Croydon Council

REPORT TO:	**PENSION COMMITTEE** **8 September 2015**
AGENDA ITEM:	**8**
SUBJECT:	**Employer Risk Strategy**
LEAD OFFICER:	**Richard Simpson, Assistant Chief Executive (Corporate Resources and Section 151 Officer)**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Treasury**
WARDS:	**All**
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: increased focus on improving governance is important in ensuring a strong covenant between Scheme employers.	
FINANCIAL SUMMARY: The continued robust health of the Pension Fund is important to all Scheme employers. This recommendation will go some way to ensuring that contributions due are received according to the regulatory timetable and that employers do not get into financial difficulties. Dealing with financial obligations for failed businesses is costly and impacts negatively on the financial health of the Pension Fund.	
FORWARD PLAN KEY DECISION REFERENCE NO: N/A	

1. RECOMMENDATIONS

1.1 The Committee is asked to approve the schedule of work detailed in the report and Appendix A to ensure compliance with the Pensions Regulator's Code of Practice as it relates to the governance and administration of public service pension schemes.

If the

2. EXECUTIVE SUMMARY

2.1 This report proposes a schedule of work to ensure compliance with the Pensions Regulator's Code of Practice as it relates to the governance and administration of public service pension schemes.

3. DETAIL

3.1 The Public Service Pensions Act 2013 introduced a raft of governance reforms to the Local Government Pension Scheme (LGPS). One of these reforms was to extend the purview of the Pensions Regulator to include responsibility for the Local Government Pension Scheme. The Pensions Regulator is now actively involved in oversight of the LGPS. It issued a Code of Practice on the "Governance and administration of public service pension schemes" in April 2015. Paragraph 114 of the new Code of Practice states:

> *'Where relevant, schemes should put in place systems and processes for making an objective assessment of the strength of an employer's covenant (which should include analysis of their financial position, prospects and ability to pay the necessary employer contributions).'*

This is particularly relevant for the LGPS given the diverse nature of the participating employers.

Assessing and monitoring employer covenant

3.2 With the number and diversity of employers participating in the Fund and the more complex pension arrangements arising, it is becoming increasingly important to assess and monitor the ability and willingness of employers to meet their pension obligations. The Fund is experiencing an increase in the number of employers raising issues about their ability to pay the certified contributions and their willingness to continue participation in the LGPS. This is likely to lead to more defaults on debt unless employer covenant is monitored regularly throughout the term of any admission agreement and, where considered necessary, appropriate remedial action taken to safeguard all employers within the Fund.

3.3 Employer covenant is defined as the "ability and willingness" of the employer or scheme sponsor to support the pension scheme through contributions. In terms of ability, this assessment should include the ability of each employer to:

1 Pay regular contributions at the level required to fund new benefit accrual in the LGPS;
2 Pay contributions towards any existing deficit or any deficit that arises as a result of adverse experience;
3 Meet the costs of any lump sum payments that arise as a result of participation in the LGPS, including ill health retirement or redundancy strain costs; and
4 Meet the costs of any final settlement of liabilities that may be required as a result of ending participation in the LGPS.

With regards to willingness, the authority should assess the willingness of each employer to fund LGPS benefits on behalf of their members including:

1 Reasons for employer participation in LGPS, e.g. legislative requirement, contractual requirement;

2 Employers' time horizon for participation in LGPS;
3 Employer's attitude to valuation funding level and deficit;
4 Employer's attitude to pensions accounting issues including balance sheet and revenue account; and
5 Employer's view on contributions levels and contribution volatility.

3.4 The purpose of assessing the strength of the employer covenant is to:

- Quantify the financial risk to which the Fund is exposed by employers, individually and in total.
- Take actions to minimise the financial risk to the Fund through employers being unable to meet the costs of participation in the Fund, firstly by establishing appropriate funding objectives for each employer and putting in place a funding and investment strategy that maximises the employer's chance of meeting these objectives and secondly, by establishing the appropriate levels of security for the Fund in the event that an employer cannot meet its obligations.

3.5 This assessment can be carried out in many ways, including:

- Regular reviews of the employer funding level;
- Regular reviews of the potential risk and financial debt on early termination (including redundancy costs);
- Assessment and review of covenant through a number of metrics and development of a risk score. Employers can be categorised based on these metrics (e.g. deficit, time horizon, gearing ratio, cash flow position etc.) and their potential financial impact to the Fund.
- An assessment of covenant by a credit rating agency (such as Experian) where this is available for employers. Due to the number of employers in the LGPS this can be obtained at low cost due to economies of scale.
- Assessment against actuarial assumptions in areas such as pay growth;
- Requirements on the admission body to notify changes in their circumstances;
- Regular assessment of the strength and value of any security put in place by the employer (e.g. bond, parent company guarantee, first charge on assets, escrow account);
- Checks to see whether an employer has failed to notify the Fund of relevant changes (e.g. closure to new entrants);
- Issue a questionnaire to determine the employer's ability and willingness to pay.

3.6 Hymans Robertson, the Scheme Actuary, has drafted a schedule, covering the period up to the completion of the next Actuarial Valuation Review, of work designed to address these issues. This is appended to this report. The work outlined in Appendix A would result in a comprehensive framework for employer risk strategy and managing deficits which will ensure better outcomes for the Fund and its employers. This work is being carried out by many LGPS funds ahead of the 2016 valuation and would demonstrate that the Fund has a system in place to manage and mitigate employer risks.

4 FINANCIAL CONSIDERATIONS

4.1 The majority of the work will involve officers' time and will be met within the existing structure. Actuarial costs are estimated to be between £15,000 and £20,000. Any costs incurred are to be met by the pension fund and will be outweighed by improved contribution management.

5. OTHER CONSIDERATIONS

5.1 Other than the considerations referred to above, there are no customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report.

6. COMMENTS OF THE SOLICITOR TO THE COUNCIL

6.1 The Council Solicitor comments that there are no additional legal considerations beyond those detailed in the body of this report.

Approved by: Gabriel MacGregor, Head of Corporate Law on behalf of the Council Solicitor & Monitoring Officer

---

CONTACT OFFICER:

Nigel Cook, Head of Pensions Investment and Treasury,
Resources Directorate, ext. 62552.

BACKGROUND DOCUMENTS:

Appendices

Appendix A: Employer Risk Strategy, Hymans Robertson LLP, 3 August, 2015.