HYMANS ROBERTSON

Sixty second summary

LGPS (Amendment) Regulations 2018

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Around two years ago, the UK Government consulted on possible changes to Fair Deal and other LGPS matters in England & Wales. We are now finally seeing some progress in the form of published **LGPS (Amendment) Regulations 2018**, together with an **explanatory memorandum** and the **Government's response** to the consultation submissions. Most of the new regulations take effect from 14 May. This Summary highlights the key points for LGPS funds to consider.

What's in the new Regulations?

The biggest change is that employers exiting the LGPS with surplus will be entitled to receive that surplus. The introduction of "exit credits" has far-reaching implications for the way that funds manage employer cessations, and much of this Summary is focussed on this one change. There are also numerous other changes that are broadly in line with those outlined in the original consultation.

What's NOT in the new Regulations?

Disappointedly, "new" Fair Deal is not covered. The Government is planning to issue a fresh consultation on the subject before the end of 2018. In the meantime, the "old" 2007 Direction and 2012 Welsh Direction will continue to apply in England and Wales respectively.

The Government has also decided not to allow LGPS members to access their LGPS AVCs under Freedom and Choice provisions on grounds of administrative complexity.

The lowdown on exit credits

What are they?

The amendments to Regulation 64 define an exit credit to be "*the amount required to be paid to the exiting employer by the administering authority to meet the excess of assets in the fund relating to that employer over the liabilities specified in paragraph (2)*". In other words, any cessation surplus should be paid to the employer.

How do exit credits alter the funding risk of employers?

Currently, the funding risk is "asymmetric" in favour of the fund (or any scheme employer that is acting as guarantor to the departing employer). If there is a debt on cessation, the employer is obliged to pay it. However, any surplus is retained by the fund/guarantor.

At first glance, the availability of an exit credit would appear to make the funding risk "symmetric", and balanced evenly between employer and fund/guarantor. However, if we add in covenant risk i.e. the risk that the employer fails to pay any cessation debt, then the funding risk moves to "asymmetric" in favour of the employer.

Is the change fair to employers and funds/guarantors?

Employers - it feels fair. They are currently obliged to pay any debt that arises on cessation so the arrival of an exit credit should be welcomed by this group.

Funds/Awarding Authorities/Guarantors - on the face of it, they ought to be comfortable with the change too. Armed with the knowledge that employers can access surplus, they can adjust funding plans and policies to reflect the change to the funding risk described above. However, the big problem for funds/guarantors is the lack of transition arrangements….

What are the transition rules?

Unfortunately there are none. The new Regulations come into force on 14 May 2018, and will apply to all cessations from that date, regardless of when the employer joined a fund. It is not clear if exit credits will apply to cessation valuations with calculation dates before 14 May that are processed on or after 14 May.

Contractors may be a particular cause for concern. Most are set up as "fully funded" when joining funds, with assets allocated from the Awarding Authority equal to the value of the transferring liabilities. Those that joined at a time when asset values were depressed, or when liability values were particularly high, may be heavily in surplus and will now be able to unlock cash that would previously have reverted to the Awarding Authority. Risk sharing (pass through) arrangements may, as a result, become even more popular going forward. In the meantime, it will be interesting to see whether this development leads to legal challenge from Awarding Authorities and/or contracts being renegotiated.

How will exit credits be taxed?

This is unclear. For example, will exit credits be subject to an authorised surplus payment (ASP) charge of 35%, or be treated as a public service scheme payment (PSSP) and be exempt from tax? Our consultation response in 2016 raised this issue. LGA have told us that that MHCLG will discuss this further with HMRC.

What practical steps should funds take next?

We strongly suggest that you speak to your Fund Actuary. Areas to discuss include:

- The way that assets are allocated to new employers e.g. is fully funded still appropriate?
- The transition process for cessation valuations that are in the pipeline, or under discussion
- The assumptions to adopt for cessation valuations, and under what circumstances
- The nature of the contracts for any contractors in the Fund
- Impact on your funding strategies and any admission and/or cessation policies (including the extent to which the Fund uses the "suspension notice", bonds and risk sharing arrangements)
- How employers with multiple admission agreements are handled e.g. where one has a deficit, and the other a surplus
- Employer monitoring in the lead-up to cessation
- Your fund's process for cessation valuations given the new 3 month time limit
- How the change is communicated to employers, including Awarding Authorities

Other amendments in the new Regulations

Among the changes worth noting are:

- more flexibility to employers to determine APP where the standard approach would, in the opinion of the employer, provide a materially lower figure than the member would normally receive;
- amendments to the transitional regulations extend the ability to retire without employer consent to those members who left before April 1998;
- confirmation that admission agreements can be agreed with retrospective effect;
- and finally, funds should note that there is now a requirement to publish a list of all existing admission agreements by 14 May 2019.

We look forward to helping funds to manage the changes.