Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
Funding Strategy Statement Update **Pensions Committee** **16th June 2021**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Appendices** **One** **AGENDA ITEM NO.**

1. INTRODUCTION

1.1 This report provides the Committee with an update on the published Government response regarding the issues below and proposals for the required changes to Funding Strategy Statement (FSS). The issues are:

- the consideration of the payment of employer exit credits (known hereafter as "Exit Credits";
- the provision of greater flexibility on employer exit payments; and
- the ability to review employer contributions between valuations (points b) and c) hereafter known as Employer flexibilities).

1.2 At the point of review, the FSS has also had a minor update in order to reference the uncertainty arising from the Goodwin case.

2. RECOMMENDATIONS

2.1 The Committee is asked to consider and approve the changes to the FSS to reflect:

- the Fund's policy on the payment of Exit Credits
- the current position the Fund's in developing its policy on the application of the Employer flexibilities regulations
- the uncertainty relating to the Goodwin case.

2.2 The Committee is also asked to agree that Officers should consult employers in the Fund on the proposed changes to the FSS as required by regulations.

3. RELATED DECISIONS

Delegated Powers Report 31 March 2020 - Final Valuation Report and Funding Strategy Statement

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

4.1 This report asks the Committee to approve changes to the FSS arising from changes in the relevant regulations and to consult participating employers in the Fund on those changes.

4.2 The FSS is an important document for the Fund, setting out its funding strategy following the finalisation of the triennial valuation. It sets out details of how employer contribution rates are set, the overall funding strategy and the appropriate links to the Fund's Investment Strategy, and several policies that might affect the funding of the Pension Fund if certain events occur.

4.3 The policies set out within the FSS can have a material impact on the funding level of the Fund and therefore impact on the Council's and other participating employers budgets via the contribution rates set.

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1 The Council’s Constitution gives the Pensions Committee responsibility for various specified functions relating to management of the Council’s Pension fund. In carrying out those functions the Committee must have regard to the various legislative obligations imposed on the Council as the Fund’s Administering Authority, particularly by the 2013 Regulations.

5.2 Those requirements include the requirement for a triennial valuation carried out by an actuary. At the time the valuation is agreed, a Funding Strategy Statement is also approved and this is required to be updated as regulations are amended.

5.3 Given these requirements, it is appropriate that the Committee consider these latest updates to the FSS, required by changes to relevant legislation since the last valuation took place.

6. BACKGROUND TO THE REPORT

6.1 In May 2019, 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

e) Potential changes to employers required to offer LGPS membership.

6.2 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).

6.3 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.

6.4 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.

6.5 On 2 March 2021 MHCLG published statutory guidance to support the application of the new regulations. This included the expectation that LGPS Funds 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.

7. Funding Strategy Statement (FSS)

7.1 Under the Regulations, all LGPS funds have a statutory obligation to produce a Funding Strategy Statement ("the FSS").

7.2 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 under Delegated Powers by the Group Director, Finance & Corporate resources in March 2020 following updates made as part of the 2019 formal valuation. This approval was in conjunction with the Chair and Vice Chair of the Committee in line with the Terms of Reference of the Pensions Committee.

7.3 Exit credits

7.3.1 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.

7.3.2 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.

7.3.4 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.

<u>*Changes to FSS*</u>

7.3.5 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 and the detail is contained in the attached Draft FSS:

- 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.)

7.4 Employer flexibilities

7.4.1 Following the MHCLG consultation (above), the LGPS Regulations 2013 were amended from 23 September 2020 to allow the Fund to recalculate employer contributions outside of the triennial formal valuation in the following circumstances:

- There has been a significant change to the liabilities of an employer;
- There has been a significant change in the employer's covenant; or
- At the request of the employer.

7.4.2 The amendments also allow greater flexibility around managing the exit of an employer from the Fund. On exit from the Fund, where the employer is in deficit, the following options are available:

- The employer pays a full cessation payment carried out in line with regulations;
- The Fund can agree a repayment schedule with an employer to allow them to spread the exit payment over a number of years; or

- The Fund and employer enter into a Deferred Debt Agreement (DDA) where an employer can continue in the Fund with no active members but continue to pay secondary contributions as determined at formal valuations. An employer entering into this arrangement would be known as a “deferred employer”.

7.4.3 Whilst many LGPS Funds have entered into similar arrangements, these practices are now strengthened by the regulation amendments.

7.4.4 At this time, Committee members are asked to understand the issues presented by the introduction of these new employer flexibility regulations and will be presented with the Fund’s related policy document at its September meeting.

Changes to FSS

7.4.5 Working alongside the Fund’s Actuary, the Fund are currently in the process of developing the Fund’s policy in relation to the LGPS Regulations 2013 as amended 23 September 2020 and statutory guidance published on 2 March 2021 MHCLG to support the application of the new regulations. Each employer’s circumstances will be assessed on a case-by-case basis, subject to the principles set out in the Fund’s Employer Flexibilities Policy which will be an Appendix to this FSS when drafted. The FSS has been updated in the relevant places in order to point to the Appendix when it is developed.

7.5 Goodwin case

7.5.1 The Goodwin tribunal was raised in the Teachers’ scheme. It claimed members, or their survivors, were discriminated against due to their sexual orientation. The claim was because the Teachers’ scheme provides a survivor’s pension which is less favourable for a widower or surviving male partner, than for a widow or surviving female partner of a female scheme member. On 30 June 2020, the Tribunal found in favour of the claimant and agreed there was discrimination. This finding and remedy is expected to apply across all public service pension schemes, including the LGPS, however this is not certain and the details are not yet known.

7.5.2 The impact, if any, of the Goodwin case on Fund liabilities is expected to be small and will largely be an administrative issue. In the absence of a resolution or any guidance to this case, no allowance has been made for this within the 2019 formal valuation.

Changes to FSS

7.5.3 The above text (7.5.1 - 7.5.2) will be included in the FSS.

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Appendices
Appendix 1 – Updated Draft Funding Strategy Statement