

WILTSHIRE COUNCIL

WILTSHIRE PENSION FUND COMMITTEE
10 March 2016

EMPLOYER CESSATION POLICY

Purpose of the Report

1. The purpose of this report is to seek Members' approval for the implementation of a revised Wiltshire Pension Fund Employer Cessation Policy.

Background

2. The Wiltshire Pension Fund originally approved a Cessation Policy on 25 February 2010.
3. With the introduction of the Local Government Pension Scheme Regulations 2013 ("the 2013 Regulations") and the additional Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ("the Transitional Regulations") now is an appropriate time to review the Cessation Policy.
4. Under the 2013 Regulations when an employer ceases active participation in a Local Government Pension Fund, the funding position of that particular employer needs to be re-evaluated by the Fund's actuary. This normally occurs when the employer in question has no remaining active (contributing) members although more commonly now is when a Transfer Admitted Body's (TAB) outsourcing contract ceases.
5. The 2013 Regulations state any cessation deficit occurring should be recovered from the employer, but there is currently no legal provision for paying back any surplus. The 2013 Regulations do not stipulate the basis or timeframe that funds shall use to recover the deficit which the Cessation Policy attempts to formalise so a consistent approach can be taken across all employers within the Fund.
6. The Fund is now experiencing cessation situations frequently, with increasing complexities of dealing with such events from both the Fund's and employers perspective. Officers feel that an updated policy will assist in managing this risk to the Fund by allowing an element of flexibility to address different cessations whilst ensuring a consistent and fair approach to all employers.
7. The attached draft Wiltshire Pension Fund Cessation Policy has been produced following discussions and consultation with Hymans Robertson.

Considerations for the Committee

Employer Types

8. By way of introduction, it is worth explaining the different types of employer within the Fund:
 - a. **Scheduled Bodies** These are typically 1st and 2nd tier local authorities, but the category also includes some ex-publicly owned bus companies, and more recently, Academy Schools. Employees of these organisations have automatic right of membership of the LGPS.
 - b. **Resolution Bodies** These are Town and Parish Councils where their Council has formally resolved to allow membership of the LGPS for all or some of their employees.

- c. Admitted Bodies This category includes all other bodies and membership of the Scheme is in accordance with an admission agreement between the employer and the Fund. This group breaks down into two categories:
 - i. *Transferee Admission Bodies (TAB)* – These are typically either private sector companies or charities which are entitled to join the LGPS as a result of winning contracts from existing Scheduled Bodies within the Fund. There is a statutory requirement for the outsourcing employer to stand guarantor for any liabilities that the TAB defaults on the Fund.
 - ii. *Community Admission Bodies (CAB)* – These are organisations that have a so-called “community of interest” with local government. They are typically housing associations, or small charities. These charities are arguably the highest risk group of employers, because they tend to be small, do not have tax-raising powers and are not usually backed by a guarantor for historic reasons. Under the Fund’s cessation. These tend to be historical employers as the Fund rarely admits a CAB without a guarantor.

9. Of the above groups:

- a. Scheduled Bodies tend not to cease as employers of the Fund (because their members have a legal right to be in the LGPS), unless there is an organisational restructuring, in which case there is highly likely to be a “successor body” to take on the liabilities.
- b. Resolution Bodies are represented by Town & Parish Councils but can occasionally cease, but as they are pooled for funding and contribution rate purposes (ie. they share the risk as if they are one employer), the loss of one does not cause a cessation situation.

10. However, the situation for Admitted Bodies is different and can be placed into three groups:

- a. Transferee Admission Bodies (TAB) with a statutory guarantor in place.
- b. Community Admission Bodies (CAB) with a contractual guarantor in place.
- c. Community Admission Bodies (CAB) without a guarantor in place.

11. The significance of the distinction between these categories is important in terms of coverage by the Regulations and the amount of potential risk posed to the Fund. Where a guarantee is in place, the Fund avoids the potential risk of the Admitted Body defaulting on payment.

12. The presence of a guarantor, whether statutory or contractual, allows the Fund to take a more relaxed attitude to the valuation of any outstanding deficit at the point of cessation, because there is much more certainty of recovery. This can take a number of forms:

- a. A longer spreading period can be allowed for recovery of the deficit (up to 14 years).
- b. Less allowance can be built in for the members living longer than currently expected, because there will be somewhere to go for a “top-up” in years to come, should there be significant improvements in longevity.
- c. A less risk-averse approach can be taken to valuing the liabilities, which means that allowance is made for higher investment performance from equities (compared to “risk-free” gilts) to help reduce the deficit.

The full implications from a, b and c above is to use a valuation akin to an “ongoing” basis”, as in the Triennial Actuarial Valuation.

13. In the event of no guarantor being in place, the Fund needs to take a more risk-averse position, because in the event of the Admitted Body defaulting on payments, the remaining deficit would be spread across all the other (unrelated) employers in the Fund. Where there is no guarantor, the starting point is a “no risk” cessation valuation, meaning no allowance for immediate payment, maximum allowance for longevity improvements and no allowance for investment performance from equities to help recover the deficit (ie. “gilts” basis).

Suspending Payment of Exit Amounts

14. The updated policy formalises the discretions introduced by the Transitional Regulations. This discretion was approved by this committee at its meeting on 10 December 2015. It effectively allows a cessation event to be suspended for up to a period of 3 years if it’s likely that the employer will admit new active members during this time. This prevents the need for a cessation event and crystallisation of a deficit payment for what could be a transitional period. This will benefit smaller employers with only a few members in the Fund.

Extending Cessation Arrangements

15. Under current market conditions using a “gilts” basis valuation results in significantly higher cessation valuation for those employers where there is no opportunity to establish a guarantor. This presents a substantial risk to both the Fund and employers. The employer can be caught being unable to afford to stay in the scheme due to the high level of employer contribution rates but can neither afford to cease participation due to the prohibitively high exit costs.
16. This revised policy offers additional flexibility to assist the Fund in dealing with employers in this position by requiring them to pay a cessation debt based on the “on-going” basis initially, but to also provide security for the difference between the “on-going” and the “gilt” basis (minimum risk approach).
17. A contribution plan will target full payment of the cessation debt based on this “gilt” (minimum risk) basis over a maximum of 14 years which will be agreed with the Fund’s actuary. This payment plan will be reassessed at each triennial valuation.
18. This approach assists the Fund with those employers who are able to provide the necessary security to manage its deficit payments over a longer timeframe when required with no additional material risk to the Fund. However, employers will be made fully aware this arrangement carries the risk they may end up paying either more or less than would have been the case without the use of the extended cessation arrangements.
19. The Fund will ensure it remains fully protected by requesting security on a value at risk basis to account for potential movement in liabilities between triennial valuations.
20. With this additional flexibilities, it will be easier to work with employers at a much earlier stage to agree plans for managing deficits and potential cessation events with targeted funding plans which should lead to a reduced risk of non recovery of cessation payments and the prospect of the cost of unfunded liabilities remaining in the Fund that is spread across all the other employers.

Environmental Impact of the Proposal

21. There is no known environmental impact of this proposal.

Financial Considerations & Risk Assessment

22. The core objective of this Policy is to reduce financial risk to the Fund and its constituent employers in a way that also manages the risk for the former employers.

Legal Implications

23. There are no known implications at this time.

Safeguarding Considerations/Public Health Implications/Equalities Impact

24. There are no known implications at this time.

Reasons for Proposals

25. This is an important policy for the Fund, covering what can be an area of considerable cost and concern for employers. The draft Employer Cessation Policy is proposed to deal with each potential cessation scenario, with the emphasis on reducing risk to the Fund, ensuring consistency, transparency and fairness for all employers and providing a framework under which the employers can plan cessation payments on a more flexible basis.

Proposals

26. The Committee is asked to approve the Wiltshire Pension Fund Cessation Policy, which will take effect from 1 April 2016.

MICHAEL HUDSON
Treasurer to the Pension Fund

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Unpublished documents relied upon in the production of this report: NONE

WILTSHIRE PENSION FUND – CESSATION POLICY

1. Introduction

This is the policy of Wiltshire Pension Fund (“the Fund”) as regards the treatment of employers on termination of their participation in the Fund. It covers the methodology for calculation and payment of any deficit on leaving the Fund (via a “cessation valuation”).

It has been prepared by the Administering Authority, in collaboration with the Fund’s Actuary, Hymans Robertson LLP. This policy replaces all previous policies on employer termination and is effective from 1 April 2016.

This policy applies to all past, current and future employers participating in the Fund.

2. Regulatory framework

The Local Government Pension Scheme Regulations 2013 (“the 2013 Regulations”) outline the general framework for employees and employers participating in the Local Government Pension Scheme in England and Wales. The regulations that are relevant to employers leaving the Fund are as follows;

- Regulation 64 (2) – where an employing authority ceases to be a Scheme Employer, the Administering Authority is required to obtain an actuarial valuation of the liabilities of current and former employees as at the exit date. Further, it requires the rates and adjustments certificate to be amended to show the exit payment due from the ceasing employer.
- Regulation 64 (2A) – the Administering Authority, at its discretion, may issue a suspension notice to suspend payment of an exit amount for up to three years.
- Regulation 64 (3) – in instances where it is not possible to obtain additional contributions from the employer leaving the Fund or from the bond/indemnity or a guarantor, the contribution rate(s) for the appropriate Scheme employer or remaining Fund employers may be amended.
- Regulation 64 (4) – where it is believed a scheme employer may cease at some point in the future, the Administering Authority may obtain a certificate from the Fund actuary revising the contributions for that employer, with a view to ensuring that the assets are expected to be broadly equivalent to the exit payment that will be due.
- Regulation 64 (5) – following the payment of an exit payment to the Fund, no further payments are due to the Fund from the exiting employer.

In addition to the 2013 Regulations summarised above, the Regulation 25A of the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 (“the Transitional Regulations”) give the Fund the ability to levy a cessation debt on employers who have ceased participation in the Fund (under the previous regulations) but for whom a cessation valuation was not carried out at the time.

These regulations relate to all employers in the Fund. This is a significant change to the previous regulations which applied only to Admitted Bodies.

3. Policy reviews

This policy will be reviewed at least every three years following triennial valuations or following changes to the regulations pertaining to employers leaving the Fund.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate. Any queries should be directed to David Anthony, Head of Pensions, in the first instance at David.Anthony@wiltshire.gov.uk or on 01225713620.

4. Cessation events

The purpose of a cessation valuation is to determine the level of any surplus or deficit in an employer's share of the Fund as at the date the employer leaves the Fund.

4.1 Current cessations

There are a number of scenarios that may lead to an employer leaving the Fund;

Contractors participating in the Fund under an admission agreement (previously referred to as Transferee Admission Bodies).

- A cessation event will occur when either a contract comes to a pre-arranged end date (the period of which will be defined in the admission agreement), a contract is terminated early or the employer has no remaining active members in the Fund.
- Following payment of any cessation debt, all active, deferred and pensioner liabilities will automatically transfer back to the Awarding Authority, along with the notional value of assets held by the ceased employer.
- If the contract is re-let, a new admission agreement will be set-up between the Awarding Authority and the new employer which may lead to some or all of the active members transferring from the Awarding Authority to the new employer.

All other employers.

- A cessation event will typically occur due to an employer having no remaining active members in the Fund.
- Following payment of any cessation debt, responsibility for all remaining deferred and pensioner liabilities will be shared amongst all remaining active employers in the Fund, unless another Scheme Employer (or group of employers) provides a guarantee that requires them to meet any future shortfall arising in respect of the ceased employer.

The calculation of the cessation position will depend on which scenario applies. See section 6 for details.

In the event that the employer is in surplus, there is currently no mechanism by which this surplus can be repaid by the Fund to the ceased employer.

4.2 Suspending payment of exit amounts

At the absolute discretion of the Administering Authority, a suspension notice may be awarded to an exiting employer. This may be for a period of up to three years after the cessation event (the maximum period permitted by the Regulations).

Any application for the Administering Authority to grant a suspension notice will normally only be considered if the following criteria apply;

- The employer can provide evidence that it is likely to admit one or more new active members to the Fund within the period of the suspension notice
- The employer is not a closed Admitted Body, as under the existing admission agreement, no new active members would be permitted to join the Fund.
- Any application for the Administering Authority to grant a suspension notice is made within three months of the cessation event.

The Administering Authority reserves the right to withdraw a suspension notice if it is of the opinion that the terms of any agreement to award a suspension notice are not being upheld by the employer.

If a suspension notice is awarded, the cessation valuation will be deferred until the earlier of 1) the end of suspension period or 2) the point at which the suspension notice is withdrawn (for any reason). If one or more new active members are admitted to the Fund the employer's full participation in the Fund will resume.

During the period of any suspension notice, the employer must continue to make such contributions to the Fund as certified in the Rates and Adjustments certificate.

4.3 Future cessations

If an employer is aware that it will be leaving the Fund in the future, it should alert the Administering Authority and request an indicative cessation valuation.

If this valuation indicates that a surplus position is likely, then the Actuary will be able to advise the Administering Authority whether a contribution reduction (before the employer ceases) is appropriate. Alternatively, if this calculation indicates a deficit position is likely then the Actuary will be able to advise of the increase in contributions required over the remaining period of membership. In either case, the Administering Authority has discretion over the funding basis to be used for this calculation.

4.4 Historic cessations

As required under Regulation 25A of the Transitional Regulations, the Administering Authority reserve the right to levy a cessation debt on employers who have ceased participation in the Fund under previous LGPS regulations, but for whom a cessation valuation was not carried out at the time.

5. Calculation Basis for cessation events

It is the Fund's policy that (unless a suspension notice has been awarded) the determination of any surplus or deficit on termination will be carried out as at the date that the final active member leaves/retires and should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the Fund have to make contributions in the future towards meeting the past service liabilities of current and former employees of employers leaving the Fund.

5.1 Contractors participating in the Fund under an admission agreement (previously referred to as Transferee Admission Bodies).

The Fund's policy is to carry out the cessation valuation in this situation in line with the 'ongoing' actuarial valuation basis from the previous valuation (updated for market conditions at the date of exit).

The Regulations require that the contribution rate for the Scheme Employer who awarded the original contract is amended on termination should there be any unfunded liabilities remaining. This may occur if the certified cessation debt payable by the ceased employer has not been paid and any payment made to the Fund from any bond in place has not been sufficient to meet the full cessation debt.

In this case, the original awarding employer is the 'guarantor' for any legacy liabilities on cessation and any remaining deficit or surplus falls to that employer alone. This 'guarantor' is also considered responsible for any surplus or deficit which arises on these liabilities after the date of cessation.

If the admission agreement is terminated earlier than the contract period set out in the agreement, then the Administering Authority reserves the right to perform the cessation valuation on an alternative basis as agreed with the original awarding authority.

5.2 All other employers (including Scheme Employers, Designated Bodies, other Admission Bodies)

(a) No Guarantor Exists

In the case of an employer where no guarantor exists, since the Regulations suggest that any unfunded liabilities (at the point of cessation or after the cessation date) should be met via increased contributions from all other employers in the Fund, the Administering Authority wishes to protect the interests of the other unconnected employers.

The cessation valuation in such a case will be performed on a 'minimum risk' basis (i.e. a gilts basis which does not allow for any outperformance above gilts from other assets such as equities, and with an increased allowance for future mortality improvements above those adopted at the last actuarial valuation).

If, in the judgement of the Administering Authority, there is a risk of pushing the ceasing employer into insolvency by adopting the 'minimum risk' basis, even after allowing for the spreading period (see 6 below), the Head of Pensions, with the prior agreement of the Chairman and Vice Chairman of the Pensions Committee and the Chief Financial Officer, may allow the cessation valuation to be performed on a set of financial assumptions that are less prudent than the 'minimum risk' basis. In these circumstances, the asset outperformance assumption will be no greater than half of the

asset outperformance used at the previous formal actuarial valuation. For the avoidance of doubt, in this situation there will be an increased allowance for future mortality improvements beyond that adopted for the previous formal actuarial valuation.

(b) Ceasing employer has a guarantor

If a guarantor does exist or if the exiting employer is able to obtain a legally binding guarantee from a Scheme Employer on cessation, and that Scheme Employer is deemed by the Administering Authority to be sufficiently large that the cessation deficit for the ceasing body is not material to the ongoing funding position of the Scheme Employer, then at their discretion the Administering Authority waive some of the above requirements. If the guarantor is prepared to absorb the exiting employer's responsibilities then the cessation valuation may be carried out on a basis more akin to the 'ongoing' assumptions.

(c) Treatment of pass-through employers

In the case where the admission agreement with the Fund specifies a full pass-through arrangement, a nil cessation amount will be certified. If an employer enters into an arrangement regarding risk-sharing or pass-through with another Scheme Employer that is not reflected in the employer admission agreement, then a cessation amount will be calculated according to (a) or (b) above and charged to the exiting employer. The exiting employer will be entirely responsible for claiming from the other Scheme Employer any monies to which the exiting employer is entitled as a result of arrangements not reflected in the admission agreement.

6 Payment of any Deficit

If it is determined that there is a deficit at the cessation date and the exiting employer is required to make a payment to the Fund, the Administering Authority will advise the exiting employer of the amount required.

The Fund's policy is for any deficit on cessation to be recovered through a single lump sum payment to the Fund, where possible. The Administering Authority may consider permitting an exiting employer to spread the payment over an agreed period, where it considers that this does not pose a material risk to the solvency of the Fund. This repayment period will not exceed the deficit recovery period that applies for any guarantor, or in the absence of a guarantor, that for non-tax raising bodies within the Fund (currently 14 years) and will incorporate within the repayment profile the unwinding of the discount rate implicit in the final deficit payment as agreed with the Fund Actuary. If however the proposed repayment period is to exceed 7 years then the Head of Pensions must obtain the agreement of the Chairman and Vice Chairman of the Pensions Committee and the Chief Financial Officer.

The first port of call for payment of the deficit is the exiting body itself and only in the final event of failure to recover from this source would other scenarios be explored. Unless the cost of doing so is deemed to outweigh the likely recovery to the Fund, the Administering Authority will pursue an exiting body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit. In the event of non-

payment, the Administering Authority will also pursue any bond or indemnity provider or guarantor, for payment where appropriate.

In the normal course of events (i.e. where the process above has been adhered to), the exiting body will not normally be exposed to interest rate, investment or other funding risks after the cessation date. Any late deficit payment will include the addition of interest at the level of the base rate plus 5% per annum between the cessation date and the final payment date(s). However, exceptions to this may need to be made depending on the circumstances of the cessation and must be agreed by the Chairman and Vice Chairman of the Pensions Committee and the Head of Finance.

7 Extended Cessation Arrangements

The methodology set out in sections 4, 5 and 6 of this policy is the Fund's preferred treatment of exiting employers. Extended arrangements for cessation valuations including delaying the calculation or payment of a cessation debt beyond the date the last active leaves the Fund, other than in the circumstances set out in Section 4.2, will be considered and if approved (at the Administering Authority's absolute discretion), will be managed as set out below.

This section of policy is based on our current understanding of the Regulations and clarification provided to us by DCLG.

- (1) A cessation debt will be calculated at the date of the cessation event on the Fund's 'ongoing' actuarial basis and this amount will be due from the exiting employer immediately. The same terms for repayment of this debt will apply as in specified in 6.
- (2) The Fund Actuary will calculate the value at risk after the 'ongoing' cessation debt payment arrangements are made, by assessing the potential cessation deficit that may arise on the 'minimum risk' basis over the next 3 years.
- (3) The exiting employer must provide an appropriate form of financial security to Wiltshire Council as administering authority to the Wiltshire Pension Fund for the amount of the value at risk. The form of financial security must be acceptable to the Administering Authority at its absolute discretion. Approved forms of security include a bond with a financial institution, a charge over assets or a Scheme Employer who will act as guarantor for the cessation debt over the extended cessation period.
- (4) The value at risk will be re-calculated at each triennial valuation and the security arrangements reviewed to ensure the outstanding value at risk is covered.
- (5) A contribution plan targeting full payment of the outstanding cessation debt calculated on the 'minimum risk' basis by a fixed date not later than 14 years after the original cessation event will be assessed at the cessation event and re-calculated at each triennial actuarial valuation by the Fund Actuary taking account of all previous payments. The Administering Authority shall require the exiting employer to enter into such agreements and other documents in the Administering Authority's standard form as are (in the Administering Authority's opinion) required to effect the extended cessation arrangement.

(6) The extended cessation arrangement will be terminated (at the "termination date") and the full amount of any outstanding cessation debt calculated on the minimum risk basis on the termination date will become due immediately in any of the following circumstances:

- a. At a termination date requested by the exiting employer with a minimum notice period of 1 month;
- b. If the exiting employer fails to meet contributions under the contribution plan;
- c. If the exiting employer is no longer able to provide appropriate security to the value required; or
- d. At a date, notified to the exiting employer with a minimum notice period of 3 months by the Administering Authority, which will be not later than 14 years after the original cessation event.

(7) All legal and actuarial costs incurred by the Fund in the process of maintaining the above extended cessation arrangements will be met by the exiting employer.

Any employer entering into extended cessation arrangements will be exposed to funding risks after the date of the cessation event. Employers could end up paying more to the Fund than the 'minimum risk' cessation amount calculated as at the cessation date.

8 Ongoing Management of liabilities after settlement of cessation debts

It is the policy of the Fund to avoid 'orphaned' liabilities and assets which can occur in the following situations:

- a) The former employer no longer exists; or
- b) The former employer still exists, but they have paid off a cessation valuation in full, so there is no further recourse to them.

In these situations, the issue remains of where the former employer's liabilities (which don't cease until the last pensioner dies) and investment assets reside within the Pension Fund's unitised structure. The approach for dealing with this is as follows:

- a) Where there is a guarantor which is also an employer within the Fund, it is the Fund's policy that they will be expected to take the legacy (deferred and pensioner) liabilities and assets into their own valuation group for the purposes of future actuarial valuations. This can also be a way of spreading the cost of any remaining deficit that the guarantor may be picking up, because the liabilities (and assets) become merged with the guarantor's existing liabilities/assets for valuation and contribution rate purposes.
- b) Where there is no guarantor, another existing employer within the Fund, such as the original ceding employer (in the case of old Community Admission Bodies) or some other organisation with close links to the former employer will be sought to similarly absorb the legacy (deferred and pensioner) liabilities and assets.

- c) If no other employer within the Fund has links to the former employer, the former employers assets will be ring-fenced until the last pensioner dies and any emerging deficit or surplus will be allocated across all current employers in the Fund at that date in proportion to their liabilities.