	Local Pension Board **12 October 2021**
Title	**Consultation on Contribution Policies**
Report of	Director of Finance
Wards	All
Status	Public
Urgent	No
Key	No
Enclosures	Appendix 1 – Exit Credit Policy Appendix 2 – Deferred Debt and Debt Spreading Policy Appendix 3 – Contribution Review Policy
Officer Contact Details	George Bruce, Head of Pensions, 0208 359 7126 george.bruce@barnet.gov.uk

Summary

This report outlines three draft policies that have been prepared in response to changes in LGPS Regulations in connection with the setting of employers' contributions either when an employer leaves the Fund or between triennial valuations. The Local Pension Board is invited to review the proposed polices. Any comments will be forwarded to the Pension Fund Committee prior to adoption of the policies.

Officers Recommendations

That the Local Pension Board review the draft policies.

1. WHY THIS REPORT IS NEEDED

1.1 In response to recent regulatory changes, three new polices dealing with contributions payable by employers have been drafted. These are:

- Exit credits – relates to surpluses on cessation
- Deferred Debt and Debt Spreading – relates to deficits on cessation
- Contribution review – relates to reviewing contribution rates between triennial valuations

1.2 The requirement to have each of these polices and the most significant aspects of each policy are discussed below. The draft policies were reviewed by the Pension Fund Committee at their July 2021 meeting and they requested consultation with the Local Pension Board and participating employers. The draft policies were sent to all employers on 30th July with a request for comments by end August. One employer has provided comments and as a consequence the policies have been revised, subject to Pension Fund Committee approval and a response will be sent to the employer. It is intended that following consultation, comments received will be reported to the Pension Fund Committee. All three policies have been reviewed by the Fund Actuary and their comments incorporated. The polices are also consistent with guidance produced by both MHCLG and Scheme Advisory Board.

Exit Credits

1.3 The LGPS 2013 (the 2013 Regulations) were amended in 2018 to allow exit credits to be paid for the first time. The changes came into effect on 14 May 2018. Where an employer ceased to be a participating employer in the Fund an exit credit became due if their pension liabilities has been overfunded at their date of exit. (An employer typically ceases to be a participating employer when their last active member of the LGPS leaves or when an admission body's admission agreement comes to an end e.g. on expiry on a contract.)

1.4 Previously scheme employers were responsible for any shortfall against their liabilities at the point of exit but could not receive the benefit of any surplus. Any surplus on exit was retained in the Fund. On the cessation of a contractor who had provided a service to a letting authority, any surplus of assets on exit would have previously been reallocated to that letting authority on the exit of the contractor from the Fund.

1.5 Following concerns with the exercise of exit credit provisions, LGPS (Amendment) Regulations 2020 came into force on 20 March 2020, but have effect from 14 May 2018, and set out that:

"An administering authority must determine the amount of any exit credit, which may be zero, taking into account the following factors:

- the extent to which the employer's assets in the pension fund are in excess of its benefit liabilities,
- the proportion of this excess of assets which has arisen because of the value of the employer's contributions,
- any representations made by the exiting employer and, where the employer participates in the LGPS by virtue of an admission agreement, any guarantor for the employer's pension liabilities, and
- any other relevant factors"

1.6 As mentioned in the Regulations, the exit credit may be nil. The main reason for that is where other parties carried some or all of the pension risks e.g. the employer was compensated if their contribution rate increased. The other main limitation is that the value of contributions paid will

be compared with the scale of the surplus. Other factors to be considered include unpaid contributions and failure to provide a required bond.

1.7 In developing the policy some additional principles have been incorporated:

- The credit will be calculated on the same basis as a deficit as specified in the Funding Strategy Statement. Some schemes have incorporated a 'gilts basis' to minimise any exit credits.
- Where the admission agreement was signed before exit credits were introduced (May 2018), it is unlikely that an exit credit will be payable unless the employer can demonstrate that this regulation was factored into their contractual arrangements.
- The Actuary can make adjustments for uncertainness' in the benefit structure e.g. while awaiting the Government's decision on McCloud discrimination.

1.8 Any unresolved dispute will be referred to the Pension Fund Committee as will any recommendation to make an exit credit.

Deferred Debt and Debt Spreading

1.9 This policy covers two distinct situations linked to an employer ceasing with a deficit when it has no active staff participating in the Fund; deferred debt, where the employer continues as an active employer and debt spreading, where the deficit is fixed at cessation and recovered over a period of years. Historically when an employer ceased due to no active members, any deficit was payable immediately in full unless there was a prospect of recruiting active members within three years. This remains the preferred approach to employer cessations.

<u>Deferred Debt Agreement (DDA)</u>

1.10 Regulation 64 (special circumstances where revised actuarial valuations and certificates must be obtained) (7A) of the LGPS Regulations 2013 enables the Fund to enter into an agreement with an employer who continues to pay secondary (deficit) contributions, that are reviewed at each triennial valuation. This type of arrangement will only be considered if there is a prospect of future active service or if the ability to recover the full deficit contributions will be enhanced by allowing continued participations or the risk to not receiving full payment does not increase. Entering into a DDA will require security in the form of bond, guarantee or asset pledge to be provided. It is not envisaged that employers who are able to pay the cessation deficit in full will be offered a DDA as continuing as a participating employer might be a less costly option for the employer but increases the risk of not collecting the cessation deficit in full.

1.11 Any proposal for a DDA will be reported to the Pension Fund Committee.

1.12 Each DDA will include a maximum duration at the end of which any remaining deficit will be assessed by the Actuary and is payable by the exiting employer unless an extension is agreed. The duration is not expected to exceed the deficit recovery period set out in Funding Strategy Statement. Both parties have the right to early termination, which also occurs if the deficit is eliminated. Termination can give rise to an exit credit. Ongoing agreements will form part of the quarterly monitoring reports to Pension Fund Committee.

<u>Debt Spreading Agreement</u>

1.13 Regulation 64B (LGPS Regulations 2013) [effective September 2020] enables the Fund to enter into a debt spreading agreement (DSA) whereby the deficit is calculated by the Actuary and repaid over an agreed period with an appropriate interest adjustment based on the discount rate used to calculate the deficit on cessation.

1.14 Entering into a DSA may be advantageous to the Fund when the prospect of recovering the cessation deficit as a single immediate payment is remote but recovery over an extended period is probable. It is intended for situations when the employer is not expected to resume active participation and the risks of using a DDA with continued exposure to changes in funding level are undesirable. Once agreed, the amounts payable are fixed and are not impacted by triennial valuations.

1.15 As with a DDA, security in the form of bond, guarantee or asset pledge will be required. The maximum period of a DSA is five years with extensions unlikely. Both the Fund and Employer can terminate the agreement early and require the remaining balance to be paid.

DSA's will form part of quarterly monitoring reports to the Pension Fund Committee.

Contribution Review

1.16 Regulation 64A of the LGPS Regulations 2013 (as amended) [effective September 2020] allows changes to an employer contribution rates between triennial valuations when:

- The Funding Strategy Statement has a policy on amending contributions, and
- The liabilities of the employer have changed significantly since the last valuation, or
- A significant change in the employer's ability to meet their obligation to the Fund, or
- The Employer requests a review.

1.17 The purpose of the regulations is to enable contributions to be reset to an appropriate level when there has been a significant change in either the funding position or employer's ability to pay, in both cases either favourably or adversely. Such reviews will be rare and any proposal to commence a review or employer's request will be reported to the Pension Fund Committee. An employer's request can only proceed if it relates to the same two criteria; change in liabilities or ability to pay. Changes in asset values or actuarial assumptions are not a reason for a contribution review. Changes in contribution rates will involve engagement with the employer and a preference for an agreed outcome.

1.18 A significant change in liabilities is most likely to arise from a change in a contract with the Council or school. We have used 10% of the liabilities as the definition of significant. Revised contributions will be calculated by the Actuary. No review will be commenced within twelve months of the next triennial valuation.

2. REASONS FOR RECOMMENDATIONS

2.1 One of the Board's responsibilities is to monitor the management of risks and funding is one of the most significant risk faced by the Fund. The Barnet Pension Fund can only consider the increased flexibilities in the LGPS Regulations if it agreed polices for the implementation.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 None

4. POST DECISION IMPLEMENTATION

4.1 Comment from the Board and employers will be reported to the Pension Fund Committee.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Good management of the Pension Fund will minimise the cost of providing benefits thus enabling funds to be directed to Council priorities as set out in the Council's Corporate Plan for 2019-2024. Changes in contribution rates can have a significant cashflow implication for employers and will impact on the Council's ability to spend in other areas.

5.2 Resources (Finance & Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 Employers paid £54 million of contributions into the pension scheme in 2020-21. Changes in contribution rates can have a significant cashflow implication for employers and will impact on the Council's ability to spend in other areas.

5.3 Social Value

5.3.1 Membership of the Pension Fund ensures the long-term financial health of contributing employees on retirement.

5.4 Legal and Constitutional References

5.4.1 The Board's Terms of Reference include "ensuring the effective and efficient governance and administration of the LGPS for the LBB Pension Fund". The contribution setting process is central to ensuring that the pension fund has sufficient assets to pay pensioners.

5.4.2 The Local Government Pension Scheme Regulations 2013 place responsibility for the local administration of pensions and other benefits under these Regulations on the administering authority, which is the London Borough of Barnet. Legal references are highlighted throughout the paper.

5.5 Risk Management

5.5.1 Risk management is central to the LGPS. LGPS pension funds are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met. Good governance is essential to managing the risks of the pension fund

5.6 Equalities and Diversity

5.6.1 Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to 1) eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; 2) advancing equality of opportunity between

persons who share a relevant 'protected characteristic' and those who do not share it; and 3) fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation. The Council also has regard to the additional protected characteristic of marriage and civil partnership even though this does not apply to parts 2) and 3) (above) of the public-sector equality.

5.6.2 Ensuring the long-term financial health of the Pension Fund will benefit everyone who contributes to it. Access to and participation in the Pension Fund is open to those with and those without protected characteristics, alike, provided that the criteria set out within the relevant Regulations are met

5.7 **Corporate Parenting**

5.7.1 Not applicable in the context of this report.

5.8 **Consultation and Engagement**

5.8.1 Consultation with Scheme Employers is discussed in the report.

5.9 **Insight**

5.9.1 Linkage is made with guidance issues by both MHCLG and the Scheme Advisory Board.

6. ENVIRONMENTAL IMPACT

6.1 N/A

7. BACKGROUND PAPERS

7.1 MHCLG guidance

https://www.gov.uk/government/consultations/local-government-pension-scheme-changes-to-the-local-valuation-cycle-and-management-of-employer-risk/outcome/guidance-on-preparing-and-maintaining-policies-on-review-of-employer-contributions-employer-exit-payments-and-deferred-debt-agreements

7.2 Scheme Advisory Board Guidance

https://lgpsboard.org/index.php/empflexm