TERMINATION POLICY
MARCH 2020

West Midlands Pension Fund

1 INTRODUCTION

1.1 This document details the West Midlands Pension Fund's (the Fund) policy on the methodology for assessment of ongoing contribution requirements and termination payments on the cessation of an employer's participation in the Fund. This document also covers the Fund's policy on admissions into the Fund and sets out the considerations for current and former admission bodies. It supplements the general policy of the Fund as set out in the Funding Strategy Statement (FSS) as available on the Fund's website.

The preparation of the Termination Policy has been based on the latest CIPFA guidance in accordance with the regulations issued in September 2016 and also the LGPS (Amendment) Regulations 2020 coming into force on 20 March 2020.

The Termination Policy was last updated from 1 April 2019 following release of LGPS (Amendment) Regulations effective 14 May 2018 and is reviewed with each actuarial valuation. The latest version was adopted and approved following consultation on xx March 2020.

1.2 Admission bodies are required to have an 'admission agreement' with the Fund. In conjunction with the regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund. Wherever possible, the Fund will seek a guarantor body within the Fund for all admissions.

1.3 Scheme employers have a statutory right to participate in the LGPS and their employees, therefore, can become members of the LGPS at any time, although some organisations (Part 2 Scheme Employers) do need to designate eligibility for their employees.

2 PRINCIPLES

2.1 **Termination of an Employer's Participation**

An employer's participation within the Fund ceases when they no longer have any active members within the Fund. This could happen for a number of reasons, typically:

- The last active member participating in the Fund leaves, retires or transfers to another employer and ceases to be a member of the Fund and the employer does not wish to admit any more employees to that admission agreement.
- For admission bodies, the contract to which the admission agreement relates, comes to an end or is terminated prematurely.
- The employer ceases to exist, for example it goes into liquidation or is taken over by/merged with another organisation.

When an employer's participation comes to an end, or is prematurely terminated for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case, the employees will retain pension rights within the Fund, i.e. either deferred benefits or immediate retirement benefits.

In addition to any liabilities for current employees, the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members except where this is a complete transfer of responsibility to another Fund with a different administering authority.

Where an admission agreement is open (or for scheme employers) and the last active member ceases membership of the scheme, the Fund will approach the relevant employer with regards to its intentions for bringing in new active members. Where an intention to allow new active members to join the scheme is identified, the Fund's policy is to allow the employer six months from the date the active member left to admit such members. During this six-month period, the Fund will require payment of a lump-sum amount broadly equivalent to the percentage of contributions calculated by the Fund actuary, based upon the pensionable payroll used in the previous actuarial valuation. It is advised this lump-sum is paid on a monthly basis, or where the period is known until the next active member joins the scheme, a prorated payment can be calculated.
In the event an employer with an open admission agreement, or a scheme employer exceeds the six-month period without any active members having joined the scheme under that agreement, the Fund will enforce termination of the employer's participation in the scheme.

2.2 **Open Admission Agreements**

An open agreement potentially allows any employee of the contractor involved in the provision of the outsourced services to become a member of the LGPS. For example, new recruits the contractor employs in the provision of the outsourced service may become members of the LGPS.

It is possible under certain circumstances that an employing body can apply to transfer all assets for current and former members' benefits to another LGPS fund in England and Wales. In these cases, no termination assessment is required as there will be no longer any orphan liabilities in the Fund. Therefore, a separate assessment of the assets to be transferred will be required.

2.3 **Pre-Funding for Termination**

An employing body may choose to pre-fund for termination, i.e. to amend their funding approach to a least-risk methodology and assumptions. This will substantially reduce the risk of an uncertain and potentially large debt being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the minimum-risk basis.

For any employing bodies funding on such a minimum-risk strategy, a notional investment strategy will be assumed as a match to the liabilities. In particular, the employing body's notional asset share of the Fund will be credited with an investment return in line with the minimum-risk funding assumptions adopted rather than the actual (largely equity related) investment return generated by the actual asset portfolio of the Fund. The Fund reserves the right to modify this approach in any case, whether it might materially affect the finances of the scheme, or depending on any case specific circumstances.

2.4 **Administering Authority Options Relating to Admission Bodies**

As noted at paragraph 1.2, a guarantor within the Fund will be sought for all admissions.

Prior to admission to the Fund, an admission body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the administering authority. If the risk assessment and/or bond amount is not to the satisfaction of the administering authority (as required under the LGPS regulations),

it will consider and determine (in particular in cases where there is no guarantor within the Fund) whether:

In order to protect other Fund employers, when considering applications for admission body status where there is no guarantor within the Fund, the administering authority can determine that:

- the admission body must pre-fund for termination with contribution requirements assessed using the least-risk methodology and assumptions; or
- the admission body's application is refused; or
- other requirements as considered appropriate in the circumstances will apply.

Some aspects that the administering authority may consider when deciding whether to apply any of the options above, in the absence of a guarantor, are:

- uncertainty over the security of the organisation's funding sources, e.g. the admission body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;
- if the admission body has an expected limited lifespan of participation in the Fund; and
- the average age of employees to be admitted and whether the admission is closed to new joiners.

In order to protect other Fund employers, where it has been considered undesirable to provide a bond, a guarantee must be sought in line with the LGPS regulations.

3 MANAGEMENT OF TERMINATION OF ADMISSION AGREEMENTS

3.1 Notification of Termination

In many cases, termination of the employing body's participation is an event that can be foreseen, for example in the case of admission bodies, because the organisation's operations may be planned to be discontinued and/or the admission agreement is due to cease. Under the regulations, in the event of the administering authority becoming aware of such circumstances, it can amend an employer's minimum contributions such that the value of the assets of the employing body is neither materially more nor materially less than its anticipated liabilities at the date it appears to the administering authority that it will cease to be a participating employer. In such cases, employing bodies are requested to open a dialogue with the Fund to commence planning for the termination as early as possible, preferably at least six months in advance of the event.

Where termination is disclosed in advance, the Fund will operate procedures to reduce volatility risks to the debt amount in the run up to actual termination of the employer's participation. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the scheme, or depending on any case-specific circumstances.

3.2 Ongoing Review

The Fund operates a management framework aimed at reducing its exposure to risk through termination of employer participations in conjunction with monitoring of the strength of employer covenant. As part of this review, the Fund endeavours to anticipate when participation might cease and analyses member movements with a view to the last active member of an employing body ceasing membership of the Fund. In addition,

aligned to the evaluation of employer covenant strength, the Fund considers where there might be employers with funding difficulties in order to attempt to pre-empt circumstances culminating in termination of an employing body's participation.

Where the Fund's review highlights areas for concern, the policy is for a proactive approach whereby dialogue is opened with the employer and, if appropriate, a meeting is scheduled to discuss the issues facing both parties. The aim of such meetings is to widen employers' awareness of the implications upon termination of an admission agreement and where possible to attempt to take steps designed to alleviate funding issues.
It should be noted that the Fund adopts such an approach in the interest of both the Fund and outgoing bodies. It is, however, reliant upon the information available, particularly in assessing the strength of covenant. It is, therefore, vital that organisations contact the Fund at the earliest instance once they become aware that termination of an employer's participation may be a possibility.

4 IMPLEMENTATION

4.1 **New Admissions**
The Fund will apply the above principles to the admission of new employing bodies into the Fund, and to the methodology for assessment of a termination payment on the cessation of such an employing body's participation in the Fund.

4.2 **Transferee Admission Bodies (TABs)**
Transferee admission bodies are a category of admission body that generally will have a guarantor in the Fund. This is due to the regulations requiring that, in the event of any unfunded liabilities on the termination of the admission, the contribution rate for the relevant scheme employer should be revised.

Any risk sharing arrangements agreed between the scheme employer and the TAB must be documented in the commercial agreement between the two parties and not the admission agreement. On termination of a TAB admission, any orphan liabilities in the Fund will be subsumed by the relevant scheme employer, acting as guarantor.

The admission body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the administering authority. This assessment would normally be based on advice in the form of a 'risk assessment report' provided by the actuary to the Fund. As the scheme employer is effectively the ultimate guarantor for these admissions to the Fund, it must also be satisfied (along with the administering authority) over the level (if any) of any bond requirement.

In the absence of any other specific agreement between the parties, deficit recovery periods for TABs will be set in line with the Fund's general policy as set out in the FSS. An exception to the above policy applies if the guarantor is not a participating employer within the Fund, including if the guarantor is a participating employer within another LGPS fund. In order to protect other employers within the Fund, the administering authority may in this case treat the admission body as if it has no guarantor.

4.3 **Community Admission Bodies (CABs)**

Historically, there was no requirement to carry out an assessment of the level of risk on termination of the admission agreement for a CAB until changes were made to the regulations via the Miscellaneous Regulations in 2012. For bodies admitted under previous legislation, despite no requirement to do so, the administering authority may have, nevertheless, decide to carry out such a risk assessment, where appropriate. As noted above, all admission bodies are now required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the administering authority.

The Fund's policy is to consider applications on a case-by-case basis, in line with the principles set out above. In general, if any risk assessment or determination of a bond amount is not to the satisfaction of the administering authority, or if a guarantor body (of sufficient standing acceptable to the Fund) is not forthcoming, the admission will either not be approved or the admission body will be required to pre-fund for termination with contribution requirements assessed using a least risk methodology and assumptions, or other requirements may be applied. Where bond agreements are to the satisfaction of the administering authority, the level of the bond amount will be subject to review on a regular basis.

Deficit recovery periods will be determined consistent with the policy set out in the FSS. The administering authority may, however, determine based on risk an employer-specific deficit recovery period will apply.

4.4 **Exiting the Fund**

When an employer's participation in the Fund terminates and the employer becomes an 'exiting employer', the LGPS Regulations require that a termination valuation is carried out. The purpose of this valuation is to determine the level of any surplus or deficit in an exiting employer's share of the Fund as at the exit date and whether the exiting employer is liable to pay an exit payment or is entitled to receive an exit credit in such circumstances. The administering authority may determine, at their absolute discretion, the amount of any exit credit payment due, having regard to any relevant considerations.

A deficit upon termination of an employer's participation might arise in the following scenarios (please note that this list is not exhaustive):

a) Non-payment of contributions to the Fund by an employing body prior to closure.

b) Premature termination of an employing body's participation where market values are depressed relative to the liabilities in respect of the employing body.

c) The actual experience is less favourable than the assumptions used in setting contribution rates for that employer – for instance, higher than expected rates of early retirement on favourable terms or pay increases.

d) Additional liabilities created as a result of the employing body closing, in particular the possible payment of immediate retirement benefits to all those over age 55 at that time.

The method used to calculate the termination valuation will ultimately depend on the characteristics of the exiting employer and in particular whether there is another scheme employer within the Fund that is prepared to act as a guarantor or succession employer

for any residual liabilities and also in the context of the materiality of any impact on other participating scheme employers' contributions.

Where liabilities are "orphaned" without sufficient assets to cover the liabilities all remaining scheme employers that have active members in the Fund will have to cover any deficit arising from these liabilities via their own employer contributions, as assessed at each actuarial valuation (as required under Regulation 62 of the LGPS Regulations) or sooner if the liability profile of the employer is materially changed.

4.5 **a) Policy for Employers With a Guarantor Participating in the Fund**

Where the exiting employer has either:

- a guarantee from a scheme employer participating in the Fund with tax-raising powers;
- a guarantee from a central government department;
- or a guarantee from a scheme employer participating in the Fund, which benefits from a central government guarantee

then the default policy of the Fund is for the exit funding position to be based on a least risk basis, with the discount rate based upon government gilt yields of appropriate duration to the liabilities. In this instance, 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 exiting scheme employer, unless the exiting employer is in surplus on the least risk valuation basis. The assets and liabilities will be subsumed within those of the guarantor employer, with future contribution requirements reassessed at each actuarial valuation.

However, for Schedule 2, Part 3 employers, 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 previous exiting employer, as assessed in line with the assumptions consistent with the most recent actuarial valuation basis (ie, partially-funded upon commencement). This is based on the premise that the new employer has a reasonable prospect of retaining contributing employees and/or there is likely to be a succession employer to inherit liabilities.
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. In line with the "pass-through" arrangements outlined below, the new employer will pay the same contribution rate (primary rate only) as the scheme employer providing the guarantee scheme employer until next review.

b) Policy for Employers Without a Guarantor Participating in the Fund

Where the exiting employer does not have a guarantee as outlined in (a.) above 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 scheme

employers from having to meet these liabilities in the future the Fund will need to ensure that there are enough assets in the Fund that are unlikely to fall in value and provide certainty to pay benefits. This is on the basis that, upon cessation, employers in this category are no longer subject to ongoing funding but have instead exited the Fund and do not have a scheme employer to subsume their assets and liabilities. Accordingly, the policy of the Fund is for assessment of the exit funding position to be based on a least risk basis, with the discount rate based upon government gilt yields of appropriate duration to the liabilities.

4.6 **Pass-Through (Risk-Sharing) Arrangements**

The Fund's policy since April 2019 is for the default arrangement to be for all new Schedule 2, Part 3 employers to pay the same primary contribution rate as the guarantor employer. The Fund will not obtain an actuarial assessment upon termination, instead the scheme employer providing the guarantee employer must accept full responsibility for the Schedule 2 Part 3 scheme employer's ("contractor's") assets and 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.

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

The Fund's policy is for these pass-through arrangements to be documented in the service contract between the guarantor employer and the Schedule 2, Part 3 scheme employer, but where not agreed, the default will be for these arrangements to be included in the Fund's tripartite admission agreement.

As an alternative to the pass-through arrangement, if the guarantor employer and contractor agree to a standard admission agreement and notify the Fund within one month of the contract commencement date, the Fund may, at its discretion, implement such an admission agreement without reference to pass-through.

The administering authority reserves the right to modify this approach on a case-by-case basis, at its sole discretion, if the circumstances warrant it based on the advice of the Fund actuary and taking into account the risk associated with an employer in the context of the Fund as a whole. For instance, in the highly unlikely event that parties insisted upon access to the Fund through a statutory route, but did not wish to participate on a pass-through arrangement then the Fund would need to consider funding the new employer on a least risk basis.

4.7 **Recovery of Deficits**

In the event that an employer's participation in the Fund terminates, a number of varied scenarios will arise for the recovery of deficits, most commonly:

- Employees transfer to a new employer body within the Fund and the successor body takes responsibility for any associated pension liabilities (including those for former employees) and any funding deficits that exist on cessation of the original employing body.
- Where an employer ceases to participate in the Fund and there is no successor body involved, the recovery of deficit initially focuses on the employing body itself and the Fund requires that body to make full and final payment of the least risk deficit.

- In the final event of failure to recover any deficit payment from the employing body, the Fund would place responsibility for the payment of deficit upon any guarantor, which might already exist under the terms of the employer's participation or could be sought to cover the deficit, usually as the original guarantor employer.
- In the event of the employing body going into liquidation, the liquidators would be contacted with a view to extracting as much of the termination deficit from the proceeds of the business as possible. The Fund would act as a creditor and reserves the right to appoint an agent to reclaim monies owed by whatever means necessary.

4.8 **Multi-Academy Trusts**

Where an employer within a multi-academy trust (MAT) fails, unless that academy is an employer in its own right there is no power within the regulations for the administering authority to commission an exit valuation under Regulation 64, unless it considers that the MAT itself may become an exiting employer and so a valuation under Regulation 64(4) is appropriate. In that case, where an employer within the MAT has failed, irrespective of whether or not the Department for Education guarantee applies, the liabilities of the exiting academy will fall to be funded by the remaining employers within the MAT rather than becoming orphaned liabilities. The administering authority may direct the Fund actuary to take this failure into account and adjust the contributions payable by the remaining employers within the MAT at the next triennial actuarial valuation.
The administering authority may also direct the Fund actuary to carry out a valuation of the liabilities of the exiting academy in the Fund at the date of exit in order to assess the effect of its failure on the remaining employers within the MAT, and ensure the remaining MAT employers (and any new employers joining the MAT) are aware to the extent of these liabilities.

Where employers within a MAT are individual scheme employers for the purpose of the regulations, and an academy within the MAT leaves or fails, an exit valuation will be carried out as at the date of exit. Where there is no successor body and the Department for Education guarantee does not make good any shortfall on exit, the administering authority would seek to recover any unpaid deficit from the remaining employers within the MAT where those employers participate in the Fund. Rather than requiring a lump sum payment, the administering authority may instead act on the assumption that the remaining MAT employers will subsume the unpaid deficit which would then fall to be recovered from ongoing contributions. In that case the administering authority will instruct the Fund actuary to allocate the assets and liabilities of the outgoing academy across the remaining employers in the MAT.

Where academies move between multi-academy trusts, for example where a MAT winds up and its academies transfer into different MATs (whether existing MATs within the Fund or newly-established MATs), the administering authority may direct the Fund actuary to carry out a valuation of the liabilities of any academy moving between MATs and of all academies within the exiting MAT. Where the exiting MAT is the scheme employer, and hence an individual funding position has not been maintained for the constituent academies, the assets notionally allocated to each of its academies will be derived by assuming each has the same funding level as the MAT as a whole. The calculation of the assets and liabilities in these circumstances is to ensure that both the former and new MAT are aware of the value of the assets and liabilities transferring and to ensure that the residual position of the exiting MAT (if any of its liabilities are not transferring to a new

academy or MAT) is correctly assessed for the purpose of the Department for Education guarantee.

4.9 **Payment of Any Deficit**

If it is determined there is a deficit and the employer is required to make a payment to the Fund, the administering authority will confirm to the employer the amount payable.

Unless the likely cost of doing so negates the amount that can be recovered by the Fund, the administering authority will pursue an outgoing body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit.
The administering authority will also pursue any indemnity provider or guarantor for payment where applicable.

The Fund's policy is for any deficit upon termination to be recovered through a single lump-sum payment to the Fund (unless agreed otherwise by the administering authority at their sole discretion). In circumstances of late payment, the Fund will request payment of the appropriate interest amount and expenses, in addition to the termination deficit identified, as calculated by the Fund actuary. The Fund may consider permitting an exiting body to spread payment over a short period, where it considers that this does not pose a material risk to the solvency of the Fund. In such instances, the Fund may request the organisation provides appropriate security to support consideration of a payment plan and, if this is not satisfactory, consideration will be given to an independent financial and governance review. Any payment plan implemented will need to be legally documented with any associated costs covered by the exiting employer.

4.10 **Payment of Any Surplus**

In the instance it is determined by the Fund actuary, based on the parameters set out in 4.5 and 4.6, that a surplus exists upon employer exit, in accordance with LGPS Regulation 64 , the Fund will pay this surplus, to the exiting employer. Any payment to or from the Fund may need to be adjusted for expenses incurred by the Fund. In addition, there will be no interest applied to exit credits unless agreed with the administering authority.

The Fund may determine, at their absolute discretion, the amount of any exit credit payment due, having regard to any relevant considerations. The payment of any exit credit due will be made within six months from the point at which the Fund received written confirmation of the employer's exit. Whilst the Fund will take into account representations made by the parties involved, it will not be obliged to enquire into precise risk-sharing mechanisms adopted.

The administering authority also reserves the right to modify this approach on a case-by-case basis at its sole discretion, if circumstance warrant it based on the advice of the Fund actuary.

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