

## HAMPSHIRE COUNTY COUNCIL

### Decision Report

<b>Decision Maker:</b>	Pension Fund Panel and Board
<b>Date:</b>	4 March 2016
<b>Title:</b>	Governance - FSS consultation update
<b>Reference:</b>	7374
<b>Report From:</b>	Director of Corporate Resources – Corporate Services

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### 1. Executive Summary

1.1. The purpose of this report is to:

- recap on the proposed changes to the Fund's grouped funding arrangements
- update the Panel on the outcomes from the employer workshops
- summarise the responses received to the extended consultation
- recommend that the Actuary's proposed changes are implemented as part of the 2016 valuation process.

### 2. Proposed changes

2.1. The Fund Actuary has recommended that:

- all education sector employers in the scheduled and admitted body funding groups, who are not backed by a government guarantee, and
- the Housing Associations within the admitted body group,

are removed from the groups and have an individual contribution rate calculated, based on:

- an allocation of assets on a 'share of fund' basis (as used for FRS accounting)
- the facility to adopt an intermediate funding target (weaker than the orphan target, depending on employer covenant)
- stepped implementation of any increase in employer contributions.

2.2. The proposed changes also include extending the current Fund wide sharing of death in service lump sum benefits to ill health retirement and death in

service partner's pension costs. These costs are currently only shared within the groups and extending them across all employers in the Fund will protect smaller employers from volatility of costs that are not within their control.

2.3. Legal advice has been obtained from the Fund's external specialist pension lawyers which confirms that:

- the LGPS regulations give the Administering Authority (AA) the statutory power to amend the funding model
- the AA must act fairly and reasonably and in line with those powers
- changes to the Funding Strategy Statement (FSS) must be made in consultation with 'such people as the AA considers appropriate'.

A recent Pensions Ombudsman case found that the AA has a duty of care to members and employers as a whole, not to one particular employer or group of employers, to adopt policies it considers fair and reasonable.

2.4. The main aims of the proposed changes are to:

- reduce risk to all employers in the Fund by recognising existing differences between employers in terms of their participation in the Fund,
- remove the cross subsidies within the groups which have increased beyond an acceptable level,
- make it possible for those employers who are likely to stop contributing, to properly manage their exits,
- facilitate the adoption of a funding strategy that recognises differences in covenant and funding arrangements, and
- ensure consistent treatment of universities currently in the admitted and scheduled groups.

2.5. Making these changes will start to bring the Fund in line with the other LGPS funds who already calculate employer contribution rates on an individual, rather than grouped basis. Additionally, the changes are in accordance with the expectations of the Pensions Regulator and other bodies with an oversight function for the LGPS regarding employer covenant.

### **3. Employer consultation**

3.1. Following the Panel meeting on 16 October 2015, the proposed changes to the Funding Strategy Statement (FSS) were launched by the Actuary at the Annual Employer's Meeting (AEM) and employers were asked for their feedback within an initial period of a month (to allow the Panel to consider their decision at the meeting on 18 December).

3.2. Some employers did not feel that they had been given sufficient time to respond, in a large part because they had failed to appreciate the importance of attending the AEM and reading pension communications, tending instead to assume that it was only relevant to their payroll teams.

- 3.3. Some employers were also reluctant to comment on the high level principles of de-grouping, without understanding the financial impact on their own organisations.
- 3.4. The Panel therefore extended the consultation period to 19 February 2016, allowing employers to attend workshops in February run by the Actuary to provide more detail about the changes. Employers were provided with financial illustrations at the workshops which showed the relative impact on their own organisation as a grouped or standalone employer, using the 2013 valuation data and assumptions. These illustrations also showed the exit position for each employer, to show the potential magnitude of the payment which would be due, should the employer leave the Fund.
- 3.5. It was clear in the workshops that the overall affordability of the LGPS for the HE/FE sector, including the prospect of any contribution increases following the 2016 valuation, was of more concern to the attendees than the way in which those increases were calculated.
- 3.6. There was also significant interest in the detail of how employer covenant assessments would be made. The consultation covers the principle of setting an intermediate funding target which is more prudent than the one currently set for bodies assumed to be in the LGPS forever, but weaker than the orphan target (which is used for employers whose participation in the Fund is known to be finite). However beyond knowing the assessments will need to be made in a cost effective and fair way, the detail is yet to be considered. Employers were made aware that there will be further consultation on the FSS as part of the normal valuation process and this would be their opportunity to feedback on the funding targets used in the valuation and their link to employer covenant, and overall affordability concerns.
- 3.7. Appendix 1 contains copies of all the communications sent to employers regarding the consultations, and a copy of the Actuary's workshop presentation.

#### **4. Consultation responses**

- 4.1. 12 responses were received within the initial consultation period, and by the end of the extended period, a further 26 responses were received. 9 of those received by the extended deadline were updated responses from employers who had replied within the original consultation period, meaning that 29 employers responded overall.
- 4.2. The employer responses were broadly similar within each sector and this is summarised in the table below. A full copy of all the responses received is attached in confidential Appendix 2.

Sector	Overall response	Summary of key points made by respondees
Colleges	Do not support the proposals	<ul style="list-style-type: none"> <li>• Receive majority of funding from central government and therefore still public sector bodies</li> <li>• De-grouping will weaken financial position in a time of financial instability - counterproductive</li> <li>• Colleges will not be allowed to fail</li> <li>• Timing is wrong – wait for conclusion of Area Based Reviews as this is designed to increase financial stability</li> </ul>
Councils	Support the proposals	<ul style="list-style-type: none"> <li>• Support grouping mechanism but removing employers without a government guarantee will reduce cross subsidies</li> <li>• Setting a more prudent funding target seems sensible</li> <li>• Welcome protection from costs of failing employers</li> </ul>
Housing Associations	Strongly support leaving the admitted body group (ABG)	<ul style="list-style-type: none"> <li>• Positive step which will allow HAs to improve their funding position</li> <li>• Will incur higher cost but the improved equity / flexibility outweighs this</li> <li>• Want to explore potential for managing exit after last scheme member leaves</li> <li>• Will be disappointed if Panel steps back from this change</li> </ul>
Private schools	Understand the reasons for the proposals, though would prefer to be left in the ABG	<ul style="list-style-type: none"> <li>• Principle of individual accountability is welcomed</li> <li>• However de-grouping unnecessary because have such a strong covenant</li> <li>• What is fair and reasonable for the whole Fund is unreasonable and disproportionate for small organisations</li> </ul>
Universities	Broadly support the proposals, and 3 are actively considering forming a smaller group	<ul style="list-style-type: none"> <li>• Register support for proposals</li> <li>• Concern that there is no university representative on the Panel</li> <li>• Highlight that investment strategy would still be at Fund level</li> <li>• Needed clarification on the wording in FSS as it appears illogical</li> </ul>

4.3. Although the workshops provided attendees with more clarity about the proposals, it is clear from some of the responses that there is still misunderstanding as to the impact of the changes. For example:

- De-grouping leads to contribution increases

The illustrations provided to employers at the workshops showed that because within each group there are cross subsidies, there will be 'winners' and 'losers' if employers are de-grouped. The upwards pressure on contributions will come from the 2016 valuation results, and the assessment of employer covenant, not whether the employer is standalone or in a group.

- Administration will be more complex / costly

Individual contribution rates are the norm across LGPS funds, so the valuation data extracts and actuarial systems are set up to calculate individual rates already. Currently these individual results have to be collated for the Hampshire grouping model.

- There is no college or university representation on the Panel

As part of establishing the joint Panel and Board, interest for an employer representative from the education sector was specifically sought. There were no applications from the colleges, and the only university applicant withdrew. The appointed member does represent all employers in the education sector.

4.4. The responses from the universities noted that the wording in the amended FSS appeared to preclude employers forming new sub groups if they were taken out from the scheduled and admitted groups. This was not the intention, and the FSS contained in Appendix 3 re-instates this paragraph on page 14. The FSS has also been amended to include the extension of fund wide cost sharing to ill health retirement costs and partner's pensions payable on death in service.

## 5. 6<sup>th</sup> form colleges

5.1. The main group of employers who do not support the proposed changes are the 6<sup>th</sup> form colleges. The key arguments which these employers made in their responses were:

- De-grouping the colleges in a time of financial and organisational uncertainty will be counterproductive as it will further weaken employers.
- Colleges are still public sector bodies and therefore share the same attributes as those employers who remain in the scheduled body group.
- The recent experience of a college exiting the LGPS was a one off and should show the administering authority that central government does stand behind colleges in the unlikely event of failure.
- Colleges are currently going through Area Based Reviews, the purpose of which is to ensure they are more financially secure. The

DfE has also announced that Colleges will be allowed to become academies, so the existing government guarantee would be extended to include colleges.

- 5.2. The purpose of removing employers from the existing funding groups is to ensure that those who remain in the group share the same characteristics and to reduce the risks of both unacceptable cross subsidies and employer failure. Even though Colleges receive the majority of their funding from the public sector, they are not classed as public sector bodies by central Government. Colleges are not tax raising bodies, nor are they backed by government guarantee so they do not share the most fundamental attributes of the other employers who it is proposed remain in the group.
- 5.3. The Education Funding Agency (EFA) did agree, after protracted discussions, to pay towards the exit costs of the college but made it clear that this did not set a precedent. The Fund would be under an obligation to seek the exit payment from any college which failed in the future, and would approach the EFA again in the event that a college could not pay. However the Fund would be in a stronger position if it had started to make changes which recognised the potential for a college to exit the Fund, rather than waiting for this event to happen.
- 5.4. The current government initiative to review 6<sup>th</sup> form colleges actually supports the need to remove these employers from the scheduled body group. It is likely that the result of these Area Based Reviews will be a reduction in the number of institutions from around 400 to 100, making the possibility of a college exiting the Fund more likely. The Government has announced that the strongest colleges will be allowed to apply to become academies, which again implies there will be weaker organisations who are more at risk of failure. If colleges do become academies, and the government guarantee in respect of LGPS liabilities is extended, this could be taken into consideration at the 2019 valuation.

## **6. Conclusions**

- 6.1. The proposed changes to the grouped funding model are based on advice received from the Fund Actuary, to ensure that all employers in the Fund are protected from the risk of employer failure and are paying a fair share of scheme costs.
- 6.2. It has never been proposed to introduce unaffordable contribution increases, although employers need to be aware that upwards pressure is inevitable following the 2016 valuation. Any contribution increases resulting from the valuation, or from the adoption of a more prudent funding target, will be managed in such a way as to maintain contribution stability and affordability as far as possible.
- 6.3. There is broad support for the proposals from all but the 6<sup>th</sup> form colleges. The Fund has an obligation to act in the best interests of all employers, and will face criticism from other employers if no action is taken.

**7. Recommendations**

- 7.1. That the Panel and Board approve and adopt the draft Funding Strategy Statement at Appendix 3, which has been amended to allow for changes to the grouped funding model.
- 7.2. That the Panel and Board agree to de-group the HE/FE employers in the scheduled and admitted body groups, and the housing associations from the admitted body group, as recommended by the Fund Actuary, and give the Director of Corporate Resources the delegated authority to make these arrangements.
- 7.3. That the Panel and Board give the Director of Corporate Resources delegated authority to approve the creation of new funding sub groups and to approve the entry of employers, who wish to join and who adhere to the criteria set out by the Fund Actuary, into these sub groups.
- 7.4. That the remainder of the report is noted.

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

<b>Hampshire safer and more secure for all:</b>	yes/no
Corporate Business plan link number (if appropriate):	
<b>Maximising well-being:</b>	yes/no
Corporate Business plan link number (if appropriate):	
<b>Enhancing our quality of place:</b>	yes/no
Corporate Business plan link number (if appropriate):	
<b>OR</b>	
<b>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.</b>	

**Other Significant Links**

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

DocumentLocation

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.