Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES		
Policy Consultation – Changes to the Valuation Cycle and Management of Employer Risk **Pensions Committee** **25th June 2019**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **One** **AGENDA ITEM NO.**

1. INTRODUCTION

1.1 This report introduces a policy consultation run by the Ministry of Housing, Communities and Local Government (MHCLG) on changes to the LGPS local valuation cycle and the management of employer risk. The report sets out the scope and timescale of the consultation and recommends an approach for the Fund to follow in responding.

2. RECOMMENDATIONS

2.1 **The Pensions Committee is recommended to agree the approach proposed in Section 6.2 for responding to the consultation**

3. RELATED DECISIONS

- None

4. COMMENTS OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES

4.1 The proposals contained within this consultation could impact the Pension Fund in numerous ways. Firstly, the proposals could impact on employer contributions payable through changes to the length of valuation cycle. Changes to exit payments and credits could also impact the terms of which an employer ceases. Additionally, the proposals could also affect the Fund's management costs through changes to actuarial and other supplier (e.g. legal) fees

4.2 Whilst it is not possible to provide a reliable estimate of the potential impact on the Fund, it is clear that the outcome of the consultation could materially impact the Fund's financial health. It is therefore in the best interests of the Fund to ensure that a carefully considered response is provided. .

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1 Regulation 62 of the Local Government Pension Scheme (LGPS) Regulations 2013 prescribes that each administering authority must obtain:

- an actuarial valuation of the assets and liabilities of each of its pension funds as at 31st March 2016 and on 31st March in every third year afterwards;
- a report by an actuary in respect of the valuation; and
- a rates and adjustments certificate prepared by an actuary

5.2 Paragraph 7 of the Pensions Committee's terms of reference state that it is responsible for 'mak[ing] arrangements for the triennial actuarial valuation, monitor[ing] liabilities and undertak[ing] any asset/liability and other relevant studies as required.

5.3 This consultation proposes amending the LGPS Regulations 2013 to move the fund valuation cycle from the current three year (triennial) to a four-year (quadrennial) cycle. Given the Pensions Committee's responsibility under its terms of reference for monitoring the funding position and making arrangements for the valuation, consideration of the Fund's response to this consultation would appear to properly fall within the Committee's remit.

6. CONSULTATION PROCESS

6.1 The consultation is being run by MHCLG. It seeks views on policy proposals to amend the rules of the Local Government Pension Scheme 2013 in England and Wales and covers the following areas:

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

6.2 It is proposed that a response is submitted by the London Borough of Hackney as administering authority for the London Borough of Hackney Pension Fund. As such, review of the Fund's response falls within the Pensions Committee's remit. As no further Pensions Committee meetings are planned between this meeting date and the closing date for the consultation (31st July 2019), it is proposed that a draft response be circulated to Members via email for comments. Final approval will be sought from the Chair of the Pensions Committee prior to the finalised response being submitted. The draft response will be circulated no later than 10th July 2019.

7. SCOPE OF CONSULTATION

7.1 The consultation covers the areas listed in 6.1. This section of the report provides a brief summary of each area of consideration and sets out the questions to which responses are requested.

7.2 **Changes to the Local Government Pension Scheme (LGPS) valuation cycle** Local fund valuations are used to set employer contribution rates and to assess whether funds are on target to meet their pension liabilities as they fall due in the years ahead, whilst the LGPS scheme valuation is used by Government to make decisions about the LGPS and its benefit structure on a basis consistent with the other public service schemes. Previously, both local fund and whole scheme valuations were carried out on a triennial cycle. However, the Government has now brought the LGPS whole scheme valuation onto the quadrennial cycle used by the other public service schemes, so the local fund and whole scheme valuation cycles no longer align.

The Government suggests that moving the LGPS local fund valuations to quadrennial cycles would deliver greater stability in employer contribution rates and reduce costs, as well as re-aligning the local valuation cycle to that of the scheme valuation. However, it could also introduce additional risk, e.g. that changes in employer contribution rates may be greater as a result of longer valuation periods and that longer valuation periods could also lead to reduced monitoring of any risks and costs.

Views are sought on whether this is the right approach and the best way of transitioning the LGPS to a quadrennial local valuation cycle

7.3 **Dealing with changes in circumstances between valuations**

To mitigate the risks detailed above, the consultation proposes introduction of a power for LGPS funds to undertake interim valuations. This would allow LGPS administering authorities to act when circumstances change between valuations and undertake full or partial valuations of their funds.

It also proposes the widening of a power that allows LGPS administering authorities to amend an employer's contribution rate in between valuations, so that contribution rates can be adjusted following the outcome of a covenant check or where liabilities are estimated to have significantly reduced. This would not affect the timing of the next quadrennial fund valuation or the scheme valuation. It would, however, potentially allow administering authorities to manage risk and avoid the need for very sharp corrections if maintaining the longer review cycle

The introduction of safeguards to prevent the timing of interim valuations to take advantage of short-term market conditions and undermine the cost and administrative advantages of a longer valuation cycle is also proposed. These would include a requirement for funds to specify in the funding strategy statement the circumstances under which an interim valuation may take place.

Views are sought on the detail of these measures and what LGPS funds should put in their funding strategy statements regarding these matters.

7.4 **Flexibility on Exit Payments**

For some employers, the cost of exiting the scheme can be prohibitive. Current regulations require that when the last active member of an employer leaves the scheme, the employer must pay a lump sum exit payment calculated on a full buy-out basis. The consultation seeks views on two alternative approaches that could reduce the cliff-edge faced by employers:

- • To introduce a 'deferred employer' status that would allow funds to defer the triggering of an exit payment for certain employers who have a sufficiently strong covenant. Whilst this arrangement remains in place, deferred employers would continue to pay contributions to the fund on an ongoing basis:
- • To allow an exit payment calculated on a full buy-out basis to be recovered flexibly – i.e. over a period of time. This may be of use where an administering

authority does not feel that granting deemed employer status would be appropriate but that some level of flexibility is in the interests of the fund and other employers.

7.5 **Exit credits under the LGPS Regulations 2013**

In 2018, the LGPS Regulations 2013 were amended to allow the payment of 'exit credits' to scheme employers in surplus at the time their last active member leaves the scheme. This followed a consultation on the introduction of exit credits undertaken by the Department in 20163. However, these amendments can cause issues where an LGPS employer has outsourced a service and used contractual arrangements to share risk with their contractor.

Views are sought on a mechanism to address this issue. The proposed solution would oblige the administering authority to satisfy itself if risk sharing between the contracting employer and the service provider has taken place (for example, via a side agreement which the administering authority would not usually have access to). If the administering authority is satisfied that the service provider has not borne any risk, the exit credit may be calculated as nil.

7.6 **Employers required to offer LGPS membership**

Given the LGPS's funded nature, with liabilities potentially falling back on local authorities and other public bodies in a particular area in the event an employer cannot meet its obligations, the Government is conscious of the need to ensure that scheme participation requirements remain appropriate. Views are sought on proposals that would remove the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer membership of the LGPS to their non-teaching staff.

It is proposed that it will be for each institution to determine whether to offer the LGPS to new employees or not. Under the proposals, current active LGPS members and those eligible for active membership in an employment with a further education corporation, sixth form college corporation or higher education corporation in England would have a protected right to membership of the scheme

7.7 **Summary of Questions**

1. As the Government has brought the LGPS scheme valuation onto the same quadrennial cycle as the other public service schemes, do you agree that LGPS fund valuations should also move from a triennial to a quadrennial valuation cycle?
2. Are there any other risks or matters you think need to be considered, in addition to those identified above, before moving funds to a quadrennial cycle?
3. Do you agree the local fund valuation should be carried out at the same date as the scheme valuation?
4. Do you agree with our preferred approach to transition to a new LGPS valuation cycle?
5. Do you agree that funds should have the power to carry out an interim valuation in addition to the normal valuation cycle?
6. Do you agree with the safeguards proposed?

7. Do you agree with the proposed changes to allow a more flexible review of employer contributions between valuations?
8. Do you agree that Scheme Advisory Board guidance would be helpful and appropriate to provide some consistency of treatment for scheme employers between funds in using these new tools?
9. Are there other or additional areas on which guidance would be needed? Who do you think is best placed to offer that guidance?
10. Do you agree that funds should have the flexibility to spread repayments made on a full buy-out basis and do you consider that further protections are required?
11. Do you agree with the introduction of deferred employer status into LGPS?
12. Do you agree with the approach to deferred employer debt arrangements set out above? Are there ways in which it could be improved for the LGPS?
13. Do you agree with the above approach to what matters are most appropriate for regulation, which for statutory guidance and which for fund discretion?
14. Do you agree options 2 and 3 should be available as an alternative to current rules on exit payments?
15. Do you consider that statutory or Scheme Advisory Board guidance will be needed and which type of guidance would be appropriate for which aspects of these proposals?
16. Do you agree that we should amend the LGPS Regulations 2013 to provide that administering authorities must take into account a scheme employer's exposure to risk in calculating the value of an exit credit?
17. Are there other factors that should be taken into account in considering a solution?
18. Do you agree with our proposed approach?
19. Are you aware of any other equalities impacts or of any particular groups with protected characteristics who would be disadvantaged by the proposals contained in this consultation?

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Appendices
Appendix 1 – LGPS Valuation Cycle Reform Consultation

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