

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel
Date:	18 December 2015
Title:	Funding Strategy Statement consultation update
Reference:	7158
Report From:	Director of Corporate Resources – Corporate Services

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1. Executive Summary

1.1. The purpose of this report is to update the Panel on the consultation responses to the proposed changes to the Funding Strategy Statement, and the draft Employer Policy.

2. Background

2.1. At the meeting on 16 October, the Fund Actuary gave a presentation to the Panel and Board which set out a proposal to remove certain employers from the Scheduled and Admitted body groups. The Panel and Board agreed the messages should be shared at the Annual Employers Meeting (AEM), and that employers should be consulted on the proposed changes.

2.2. The Actuary went through in detail a proposal to review the employers within the Scheduled Group because the HE and FE employers represent an increasing risk of default to the Group and under the current pooling approach, little can be done to mitigate the risk. The key evidence for the necessity of this proposal was:

- HMT categorising these employers as 'Private Sector'
- More income for these employers coming from student fees and less from central government grants
- No government guarantee (unlike for academies)
- The dissolution of Totton College with no successor body in the LGPS

2.3. The proposal also covered a review of the employers in the Admitted body group, where there are similar concerns about the financial covenant of employers but also where employers are increasingly diverse and the cross subsidies are beyond that which the employers themselves may find

acceptable. This affects housing associations, universities and independent schools.

- 2.4. In light of the increased scrutiny of LGPS Funds, including the Pensions Regulator's new guidance on Employer Covenant, the proposed review would also seek to align the funding target for these groups of employers to the risks they pose to the Fund, although any increases to contribution rates would have to be managed so that employers can budget for increasing costs over a transitional period. Consideration would also be given to the stability objective in the Funding Strategy Statement to ensure continued affordability.
- 2.5. The LGPS regulations do not prescribe the funding or pooling methodology which the Administering Authority can adopt and such policies are set out in the Administering Authority's Funding Strategy Statement which must be consulted with employers. Revisions to the Funding Strategy Statement (FSS) to reflect the proposal were drafted and these were shared with all employers following the AEM. Legal advice has been sought which indicates that the Fund is not exposed to risk of challenge from employers affected by the proposal.
- 2.6. The Panel and Board were asked to consider the draft Employer Policy which aims to codify the treatment of new employers in the Fund. Employers were also invited to comment on the draft policy after the AEM.

3. Pressures on the existing grouped funding arrangements

- 3.1. In the event that a scheduled body exits the Fund there is a risk that it does not have the resources to meet their share of the Fund's deficiency, leading to an increase in contribution rates for all employers in the Fund. The risk to the Fund is greatest from the non-tax-raising bodies and those which are not guaranteed by a body with a secure source of funding. It is therefore appropriate to consider employer risk and covenant as part of a risk-based funding strategy for those bodies.
- 3.2. These issues were covered by CIPFA in their publication titled 'Management of Risk in the Local Government Pension Scheme'. It is expected that when CIPFA publish their updated guidance on the preparation of the Funding Strategy Statement (expected shortly), there will be a greater focus on employer covenant. The Scheme Advisory Board is also considering its guidance covering the management of employer-risks within the funding strategy which may draw on the guidance issued by the Pensions Regulator for private sector schemes.
- 3.3. The operation of a covenant-based funding strategy is not possible under the current grouping arrangements where a common funding strategy applies across the Group. It would be necessary for certain categories of employers (as identified within the consultation) to exit the grouped funding arrangements to enable the consideration of a funding strategy which takes into account the employer covenant.
- 3.4. Additionally, the grouped funding arrangements are not suitable for those employers who are expected to exit the Fund due to being closed to new entrants because:

- Employers participating in the grouped funding arrangements share future service costs yet the underlying costs for 'closed' employers increases over time due to the ageing profile of their membership. This creates an upward pressure on the Grouped contribution rate and a cross subsidy from 'open' employers to 'closed' employers. It may be difficult to justify this cross subsidy as part of the wider risk-sharing within the Groups because it is based on employer decision making rather than uncontrolled risk.
 - The grouped funding arrangements do not permit the payment of additional contributions by employers to appropriately meet the required funding target on their anticipated exit from the Fund. For the funding strategy to operate effectively for those employers they will have to exit the group funding arrangements.
- 3.5. The FSS was updated with proposed changes that would allow the Actuary to remove employers from either of the Groups, for the purpose of ensuring those remaining in the Groups would be protected from the upwards pressure on the grouped contribution rate, and to allow officers to work with employers to provide a managed exit plan, rather than risk default.
- 3.6. Employers were provided with information about these proposed changes at the AEM, and responses to the revised FSS and draft Employer Policy were invited through a one month consultation period which closed on 20 November.

4. Consultation responses

- 4.1. Only one response was received on the draft Employer Policy, resulting in a minor change to clarify the intention of section 6, which covers wholly owned companies set up by Part 1 Scheduled bodies. The Panel and Board are therefore asked to approve the final version of the Employer Policy contained in Appendix 3.
- 4.2. 12 responses were received to the proposed changes to the Funding Strategy Statement (shown in Appendix 4). A summary of these responses is attached in Appendix 5.
- 4.3. As anticipated, responses to the FSS consultation were only received from employers who would exit the grouped funding arrangements under these proposals; not from any other employers who would be protected by these proposals (noting that all employers in the Fund would benefit from the stronger focus on employer risk within the funding strategy). The responses therefore tended to focus on the individual concerns rather than the high level principles of the proposal. Some of these concerns were shared across employers, such as:
- removing small employers from the Groups does not materially reduce risk for the Group but may have a material impact on the individual employer
 - creating stand alone employers in a time of instability might increase the risk of default

- the affordability of contribution increases in times of financial constraint.

However even amongst the relatively negative responses received from the HE/FE sector, two did support the reasons for the proposal, despite being unsure as to the individual impact on their own contribution levels.

- 4.4. The majority of HE/FE employers were concerned that the consultation did not include information about the impact the proposal would have on their own individual contribution rates, with some unable to comment at all on the proposals before this information was available. It is intended to cover the detail at the individual employer level at the workshops which are booked for early February 2016.
- 4.5. No employers put forward alternative suggestions as invited by the consultation and nothing was received to suggest the proposals failed to meet the objectives as put forward.
- 4.6. It is proposed that employers should be invited to put forward proposals for sharing risks between themselves through new grouping arrangements to address the concerns which some employers made in their responses over the future risks/volatility from a stand-alone position in the Fund.
- 4.7. Some responses were received around the closing date requesting additional time to consider the consultation because they had not been made aware of the consultation internally until late in the consultation period. These employers had not attended the AEM nor recognised the significance of the consultation when it was first sent out. The result of this has been that employers are reviewing the 'high level' contacts they have provided to Pensions Services. The high level contact should be the person at the organisation with a strategic view of how pensions affect their overall financial and staffing position (e.g. receive formal notification of contribution rate changes and information on major pensions reform). However the consultation process has shown that some employers have delegated this high level contact to a more junior contact who did not understand the importance or implication of the information that was sent out.

5. Proposed timetable

- 5.1. If the proposal to review the Groups is approved, the position has to be considered within the overall timetable for the 2016 valuation. It is not possible to extend the period of consultation without compromising the position of employers remaining in the Groups.
- 5.2. An important element of the timetable is ensuring that a clear decision can be made with sufficient time to work with employers to implement the change fairly. This meant restricting the initial high level consultation with all employers in the Fund to one month, allowing over three months for more detailed discussions with those employers directly affected by the changes. The timetable allows for workshops to be held with employers (covered in more detail in section 5 below) and for employers to have time to provide information about their own financial strength before the Actuary carries out

any calculations. An extension to the consultation period would reduce the opportunities for employers to have input into the detail of the changes, as they affect individual organisations.

- 5.3. The high level timetable was discussed at the last meeting and at the AEM, and is set out in more detail below.

Date	Action
16 October 2015	Fund Actuary proposal presented to Panel and Board
23 October 2015	Fund Actuary present proposal to employers at AEM
26 October – 20 November 2015	Employers asked for comments on the revised Funding Strategy Statement
23 November – 8 December 2015	Assessment of consultation responses and report for Panel and Board
18 December 2015	Panel and Board decision on proposal
February 2016	Workshops with employers affected by proposals
February – March 2016	Employer submission of evidence of individual financial covenant
April – June 2016	Covenant assessments made and fed into actuarial calculations
Summer 2016	Early results from 2016 valuation
Autumn 2016	Detailed results from 2016 valuation
1 April 2017	Implementation of contribution rate changes from 2016 valuation

6. Workshops

- 6.1. A key element of engaging employers and ensuring a fair implementation of the proposed changes are the workshops which will be held in February and run by the Fund's Actuary. The workshops will be held with the four groups of employers (colleges, independent schools, universities and housing associations).

- 6.2. Prior to the workshops, an individual information sheet will be provided to each employer. This will show the effect on that employer of leaving the group, using the 2013 valuation data and assumptions (i.e. not taking into account any other upwards contribution pressures from the 2016 valuation). The employer would also be given a gilts exit position to show the extent of the deficit which would be attributed to that employer, should they leave the Fund (which is significantly higher than the annual FRS17 values). Time will be given at each workshop for employers to ask the Actuary for clarification on the implication of the figures for the individual employer.
- 6.3. However the primary purpose of the workshops will be to discuss the extent to which employers want to form sub groups or to share certain risks which would help reduce volatility (e.g. future service costs). The Actuary will also be able to explain in more detail how notional assets will be assigned to employers.
- 6.4. The workshops will provide an opportunity for employers to start discussing the overall financial covenant for their particular sector, to feed into the review of funding targets. Following the workshops, all the employers will be given the opportunity to provide evidence as to their own individual financial strength, which can then be used to assess the extent to which their own funding target is revised.

7. Recommendations

- 7.1. That the Panel and Board approve the Employer Policy:
- 7.2. That the Panel and Board approve the changes to the Funding Strategy Statement which allow the Fund Actuary to remove employers from the Scheduled and Admitted body groups.
- 7.3. That the Director of Corporate Resources is given the delegated authority to implement the changes to the Groups, in accordance with the valuation timetable, and to further discussions with the affected employers around new pooling/grouping arrangements with employers within specified sectors
- 7.4. That the remainder of the report is noted.

CORPORATE OR LEGAL INFORMATION:**Links to the Corporate Strategy**

Hampshire safer and more secure for all:	yes/no
Corporate Business plan link number (if appropriate):	
Maximising well-being:	yes/no
Corporate Business plan link number (if appropriate):	
Enhancing our quality of place:	yes/no
Corporate Business plan link number (if appropriate):	
OR	
This proposal does not link to the Corporate Strategy but, nevertheless, requires a decision because actions are required concerning the training of Pension Fund Panel members.	

Other Significant Links

Links to previous Member decisions:		
<u>Title</u>	<u>Reference</u>	<u>Date</u>
Direct links to specific legislation or Government Directives		
<u>Title</u>	<u>Date</u>	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

<u>Document</u>	<u>Location</u>
None	

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;
- b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;
- c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionately low.

1.2. Equalities Impact Assessment:

1.3. Equality objectives are not considered to be adversely affected by the proposals in this report.

2. Impact on Crime and Disorder:

2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

3. Climate Change:

a) How does what is being proposed impact on our carbon footprint / energy consumption?

No specific impact.

b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.