REPORT TO:	**PENSION COMMITTEE** **25 May 2021**
SUBJECT:	**FSS updates - Exit Credit and Employer Flexibilities Regulatory Amendments.**
LEAD OFFICER:	**Nigel Cook** **Head of Pensions and Treasury**

CORPORATE PRIORITY/POLICY CONTEXT:

This is a matter for the Pension Committee.

FINANCIAL SUMMARY:

This report relates to new flexibilities relating to contribution rates levied on Scheme employees and options to be more flexible in the event of an employer leaving with a deficit.

FORWARD PLAN KEY DECISION REFERENCE NO.: N/A

1 RECOMMENDATIONS

1.1 The Committee is asked to:

1.2 Note. the draft changes to the Funding Strategy Statement;

1.3 Instruct officers to undertake an employer consultation on these changes.

2 EXECUTIVE SUMMARY

2.1 This report considers changes introduced to the LGPS in respect of exit credits and the option for a contribution review. The report suggests how these changes could be reflected in the Funding Strategy Statement.

3 BACKGROUND

3.1 In May 2019, the Ministry for Housing, Communities and Local Government (MHCLG) launched its consultation "Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk". The consultation sought views in the following areas:

a) Changes to the LGPS local fund valuation cycle;
b) Increased flexibility for Funds to carry out interim valuations and/or review employer contributions between formal valuations;
c) Proposals for flexibility around employer cessation debts;
d) Proposals for policy changes for payments of employer exit credits; and
e) Potential changes to employers required to offer LGPS membership.

3.2 At the date of writing, there has been no update on changes to the valuation cycle proposals (a) or to the employers who are required to offer LGPS access (e). The outcome of the exit credit consultation (d) was published in February 2020 and the subsequent regulation changes came into force from 20 March 2020. A response to items (b) and (c), together known as "employer flexibilities", was published in August 2020 and the subsequent regulation changes came into force from 23 September 2020.

3.3 On 2 March 2021 MHCLG published statutory guidance to support the application of the new regulations. This included the expectation that LGPS Fund's would prepare and maintain policies in relation to items (b), (c) and (d). Therefore, working alongside the Fund's Actuary, officers have considered the new regulations and guidance to apply the policy updates required to the Fund's Funding Strategy Statement, such that:

- A consistent approach is taken between employers and over time; and
- The interests of all parties are taken into account.

3 DETAIL

Funding Strategy Statement (FSS)

3.4 Under the Regulations, all LGPS funds have a statutory obligation to produce a Funding Strategy Statement ("the FSS"). The Fund reviews the FSS at least every three years alongside the formal actuarial valuation but also from time-to-time when required. The current version of the FSS was approved by this Committee in March 2020 following updates made as part of the 2019 formal valuation.

Exit credits

3.5 Following the MHCLG consultation (above), the LGPS Regulations 2013 were amended from 20 March 2020 to address issues arising as a result of previous changes requiring Administering Authorities to pay exit credits when an employer ceased while in surplus (on their respective exit valuation basis). Previously, the

Fund's Actuary would determine the level of any exit credit to be paid. However, the updated Regulations, while still requiring the Actuary to carry out an exit valuation to determine the amount of any surplus, place the responsibility for determining the level of any exit credit on the Administering Authority, having considered various factors.

3.6 When applying these new discretionary powers, the Regulations require the Fund to take account of:

- The extent to which the employer's assets are in excess of its liabilities – this is not contentious for the Fund as our actuary tracks each employer's assets and liabilities (unless a "pass-through" arrangement is in place).

- The proportion of the excess of assets which has arisen because of the value of employer's contributions – the initial regulations had unintentionally enabled some short-term employers to leave funds with large exit credits (due mainly to strong growth on the assets that were transferred from letting authorities). In some cases, across the LGPS, exit credits have been large and have even dwarfed any contributions made by the contractor. This amendment now allows the Fund to consider whether or not to restrict future exit credits to growth only on the money paid by employers.

- Any representations made by the exiting employer and the letting authority/guarantor – the intention behind this is to allow any risk-sharing arrangements that sit behind an employer's participation to be taken into account. The Government has said however that there is no onus on the Fund to 'enquire into the precise risk sharing arrangements adopted'. Instead, it will be left to the employer and letting authority/guarantor to explain why the arrangements made by them make payment of an exit credit more or less appropriate. There is a risk that the Fund could get caught up in the middle of arguments between employers over commercial terms that were agreed outside the Fund, leading to higher actuarial, legal and internal management costs, and of course delays to the settlement of cessation valuations. It is worth noting that the amending regulations force the Fund to notify how it intends to deal with the exit credit to both parties ahead of any payment.

- Any other relevant factors – this gives a lot of discretion to the Fund to consider whatever factors it feels is relevant in its decision. The Fund will need to ensure that it applies this discretion consistently over time and provide justification to the employer and letting authority/guarantor about why any factors have been considered.

3.7 In addition, the amendments have extended the maximum time period by which an exit credit must be paid to an employer from three to six months.

Changes to FSS

3.8 Working alongside the Fund's Actuary, the FSS has therefore been updated to allow for the Fund's policy on applying these new discretions on determining the payment of exit credits. The following summarises the proposed approach:

- exiting employers should be assessed on a case-by-case basis, and be subject to the principles set out in the revised FSS in order to consistently apply the discretion in assessing the amount of and in paying any exit credit.

- In the first instance, the onus is on the exiting employer (and any letting/guaranteeing employer) to provide representations on how they consider any exit credit should be treated.

- However, in all cases, the Fund considers that the maximum value of any exit credit is the surplus identified in the Fund Actuary's exit valuation on the exit basis appropriate to the cessation event/employer.

- The approach differentiates by the type of body involved. This is a result of Admission bodies being able to terminate their participation in the Fund at any time. On the other hand, Scheduled bodies do not have this ability.

- In general, where an admission agreement began prior to 14 May 2018 (the date when exit credits became allowable under the Regulations), the Fund will not pay an exit credit as the potential for an exit credit would not likely have been priced into tenders for service.

- Where guarantees, pass-through and risk sharing agreements are clearly set out in admission terms, the Fund will reflect these in its determination. In particular, no exit credit will be payable to any admission body which participates in the Fund via a pass through agreement.

- Where pass through or risk sharing agreements are not applicable, the Fund will generally limit any exit credit to the value of employer contributions paid over the employer's contract allowing for investment returns on those contributions. The Fund will ask the actuary to carry out this calculation alongside the cessation valuation. (Noting that a proportionate approach to this calculation may have to be taken when an employer has participated in the Fund over a long period and historic contribution information may not be readily available.)

Changes to FSS

3.9 Working alongside the Fund's Actuary, the FSS has therefore been updated to allow for the Fund's policy in applying these new employer flexibilities. These proposed changes are summarised below:

- **Contribution review** - In general, the draft FSS updates consider an amendment to contribution rates between valuations only as a result of significant changes to the liabilities or covenant of an employer. While the Fund would consider requests from employers to review contributions, it is expected that the reason for the request is a material change in covenant or significant restructure which impacts their membership and consequently liabilities in the Fund.

- **Exit arrangements** - despite the updates, for an employer ceasing with a deficit, the normal policy within the draft FSS remains the requirement to immediately pay any debt. Any variation away from this would be considered in the light of this benchmark and would primarily need to be in the interests of the Fund. However, the FSS updates allow the Fund to be mindful of the broader objectives and finances of the employer when considering a more flexible exit arrangement. For example, a flexible approach may in some cases still be appropriate where the employer covenant is weak as it may allow the employer to avoid building up further liabilities. When entering into any flexible exit arrangement, a continual but proportionate review of the conditional elements will be required to ensure it remains appropriate and in the best interests of all parties.

3.10 Appended to this report is an updated version of the Funding Strategy Statement incorporating these proposed changes.

4 CONSULTATION

4.1 Officers have fully consulted with the Pension Fund's Scheme Actuary in preparing this report.

5 FINANCIAL CONSIDERATIONS

5.1 This report deals exclusively with the management of the Council's Pension Fund.

Approved by: Chris Buss, Interim Director of Finance, Investment and Risk, S151 Officer

6. LEGAL CONSIDERATIONS

6.1 The Pension Committee's role is to ensure the Fund is properly operated in accordance with the Local Government Pensions Scheme (LGPS) Regulations ("the Regulations") and the other relevant legislation and best practice as advised by the Pensions Regulator, including financial, governance and administrative matters.

6.2 The Committee is asked to note the changes to the funding strategy brought about by changes to both the Regulations in September 2020 and Guidance produced by the MHCLG in March 2021.

6.3 These changes relate to the strategy being updated to address the new discretionary powers that Administering Authorities have when paying exit credits. The updated Regulations place the responsibility for determining the level of any exit credit on the Administering Authority itself, upon the consideration of various factors.

6.4 In addition to the report outlining the relevant considerations and consequential changes to the strategy, the amended strategy has also been appended highlighting the changes made to it.

6.5 Confirmation has also been provided within the recommendations that additional consultation will be carried out with the other Scheme Employers who have an interest in the strategy.

6.6 There are no further legal implications arising from the recommendations within the report that requires additional legal comment.

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

7. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

7.1 This report contains only information that can be publicly disclosed.

8. HUMAN RESOURCES IMPACT

8.1 There are no direct workforce implications arising from the recommendations within this report.

Approved by: Sue Moorman, Director of Human Resources

9. EQUALITIES IMPACT

9.1 There are no equalities impacts arising from this report.

10. ENVIRONMENTAL IMPACT

10.1 There are no environmental impacts arising from this report.

11. CRIME AND DISORDER REDUCTION IMPACT

11.1 There are no crime and disorder impacts arising from this report.

12. DATA PROTECTION IMPLICATIONS

12.1 **WILL THE SUBJECT OF THE REPORT INVOLVE THE PROCESSING OF 'PERSONAL DATA'?**

NO

The Director of Human Resources comments that this report relates to matters relating to the administration of the LGPS and the Croydon Pension Fund.

Approved by: Sue Moorman, Director of Human Resources

CONTACT OFFICER:

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BACKGROUND DOCUMENTS:

Appendices:
London Borough of Croydon Pension Fund Funding Strategy Statement April 2021 updated from March 2020.