently a least risk basis, with the discount rate based upon government gilt yields of appropriate duration to the liabilities.

7.0 Introduction of "pass-through" arrangements for future new employers

7.1 The Fund proposes that from the effective date of the revised policy, all new Schedule 2, Part 3 employers (admission bodies) will pay a contribution rate ('combined rate' based on both the primary and secondary rate set out in the actuarial Rates and Adjustments certificate) in line with the ceding Scheme Employer.

7.2 The Fund will not obtain an actuarial assessment upon termination, instead the ceding Scheme Employer must accept full responsibility for the Schedule 2 Part 3 employer's ("contractor's") liabilities in the Fund and will correspondingly be entitled to benefit from any surplus within the Fund relating to those liabilities. This arrangement is known as a pass-through arrangement.

7.3 The contribution rates for all employers will be reviewed at each subsequent actuarial valuation in line with Regulation 62 of the LGPS Regulations.

7.4 The Fund proposes that these pass-through arrangements will be documented in the service contract between the ceding Scheme Employer and the Schedule 2, Part 3 employer, but where not agreed, the default will be for these arrangements to be included in the tripartite admission agreement.

8.0 Consultation process

8.1 As outlined above, as the proposed amendments represent a material change in funding arrangements, it is necessary to consult with a wide range of stakeholders on these changes.

8.2 The Fund opened consultation with all participating employers the week commencing 18 March 2019, discussions have been held with groups of employers, including the Employer Peer Group and the seven local authorities (as primary outsourcers of contracts). The proposed changes were discussed with Pensions Committee on 27 March 2019. Pension Board members are invited to comments ahead of the consultation closing on 30 April.

8.3 The consultation proposes that changes to the FSS and Termination Policy will be effective from 1 April 2019.

8.4 Following the consultation, and in consideration of the feedback received, the FSS and Termination Policy will be finalised by the Director of Pensions in consultation with the Chair of Pensions Committee, this process having been approved by Pensions Committee at the 27 March 2019 meeting.

9.0 2019 Actuarial Valuation

9.1 A further review of the FSS and Termination Policy will be required as part of the 2019 actuarial valuation, with any changes effective 1 April 2020.

9.2 Planning and preparation for the 2019 actuarial valuation is underway and the Board will be updated on the process and progress at its meeting in September.

10.0 Financial implications

10.1 This report has financial implications for the way guarantors and exiting employers are treated upon exit from the Fund in that it constitutes a change, in some circumstances, to the actuarial methodology used to assess the assets and liabilities.

10.2 The proposal for pass-through arrangements for all future admissions also has potential financial implications in as much as the contribution requirement for new employers will be set based upon those of the ceding Scheme employer, to be reassessed with each triennial valuation. This is expected to reduce the volatility and range of contribution rates, often driven by specific make-up and changes to relatively small groups of participating members.

10.3 As a consequence of 8.1 and 8.2 above, there may be a greater requirement for consideration of pension liabilities to be reflected in service contract pricing. In some cases, in particular, through the introduction of pass-through arrangements. This may result in the reduction of ‘risk premiums’ applied by contractors to reflect pension liability risk exposure.

11.0 Legal implications

11.1 The proposals included within this report will require robust legal documentation, to include amendments to service contracts and inclusion of specific wording in admission agreements.

12.0 Equalities implications

12.1 The report contains no direct equalities implications.

13.0 Environmental implications

13.1 The report contains no direct environmental implications.

14.0 Human resources implications

14.1 The report contains no direct human resources implications.

15.0 Corporate landlord implications

15.1 The report contains no direct corporate landlord implications.

16.0 Schedule of background papers

16.1 None

17.0 Schedule of appendices

17.1 Appendix A: Draft Funding Strategy Statement and Termination Policy, effective from 1 April 2019