worcestershire countycouncil

AGENDA ITEM 12

PENSIONS COMMITTEE
16 MARCH 2021

DRAFT FUNDING STRATEGY STATEMENT (FSS) POLICY UPSATE

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The draft termination policy changes for Deferred Debt Agreements and deficit spreading arrangements be approved (Appendix 1);**

   b) **The draft new policy for Flexibility in Contribution Rates be approved (Appendix 2);**

   c) **He be granted delegated authority to make any necessary final changes to the draft policies following the Committee meeting and undertake consultation on the updated Funding Strategy Statement (including the appeals process) with Fund employers, having taken advice from the Fund Actuary.**

REPORT SUMMARY

2. The purpose of the Funding Strategy Statement ("FSS") is to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward. The last FSS was agreed by Committee in December 2019 and took on board the actuarial valuation of the Fund by Mercers. In between the triennial period, the FSS needs to be reviewed to take on board any changes in regulations or policy.

3. A number of proposed employer flexibilities were introduced in the Pension Regulations and the Fund was awaiting the MHCLG statutory guidance and Scheme Advisory Board (SAB) guide to be released before the Fund could commence the consultation process with Fund employers

4. This report covers updates to the termination policy and a new contributions flexibilities policy in light of the new Regulations that came into force on 23 September 2020. The Regulations require these policies to be included in the Funding Strategy Statement (FSS).

Updated Termination Policy

5. The default position for exit payments is that they are paid in full at the point of exit. The termination policy has therefore been updated to allow for the new Regulations which allow exiting employers (subject to a suitable review of the unaffordability of an immediate exit debt payment) to spread their exit debt over a set period or to enter in to a Deferred Debt Arrangement allowing them to remain in the Fund with no active members. The policy sets out the process that must be followed by the Fund when an employer exits the Fund (usually triggered when the last active contributing member leaves pensionable service). Amendments have been highlighted in the document.

New Contributions Flexibilities Policy

6. The new Regulations also permit contribution rates to be adjusted between valuations. Currently the contribution rates set out in the valuation report stay in place until the next valuation (except in limited circumstances or where an employer exits the Fund). These Regulations allow changes to contributions to be made before the next valuation if they meet the criteria. The policy sets out the situations where contributions may be reviewed between actuarial valuations and the conditions that must be met.

BACKGROUND INFORMATION

7. A number of regulatory changes came into force on 23 September 2020 (LGPS (Amendment No.2) Regulations 2020). These allow for more flexibilities with contributions both on exit from the Fund (via spreading of exit payments and allowing employers to remain in the Fund with no active members) and via interim contribution reviews between actuarial valuations. In line with these Regulations, the Fund is required to include policies within its Funding Strategy Statement (FSS) which sets out how the flexibilities will apply in practice to employers. The Fund has therefore updated its policies to incorporate the new Regulations. These policies aim to provide much needed flexibilities to manage the liabilities.

8. To assist with drafting the policies and applying the Regulations, the Scheme Advisory Board (SAB) has produced a practical guide for Funds and the MHCLG has produced statutory guidance on the amendments to the FSS. A consultation took place on the supporting guide from the SAB which ran until 9 January 2021 and both the final documents were published on 2 March 2021.

9. Once the draft policies have been finalised, a short consultation with Fund employers will take place covering the new policies. The FSS will then be updated to include the new policies. These policies do not alter the main principles of the current funding strategy but instead provide the Fund and employers with further flexibilities.

10. There will be some further cosmetic updates to the wider FSS which will be included in the consultation for completeness. In addition, there is also some refinements to the wording in the termination policy in relation to the process involved in determining how an exit credit (i.e. a surplus) should be dealt with when an employer exits the Fund. In particular, the Fund will provide the exiting employer with a determination notice setting out who will receive the exit credit and the reasons behind this decision (e.g. details of the commercial or admission agreements referenced).

11. The employer will be able to appeal the process if they disagree with the outcome of the decision. The appeal process will need to be communicated to employers when the decision is made. The Administering Authority will need to consider whether they use an existing process or develop a bespoke process for this purpose. The Committee is requested to delegate consideration of the appeals process to Officers as part of the employer consultation.

12. The policies have been drafted based on the statutory guidance and SAB guide. It is proposed that any changes required to the draft policy following the Committee meeting and employer consultation will be made by Officers on the advice of the

Actuary. We do not expect substantive changes will be required but if there were then consideration will be given to whether this is brought back to the Committee.

13. Further information regarding the changes made to the policies are set out below.

DRAFT TERMINATION POLICY UPDATES - FLEXIBILITY FOR EXIT DEBT PAYMENTS AND DEFERRED DEBT AGREEMENTS

14. The default position for exit payments is that they are paid in full at the point of exit and this will continue under the new policy. The previous regulations generally required the exit debt to be paid in full on exit. This restricted the ability of employers to leave the Fund in an ordered and affordable manner and put the Fund (and therefore the taxpayer) at higher risk of unrecoverable debts. This is especially the case for those employers in a weak financial situation. As a consequence, employers tended to remain in the Fund building up further, often unaffordable, liabilities. The new Regulations provide greater flexibility to manage this debt in conjunction with the employer and allow the employer to limit the further accrual of liabilities.

15. The new Regulations permit LGPS funds to develop policies that provide alternative options to employers when the last active member leaves the employer (subject to a covenant assessment and consideration of security):

a) **Spreading payments** - Allow the Fund and the employer to enter into agreement which instead spreads the payment of the final exit debt calculated by the Actuary over an agreed period of time (the amounts and frequency of the payments in the payment plan will be agreed at the outset along with any early payment terms); or

b) **Deferred Debt Arrangement (DDA)** - The employer may enter into a DDA with a scheme employer. This allows the employer to defer its obligation to make an exit payment and continue to make 'deficit' (secondary rate) contributions to the Fund. Contribution requirements will continue to be reviewed as part of each actuarial valuation under this option, which is essentially an employer continuing ongoing participation, but with no contributing members. The Fund or employer can terminate the DDA and settle a revised (potentially more affordable) exit debt and the DDA would automatically cease when the debt (updated accordingly) is met

16. The Fund can only enter into one of the above arrangements if the FSS includes a policy setting out how the employer will be treated. The Fund are also required to consult with the exiting employer, following advice from the Fund Actuary as well as any other specialists as appropriate as part of the process.

17. Appendix 1 sets out the draft policy FSS changes to incorporate these flexibilities for the Committee to consider (highlighted in yellow). The policies have been designed to strengthen the Fund's ability to manage employer liabilities, ensuring there is no detriment to the solvency of the Fund.

FLEXIBLE CONTRIBUTIONS POLICIES - DRAFT POLICY

18. The new Regulations also permit contribution rates to be adjusted between valuations. Currently the contribution rates set out in the valuation report stay in place until the next valuation except in limited circumstances or where an employer exits the Fund. These Regulations allow changes to contributions to be made before the next valuation if they meet the criteria.

19. Such a revision to contribution rates is only permitted if the Fund's policy is set out in the FSS and one of the following apply:

a) it appears likely to the administering authority that the amount of the liabilities arising or likely to arise has changed significantly since the last valuation:
b) it appears likely to the administering authority that there has been a significant change in the ability of the Scheme employer or employers to meet the obligations of employers in the Scheme; or
c) a Scheme employer or employers have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review (and point (a) or (b) also applies)

20. Appendix 2 sets out the draft policy for the Committee to consider. The policy ensures that any contribution changes will only be due to significant liability or covenant changes which would create additional risk to the Fund or employer.

Contact Points

Specific Contact Points for this report
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Supporting Information

Appendix 1 - Draft revised Termination Policy including updates regarding exit debt payments and deferred debt agreement flexibilities
Appendix 2 - Draft Policy regarding flexible contributions

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.