**WILTSHIRE COUNCIL** **AGENDA ITEM NO. 10**

WILTSHIRE PENSION FUND COMMITTEE
25 February 2010

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# EMPLOYER CESSATION POLICY

## Purpose of the Report

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

## Background

2. Under the Local Government Pension Scheme (Administration) Regulations 2008 ("the Regulations") which came into force on 1 April 2008 in England and Wales, when an Admitted Body 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 Admitted Body in question has no remaining active (contributing) members.

3. Under the Regulations, any deficit occurring should be recovered from the Admitted Body, but there is currently no legal provision for paying back any surplus. However, the Regulations do not stipulate the basis or timeframe that funds shall use to recover the deficit.

4. Historically, Wiltshire Pension Fund have experienced few cessation situations, but in the light of an increased number recently, along with the complications surrounding these and the potential for more in the future, officers feel that a clear policy is needed to reduce risk to the Fund and to ensure a consistent and fair approach to different cessations as they occur.

5. The draft Employer Cessation Policy (Appendix) has been produced following discussions and consultation with Hymans Robertson.

## Considerations for the Committee

The Wiltshire Approach

6. 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. However, under the Fund's more recent admissions policy, it would be unusual to admit a CAB without a guarantor.

7. 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 from the group of approximately 25 in the Fund 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.

8. However, the situation for Admitted Bodies is different and the rest of this paper focuses on them. The Admitted Bodies currently in the Fund 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.

9. 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 (ie. 8a and 8b), the Fund avoids the potential risk of the Admitted Body defaulting on payment.

10. 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 flexibility 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" bonds) to help reduce the deficit.

    If the full flexibility from a, b and c above were to be used, the valuation would be akin to an "ongoing' basis", as in the Triennial Actuarial Valuation.

11. 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 in 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).

12. To avoid this, a provision is included for former admission bodies to obtain a formal agreement from another Scheme Employer (ie. Scheduled Body) to act as a guarantor for the purpose of the cessation.

13. However, failing this, the proposed policy does allow some flexibility where there is a risk of pushing the employer into insolvency by adopting the "gilts" basis, even after allowing for spreading period. In this case, with the prior agreement of the Chairman, Vice Chairman and Chief Finance Officer, the Head of Pensions may allow the cessation valuation to be performed on a set of financial assumptions that are up to half-way between the ongoing and gilts bases. For the avoidance of doubt, in this situation the increased provision for future mortality improvements beyond that adopted for the previous formal actuarial valuation would be included.

14. The draft policy also deals with the policy on "orphaned" liabilities (which don't cease until the last pensioner dies) and the associated investment assets. This is a situation that arises when the former admission body no longer exists or there is no longer any legal recourse to them. In summary, another employer within the Fund (usually the guarantor) will be sought to take these "orphans" into their valuation group for the purposes of calculating funding levels and contribution rates.

**Environmental Impact of the Proposal**

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

**Financial Considerations & Risk Assessment**

16. 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 Admitted Body.

**Reasons for Proposals**

17. This is a significant Policy, covering what can be an area of considerable cost for departing 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 be pay for deficit on a more flexible basis.

**Proposals**

18. The Committee is asked to approve the Wiltshire Pension Fund Cessation Policy, which will take immediate effect.

MARTIN DONOVAN
Chief Finance Officer

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

# WILTSHIRE PENSION FUND – ADMISSION BODY CESSATION POLICY

## 1. Introduction

This is the policy of the Wiltshire Pension Fund ("the Fund") as regards the treatment of admission bodies on termination of their admission. 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 1st March 2010.

This policy will be reviewed at least every three years following triennial valuations or following changes in the Local Government Pension Scheme Regulations ("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 Andy Cunningham, Employer Relationship Manager, in the first instance at andrew.cunningham@wiltshire.gov.uk or on 01225 713612.

## 2. Cessation of Admission Agreement

Organisations which are admission bodies within the Fund cease when they no longer have any active members within the Wiltshire Pension Fund. This happens for a number of reasons, typically:

a) The last active member of the Fund has left/retired and the employer does not wish to admit any more employees.

b) The relevant employees are transferring to another employer (eg. because the employer lost the contract).

c) The employer ceases to exist (eg. goes in liquidation or is subsumed into another organisation).

When an employer ceases, the Regulations require that a cessation valuation is carried out. 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.

In the event that the employer is in surplus, there is currently no mechanism by which this surplus can be repaid by the Fund. 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 under Regulation 34(4) of the Local Government Pension Scheme (Administration) Regulations 2008. 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.

## 3. Recovery of Deficits

Turning to deficits, the simplest (but most uncommon) scenario is where employees transfer to another employer ("successor body") within the Fund. In this case, the successor body would take responsibility for the legacy liabilities and any funding deficits that exist on cessation of the original admission body.

In the event of the admission body going into liquidation, the liquidators would be contacted with a view to extracting as much of the cessation deficit from the proceeds of the business as possible.

However, more commonly the first port of call for recovery of the deficit is the ceasing admission body itself and only in the final event of failure to recover from this source would other scenarios be explored. Typically this is a "guarantor", which might already exist under the terms of the admission agreement or might be sought (usually the original ceding employer) to meet the deficit that cannot be recovered from the admission body itself.

Failing that, where the ceasing admission body cannot pay the cessation valuation and there is no successor body or guarantor in place (for instance, this could apply in the case of historic admission agreements set up some time ago), the deficit of the admission body would fall on the Fund as a whole, which effectively means all employers in the Fund.

## 4. Calculation of Deficit

It is the Fund's policy that 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.

### 4.1. Transferee Admission Bodies (TABs)

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. Therefore the original awarding employer is the successor body for any legacy liabilities on cessation and any remaining deficit falls to that employer alone. The Fund's policy is to carry out the cessation valuation in this situation on an "ongoing" approach in line with the long term actuarial valuation basis from the last valuation (updated for current market conditions), as there is no requirement to protect the other employers in the Fund. If the admission agreement for a TAB is terminated earlier than the contract period set out in the agreement, then the Administering Authority reserve the right to perform the cessation valuation on an alternative basis as agreed with the original awarding authority.

### 4.2. Community Admission Bodies (CABs)

The cessation of a CAB can fall under any of scenarios a) to c) above. Whilst the current admission policy in force requires that a CAB has a guarantor in place (other than in exceptional circumstances), this has not always been the case and there are historic CABs with no legal guarantor to take on legacy liabilities or meet unpaid deficits.

Therefore, there are essentially three scenarios:

a) In the case of a CAB with a historic agreement where no guarantor exists, since the Regulations suggest that any unfunded liabilities should be met via increased contributions from all other employers in the Fund, the Administering Authority wish to protect the interests of the other unconnected employers. Therefore the cessation valuation in such a case will be performed on a "minimum risk" basis (ie. a "gilts" basis which does not allow for any outperformance of other assets such as equities, with an increased allowance for future mortality improvements above those adopted at the last actuarial valuation).

b) However, if the admission body 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 admission body is not material to the ongoing funding position of that employer, then at their discretion the Administering Authority may waive some of the above requirements. In these circumstances, if the guarantor is prepared to absorb the departing employer's responsibilities then the cessation valuation may, subject to the agreement of the guarantor, be performed on a basis more akin to an "ongoing" basis.

c) There is a third scenario, in which there is no guarantor, but in the judgement of the Administering Authority, there is a risk of pushing the employer into insolvency by adopting the "gilts" basis, even after allowing for spreading period (see 5 below). In this case, with the prior agreement of the Chairman, Vice Chairman and Chief Finance Officer, the Head of Pensions may allow the cessation valuation to be performed on a set of financial assumptions that are up to half-way between the ongoing and gilts bases. 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.

**5. Payment of any Deficit**

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

Unless the cost of doing so is deemed to outweigh the likely recovery to the Fund, the Administering Authority will pursue an outgoing body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit. The Administering Authority will also pursue any bond or indemnity provider or guarantor, for payment where appropriate.

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 admission body 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 period will not exceed the spreading period that applies for the guarantor, or in the absence of a guarantor, that for non-tax raising bodies within the Fund (currently 14 years). If the proposed spreading period is to exceed 7 years (in any circumstances), the Head of Pensions must obtain the agreement of the Chairman, Vice-Chairman and Chief Financial Officer.

## 6. Residual Risk to Admission Body after Cessation Date

In the normal course of events (ie. where the process above has been adhered to), the outgoing admission body will not normally be exposed to interest rate, investment or other funding risks after the cessation date. The final deficit payment will be calculated by the addition of interest at the level of the base rate 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.

## 7. On-going Management of Liabilities after Cessation Valuation

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

a) The former admission body no longer exists; or

b) The former admission body still exists, but they have paid off the cessation valuation in full, so there is no further recourse to them.

In these situations, the issue remains of where the former admission body’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 pensioner 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 CABs) or some other organisation with close links to the former admission body will be sought to similarly absorb the legacy (deferred pensioner and pensioner) liabilities and assets.

Similarly, where there is a guarantor in place and the former Admitted Body is paying off the deficit over time, it is the policy of the Fund to require the guarantor to take the legacy liabilities and assets into their own valuation group.

*Approved by Wiltshire Pension Fund Committee on 25 February 2010*