Pension Fund Committee

9 December 2021

Employer Flexibility Policy

Report of Paul Darby, Corporate Director of Resources

Purpose of the Report

1 To seek agreement on implementing a policy approach to new powers allowing Administering Authorities to exercise discretion in respect of Employer Flexibilities.

Executive summary

2 The Local Government Pension Scheme (LGPS) Regulations require the Fund to maintain and publish a Funding Strategy Statement (FSS). The FSS has been amended to reflect the approach recommended by the Actuary in respect of DLUHC's partial response to its 'Changes to the Local Valuation Cycle and the Management of Employer Risk' consultation.

3 Additionally, the Fund has drafted a Policy approach to the range of flexibilities in respect of Participating Employers (the 'Employer Flexibilities') set out in the 'Changes to the Local Valuation Cycle and the Management of Employer Risk' consultation.

Recommendation(s)

4 Members are asked to:

(a) note the report and to advise of any comments they may have on the draft policy set out in the appendices to this report,

(b) authorise the Corporate Director of Resources to finalise the wording of, publish and implement the finalised policy; taking into account comments of the Committee and employer feedback received, and amend the Funding Strategy Statement (FSS) to signpost the new policy and approach, and;

(c) authorise the Corporate Director of Resources to make a determination in respect of the flexibilities implemented as the requirement to do occurs

Background

5 Regulation 58 of the Local Government Pension Scheme Regulations 2013 (‘the LGPS regulations’) requires Local Government Pension Schemes (LGPS) administering authorities to prepare, maintain and publish a ‘Funding Strategy Statement’ (FSS).

6 The key requirements for preparing the FSS can be summarised as follows:

> After consultation with all relevant interested parties involved with the Fund the Administering Authority will prepare and publish their funding strategy; In preparing the FSS, the Authority must have regard to:
>
> i. the guidance issued by the Chartered Institute of Public Finance (CIPFA) for this purpose; and
> ii. their own Investment Strategy Statement (ISS)
> iii. the FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the ISS

7 On 8 May 2019 DLUHC launched its LGPS consultation ‘Changes to the local valuation cycle and the management of employer risk’. To date there have been two partial responses to the consultation covering separately Exit Credits and Employer contributions and Exit Payments.

8 On 27 February 2020 the Local Government Pension Scheme (Amendment) Regulations 2020 were laid before parliament. They come into force on 20 March 2020, but have effect backdated to 18 May 2018. The amended rules give LGPS funds a discretion to determine the amount of exit credits when a participating employer leaves the fund in surplus. The Fund formulated an Exit Credit policy in response to the Amendment Regulations.

9 In August 2020 DLUHC issued a partial consultation response in respect of Employer contributions and Exit Payments. Statutory Guidance following DLUHC’s response allows administering authorities, where appropriate, to revise scheme employer contributions between valuations, spreading of Exit Payments and Deferred Debt Agreements.

Employer Flexibilities

10 The introduction of ‘The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2020’, DLUHC’s Statutory Guidance and the more detailed guidance prepared by the LGPS Scheme Advisory Board (SAB) enables Administering Authorities to review employer contributions, spread exit payments and set up Deferred Debt

Agreements (DDA). Whilst utilising these powers is not mandatory, SAB "actively encourages" Administering Authorities to do so.

11 The contribution rates payable by Participating Employers in the Fund are set every three years at the Fund's Valuation. Due to the nature of the Fund's liabilities a long-term view is taken at the Valuation. There are circumstances however, where there are short-term changes that are sufficiently material to warrant consideration of a change in contribution rate. The new powers in respect of Employer Flexibilities allow Administering Authorities to consider a rate change where:

(a) the Administering Authority believes that there is a reasonable likelihood that there has been a change in liabilities arising,

(b) the Administering Authority believes that there is a reasonable likelihood that there has been a change in the employer's ability to meet their obligations, or;

(c) the employer has requested a review

12 Where a Participating Employer leaves the Fund and their notional share of the assets and liabilities are in deficit, the default position remains that any deficit payment would normally be levied on the exiting employer as a single capital payment. The new powers allow Administering Authorities to recover that exit debt over an agreed period through a Debt Spreading Agreement (DSA).

13 SAB outlines that a DSA arrangement may be appropriate for an employer which has no active members, no intention of returning to active employer status in the future and wishes to crystallise any debt to the Fund. Employers have an obligation to make good on the payments due under the DSA, which when completed will finalise their exit.

14 Finally, the new powers introduce the concept of a Deferred Debt Agreement (DDA). A DDA allows Administering Authorities to defer the triggering of an exit debt, enabling an employer to terminate future accrual in the scheme. When a DDA is in place the employer becomes a 'deferred employer' in the Fund and will continue to make deficit contributions to the Fund and continue to benefit from positive investment returns whilst remaining exposed to investment risk.

15 SAB identify that a DDA arrangement may be appropriate for an employer which although they have no active members may return to active employer status at some point. Alternatively, a DDA may be used for employers who do wish to exit but do not wish to crystallise any debts to the Fund. They continue to share in the fortunes and risks of the Fund for the duration of the DDA.

Fund Policy and Consultation

16 The Fund's draft 'Policy on Employer Flexibilities' is included in Appendix 1. The policy was drafted in consultation with the Fund's Actuary and sets out the approach of the Fund in respect of the review of employer contributions, employer exit payments and deferred debt agreements (collectively, 'Employer Flexibilities').

17 The policy takes into account changes introduced by the Local Government Pension Scheme (Amendment) (No. 2) Regulations 2020. The policy also takes account of "Guidance on preparing and maintaining policies on review of employer contributions, employer exit payments, and deferred debt agreements" issued by MHCLG (now 'DLUHC'). The policy aims to take a balanced approach, protecting all employers in the Fund.

18 The policy has been shared with all employers for consultation and an overview was provided at the Fund's Annual Meeting, held in November. Only one employer sought to comment on the policy and provided detailed feedback on the policy. An anonymised copy of the feedback is included in Appendix 2.

19 The employer feedback was constructive and as noted went into some detail on aspects of the Fund's approach. The most significant aspect of the feedback related to the mechanics of any DDA arrangement, in particular where there is a weakening of covenant over time. It is proposed that further actuarial guidance is sought, and that Officers finalise the policy taking into account any comments from the Committee and employer feedback received.

Author(s)

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Appendix 1: Policy on Employer Flexibilities