worcestershire countycouncil

AGENDA ITEM 12

PENSIONS COMMITTEE
29 JUNE 2021

DRAFT FUNDING STRATEGY STATEMENT (FSS) POLICY UPDATE

Recommendation

1. The Chief Financial Officer recommends that:

a) The consultation that was sent to employers on proposed changes to the Funding Strategy Statement (FSS) (Appendix 1) and the feedback from the consultation on the proposed changes to the termination policy changes for Deferred Debt Agreements and the deficit spreading arrangements set out in paragraph 7 below be noted; and

b) The revised FSS taking on board the changes in the consultation (Appendix 2) be approved.

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. In March, the Committee were notified of a number of proposed employer flexibilities covering 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 required these policies to be included in the Funding Strategy Statement (FSS). Committee were provided with the background and details of the proposed changes to be consulted on with employers. Paragraphs 4 and 5 below provide a brief summary of the proposed changes.

Updated Termination Policy

4. 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

5. 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

6. Committee also agreed to delegate any final changes to the draft policies, as necessary, following the Committee meeting and consultation on the updated Funding Strategy Statement (including the appeals process) with Fund employers to Officers, having taken advice from the Fund Actuary.

7. The Fund consulted on these changes with Employers (see Appendix 1) on the 29 April with a deadline of the 21 May 2021. The Fund received one response from Community Housing Group which is detailed below

In general, we welcome the proposed flexibilities and WPF's draft policy provides sufficient scope for employers to agree bespoke agreements appropriate to their circumstances.

Our overarching view is that these options should be open to all employers. These will allow them the flexibility to set a pension strategy that is appropriate for the whole organisation, while ensuring that the many not-for-profit organisations can continue to invest in the local community without the financial constraints of meeting significant exit debt payments. Therefore, we think DDAs should be an option for employers even if the exit debt is theoretically affordable.

We have the following comments on the proposals:

- *We note the potential for security to be requested by the Fund. We understand that this may be necessary in some circumstances however, where the employer's covenant strength is deemed sufficiently strong (and is regularly monitored), then we would propose that the covenant itself may be regarded as providing this security (rather than actual physical security over assets being required). We would also note that the transaction costs and management time involved in agreeing and arranging physical security can be significant and depending on the circumstances may not represent good value to members, employers or the pension fund when the employer is already liable and has appropriate covenant strength.*

- *We believe that the default length of a DDA should equal the default length for the deficit recovery period – 15 years. For strong employers, we think the DDA could be open ended. We also believe that the end date of any agreement should be flexible, with the ability for both parties to amend (subject to the relevant covenant strength considerations).*

- *We recognise that for some employers, reducing investment risk alongside a DDA may be appropriate. However, this will definitely not be the case for all.*

The attractiveness of a DDA is that for an employer with a suitably strong covenant and a suitable time horizon, the expected cost of meeting any exit debt is reduced by the exposure to a diversified portfolio of growth assets. Employers should have the option to select a lower risk investment strategy as their section approaches full funding on a cessation basis.

8. The above has been discussed with our actuary and it is felt that there is sufficient flexibility within the original proposed FSS to take on board the comments / suggestions from CHG. However, it should be noted that upfront payment of the exit debt (the existing approach) will remain the default option when an employer terminates (see page 37 of the FSS).

9. Therefore, after consultation with the actuary and taking on board the comments received from CHG the recommendation is to implement the changes as provided to Committee on the 16 March 2021.

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.