ISLINGTON

Finance Department
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Report of: Corporate Director of Resources

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pension Board/Pensions Sub-Committee	14th September 2021		n/a

Delete as appropriate	~~Exempt~~	Non-exempt

SUBJECT: EMPLOYER FLEXIBILITIES CONSULTATION TO FUNDING STRATEGY STATEMENT

1. Synopsis

1.1 A Funding Strategy Statement will be prepared by London Borough of Islington (the Administering Authority) to set out the funding strategy for the Islington Council Pension Fund (the "Fund"), in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Under the Regulations, the administering authority must prepare, maintain and publish a written statement setting out their funding strategy. In doing so the administering authority must consult with such persons as they feel appropriate. The Fund's actuary must have regard to the FSS in carrying out the formal actuarial valuation of the Fund.

A number of important regulatory changes have been made and supporting guidance came into force recently to provide greater flexibility to the Fund and employers in reviewing contributions and managing termination debts in certain circumstances. The Fund has considered its policies in these areas and has updated the FSS to reflect these changes.

1.2 This report informs the pension board and pensions sub-committee of the main issues that employers admitted into the Fund are to be consulted on, in the draft FSS.

2. Recommendations

2.1 To review and note a summary of the main updates in the draft FSS , that employers are going to be consulted on between September and October.

2.2 Agree that officers with the Fund Actuary update the FSS for consultation with Employers admitted into the Islington Fund .

3. Background

Introduction

3.1 A number of important regulatory changes have been made and supporting guidance came into force recently to provide greater flexibility to the Fund and employers in reviewing contributions and managing termination debts in certain circumstances. The Fund has considered its policies in these areas and has updated the FSS to reflect these changes.

3.1.1 The current Islington Council Pension Fund 2020 Funding Strategy Statement (FSS), was implemented following the 2019 Actuarial Valuation. The LGPS Regulations provide the statutory framework under which the Administering Authority is required to prepare and publish a Funding Strategy Statement (FSS) alongside each actuarial valuation. The Fund Actuary must have regard to the FSS as part of the actuarial valuation process.

The FSS must also be revised and published whenever there is a material change in either the policy set out in the FSS or the Investment Strategy Statement.

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3.1.2 The draft FSS has been updated to reflect the regulatory changes on flexibilities for employers on termination and contribution rates between valuations. The main changes are highlighted below:

1. Employer Flexibilities - How has the Funding Strategy Statement changed?

   If certain conditions are met, the changes now allow:

   - The Fund to review employer contributions between actuarial valuations (for example, where employers have a significant change in membership or financial covenant)
   - An exit debt to be spread over an appropriate period
   - An exit debt to be deferred, with the employer remaining in the Fund once all active members have left.

   In light of the new Regulations, the Fund is required to include policies within its Funding Strategy Statement (FSS) which set out how the flexibilities will apply in practice for employers.

   These policies aim to provide much needed flexibilities to manage the liabilities and have been developed allowing for the guide from the Scheme Advisory Board (SAB) (https://www.lgpsboard.org/index.php/empflexm) and the statutory FSS guidance from the Ministry of Housing, Communities and Local Government (MHCLG) (https://www.gov.uk/government/consultations/local-government-pension-scheme-changes-to-the-local-valuation-cycle-and-management-of-employer-risk/outcome/guidance-on-preparing-and-maintaining-policies-on-review-of-employer-contributions-employer-exit-payments-and-deferred-debt-agreements). These policies do not alter the main principles of the current funding plan as agreed as part of the 2019 actuarial valuation.

   To implement these new policies the following updates have therefore been made to the Funding Strategy Statement.

2. Introduction of a new policy - Review of Employer Contributions between Valuations

Previously the contribution rates set out in the valuation report stayed in place until the next valuation (except in limited circumstances or where an employer exits the Fund). The new Regulations allow changes to contributions to be made before the next actuarial valuation under the following circumstances:

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)

It should be noted that the introduction of this new policy does not mean employers can simply request a reduction in contributions during an inter-valuation period. Further details on how this can be applied in practice are set out within the policy in Appendix D.

For the avoidance of doubt, the Fund still requires employers to notify the Fund of any material changes in their financial covenant i.e. their ability to meet their obligations to the Fund (in line with b) above) as was the case prior to the introduction of these new policies.

3. Updates to the Termination Policy when an employer exits the Fund

Whilst the Fund's policy remains that any exit debt is paid up front, the changes now allow us to develop policies that provide more flexibility to employers in certain circumstances.

The options upon termination will therefore be as follows:

a) Upfront payment of the exit debt (the existing approach)
This will remain as the default option when an employer terminates.

b) Spreading exit payments
Where the upfront payment of the deficit has been determined as unaffordable by the Fund, the parties can enter into an agreement to instead spread the payment of the final exit debt. This will be over an agreed period of time with the amounts and frequency of the payments in the payment plan agreed at the outset along with any early payment terms. The maximum period proposed in the policy is 5 years from exit, except in exceptional circumstances at the sole discretion of the Fund based on the advice of the Actuary.

c) Deferred Debt Arrangement (DDA)

Alternatively, where the upfront payment has been determined as unaffordable by the Fund, the parties may enter into a DDA which allows them to defer their obligation to make an exit payment and continue to make contributions to the Fund. Contribution requirements will continue to be reviewed as a minimum as part of each actuarial valuation under this option. This option 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 in the future, or the DDA would automatically cease when the exit debt is paid.

If the Fund agrees that an employer may adopt any of the flexible termination options above then the employer will be required to supply regular covenant information and to notify the Fund of any change in circumstances under a notifiable event framework. The conditions for entering into any arrangement will be set out in the agreement between the parties.

4. Termination Basis – What has changed?

Alongside the additional flexibilities potentially available to exiting employers, following a review undertaken by the Actuary, the actuarial assumptions underlying termination calculations (for those employers where a guarantor does not exist to take on responsibility for any residual liabilities of the exiting employer) have been updated. The changes made reflect changes in market conditions and the wider defined benefit pension's landscape.

A new "low risk" basis of termination is to now be applied in such cases, replacing the "minimum risk" basis that applied previously. This change will serve to slightly reduce the liabilities assessed for exiting employers.

In addition, for any employer exiting the Fund the termination liabilities assessed will now include allowance for the estimated administrative expenses associated with any members remaining in the Fund associated with the exiting employer.

5. New Admissions (less than 5 members)

When a new employer enters the Fund, the Actuary would currently be required to carry out an assessment of the contribution rate payable by the new employer. Going forwards, to assist with the process for small admissions, it is proposed that where less than 5 members are involved, the initial contribution rate for the new employer will be set in line with the contribution rate payable by the letting employer. The Actuary would then reassess the new employer's contribution requirements in full at the subsequent actuarial valuation.

Whilst this approach would mean that the new employer is paying a contribution rate that does not reflect its own membership profile (and thus could result in an under/over payment) the approach will simplify the admission process for these small admissions to ensure that all parties (both new employer and letting employer) are aware that there will be pension costs from the date of admission and these can start to be paid from the outset.

Should the new employer require accounting calculations, or should the letting employer require their own calculations to reflect the transfer to the new employer, it should be noted that the Actuary will need to carry out calculations in these circumstances based on the relevant membership data.

More generally, the Fund will be writing to employers again in the autumn to propose a separate training session in this area relating to the roles and responsibilities of employers when services are outsourced.

6. Other Changes

In addition, the termination policy has been updated to clarify 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, upon request, the Fund will provide the exiting employer with a 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). The employer will be able to appeal this decision if they do not agree with the determination.

Some small clarification and technical changes have also been made throughout the document to allow for updated information after the valuation date.

3.1.3 Members are asked to note the updates and agree that officers with the Fund Actuary update the FSS for consultation with Employers admitted into the Islington Fund. The results of the consultation will be reported to Members at the November meeting so that an informed decision can be made to approve the final version of FSS for publication by December.

4. Implications

4.1 Financial implications

4.1.1 The cost of providing actuarial advice is part of fund management and administration fees charged to the pension fund.

4.2 Legal Implications

The Local Government Pension Scheme Regulations 2013 (as amended) ("the 2013 Regulations") and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ("the 2014 Transitional Regulations") (collectively; "the Regulations") provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS).

Prior to agreeing the statement, the Council must have proper regard to any comments received from the consultees.

4.3 Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:

None applicable to this report. Environmental implications will be included in each report to the Pension Board Committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of the fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf

4.4 **Resident Impact Assessment**

None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

4.4.1 An equalities impact assessment has not been conducted because this report is an update on existing exercise and the consultation of employers will mitigate any inequality issues.

5. Conclusion and reasons for recommendation

5.1 Members asked to review and note the updates to prepare the draft FSS for employers' consultation.

Background papers:
None

Final report clearance:

Signed by: Corporate Director of Resources Date 07 September 2021

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