HYMANS ROBERTSON

Sixty second summary

Management of employer risk regulations

- New LGPS regulations will be formally introduced in England and Wales from 23 September to (i) review employer contributions outside formal valuations and (ii) manage employer cessation arrangements.
- While many funds are already practising similar employer management, key actions will be to create processes and update fund policies and the Funding Strategy Statement to allow for the new powers

With the ink only about dry on the funding policy changes from exit credits, on 26 August MHCLG published another partial response to the same May 2019 consultation, "Changes to the local valuation cycle and management of employer risk". The response notes the need for new regulations to allow administering authorities and employers to be able to manage and mitigate risks arising from the COVID-19 pandemic.

Following the response being published the new regulations have quickly been made and are due to come into force from 23 September 2020 via the snappily named Local Government Pension Scheme (Amendment) (No. 2) Regulations 2020.

The new regulations focus on three key areas:

1. Review of employer contributions
2. Spreading exit payments
3. Deferred Debt Agreements

We look at each of these in more detail below.

1. Review of employer contributions

Strictly speaking, employer contributions can only currently be reviewed at formal valuations or under Regulation 64 (4) when an employer is "likely" to exit the fund. The consultation has acknowledged that employers' circumstances may change between valuations, for example due to a "change in covenant strength or workforce composition, or local government reorganisation."

In view of responses to the consultation, the Government has concluded that the power to review contributions should be available in respect of all employers - thus enabling administering authorities to respond to a "full range of circumstances". Regulation amendments have therefore been made to allow administering authorities to review employer contributions where there has been a "significant change" to the liabilities or covenant of an employer. The consultation response notes that market volatility, and changes to asset values, would not be a proper basis for a change in contributions outside a full valuation. Nonetheless, we recognise that changes to pension surplus or deficit due to market conditions can affect covenant and may trigger a review of contributions.

In addition, an employer may request a review of contributions from the administering authority provided they have also agreed to "meet the costs of that review".

The practicalities of reviewing an employer's contributions will require the administering authority to:

- consult with the impacted employer (if the request hasn't originated from the employer itself)
- state its policy on the review of employer contributions in its FSS and obtain advice from its actuary
- consider the impact on other employers in the fund

Funds advised by Hymans will usually have provision to review employer contributions when triggered by significant events via Section 3.3 Note (f) of the FSS. However, we would suggest the new regulations require a review to explicitly refer to the fund's policy. Given the current environment, administering authorities could potentially expect a deluge of employer requests (particularly where employers have their own actuarial/legal advisers). Therefore, quickly establishing an employer contribution review policy and process will be key.

2. Spreading exit payments

Again, while there is nothing in the current regulations to allow exit or cessation debt payments to be spread after exit, this is fairly common practice by administering authorities.

The Government has recognised the need to amend regulations to allow administering authorities the ability to spread exit payments over a period which it "considers reasonable" (…along with helpfully modifying its use of "buy-out" basis terminology from within the consultation….).

Focussing on the need for consistency and transparency, the administering authority will be required to:

- set out within its FSS its policy on spreading exit payments and to obtain advice from its actuary
- take account of the interests of all employers and LGPS funds when determining the payment terms.

Funds advised by Hymans will usually have policy provision to spread exit payments via Section 3.3 Note (j) of the FSS. However, we would propose to work alongside officers to review this in light of the new regulations.

3. Deferred Debt Agreements (DDAs)

The new regulations also introduce "deferred employer" status and DDAs within the LGPS for exiting employers. This will formally allow secondary contributions to be certified for employers with no active members and be subject to revision at formal valuations. The DDA must set out the "specified period" over which is arrangement will run and the termination events.

Again, highlighting the need for consistency and transparency, the administering authority will be required to set out within its FSS its policy on DDAs and to obtain advice from its actuary.

When entering into a DDA with an employer, an administering authority should:

- consider all the evidence available and "use judgement and local knowledge"
- monitor the DDA carefully (including at valuations) to ensure it is on track to meet its funding target
- put in place recovery plans where shortfalls are identified.

There is also a curious comment in the response that DDAs "generally will not include a separate investment strategy". We would, however, encourage the use of differing notional investment strategies as a tool to deliver the best funding outcomes and minimise risk of excessive surplus or deficit for each employer where appropriate, including those deferred employers.

Key actions for administering authorities include updating the FSS and developing a DDA policy, establishment/ monitoring process and standard agreement.

Timeline and guidance

While many funds are already practising some of the above areas, these will now be covered formally in new regulations from 23 September. The consultation response also notes MHCLG's intention to develop guidance on the use of the new powers by working with the Scheme Advisory Board and CIPFA.

Next steps

Given the new regulations are to come into force later this month and employers will be keen to see progress, we would suggest that each administering authority quickly discusses the changes and required actions with its Fund Actuary.

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