

Pensions Committee

2.30 p.m., Wednesday, 24 June 2015

Funding Strategy – Employer Appeals and Cessations

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide an update on employer engagement regarding the decision of the Pensions Committee of 25 March 2015 to allow certain employers the right of appeal against the funding strategy. As a reminder, this specifically refers to those employers (Community Admission Bodies) who are closed to new members and have less than 5 active members, or are expected to leave the Fund within two valuation periods (6 years). For these employers, the revised Funding Strategy Statement assumes investment in lower-risk assets i.e. index-linked government bonds.

To-date 14 of the 27 employers affected have notified Lothian Pension Fund of their intention to appeal. Of these, only one employer has provided its appeal submission in the initial phase. An oral update will be provided to Pensions Committee on the progress of the appeals. Committee is also advised of the cessation of membership by two employers as at 31 March 2015.

In England and Wales, cessation valuations are expected to be considered by the Scheme Advisory Board for the Local Government Pension Scheme (LGPS). Similarly it is expected that the Scheme Advisory Board for the LGPS in Scotland will also reflect upon this issue.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Funding Strategy Appeals – Employer Appeals and Cessations

Recommendations

The Committee is recommended to:

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 Note the update on funding appeals including the communication to, and engagement with, employers, the update on the progress of appeal(s); and the cessation of membership of Lothian Pension Fund of two other employers with effect from 31 March 2015.
- 1.3 Note that the basis for cessation valuation is being debated across the UK Local Government Pension Scheme.

Background

- 2.1 Committee is reminded that when the last active member of an employer leaves the Fund, as required by the Scheme regulations (and the Fund's policy on employers leaving Fund), a cessation valuation must be carried out to value the employer's liabilities and identify any payment required to cover such liabilities.
- 2.2 The Fund's policy has been for the cessation valuation to be undertaken using government bond discount rate with a prudent allowance for mortality improvements (subject to the covenant strength of any successor body and / or guarantor which may be in place after the cessation date). As a result, cessation valuations can often result in large deficits. This approach is unchanged over recent years, is consistent with the approach to cessations in other Funds across the LGPS and is in line with the Actuary's advice.
- 2.3 In order to improve employers' understanding of pension liabilities and cessation valuations, during the 2014 actuarial valuation the Actuary provided each employer with the value of their pension liabilities on the cessation basis as at 31 March 2014. In addition, the funding and contribution strategy was amended for those employers with:
 - less than 5 active members, and/or
 - a future working lifetime of active members of less than 6 years.in order to address the previous inconsistency between the actuarial valuation and cessation valuation.

2.4 As well as raising awareness of the cessation valuation, this strategy smoothes employer contributions in the period leading up to the employer's exit from the Fund. It also reduces the risk of employers being unable to pay large deficits when the last active member leaves. A change in investment strategy is also being adopted for these employers. Assets will be invested in lower-risk investments which will help reduce the degree of short-term change in employer contribution rates in the period prior to the employer leaving the Fund

2.5 The Pensions Committee, at its meeting on 25 March 2015, considered a report on the revised Funding Strategy Statement (FSS). This included coverage of the investment strategy, at reference 8.2, as follows:

“Overall the Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer.

However employers (with the exception of Transferee Admitted Bodies) who are closed to new members and have less than 5 active members, or are expected to leave the Fund within two valuation periods (6 years), will be assumed to be invested in lower-risk investments i.e. index-linked government bonds. This aims to reduce the degree of short-term change in employer contribution rates in the period prior to the employer leaving the Fund and hence manage risks for both the individual employer and for the Fund as a whole.”

2.6 A deputation from the Centre for Moving Image (CMI) and Festival City Theatres Trust (FCTT) representing 12 other employers was present. The deputation asked the Committee to postpone the implementation of the revised FSS in order to allow time to reconsider the strategy, particularly for those employers impacted by a change to a lower risk, gilts valuation basis. The Committee then asked questions of the deputation and then discussed the FSS.

2.7 Committee noted the responses to the consultation on the revised FSS and, whilst endorsing the proposed revised strategy, it recognised the potentially significant cashflow implications the proposal could have for certain employers.

2.8 The Convenor tabled a motion to amend the revised FSS which was subsequently agreed by Committee. The amendment adds an additional section to reference 8.2 of the FSS as follows: ‘If there are specific circumstances where an employer may assert that the lower-risk funding strategy would place its future existence in jeopardy and therefore a less prudent funding strategy should prove advantageous to Lothian Pension Fund and the employer, then an appeal may be submitted to Lothian Pension Fund no later than 15 months after the date of the actuarial valuation. An appeal should include an alternative funding proposal recognising the need for the employer to meet their pension liabilities. Any such appeal would be considered by the Director of Corporate Governance in consultation with the Convenor of the Pensions Committee, Convenor of the Pensions Audit Sub-Committee and the Independent Professional Observer and

the decision reported subsequently to the Pensions Committee. In order for any appeal to be upheld, support from any respective 'aligned body' or guarantor would be required, together with approval of the Fund's Actuary. Should such appeal be successful, then a revised 'Rates and adjustment certificate' would be issued. Pending determination of any appeal, the actuarial valuation 'rates and adjustment certificate would remain applicable'.

Main report

Communication prior to submission of appeal

- 3.1 Lothian Pension Fund ('the Fund') has been engaged in ongoing dialogue with those employers who have the option to appeal against the funding strategy changes. Specifically, the Fund has been liaising with senior officials from the Centre for the Moving Image (CMI) and Festival City Theatres Trust (FCTT), the two employers who provided the deputation to Pensions Committee, about the appeal process.
- 3.2 Their comments as to the requested content and timing of any appeal were reflected by the Fund in the "Employers' Bulletin Special Edition – Funding Appeals" which was issued both to the affected employers and to the members of the Pensions Committee on 9 April 2015. For reference, this is included at Appendix 1.
- 3.3 The Fund also accepted an invitation to attend a meeting of a group of the affected employers, which was held on 20 April 2015. Representatives of thirteen employers were present. An actuarial consultant, commissioned by the employers, was also in attendance. Discussions on various specific points were held, with suitable clarification provided by the Fund as to the basis of any appeal.
- 3.4 A further meeting was held on 21 April 2015. CMI and FCTT represented the employer group, together with councillors and officials of the City of Edinburgh Council (as aligned body to a number of the employers) and the Fund. A pragmatic approach to consideration of any appeal was envisaged, with the twin objectives of ensuring that individual employers recognised and met their respective pension liabilities in full, whilst seeking not to place their future existence in jeopardy as a consequence.

Submission of Appeal(s)

- 3.5 Although the formal deadline for appealing is 30 June 2015, the Fund offered employers an option to lodge an appeal by 1 May 2015, with a commitment to concluding these early appeals around the end of June. The Fund did appreciate that not all employers would be able to meet this tighter timescale and appeals received after 1 May are expected to be concluded by the middle of September.
- 3.6 To-date, of the 27 employers affected by the change of funding approach, 14 have notified the Fund of their intention to appeal. Of these, only one employer

provided its appeal submission in the initial phase. To date, 6 employers have indicated that they will not appeal and 7 have not informed the Fund of their intention.

- 3.7 As agreed by Committee, the Director of Corporate Governance will consider the appeals in consultation with the Convenor of the Pensions Committee, Convenor of the Pensions Audit Sub-Committee and the Independent Professional Observer.
- 3.8 An oral update will be provided to Pensions Committee on the progress of the appeal(s).

Employer Cessations

- 3.9 Two employers, Mental Welfare Commission for Scotland and Pilton Community Health Project, ceased their membership of the Fund as at 31 March 2015.
- 3.10 Mental Welfare's last active member retired on 31 March 2015. A cessation valuation has been issued by the Actuary to the Fund and it is anticipated that the pension deficit will be settled in full in the near future. The Scottish Government is the body to which the Mental Welfare Commission is aligned.
- 3.11 Pilton Community Health Project is part of the pool of smaller employers which had previously closed to new entrants. It has decided to close to future accrual and is now engaged in dialogue with the Fund and the City of Edinburgh Council as to payment of the pension deficit.
- 3.12 Pensions Committee is reminded that "The Fund's general policy is for any deficit on cessation to be recovered through a single lump sum payment to the Fund. In exceptional circumstances, the Fund may consider permitting an 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. The Fund may take into account the covenant strength of any successor body and / or guarantor which may be in place after the cessation date. In this instance, interest at a rate advised by the actuary will be applied to determine the appropriate payments to be made."
- 3.13 It is likely that Pensions Committee's approval of the cessation valuation payment terms for Pilton Community Health Project will be sought in due course.
- 3.14 It is also considered likely that some other employers, for example, those with the option to appeal against the recent funding strategy changes, may seek similar recourse. It will be important for the Fund and the Pensions Committee to ensure consistency, whilst recognising specific individual employer circumstances.

The Principles and Basis of Cessation Valuations

- 3.15 The principles of cessation valuations (i.e. the crystallisation of pension liabilities when there are no more active members) are receiving attention nationally across the LGPS.
- 3.16 In England and Wales, cessation valuations are expected to be considered by the Scheme Advisory Board for the Local Government Pension Scheme (LGPS). Similarly it is expected that the Scheme Advisory Board for the LGPS in Scotland will also reflect upon this issue.
- 3.17 Both the basis for the calculation of the pension liabilities at cessation and repayment terms of any debt are being debated.
- 3.18 The Fund will continue to monitor and engage in the debate over cessation valuations and will advise Committee of developments.

Measures of success

- 4.1 None directly arising from this progress report.

Financial impact

- 5.1 None directly arising from this progress report, although the determination of any employer appeal against the funding strategy will obviously have financial implications for Lothian Pension Fund. Similarly, any spreading of a deficit payment on cessation of an employer will also be of consequence.

Risk, policy, compliance and governance impact

- 6.1 None directly arising from this progress report, although the determination of any employer appeal against the funding strategy shall comply with the decision of the Pensions Committee, at its meeting on 25 March 2015. The risk that any individual employer is unable to fulfil its financial obligations to meet pension liabilities is addressed by the Fund's Funding Strategy Statement.

Equalities impact

- 7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

- 8.1 There are no adverse sustainability impacts from this report.

Consultation and engagement

- 9.1 The Fund has engaged in extensive consultation and dialogue with its employers over the changes to its funding strategy and the appeals process. Similarly, there has been full engagement with employers regarding the implications of cessation of LGPS membership.
- 9.2 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

None

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Director of Corporate Governance

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Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices Appendix 1: Special Employer Bulletin

From: George Kirk on behalf of LPF Employers
Sent: 09 April 2015 11:25
Subject: Employers Bulletin: Special Edition - Funding Appeals



Employers' Bulletin

Special Edition – Funding Appeals

UPDATE

The Special Edition of the Employer Bulletin sent on 31 March outlined the results of the [2014 Actuarial Valuation](#) of Lothian Pension Fund. It also explained an option for the employers with a lower-risk funding strategy, to appeal and propose an alternative funding approach if their future existence is being put in jeopardy due to the change in funding. This bulletin provides details of the appeals process.

Appeals Process

Stage 1

Employer lodges intent to appeal.

Stage 2

Employer lodges appeal with Lothian Pension Fund. An indication of the information which would be helpful for the appeal to be considered is outlined below:

- Most recent financial statements, both audited and unaudited, highlighting any qualification or reservation expressed by the auditor.
- Financial forecasts (Profit & Loss,

IN THIS EDITION

UPDATE:

[Appeals Process](#)

[Timetable](#)

[Employer Contributions during Appeal Process](#)

[Employer Contributions after Appeal Process](#)

[Next steps](#)

Contact details for employers

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Contact details for employees

Members pension helpline: 0131

Balance Sheet and Cashflow) reflecting the pension contribution as certified by the Actuary for the 2014 actuarial valuation, together with evidence to support the view that such payments would place the employer's future existence in jeopardy. The forecasts should cover, as a minimum, the period April 2015 to March 2018, the period which is relevant for the actuarial valuation.

- Financial forecasts (Profit & Loss, Balance Sheet and Cashflow) reflecting the contributions being proposed by the employer. These should include explicit coverage of the size and duration of proposed payments in relation to the future working lifetime of active members, as stated by the actuary, and the estimated gilts deficit as at 31 March 2014. (This information is included in the employer results schedule). Please explain how contributions to the pension fund are proposed to be used to make the employer more sustainable.
- Details of future funding sources, i.e. assumptions re grant and other income and the extent to which such funding is assured and by whom.
- Details of any security held on the organisation's assets, if relevant.
- Any potential options for security of assets available to the Fund or guarantor.
- Details of any contingent liabilities.
- Basis of admission to LGPS e.g. voluntary request, staff transfer from any local authority.
- Any other information the employer feels is appropriate.

Please note that not all of this information may be essential in every instance. If you are unable to supply such information, please let us know why.

Employers should also note that the Fund is not expecting that the proposed alternative funding strategy is based on precise actuarial calculations and therefore we do not envisage you having to take actuarial advice. It is recognised that appeals are for employers whose future existence may be in jeopardy hence it is expected that affordability will be the sole driver.

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e-mail

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DATES FOR YOUR DIARY:

Finance Briefing : Thursday 25
June at 9am

For the purposes of consideration by any aligned body or guarantor, please explain:

- The impact of the change in the funding strategy will have on your service;
- The impact of your service which would result under your proposed funding approach;
- Your commitment to managing discretionary pension liabilities in the future.

Stage 3

Consideration of appeals by Director of Corporate Governance including consideration and views of aligned bodies/guarantors and the Actuary. Consultation with convenors of the Pensions Committee and Pensions Audit Sub-Committee and independent observer will follow.

Stage 4

Communicate results of the appeals to employers and Pensions Committee.

Timetable

The Funding Strategy Statement says that 'an appeal may be submitted to Lothian Pension Fund no later than 15 months after the date of the actuarial valuation'. The deadline for submitting an appeal on the results of the 2014 Actuarial Valuation is therefore **30 June 2015**.

Although the formal deadline for appealing is 30 June, we would like to offer employers an option to lodge an appeal by 1 May 2015. We will commit to concluding these early appeals around the end of June.

We appreciate that not all employers will be able to meet this tighter timescale and appeals received after 1 May are expected to conclude around the middle of September.

Employer Contributions During the Appeals Process

Contribution rates in the rates and adjustments certificate on pages 39 and 40 of the 2014 Actuarial Valuation report have been certified by the Actuary and they apply from **1 April 2015**. Employers were previously

advised of these rates in their individual results schedules.

Employer contributions expressed as a percentage of payroll (Future Service Rate) are payable every month. The monetary contributions in respect of Past Service Deficits (£000s) are payable at any time during the relevant financial year.

In accordance with regulations, any employer who pays less than the certified rates will be charged interest on late payments. With effect from 1 April 2015, the Fund is also applying penalties for late payments to cover the costs of recovering late payments.

We can confirm that payment of the rates certified in the 2014 Actuarial Valuation prior to an appeal will **NOT** jeopardise the outcome of the appeal.

Employer Contributions After the Appeals Process

Should an appeal be successful, the Actuary will revise the rates and adjustment certificate and the amounts paid from 1 April 2015 to the date of the outcome of the appeal will be taken into consideration as a prepayment.

Next steps

If you intend to appeal, please let us know as soon as possible. Also, please let us know when you expect to appeal by. This will help us plan the appeals process and deal with them more efficiently and respond to you quicker.

Pension Fund representatives have been invited to attend a meeting of employers at 11am on Monday 20 April at the Festival Theatre and we have agreed to attend to answer any questions around the appeals process. If any employer is interested in attending that meeting, please contact Ian Dickson at Centre of Moving Images on lpf@cmi-scotland.co.uk.

We received a number of letters from individual employers regarding the funding strategy after the deadline for the consultation. Apologies for the delay in replying to these letters – our focus has been on communicating with all employers at this

stage. We intend to reply to these individual letters over the coming weeks.

If you have any questions about the funding strategy, or the appeals process, please do not hesitate to call Erin Savage on 0131 529 4660 or e-mail erin.savage@edinburgh.gov.uk.

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