Croydon Council

REPORT TO:	**Pension Committee** **11 June 2019**
SUBJECT:	**Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk**
LEAD OFFICER:	**Nigel Cook Head of Pensions and Treasury**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Resources**
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: This consultation by the Ministry of Housing Communities and Local Government (MHCLG) relates to the periodic valuation of the Pension Fund and matters relating to other scheme employers.	
FINANCIAL SUMMARY: This report describes proposals to align valuation cycles in the LGPS and to deal with exit credit payments.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1. RECOMMENDATIONS

1.1 That the Committee note the appended consultation from the Ministry of Housing Communities and Local Government (MHCLG).

1.2 That the Committee note that the Council will be responding to this consultation; the response will be made by the Director of Finance, Investment and Risk in consultation with the Chair and Cabinet Member for Finance and Resources.

2. EXECUTIVE SUMMARY

2.1 This report details a MHCLG consultation which seeks views on policy proposals to amend the rules of the Local Government Pension Scheme 2013 in England and Wales. It covers the following areas:

1. Amendments to the local fund valuations from the current three year (triennial) to a four-year (quadrennial) cycle;
2. A number of measures aimed at mitigating the risks of moving from triennial to quadrennial cycles;
3. Proposals for flexibility on exit payments;
4. Proposals for further policy changes to exit credits; and
5. Proposals for policy changes to employers required to offer LGPS

membership.

3 DETAIL

3.1 The Ministry of Housing Communities and Local Government (MHCLG) have launched a consultation about changes to the valuation cycle and the management of employer risk for LGPS funds in England and Wales. The consultation closes on 31 July 2019. The consultation can be found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf.

3.2 The five key proposals covered by the consultation are:

1. Amendments to the local fund valuations from the current three year (triennial) to a four-year (quadrennial) cycle;
2. A number of measures aimed at mitigating the risks of moving from triennial to quadrennial cycles;
3. Proposals for flexibility on exit payments;
4. Proposals for further policy changes to exit credits; and
5. Proposals for policy changes to employers required to offer LGPS membership.

These are addressed in turn below.

Amendments to the local fund cycle

3.3 In order to provide a consistent picture across the public services and to enable the Government Actuary Department to monitor the aggregate cost of the local government scheme the LGPS (England and Wales) is to be valued over a four-year cycle. This consultation proposes that local fund valuations are transitioned from 3 yearly to 4 yearly, so that the national LGPS cost management valuation and local LGPS valuations are aligned from 31 March 2024 onwards.

3.4 This change is being brought in to match the same four-yearly cycle that applies in other public service schemes. However there are sound reasons why the approach adopted by the LGPS might be different. Most significantly, the LGPS is a funded public pension scheme. This means that contributions from employers and employees are paid into a fund, which is invested and from which pension benefits are paid. The other main public service schemes are unfunded. They operate on a pay-as-you-go (PAYG) basis, which means there is no fund of assets which is invested and from which pension benefits are paid. Employer and employee contributions are paid to the sponsoring government but these contributions are not invested. Instead, the sponsoring government department pays benefits to pensioner members, netting off the contributions received. There are, as a result, good reasons why a funded scheme should have a shorter valuation cycle than an unfunded scheme such as to allow better management of risks relating to market volatility or changes to employer circumstances. Given the significant events that are bound to impact on the valuation, such as Brexit, global economic volatility and the need to monitor the funding gap closely it would seem preferable for this fund to carry out a valuation in 2022, rather than leaving contribution rates in place for half a decade until the next valuation.

3.5 The 2016 Valuation, covers the period 1st April 2017 to 31st March 2020, i.e. the three financial years 2017/2018; 2018/2019 and 2019/2020. As it stands, the 2019 valuation, the current valuation, will cover the period 1st April 2020 to 31st March 2023 – the years 2020/2021; 2021/2022; and 2022/2023. If valuations are aligned from 2024 then it must be assumed that the current valuation in progress will be in place until the new four-year cycle valuation takes effect from April 2024 – in 5 years.

Measures aimed at mitigating the risks of moving cycles

3.6 The second proposal considers giving Funds the power to carry out 'interim' valuations between formal valuation dates, and adjust employer contribution rates upwards or downwards to reflect changing circumstances (with the 'trigger points' for the interim valuations subject to statutory guidance).

3.7 LGPS funds have a diverse range of sponsoring employers, and they bring varying degrees of risk. The financial covenant and experience of these employers can change quickly. This extreme volatility can result in significant changes to market conditions such that deficits can become surpluses, or vice versa. The ability for funds to assess the impact of such changes, and have the power to carry out an interim valuation under a wider range of circumstances than the current Regulations allow, should be welcome from a risk management perspective. The extent to which there should be guidance on the use of that power is another discussion point.

Proposals for flexibility on exit payments

3.8 The third proposal is to allow Funds more flexibility around the way in which they manage employers that exit the LGPS, by spreading cessation debt repayments or setting up private sector style 'deferred debt' arrangements to ease employer concerns over affordability

3.9 In many respects, this is long overdue, some LGPS funds, including this one, are already using these sort of arrangements to allow employers to exit the LGPS in an affordable manner or indeed without triggering some sort of budget crisis. It is generally not in a fund's interest to force an employer out of business over a debt, and the arrangements described (subject ideally to some level of security from the employer) can be structured to minimise the risk of unpaid debt and avoid the cost and implications of suing employers that are unable to pay a large one-off lump sum. So this proposal is useful in that it puts these arrangements on a more formal footing.

Proposals for further policy changes to exit credits

3.10 The next proposal is to amend the LGPS Regulations to allow exit credits to be reduced to nil where a pass-through arrangement is in place. This is new; the current regulations allow for deficits but are silent on the subject of credits.

3.11 This amendment would remove one of the unintended consequences of the introduction of exit credits and is sensible. It is worth clarifying that the actuarial assumptions used for these calculations are not prescribed in the regulations, but are instead at the discretion of the Fund and its Actuary.

Proposals for policy changes to employers required to offer LGPS membership

3.12 The final proposal relates to removing the requirement for further education, higher education and sixth form college corporations in England to offer new employees access to the LGPS. Many of these institutions have been looking at ways to manage their pensions costs and it is possible that many will close to new entrants. It is not uncommon for their LGPS liabilities to be worth tens of millions of pounds. In terms of risk management and assessing the strength of these covenants officers have kept in close touch with these employers and regularly monitor their financial strength, and wherever possible seek security to reduce the risk of unpaid liabilities falling on other employers in the event of insolvency. If an employer were to close to new entrants, this authority would seek to agree an exit strategy in advance to address any affordability and security concerns. This proposal would in effect create a two-tier work force and with that additional monitoring issues such as preventing employers from inducing staff to leave the scheme. Note that the teachers' scheme is distinct and not impacted by this proposal.

3.13 Responses to the consultation are due by 31st July, 2019. The authority will draft a response.

4 FINANCIAL CONSIDERATIONS

4.1 There are potentially significant financial considerations for individual scheme members arising from the proposals in this consultation. At this stage it is difficult to estimate these as it is unknown which proposals will be implemented.

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 Head of Litigation and Corporate Law comments on behalf of the Director of Law and Governance that there are no direct legal consequences arising from the recommendations in this report.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law on behalf of the Director of Law and Governance and Deputy Monitoring Officer.

CONTACT OFFICER:

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Resources department, ext. 62552.

BACKGROUND DOCUMENTS:

None.

PEN 11062019

Appendices

Appendix A

Local government pension scheme: changes to the local valuation cycle and management of employer risk, Ministry of Housing, Communities & Local Government, 8 May 2019