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Consultation outcome

Guidance on preparing and maintaining policies on review of employer contributions, employer exit payments and deferred debt agreements

Updated 2 March 2021

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Local Government Pension Scheme (England and Wales): Guidance on preparing and maintaining policies on review of employer contributions, employer exit payments and deferred debt agreements

1 Introduction

1.1 The government amended the Local Government Pension Scheme (LGPS) Regulations 2013 in September 2020^[footnote 1] introducing new powers for administering authorities to review employer contributions, spread exit payments and set up Deferred Debt Agreements (DDA) (<https://www.gov.uk/government/consultations/local-government-pension-scheme-changes-to-the-local-valuation-cycle-and-management-of-employer-risk>). The relevant regulations are set out in the appendix.

1.2 We have developed this guidance to assist administering authorities who wish to use the new powers. The guidance sets out high level principles and points which the government believes should be considered by administering authorities. It will also be of interest to scheme employers.

1.3 The guidance is issued under regulations 2(3A) and (3B) of the LGPS Regulations 2013 which enables the Secretary of State to issue statutory guidance on the administration and management of the Scheme subject to a requirement to consult such persons as he considers appropriate before doing so.

1.4 We would like to thank the Scheme Advisory Board and the working group of practitioners who have assisted with the preparation of the guidance, as well as all those who responded to the technical consultation undertaken between 2 November 2020 and 23 November 2020.

1.5 An additional guide for employers and administering authorities on the practical application of the new powers is to be published by the Local Government Pension Scheme Advisory Board (SAB) for England and Wales. Administering authorities are advised to consider both documents when developing policies in relation to the new powers.

1.6 In the event of any dispute relating to the new powers, we anticipate the normal mechanisms for resolving these, including the LGPS internal dispute resolution procedures would apply. ^[footnote 2]

1.7 The guidance is divided into the following sections:

- section 2 provides further context and the relationship to other guidance
- section 3 provides guidance on the process of developing policies
- sections 4, 5 and 6 provide guidance on the content of policies
- section 7 sets out the relevant (as amended) regulations

2 Background

2.1 The LGPS has a large and diverse employer base of over 18,000 public and private sector employers (table 5 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/932430/LGP_S_England_and_Wales_2019-20.pdf)). As a result, employers join and leave the scheme every year and the circumstances of employers may change significantly between valuations, affecting both funds and employers.

2.2 For some employers, a significant issue has been the cost of exiting the Scheme, which can be prohibitive. Prior to September 2020, the LGPS Regulations 2013 required the payment of an exit payment when the last active member of a fund employer left the Scheme, or an employer otherwise ceased to be an employer in the fund, and the employer was in deficit at the time of their exit. The

introduction of deferred employer status allows an administering authority to defer the triggering of an exit payment for a fund employer where the authority deems this appropriate, has had regard to actuarial advice and has set out its policy in its funding strategy statement. While this arrangement is in place, deferred employers will continue to pay contributions to the fund as required by the administering authority, as revised from time to time following actuarial valuations. Additionally, a new alternative power of spreading an exit payment allows an administering authority to recover an employer's exit payment over a period of time. This may be of use where an administering authority does not consider that granting deferred employer status is in the interests of the fund and other employers.

2.3 Administering authorities and employers may also face issues created by changes in the circumstances of employers. The contribution rates of fund employers are normally assessed and set at fund valuations, every three years. Administering authorities, working with their actuary, will consider a variety of factors in setting an employer's contribution rate during valuations. But there may be significant changes between fund valuations, for example due to a change in covenant strength or workforce composition following a reorganisation. The September 2020 Regulations broaden the circumstances in which an administering authority may amend an employer's contribution rate between valuations to cover the following situations:

- where it appears likely to the administering authority that the fund employer's liabilities have changed significantly since the previous valuation,
- where it appears likely to the administering authority that there has been a significant change in a fund employer's ability to meet their statutory obligations (e.g. payment of employer contributions), or
- where a fund employer has requested a review and undertaken to meet the costs of that review.

The introduction of the new powers is intended to help administering authorities manage their liabilities, ensuring that employer contribution rates are set at an appropriate level and that exit payments are managed, with steps taken to mitigate risks, where appropriate.

2.4 There is no requirement on administering authorities to use any of the new powers. The amendments to the LGPS Regulations 2013 made by the 2020 Regulations require that an authority may do so only where it has set out its policy in its funding strategy statement (FSS). This is to ensure consistency and transparency.

2.5 Statutory guidance on the FSS produced by CIPFA^[footnote 3] requires administering authorities to identify the risks that inevitably arise from managing employers including many private sector providers whose covenants may vary in strength. As set out in the CIPFA guidance, the purpose of the FSS is to document the processes by which the administering authority establishes a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward^[footnote 4]. Any policies on the use of the new powers that administering authorities may wish to include should be guided by this over-arching purpose.

3 Developing policies on the new powers

3.1 In developing new policies for inclusion in their funding strategy statement (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, and that
- the process of applying any new policies is clear and transparent to all fund employers.

3.2 The FSS is a high-level statement of an administering authority's approach to funding strategy. It must be kept under review and revised whenever there is a material change in the authority's policy on the matters covered by the document ^[footnote 5]. However, supporting information or detail may be set out elsewhere rather than in the FSS itself, in order to avoid frequent minor changes. Where authorities choose to do this, clear and up to date links to and means of accessing such documentation or information should be included.

3.3 Administering authorities are also required to consult persons they consider appropriate on any material changes to the FSS. Given the potential impact on fund employers resulting from the use of the new powers to manage and mitigate employer risk, it is expected that all fund employers would be considered as appropriate for this purpose and included in consultation on changes to ^[footnote 6] the FSS.

3.4 When deciding whether to make use of any of the new powers in relation to a specific employer, the administering authority should consider that employer's views, but without prejudice to the administering authority's ultimate decision-making responsibility.

3.5 Administering authorities are required to include a report of the administration arrangements made during the year in the pension fund annual report. Any new arrangements with employers under the new powers would be administration arrangements for the purposes of the report. ^[footnote 7] Reporting may be limited to stating that an agreement was made and the term of arrangement in order to respect commercial confidentiality.

3.6 Administering authorities should ensure that, where they have utilised the powers covered by this guidance, appropriate records are held to ensure that these arrangements can be effectively audited for compliance.

4 Reviewing Employer Contribution Rates between Fund Valuations

4.1 An administering authority's policy on amending contributions between fund valuations should cover the following matters at a high level:

- i. The key factors that the authority will use to consider whether a contribution review for an employer or a group of employers should take place, taking account of actuarial advice.
- ii. What factors the administering authority will take into account when assessing the risk or impact of an employer contribution review on other fund employers.
- iii. How an employer will be involved in a contribution review and the circumstances in which the administering authority would consider it appropriate to consult other fund employers – for example, where they have provided a guarantee to the employer involved.
- iv. The periods in the triennial valuation cycle during which the administering authority considers it may be inappropriate to conduct a review.
- v. The matters on which the administering authority will take actuarial advice in setting an employer's revised contribution rate, including the following:
 - any increase or decrease in the liability of the employer,
 - the effect of changes in the employer's covenant and their ability to meet obligations to the Scheme.
- vi. The process required for an employer to apply for a review, the evidence they may be required to submit, and how the cost to the employer will be calculated.

4.2 Policies should also set out:

- indicative timetable for a review, noting that there may be circumstances where the timetable may vary,
- how any change in the employer's circumstances may be monitored after a change in contribution rate,

- a requirement for employers to support any reasonable information requests in order to allow effective monitoring of the changes in covenant.

5 Spreading Exit Payments

5.1 An administering authority's policy on spreading exit payments should cover the following matters at a high level:

- i. The key factors that the authority will use to consider whether an employer's exit payment should be spread, taking account of actuarial advice, as well as any other advice the administering authority may consider necessary.
- ii. Any circumstances where the administering authority considers it would not be appropriate to spread an exit payment.
- iii. How the administering authority will consider the appropriate length of time for an exit payment to be spread, including its view on the maximum length of any spreading period.
- iv. The process the authority will adopt for consulting the fund employer in question under regulation 64B(2)(a). Policies should indicate that proposed exit payment spreading will always be discussed with the employer, whether at the employer's request or not.
- v. The evidence an administering authority would expect to require from a fund employer to consider the spreading of an exit payment.
- vi. How an administering authority will inform an employer of its decision, and the details to be included in the decision, such as:
 - the spreading period,
 - the annual payments due,
 - interest rates applicable,
 - other costs payable, and
 - the responsibilities of the employer during the exit spreading period.
- vii. The administering authority's approach to monitoring an exit payment that has been spread, how it will engage with the employer, and any circumstances in which the spreading of the exit payment for a particular employer may be reviewed again (for example, as a result of a change in an employer's covenant).

5.2 Policies should also set out:

- the indicative timetable for a review, noting that there may be circumstances where timings may vary,
- that the administering authority will take actuarial, covenant, legal and other advice as necessary in considering a case, and
- the process for employers to share updated information if or when their circumstances change, to allow effective monitoring of the arrangement.

6 Deferred Debt Agreements

6.1 An administering authority's policy on entering into deferred debt agreements (DDAs) should cover the following matters at a high level:

- i. The key factors which the authority will use to consider whether to enter into a DDA with an employer, taking account of actuarial advice, as well as any other advice the administering authority may consider necessary.
- ii. Any circumstances where the administering authority considers it would not be appropriate to enter into a DDA with an employer.
- iii. The process the administering authority will adopt for consulting the exiting fund employer in question under regulation 64(7B)(c)(i). Policies should indicate that proposed DDAs will always be

discussed with the employer, whether at the employer's request or not.

iv. The evidence an administering authority would expect to require from a fund employer to consider a DDA.

v. The matters, aside from those required by regulations, which the administering authority will expect to include in the DDA, including:

- the responsibilities of the deferred employer,
- circumstances triggering a cessation of the arrangement,
- leading to an exit payment (or credit) becoming payable.

vi. The administering authority's approach to monitoring a DDA, including frequency, and the circumstances in which the administering authority may consider:

- approaching the fund employer to seek to agree a variation to the length of the agreement under regulation 64(7D), and
 - serving notice on the fund employer that it is reasonably satisfied that the deferred employer's ability to meet the contributions payable under the deferred debt arrangement has weakened materially, or is likely to weaken materially in the next 12 months, as set out under regulation 64(7E)
- (d)

6.2 Policies should also set out:

- how the costs of entering into a DDA would be calculated and met,
- the indicative timetable for entering into a DDA, noting that there may be circumstances where timings may vary,
- that the administering authority will take actuarial, covenant legal and other advice as necessary in considering a case,
- the process for employers to share information if or when their circumstances change to allow effective monitoring of the arrangement.

7 Appendix

Extracts from the LGPS Regulations 2013 (as amended) on review of employer contributions, employer exit payments and deferred debt agreements

Revision of rates and adjustments certificate: Scheme employer contributions

64A. - (1) An administering authority may obtain a revision of the rates and adjustments certificate under regulation 62 (actuarial valuations of pension funds) showing any resulting changes to the contributions of a Scheme employer or employers where -

(a) the funding strategy mentioned in regulation 58 (funding strategy statements) sets out the administering authority's policy on amending contributions between valuations; and

(b) one of the following conditions applies -

- (i) 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;
- (ii) 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
- (iii) a Scheme employer or employers have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review.

(2) In revising the certificate, an administering authority must -

- (a) consult the Scheme employer or employers; and
- (b) have regard to the views of an actuary appointed by the administering authority.

Revision of actuarial certificates: exit payments

64B. - (1) Where the funding strategy mentioned in regulation 58 (funding strategy statements) sets out the administering authority's policy on spreading exit payments, that administering authority may obtain a revision of the rates and adjustments certificate under regulation 62 (actuarial valuations of pension funds) to show the proportion of the exit payment to be paid by the exiting Scheme employer in each year after the exit date over such period as the administering authority considers reasonable.

(2) In revising the certificate, an administering authority must -

- (a) consult the exiting Scheme employer; and
- (b) have regard to the views of an actuary appointed by the administering authority."

In regulation 64 (special circumstances where revised actuarial valuations and certificates must be obtained) -

(a) after paragraph (7)

"(7A) An administering authority may enter into a written agreement with an exiting Scheme employer for that employer to defer their obligation to make an exit payment and continue to make contributions at the secondary rate ("a deferred debt agreement").

(7B) An administering authority may enter into a deferred debt agreement with an exiting Scheme employer where -

- (a) the last active member in respect of that Scheme employer has left the Scheme;
- (b) the funding strategy mentioned in regulation 58 (funding strategy statements) has set out the administering authority's policy on deferred debt agreements; and
- (c) the administering authority has -
 - (i) consulted the exiting Scheme employer; and
 - (ii) had regard to the views of an actuary appointed by the administering authority.

(7C) Where a deferred debt agreement has been entered into under paragraph (7A) -

- (a) the exiting employer becomes a deferred employer on the date specified in the agreement;
- (b) the deferred employer must -
 - (i) meet all requirements on Scheme employers except the requirement to pay the primary rate of contributions as determined under regulation 62(5) (actuarial valuations of pension funds); and
 - (ii) pay the secondary rate of contributions as determined under regulation 62(7) as revised from time to time following an actuarial valuation until the termination of the deferred debt agreement.

(7D) A deferred debt agreement must include express provision for it to remain in force for a specified period, which may be varied by agreement of the administering authority and the deferred employer.

(7E) A deferred debt agreement terminates on the first date on which one of the following events occurs -

- (a) the deferred employer enrolls new active members;
- (b) the period specified, or as varied, under paragraph (7D) elapses;
- (c) the take-over, amalgamation, insolvency, winding up or liquidation of the deferred employer;
- (d) the administering authority serves a notice on the deferred employer that the administering authority is reasonably satisfied that the deferred employer's ability to meet the contributions payable under the deferred debt arrangement has weakened materially or is likely to weaken materially in the next 12 months; or
- (e) an actuary appointed by the administering authority assesses that the deferred employer has paid sufficient secondary contributions to cover the exit payment that would have been due under paragraph (1) if the employer had become an exiting employer on the calculation date.

(7F) Paragraph (7E)(c) does not apply where the administering authority serves a notice on the deferred employer that the administering authority is satisfied that the event would not be likely to significantly weaken the deferred employer's ability to meet the contributions payable under the deferred debt agreement in the next 12 months.

(7G) On the termination of a deferred debt agreement under paragraph (7E) a deferred employer becomes an exiting employer in relation to the relevant fund for the purposes of this regulation.”.

(b) in paragraph (8), before the definition of “exit credit”, insert - ““deferred employer” means a Scheme employer which enters into a deferred debt agreement with an administering authority;”.

1. The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2020 (S.I. 2020/893)
(<https://www.legislation.gov.uk/ukSI/2020/893/contents/made>)
2. LGPS Regulations 2013, Regulations 74 - 79
3. LGPS 2013, Regulation 58(4)(a)
4. CIPFA (2016) Preparing and Maintaining a Funding Strategy Statement
5. LGPS Regulations 2013, Regulation 58
6. LGPS Regulations 2013, Regulation 58(3)
7. LGPS Regulations 2013, Regulation 57(1)(c)