Consultation on draft SAB guidance on new employer flexibilities

Background and Scope

- Paragraphs 5 and 6 – change "wider employer base", etc to "other employers within the fund"
- Paragraph 6 – replace "complaint" with "compliant"
- Paragraph 6 – suggest change "Wednesbury" legal principles reference to plain English description
- Paragraph 6 – we are unclear of the risks to the "scheme members" as a result of the Administering Authority making use of the flexibilities
- Paragraph 7 – this may be misleading as the Regulations require exit valuations to be carried out by the actuary where an exit event takes place or a deferred debt arrangement ends. Additionally, contribution rates must be certified within the Rates and Adjustments Certificate. We suggest the wording be changed to:

This guide makes reference to instances in which the Administering Authority may wish to take advice from their actuary. Where actuarial involvement is not strictly required under the Regulations, this will be at the discretion of the Authority taking into account their FSS, normal procedures and policies.

Section 1 - A Guide for Administering Authorities

Overview

- Paragraph 4 - change wording in first bullet to "*As a principle the approach and assumptions from the FSS in force at the time would provide an appropriate starting point.*"
- Paragraph 6 – in the first bullet replace "*isthat*" with "*is that*"
- Paragraph 6 – the third bullet may be misleading as the end of accrual does not necessarily mean an employer's liabilities will not increase (i.e. if inflation increases). We suggest the end of the bullet point is extended as follows "*…covenant is weak as it may allow an employer to avoid accruing further liabilities.*"

Q&A

The Review Process

- Question 1 Paragraph 2 – there is a full stop missing after *"conditions"*
- Question 1 Paragraph 3 & Question 6(b) Paragraph 2 – a full valuation may not be required to adjust rates (a roll forward valuation may be adequate and proportionate). We suggest *"full"* is removed from this paragraph.
- Question 2 Paragraph 1 – while strictly correct under the Regulations, we would suggest any employer providing a guarantee might also have a vested interest as to whether a review is carried out and whether this should be further incorporated into the guidance.
- Question 3 Paragraph 1 – we suggest the following wording *"…is responsible have materially changed…."*

- Question 3 Paragraph 3 sub paragraph ii & Question 4 Paragraph 2 sub paragraph ii – as the guidance is requiring a balanced approach, we suggest this sub paragraph also include possible decreases in risk. We suggest the wording is amended to *"…a negligible increase or decrease in risk…"*
- Question 3 Paragraph 3 sub paragraph iii & Question 4 Paragraph 2 sub paragraph iii – this fails to recognise that the valuation date and the date the next Rates and Adjustments Certificate comes into force are a year apart which can leave a substantial period of time where reviews may be excluded. This is also inconsistent with the wording in Question 7 Paragraph 4 (see below). We suggest that both sub paragraphs are changed to *"the new Rates and Adjustments Certificate as part of a full valuation exercise as required under Regulation 62 will imminently come into force, and any changes will be included within that Certificate."*
- Question 3 Paragraph 3 – we suggest this point is expanded to clarify the guidance being provided. For example, we assume the point being made is that although the intention is that "a change in liabilities due to the assumptions used" should not be considered as a reason for prompting a review, it is nonetheless recognised that there is a direct correlation between an employer's funding liabilities and its ability to meet their obligations (or covenant) - which is deemed a trigger for review.
- Question 4 Paragraph 1 sub paragraph iv – missing "*to*" in "*ability to contribute to the Fund*"
- Question 5 – we suggest changing "would" to "could" in the question itself.
- Question 5 – we suggest the addition of a 3rd paragraph setting out that the employer is willing to meet the costs of the review to help eliminate speculative requests.
- Question 6(a) Paragraph 1 – suggested change to wording "*In some cases, the starting point could be the membership data provided for the most recent triennial valuation, for example if the review was happening during or shortly after the valuation. In most cases, given that the review will only be happening due to material changes in membership, the employer and Fund should work together to prepare a fully updated data set for the actuary to use in their calculations. There may be instances where updated membership data…*"
- Question 6(a) Paragraph 2 – missing "*in*" in "*change in an employer's ability*"
- Question 6(a) Paragraph 3 – change *"may wish"* to *"should"* – if the Actuary is being asked to carry out calculations they should have a say in the membership data used
- Question 6(b) Paragraph 1 sub paragraph ii – suggest change wording to *"as a result of transfers of liabilities and notional assets between employers in the Fund, market related calculations…"*
- Question 6(b) Paragraph 2 – we suggest the following update to the wording *"…and allow for updated market conditions."*
- Question 6(c) Paragraph 2 – we believe any change in the structure or derivation of assumptions would always require an Administering Authority to consult with their actuary (as the actuary ultimately needs to sign off the Rates & Adjustments Certificate) and potentially require an amended FSS which may need wider consultation. For example, considering a circumstance where local authorities are reorganised into a new unitary, it is not uncommon for local authorities to constitute 80% or more of a fund's assets and liabilities. Any change in the derivation of assumptions when reviewing the new unitary's rate could therefore have significant repercussions on the fund.
- Question 6(c) – there is an errant paragraph 3 number with no wording; the section wording goes a, b, c, i, ii, iii, iv

- Question 6(i), (ii) and (iii) – these sections contain actuarial jargon and may benefit from further explanation if employers are an intended reader of this guide.
- Question 7 Paragraph 1 – there are a few minor typographical errors. In addition, we think "*covenant review*" should read "*contribution review*"?
- Question 7 Paragraph 2 – our understanding is this question is on the cost of contribution reviews, therefore the second part of this answer does not appear appropriate as this is in relation to evaluating covenant. Therefore we suggest the sentence starting *"An Administering Authority may wish…"* is removed.
- Question 7 Paragraph 4 – as set out earlier, we believe this is inconsistent with Question 3 Paragraph 3. We believe the interpretation in this paragraph is correct, however, we believe the wording could be clearer and suggest the following sentence within the paragraph is amended to *"For instance, within the 12 months following the statutory valuation date….*
- Question 7 Paragraph 5 – the intention here is clear, however the wording may be interpreted as only allowing a set number of reviews for all employers (i.e. the fund will do no more than 5 reviews per year, even if 10 request reviews) which may not be consistent with the Regulations. We would suggest the wording is changed to *"…its own policy a maximum number of requests per employer within a set period…."*
- Question 8 Paragraph 2 sub paragraph i – suggest change to "*appropriate to each employer*" instead of Fund – as materiality depends on employer size more than fund size.
- Question 8 Paragraph 2 sub paragraph vi – this would prompt a review under Regulation 64(4) as an exit event would be imminent. So while we agree it should be a notifiable event, it may not be relevant to this guidance and the Regulations under 64A.
- Question 10 Paragraph 1 – is missing a comma after "*process*".
- Question 10 Paragraph 2 – we suggest the wording is updated to *"Details of the employer request…."*
- Question 11 – while we agree with the answers, Funds should now have (or be in the process of having) an appeals process in the event exiting employers challenge an Administering Authority's determination of an exit credit to be paid. We suggest the same process would be followed for any appeals of these such that there is a single route for employers to bring grievances in respect of the Administering Authority exercising its powers and discretions.

Debt Spreading Arrangement and Deferred Debt Agreement

- Question 12 Paragraph 2 – suggest change to "*share in the fortunes and risk of the Fund…*"
- Question 13 Paragraph a3 – "*I*" in the second should be changed to "*It*". In addition, while the answer is factually correct, it may be misleading if not read along with Paragraph 4 (i.e. the ongoing basis may not be the basis used to determine the exit debt/credit). We suggest the following final sentence is added to ensure this is not misinterpreted *"It should be noted that an employer's cessation basis may use actuarial assumptions that are more prudent than those used for the ongoing funding basis. Therefore, a surplus on an ongoing basis may not be sufficient to meet exit debt on an employer's cessation basis."*
- Question 13 Paragraph a4 - there may be no requirement for an exit payment, but there may be an exit credit payable. In addition, membership experience may also be a source of positive outcomes. We suggest this paragraph is amended in two places as follows *"…without any requirement for an exit payment. Where a surplus exists on a cessation basis, an exit credit may be payable as determined by the*

Administering Authority. The employer will…" and "…through investment returns, positive membership experience and/or the unwinding of prudence."

- Question 13 Paragraph c1 – having a long term DDA is not the same as having a long time horizon / deficit recovery period. Therefore, a long DDA will not necessarily result in a low level of contributions which are determined in accordance with a fund's FSS. We also believe that recovery periods longer than say 25-30 years would mean deficit payments are insufficient to cover the interest arising on the liabilities thereby eroding the employer's position further all else being equal. Most funds will not allow recovery periods of this length except in exceptional circumstances. This reluctance has been reinforced as GAD collect data on recovery periods as part of Section 13 so this may risk a 'flag' or the administrative burden of interacting with GAD/MHCLG as part of this process. As a result, we suggest the wording of this paragraph is changed to *"…in place a DDA over an appropriately long period and a sufficiently long recovery plan to manage the employer's situation as far as practical and within the allowances set out in the fund's funding strategy statement, effectively relying …"*
- Question 13 Paragraph c2 – we suggest amending the wording to *"some form or guarantor or security could be considered."* as not all employers will be able to obtain a guarantee.
- Question 13 Paragraph d1 – our expectation is that in these circumstances DDA will now be the preferred route over a suspension notice. In particular, the removal of a hard deadline means the DDA is more flexible and therefore may remove some of the administrative overhead of tracking suspension notices and their respective deadlines.
- Question 13 Paragraph e1 – we would remove the reference to FRS102 as it is not strictly true. The rules of FRS102 and IAS19 on exit from the scheme generally require you to recognise the cost of exiting the scheme (i.e. the accounting assumptions are set equal to those used to determine the cessation basis) and therefore an accounting deficit may need to be recognised at the cessation date. In addition, the employer would likely need to disclose its obligations under the DSA in a note to its accounts. Therefore, we suggest removing the following *"and the need to disclose an FRS102 accounting deficit".*

Section 2 - Employer guidance on new LGPS flexibilities

Overview

- Paragraph 2 – For clarity and to be consistent with the Regulations we suggest the following change *"….expected to consult on material changes to the FSS…"*
- Paragraph 3 – see Question 7 Paragraph 1 below.
- Paragraph 5 – we believe this statement is OK but please see our comments on Question 11 above. In addition, *"Administering"* is missing from in front of *"Authority"*

Review of Contributions

- Question 2 Paragraph 3 – see comments on Question 3 above. We suggest the wording is changed to *"…that is requested in the 12 months following a formal valuation date."*
- Question 3 Paragraph 1 – the Administering Authority does not need to request a review, it can just carry one out. Therefore we suggest the opening sentence is removed.
- Question 3 Paragraph 2 – the FSS sets out policy not processes, as a result we suggest this is included in the administration policy rather than the FSS.

- Question 5 Paragraph 1 – we suggest adding the following *"…of any change in membership or covenant strength…"*

Debt Spreading Arrangement

- Question 6 Paragraph 1 – in the parenthesis the wording should start *"...(as reported in the Funding…"*
- Question 6 Paragraph 3 – under a DSA, the fund is giving up the anticipated return it may have earned on a single payment and therefore may require interest to compensate for allowing a DSA. As a result, we suggest the wording is amended to *"…an exit payment, any interest that may apply, over what period…".* In addition, the wording that any payment structure must be *'mutually acceptable'* is misleading as the Administering Authority has the ultimate power in determining the length of a DSA. Therefore, we suggest the wording *"to agree a mutually acceptable payment structure."* is removed.
- Question 6 Paragraph 4 – there is a superfluous sentence fragment at the end of the paragraph that needs removed.
- Question 6 Paragraph 5 – amend wording to *"…will be required as this could reduce the risk to other employers. The FSS would be expected to include whether security may be required…"*
- Question 7 Paragraph 1 – this unnecessarily adds to the administration burden of the Administering Authority – while we agree all employers would ideally have a planned exit mutually agreed with their fund, it is not possible to know in advance what the circumstances will be on an employer's exit date. Will there be a surplus or a deficit, will they be able to afford a single payment or a payment plan etc. Therefore, we suggest that we encourage employers to engage in advance of leaving the fund, but that employers instead seek to understand the options that might be open to them and under what circumstances they may consider them instead of putting in place an agreement or plan that may not be realisable. As a result, in the earlier 'Overview' section we suggest adding the wording below to the end of Paragraph 3:

"In particular, where an employer is considering exiting the LGPS or will be exiting as a result of another trigger event, it is highly encouraged that the employer engage with the Administering Authority in advance of leaving the fund to understand the options that may be open to them on exit."

In addition, in Question 7 Paragraph 1, we suggest removing the sentence "*Therefore, we would expect that in the main…..*".

- Question 8 Paragraph 1 – please add an '*s'* to the end of '*provide'* in the second sentence. In addition, funds may require interest (see Question 6 Paragraph 3 above) on DSA's. As a result, paying up front minimises the costs of exiting where a DDA is not arranged. Therefore, we suggest the following amendment *"…usually be the preferred option for the Administering Authority as this provides greater certainty for future funding, may minimise any interest the Administering Authority may charge for spreading payments and minimises…"*
- Question 8 Paragraph 2 – "*duration of covenant*" is not common terminology and therefore this may need to be defined to aid employer understanding.
- Question 8 Paragraph 3 – we believe this should be set out in the administration strategy rather than the FSS as this is procedural.
- Question 9 Paragraph 2 – we would suggest that 'sources of income' and 'access to government support' could be added to the list of key information.

Deferred Debt Arrangement (DDA)

- Paragraph 1 – we suggest the final sentence be amended to *"…LGPS funds or for funds to set out clear reasons for…"*
- Paragraph 2 – full stop required at the end of the final sentence (currently has a comma).
- Question 11 Paragraph 1 – is missing a couple of full stops
- Question 12 – the numbering of the paragraphs should restart at 1 to be consistent with the rest of the document.
- Question 12 – in the question itself *"spread exit payment"* should be changed to *"Debt Spreading Arrangement"* for consistency
- Question 12 – the descriptions are as expected, but may give the false impression that these options are available when they are actually at the discretion of the administering authority. We suggest additional wording be included to ensure employers understand that while these flexibilities may be in the Regulations, they should discuss these with their relevant Administering Authority to understand what is achievable under each fund's policies.
- Question 12 Paragraph 2 (numbering as per current draft) – the exit payment should be calculated on an actuarial basis that is consistent with the fund's funding strategy statement (i.e. it is not the 'actuary's basis'). We suggest the wording is amended to *"…using a basis consistent with the fund's Funding Strategy Statement to assess…."*
- Question 12 Paragraph 3 (numbering as per current draft) – the draft currently states that *"…the actual duration over which the employer will be required to continue to fund the deficit will be unknown at the start".* We would anticipate that the duration would be the known period of the DDA (the period being specified as required by Regulation 64 (7D)). Separately, the time horizon used to calculate the contribution plan under the DDA would be agreed between the parties and certified by the actuary.
- Question 12 Paragraph 4 – we agree this statement and would also encourage including a similar paragraph in the DSA section (or perhaps to the Overview section) as the accounting treatment of an exiting employer may be materially more complicated than an employer continuing in the Fund under a DDA.
- Question 13 Paragraph 1 – the information required is procedural and therefore we feel this should be covered in the administration strategy rather than the FSS.
- Question 14 Paragraph 1 – changes in the funding level may also trigger an exit from a DDA (i.e. if a surplus on the employer's exit basis is realised). In addition, an exit payment may not necessarily be the outcome, the only known outcome is an exit valuation will be required under the Regulations. Therefore, we suggest the following amendments to this paragraph "….regular engagement, monitoring of the employer's funding level between formal valuations, monitoring of the employer's covenant…." and "…, triggering an exit valuation, should…." and "..in covenant or change in funding level." In addition, there is a rogue full stop after "This process". We would also suggest using the full name of the DSA for clarity in the final sentence: "…lead into a Debt Spreading Arrangement to allow…"

Schedule A

Please note, we are not lawyers and therefore any comments set out below should not be construed as legal advice. We suggest our recommendations are referred to Eversheds for their consideration before including them in the documentation.

- "The Fund" appears not to be defined within the template Agreement.
- Paragraph 8.3 – the final section in the table entitled 'Event triggering termination:'. The exit debt may be eliminated for any number or reasons (such as positive membership experience and/or investment returns as well as the contributions paid by the employer) and therefore we believe this section should be broadened. In addition, as the employer is agreeing to take on the ongoing pension risks, we do not believe comparisons to the exit debt as at the exit date are appropriate. We therefore suggest the following wording replaces the wording in the final row of the table *"the Actuary assesses that an Exit Payment is no longer required from the Deferred Employer if this Agreement were terminated."*

Schedule B

- It is perhaps worth making it clear that a deferred employer would need to ensure up-to-date discretions were in place for all employer discretions were it to have any new active members at a future date.
- Similarly, any employer discretions that might be capable of application in respect of any former active members on or after the signing of a DDA should remain in force despite their application occurring after the effective date of the DDA itself (for example the extension of any time limits where considered appropriate).
- For all those discretions marked as "employer?" for a deferred employer, we would suggest they do fall to the employer as a deferred employer and the '?' be removed. We also believe the deferred employer should continue to have the ability to recover a monetary amount from the Fund as a consequence of fraud, etc., as this could come to light following the effective date of the DDA itself.