Division(s):N/A

PENSION FUND COMMITTEE – 3 DECEMBER 2010

VALUATION ON CESSATION OR SIGNIFICANT REDUCTION IN FUND MEMBERSHIP

Report by Assistant Chief Executive & Chief Finance Officer

Introduction

1. This report responds to the concerns from a number of Community Admitted Bodies to the Oxfordshire Pension Fund about the potential costs associated with the ending or significant scaling down of their Fund membership. Fund membership may end or significantly reduce as a result of the unaffordability of continued membership of the LGPS, insolvency of the company itself, or the loss of a contract under a re-tendering exercise. The report considers alternative options to the current practice in undertaking revised valuations following closure of the scheme to new members or a significant reduction in membership on loss of a contract. Members are asked to consider the principles to adopt going forward.

2. This report does not cover the Scheduled and Designated Bodies for which the Regulations assume continuous Fund membership. Nor does this report consider the Transferee Admission Bodies where any deficit falls back onto the sponsoring employer.

Current Valuation Approach

3. The requirements on the Fund Actuary to carry out a valuation exercise and produce a rates and adjustment certificate setting out employer's contributions are set out in the Local Government Pension Scheme (Administration) Regulations 2008 under regulations 36 and 38. The Actuary is required to set a contribution rate to secure the solvency of the Fund and to ensure that the assets held by the fund are neither materially higher nor lower than the expected liabilities of the Fund.

4. The Administering Authority is required to obtain from the Actuary a revised rates and adjustment certificate where an admission agreement is set to end, or where it believes that there have been material changes to the expected liabilities and assets since the last Valuation.

5. Circumstances which can require a revised rates and adjustment certificate therefore include:

   - an employer proposing to close their admission agreement to new members
   - an employer proposing to cease their admission agreement, for both new and existing members
   - an employer ceasing business

- the transfer of a significant proportion of staff (up to 100%) to a new employer under TUPE.

6. Both our current and former Actuary in preparing a revised rates and adjustment certificate under these circumstances would seek to minimise the risk of any future deficit falling to the Fund as a whole. As such, the Actuary has discounted future liabilities based on conventional gilt yields, rather than the more generous discount rate used in an on-going valuation, which reflects the higher investment returns associated with the equity holdings within the Fund. The Fund could therefore choose to invest the assets held in the name of these employers in conventional gilts and therefore guarantee the future income streams (though the liabilities can never be guaranteed as they will vary with future inflation, longevity etc outside the assumptions set by the Actuary).

7. The use of the lower discount rate can make a significant difference to the results of the valuation process. In one case, the Actuary calculated a cessation valuation on the basis of the low risk discount rate as £95,000. Discounting the future liabilities using the on-going discount rate showed that the employer was £1,000 in surplus.

8. The adverse financial circumstances facing the Country at the moment have led a number of the admitted bodies within the Oxfordshire Pension Fund to review the costs of the membership. The latest announcements on public sector spending have also left a number of these bodies questioning their future viability in light of potential cuts in their funding. We have been approached by a number of these bodies who are expressing concern about the costs of their on-going pension liabilities and the costs of any closure or cessation valuations. Depending on the constitution of these bodies, this concern may be a personal financial concern as they have ultimate liability for any deficit. For others where the company is limited by guarantee, the concern is more around the wish to act reasonably in respect of making adequate provision for pension liabilities to avoid any future legal challenge.

9. The issue with an employer facing a significant reduction in their Fund membership as a result of a TUPE transfer is related and again we have been approached by a number of organisations in this situation. It is worth pointing out again that this scenario does not relate to those bodies initially set up under a TUPE transfer under contract with a Scheme Employer where the body has been admitted to the Fund as a Transferee Admission Body.

10. The key feature for this group of employers is that under the Regulations, any new Admission Body starts fully funded and therefore any deficit at the time of transfer remains with the initial Admission Body. However the money to fund this deficit is retained by the contracting body. The initial Admission Body can therefore be faced with a significant cessation valuation or significant increase in contribution, when expressed as a percentage of payroll, without any funding to meet this liability.

An Alternative Approach to Future Valuations

11. This Committee has previously considered the financial burden on community admitted bodies and agreed to change the practice of our previous Actuary who undertook all valuations for admitted bodies on a low risk basis. This decision was taken in the knowledge that it may increase potential deficits on cessation of an admission agreement. The Committee has also agreed, after detailed consideration of the exceptional circumstances, to undertake a cessation valuation for a community admission body using the on-going discount rate. These changes have been reflected in the Funding Strategy Statement for the Oxfordshire Fund.

12. The Committee is now invited to consider whether to agree a set of principles whereby future valuations undertaken on the cessation of an admission agreement or on a proposed future date for the cessation of the admission agreement are undertaken using on-going discount rates rather than the lower risk discount rate based on conventional gilt yields. This would reduce the risk of significant and unplanned pension liabilities falling to admission bodies at the time they can least afford to meet the cost and potentially would enable many to continue to provide a public service after closing their membership to the LGPS.

13. It should be noted that if the Fund's assets behave in the long term in line with the assumptions used by the Actuary in carrying out their valuation, such a change in valuation practice will not lead to any additional costs to the Fund or its remaining members.

14. However it is accepted that such a policy does carry some risk, as there can be no guarantee in respect of the long term investment performance. However it should be noted that less than 3% of scheme members work within community admission bodies and of those around half work for Housing Associations or Government sponsored bodies. It would be expected that, in the event of these bodies ceasing membership, the low risk discount factor would be applied in the case of this latter group given their strength of covenant.

15. The use of the on-going discount rate would therefore be restricted to those community admission bodies that have a direct link to the remaining employers in the Fund (whether that is through the provision of financial support or the links in service provision). To minimise further the risk to the Fund, it would also be expected that, where such a body was suffering a declining membership before the cessation of the admission agreement, it was paying for past service deficit by way of a cash sum, rather than as a percentage of payroll, so minimising the deficit on cessation.

16. In terms of pension deficits crystallised at the point of a TUPE transfer, the options are to :

(i) continue with the existing practice, and require the initial employer to pick up the deficit either through a cessation valuation if all scheme members have transferred or through an on-going cash amount if they remain members of the scheme. This option does appear to be consistent with the Regulations.

(ii) seek recovery of the deficit from those scheme employers funding the contractual arrangements, who arguably have retained the resources to meet this deficit payment on an on-going basis. There is no statutory basis to enforce this option if the relevant scheme employers do not accept responsibility.

(iii) treat the deficit in line with "orphaned" scheme members, so that the deficit is recovered across all employers. This would be the end result in the event that the deficit is not recoverable under the first two options.

17. The most appropriate option would be to transfer any deficit with the staff who transfer, so that the funding moves with the deficit. This would also have the benefit of levelling the playing field for the tendering exercise, where the current contract holder needs to include an element in their costs to cover past service deficits, whereas all other tenderers can ignore this cost. This option though is not seen to be possible under the current Regulations. Members may wish to write to the Department for Communities and Local Government on this point.

18. In the meantime, the Committee is invited to consider whether it would be happy to move to following option (ii), i.e. inviting those scheme employers funding the contract to own the deficit and resort to option (iii) where this is declined.

RECOMMENDATION

19. **The Committee is RECOMMENDED:**

(a) **to consider its approach to future valuations for community admission bodies in the event of closure, cessation or significant membership reduction following TUPE ; and**

(b) **to determine whether it wishes to agree a revised approach in line with paragraphs 11-18 above and to ask Officers to amend the Funding Strategy Statement accordingly.**

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Background papers: Nil

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