**FOR PUBLICATION**

**DERBYSHIRE COUNTY COUNCIL**

**PENSIONS AND INVESTMENTS COMMITTEE**

**21 July 2021**

**Report of the Director of Finance & ICT**

# Derbyshire Pension Fund
# Updates to the Funding Strategy Statement

## 1 Purpose of the Report

To advise Committee of proposed changes to the Funding Strategy Statement (FSS) following amendments to the Local Government Pension Scheme Regulations 2013 (LGPS 2013) which introduced new powers for administering authorities to review employer contributions between actuarial valuations and to adopt more flexible methods of collecting exit payments from exiting employers.

To advise Committee of Derbyshire Pension Fund's (the Fund) intention to consult with all of its participating employers on the draft updated FSS (updated FSS).

To seek approval for minor amendments to the Fund's Exit Credits Policy which is incorporated in the Admission, Cessation and Bulk Transfer Policy; and referenced in the Fund's FSS.

## 2 Information and analysis

### Funding Strategy Statement (FSS)

Administering authorities are required to prepare, maintain and publish an FSS which must be kept under review, consulting with such persons as they consider appropriate when undertaking a review.

The FSS sets out the objectives of the Fund's funding strategy which include:

- Ensuring the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment
- Ensuring that employer contribution rates are reasonably stable where appropriate

- Minimising the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return
- Reflecting the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years
- Using reasonable measures to reduce the risk to other employers and ultimately to the council taxpayer from an employer defaulting on its pension obligations

The FSS sets out how the administering authority aims to balance the differing targets of stable and affordable contributions, and a prudent long-term view for maintaining the solvency of the Fund.

The FSS is usually reviewed every three years as part of the Fund's actuarial valuation and is also subject to review following a material change in the administering authority's policy on the matters covered by the document (this would normally follow amendments to relevant scheme regulations or statutory guidance).

The most recent version of the FSS was published in March 2020 after being approved by the Committee at its meeting on 4 March 2020 following consultation with the Fund's stakeholders.

**Amendment regulations**
Following a consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG), the Local Government Pension Scheme (Amendment) (No.2) Regulations 2020 (2020 Regulations) came into force from 23 September 2020.

These regulations allow for greater flexibilities for reviewing employer contribution rates and for collecting exit payments from employers ceasing their active participation in the Fund (these employers are known as exiting employers). An exiting employer is liable to pay an exit payment if their LGPS liabilities exceed their LGPS assets or may be entitled to receive an exit credit if their LGPS assets exceed their LGPS liabilities.

The 2020 Regulations give administering authorities the power to:

- Review employer contributions between the triennial actuarial valuations in certain situations
- Allow an exiting employer to spread an exit deficit payment rather than pay it fully at the point of exit
- Allow an employer to continue to pay contributions to the Fund as a 'deferred employer' under a formal 'Deferred Debt Agreement' and for those contributions to be reviewed at future valuations

The new powers (known as employer flexibilities) were introduced to increase the range of options available to administering authorities to manage covenant risk in the LGPS which arises where a Scheme employer may be unable to meet its future obligations. They are intended to help administering authorities ensure that employer contribution rates are set at an appropriate level and that exit payments are managed, with steps taken to mitigate risk, where appropriate.

There is no requirement on administering authorities to use the new powers and the 2020 Regulations require that an authority may only do so where it has set out its policy with respect to the new flexibilities in its FSS, in order to ensure consistency and transparency.

**Statutory Guidance**
MHCLG published statutory guidance to assist administering authorities in implementing and operating the new regulations on employer flexibilities. The guidance, attached at Appendix 2, set out that in developing new policies for inclusion in their FSS and in using the new powers, administering authorities should aim to ensure:

- Consistent use of any new policies in relation to all employers within the fund
- A clear and transparent process of applying the new policies

The LGPS Scheme Advisory Board (SAB) subsequently produced detailed operational guidance to be considered in conjunction with the MHCLG statutory guidance, attached at Appendix 3.

**Draft updated FSS**
The updates to the FSS, which largely reflect the Fund's policy on the new employer flexibilities, have been drafted in consultation with the Fund's actuary and in consideration of the guidance from MHCLG and the SAB.

The proposed changes to the FSS are highlighted in the updated FSS attached at Appendix 4 (deletions in blue, and changes in yellow), with the matters that the Fund will consider under each flexibility clearly set out. In drafting the proposed changes related to employer flexibilities, the interests of the employer concerned and the interests of all the other employers in the Fund has been considered.

**Review of employer contributions between actuarial valuations**
LGPS 2013 already provided that a Fund can undertake a review of an employer's contributions where it may become an exiting employer.

The new regulations allow a review of employer contributions to take place between actuarial valuations in the following additional circumstances:

- It appears likely that the amount of liabilities arising, or likely to arise, for an employer or employers has changed significantly since the last valuation
- It appears likely that there has been a significant change in the ability of an employer or employers to meet their obligations
- Where an employer or employers have requested a review and have undertaken to meet the costs of that review

The SAB guidance makes it clear that whilst a review of contribution rates as part of the actuarial valuation takes into account changes in economic and demographic conditions, as well as changes in membership and individual employer circumstances, a review under the new regulations would only be triggered as a result of either a significant change in membership data or an employer's circumstances.

The updated FSS includes details of the circumstances that the Fund would consider as a potential trigger for a review and clarifies that an employer's reason for requesting a review would be expected to fall into one of the same trigger categories. The requirement for the employer to meet the cost of a requested review is also clearly documented.

**Spreading of exit payments**
At the point of an employer exiting the Fund, a formal assessment of the employer's funding position (its assets compared to its liabilities) at the date of exit is undertaken by the Fund's actuary.

Employers are usually required to make a single lump sum payment to cover any deficit on exit and that will remain the Fund's default position.

However, where an employer can demonstrate that the payment of the debt in a single immediate payment would have a material detrimental impact on its normal operations, the Fund will in future be able to consider entering into a debt spreading arrangement with the employer subject to actuarial, legal and covenant considerations. The ability to enter into debt spreading arrangements formalises a practice already adopted by many LGPS funds.

In cases where payment of debt is spread, the Fund may require the exiting employer to provide some form of security (such as a charge over assets, bond indemnity or guarantee) in order to reduce the risk of an unpaid debt.

The length of any spreading period will depend on the employer's financial circumstances and on the strength of any security provided and would not ordinarily exceed five years. Any debt spreading arrangement will be solely at the discretion of the Fund.

**Deferred Debt Agreements**

Deferred Debt Agreements (DDA) will allow employers to continuing paying contributions to the Fund as a deferred employer when they no longer have any active members, essentially allowing an employer to defer the payment of an exit debt in return for an on-going commitment to meet their responsibilities as an employer in the LGPS.

A DDA is different to a debt spreading arrangement in that the employer does not formally exit the Fund and it allows for the flexibility of active membership returning.

It also allows for employers whose preference is to remain in the Fund and continue to share the risks of continuing participation (e.g. potentially benefiting from investment returns) rather than crystalising any debt at the point of active membership ceasing.

Under a DDA, an employer continues in the Fund with the same obligations as an active employer, with the exception of paying contributions on employees' active LGPS membership (i.e. primary contributions, which fund ongoing future service accrued by employees).

The Fund's actuary would determine a level of secondary contributions (which fund liabilities accrued from historic LGPS membership) and review the level of secondary contributions at each triennial valuation which falls within the period of the DDA.

A DDA would end at the earlier of:

- a fixed end date set in the DDA
- the return of employees with active LGPS membership
- the Fund's actuary determining that the deficit has been fully paid
- the employer requesting to formally exit the Fund and crystalise any outstanding deficit
- the Fund determining that the employer's ability to meet the contributions payable under the DDA has weakened materially or is likely to weaken materially in the next twelve months

The decision on whether to enter into a DDA will be solely at the discretion of the Fund, taking into account actuarial, legal and covenant considerations.

**Other proposed changes to the FSS**
In addition to proposed changes to reflect the Fund's policy on the new employer flexibilities, a small number of other minor revisions have been included in the updated FSS.

**Exit Credits Policy**

The FSS includes a reference to the Fund's Exit Credits Policy, which sets out the policy for determining the payment of an exit credit if pension liabilities have been overfunded at the date of an employer exit, and which is included in the Fund's Admission, Cessation and Bulk Transfer Policy.

The Local Government Pension Scheme (Amendment) Regulations 2020 allow LGPS funds to take into account pension risk sharing arrangements and the extent of an exiting employer's contributions to the fund when making an exit credit determination.

The recent ruling of a judicial review made by the High Court on 27 May 2021 in the case of Enterprise Managed Service Limited & Amey plc v Secretary of State for MHCLG, confirmed that all relevant facts should be considered by a Fund when determining the value of an exit credit and that no single factor should be conclusive.

This requires a minor change to the Fund's Exit Credits Policy and subsequently to the reference to the policy included in the FSS. The change is highlighted in the updated FSS and in the Fund's Admission, Cessation and Bulk Transfer Policy attached at Appendix 5.

**McCloud**
A revision to the summary of the Fund's approach to the McCloud judgement during the 2019 valuation is included in the updated FSS.

The McCloud judgement highlighted age discrimination related to changes in benefit structures which were introduced into public service pension schemes in 2014 and 2015. Details of the LGPS remedy following the judgement are still to be confirmed by MHCLG, however, the expected changes are likely to increase the value of employer liabilities.

The Fund decided at the 2019 valuation, to reflect the possible costs of the expected remedy for McCloud by increasing the required likelihood of employers reaching their funding target.

**Goodwin**
A brief summary of the possible impact of the Goodwin tribunal on Fund liabilities, which may have cost implications for all public service pension schemes, is included in the updated FSS.

The Goodwin tribunal related to a claim against the Teachers' Pension Scheme that members, or their survivors, were discriminated against due to their sexual orientation as males survivors of female scheme members were entitled to a lower survivor benefit than a comparable same-sex survivor.

The tribunal ruled in favour of the claimant and the remedy is expected to apply across all public service pension schemes. The proposed remedy is not yet known, however, the cost impact on the Fund is expected to be minimal. The updated FSS confirms that no allowance was made for the potential remedy to the Goodwin ruling during the 2019 valuation.

**Prepayments**
The Fund may, at its sole discretion, allow an employer to make advance payments of its employer contributions in return for a discount determined by the Fund's actuary.

The updated FSS confirms that where prepayments calculated on forecast payrolls have been approved by the Fund and result in an 'excess' payment when actual payrolls are taken into account, no refund would be payable to the employer, instead the surplus would remain allocated to the employer's assets within the Fund.

**Consultation with employers**
A consultation will be undertaken on the FSS with all of the participating employers in the Fund. It is anticipated that the consultation will run for a period of four weeks from 26 July 2021 to 22 August 2021. The result of the consultation will be reported to Committee in September when the final FSS will be presented for approval.

## 3. Implications

Appendix 1 sets out the relevant implications considered in the preparation of the report.

## 4. Background papers

Papers held by the Pension Fund.

## 5. Appendices

5.1 Appendix 1 – Implications

5.2 Appendix 2 – MHCLG Guidance on preparing and maintaining policies on review of employer contributions, employer exit payments and deferred debt agreements

5.3 Appendix 3 – SAB Guide to employer flexibilities

5.4 Appendix 4 – Draft updated FSS

5.5 Appendix 5 – Amended Admission, Cessation and Bulk Transfer Policy

## 6. Recommendations

That Committee:

Notes the proposed changes to the FSS following the introduction of new powers for administering authorities to review employer contributions between actuarial valuations and to adopt more flexible methods of collecting exit payments from exiting employers.

Notes the Fund's intention to consult with all participating employers on the updated FSS.

Approves the minor amendments to the Fund's Exit Credits Policy, which is incorporated in the Admission, Cessation and Bulk Transfer Policy.

## 7. Reasons for recommendations

The information and analysis in this report sets out the proposed changes to the FSS in recognition of amendments made to the LGPS 2013 with respect to employer flexibilities.

The Fund is required to consult with such persons as it considers appropriate when making a material change to its FSS.

Following a recent high court ruling an amendment to the Fund's Exit Credits Policy is necessary.

**Peter Handford**

**Director of Finance & ICT**

**Appendix 1**

## Implications

### Financial

1.1 The implementation of the new provisions in the draft revised Funding Strategy Statement may have financial implications for the Fund employers concerned.

### Legal

2.1 Debt spreading arrangements and Deferred Debt Agreements would be subject to formal legal documentation.

### Human Resources

3.1 None

### Information Technology

4.1 None

### Equalities Impact

5.1 None

### Corporate objectives and priorities for change

6.1 None

### Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None