Agenda Item No. 4 (a)

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

21 July 2020

Report of the Director of Finance and ICT

DERBYSHIRE PENSION FUND EXIT CREDITS POLICY

1 Purpose of the Report

To seek approval for the Derbyshire Pension Fund's (the Fund) proposed Exit Credit Policy as set out in Appendix 1.

2 Background

May 2018 Amendment
The Local Government Pension Scheme Regulations 2013 (the 2013 Regulations) were amended in 2018 to allow exit credits to be paid for the first time. The changes came into effect on 14 May 2018 but were backdated to 1 April 2014.

Where an employer ceased to be a participating employer in the Local Government Pension Scheme (LGPS), an exit credit became due if their pension liabilities had been overfunded at their date of exit. (An employer typically ceases to be a participating employer when their last active member of the LGPS leaves or when an admission body's admission agreement comes to an end e.g. on expiry on a contract.)

The amendment was introduced to give administering authorities more flexibility to manage liabilities when employers leave the LGPS and to allow pension risks to be shared more fairly; previously scheme employers were responsible for any shortfall against their liabilities at the point of exit, but could not receive the benefit of any surplus. Any surplus on exit was retained in the Fund. On the cessation of a contractor who had provided a service to a letting authority, any surplus of assets on exit would have previously been reallocated to that letting authority on the exit of the contractor from the Fund.

Concerns were subsequently raised that the introduction of exit credits had created unforeseen issues, specifically where scheme employers had outsourced services or functions to service providers on the basis that exit credits were not legally possible.

As part of outsourcing agreements, scheme employers and their service providers may have entered into risk sharing side agreements based on the 2013 rules. Such agreements would often sit outside of the admission agreement in the service contract. Under these agreements, the letting scheme employer may have shared the pensions risk with their service provider by picking up the risk of contributions increasing beyond a certain amount, or by picking up the risk of an exit deficit arising at the end of the contract, in exchange for a lower contract price.

In these circumstances, it was widely considered to be unfair that service providers who had been protected from the pension risks during the contract should then benefit from an unanticipated windfall on exit that was not envisaged when the service contract was drawn up.

May 2019 Ministry of Housing, Communities and Local Government (MHCLG) Consultation
In May 2019, in response to these widespread concerns, the Secretary of State for Housing, Communities and Local Government opened a consultation (the Consultation) on a number of proposed changes to the 2013 Regulations, including a proposed further change to the rules on exit credits.

The Consultation asked the following questions with respect to exit credits:

Do you agree that we should amend the LGPS Regulations 2013 to provide that administering authorities must take into account a scheme employer's exposure to risk in calculating the value of an exit credit?

Are there other factors that should be taken into account in considering a solution?

February 2020 Partial MHCLG Response to the Consultation
At the end of February 2020, MHCLG published a summary of responses received in relation to the proposal for further changes to the rules on exit credits only and issued its own response to the representations received.

Whilst respondents strongly supported MHCLG's overall approach, many highlighted that there are a wide range of risk sharing arrangements that could make it difficult to determine the appropriate level of an exit credit. It was also noted that administering authorities would not necessarily be aware of or have access to the detailed agreements reached between a letting scheme employer and its service provider.

MHCLG announced its intention to amend the 2013 Regulations so that administering authorities may determine, at their absolute discretion, the amount of any exit credit payment due, having regard to any relevant considerations.

Local Government Pension Scheme (Amendment) Regulations 2020 (the 2020 Regulations)
The 2020 Regulations came into force on 20 March 2020, but have effect from 14 May 2018, and set out that:

An administering authority must determine the amount of any exit credit, which may be zero, taking into account the following factors:

- the extent to which the employer's assets in the pension fund are in excess of its liabilities (the cost of the benefits in respect for the exiting employer's current and former employees)
- the proportion of this excess of assets which has arisen because of the value of the employer's contributions
- any representations made by the exiting employer and, where the employer participates in the LGPS by virtue of an admission agreement, any body that has acted as a guarantor for the employer's pension liabilities (in many cases this will be the letting authority)
- any other relevant factors

Administering authorities are also required to:

- notify the exiting employer and its letting authority/guarantor of its intention to make an exit credit determination

- pay any amount determined to the exiting employer within six months of the exit date (or such longer time as the administering authority and the exiting employer may agree)

MHCLG has confirmed that any exit credits that have not been paid (even if overdue) shall only be due following the administering authority's exercising of its discretion. The Fund has not paid any exit credits prior to the Exit Credit Policy being considered by the Committee.

In the event of any dispute or disagreement on the amount of any exit credit paid and the process by which that has been considered, the appeals and adjudication provisions contained in Regulations 74-78 of the LGPS Regulations 2013 would apply. The Pensions Ombudsman also has jurisdiction to hear complaints of maladministration arising between those involved in running a pension scheme, if the internal dispute resolution process is unsuccessful.

3 Draft Exit Credits Policy

The new responsibility placed on the administering authority for determining the level of any exit credit and the discretion available makes it essential that the Fund adopts a fair and reasonable exit credits policy which:

- ensures that a consistent approach is taken between employers and over time
- aims to protect the interests of the members and employers as a whole
- ensures that representations from all interested parties are taken into account
- is consistent with the approach set out in the Fund's Funding Strategy Statement and Admission, Cessation & Bulk Transfer Policy
- takes into account relevant actuarial and legal advice

As with the exercise of any discretion by the administering authority, due process must be followed, relevant factors considered, irrelevant factors ignored and a reasonable decision reached, which is recorded with reasons.

The Fund's Exit Credits Policy (the Policy) will be incorporated into the Fund's Admission, Cessation and Bulk Transfer Policy which was approved on 22 January 2020. The Pension Fund's Funding Strategy Statement, which was approved on 4 March 2020 following a consultation exercise, will also be updated to reflect the new 2020 Regulations.

Matters Considered
In formulating this Policy, legal and actuarial advice has been taken into account and the following issues have been considered:

- the determination of the extent to which the employer's assets in the Fund are in excess of its liabilities (in respect of benefits in respect of the exiting employer's current and former employees)
- whether an exit credit payment should be considered in respect of admissions to the Fund before 14 May 2018 when exit credits were introduced
- the basis on which the cessation valuation should be carried out

- whether any exit credit payment should be limited to the proportion of the excess of assets which has arisen because of the value of the employer's contributions
- how the Fund should ensure that representations from the exiting employer and any guarantor for the exiting employer's pension liabilities will be considered
- what 'other relevant factors' should be considered by the Fund in determining the amount of any exit credit

Decisions & Disputes
In the event of any dispute or disagreement with the determination of any exit credit, the appeals and adjudication provisions contained in Regulations 74-78 of the 2013 Regulations would apply. The Pensions Ombudsman also has jurisdiction to hear complaints about decisions made by the Pension Fund, if a complainant is dissatisfied with the outcome of the internal dispute resolution process.

Consultation
Given the potential impact on participating employers of the Fund's exercise of its discretion in relation to exit credits, the Fund will consult with scheme employers, the local pension board and other stakeholders on the proposed policy. The results of the consultation will be reported to Committee in September 2020.

Approval is sought for the Director of Finance & ICT, in conjunction with the Chair of the Committee to consider the results of the consultation in the meantime, and to determine if any revisions to the proposed Policy are necessary following the consultation, to enable the Policy to be adopted as soon as possible.

4 Other Considerations

In preparing this report the relevance of the following further factors has been considered: financial, legal, human rights, human resources, equality and diversity, health, environmental, transport, property, social value and prevention of crime and disorder.

5 Background Papers

All background papers are held by the Head of Pension Fund.

6 Officer's Recommendation

That the Committee:

(i) Approves the proposed Exit Credits Policy attached as Appendix 1, subject to the outcome of the consultation with the Fund's stakeholders

(ii) Delegates the consideration of the results of the consultation, and the determination of whether any revisions to the proposed Exit Credits Policy are necessary following the consultation, to the Director of Finance & ICT in conjunction with the Chair.

Peter Handford
Director of Finance and ICT

Appendix 1

Derbyshire Pension Fund Exit Credits Policy

Introduction
The Local Government Pension Scheme Regulations 2013 (the 2013 Regulations) were amended in 2018 to allow exit credits to be paid for the first time. The amendment came into effect on 14 May 2018 but had retrospective effect back to 1 April 2014. Further amendment regulations came into force on 20 March 2020 which were also deemed to have effect from 14 May 2018.

If an employer becomes an exiting employer under Regulation 64 of the 2013 Regulations, it may be entitled to receive an exit credit if its pension liabilities have been overfunded at its date of exit.

Exit Valuation
When an employer becomes an exiting employer, Derbyshire Pension Fund (the Fund) must obtain from the Fund actuary:

1. an actuarial valuation as at the exit date of the liabilities of the Fund in respect of benefits in respect of the exiting employer's current and former employees

2. a revised rates and adjustments certificate showing the exit payment due from the exiting employer; or the excess of assets in the Fund relating to that employer over its liabilities as calculated by the valuation

When commissioning the valuation from the actuary, the Fund will also request the actuary to confirm the proportion of any excess of assets which has arisen because of the value of the employer's contributions. This a factor the Fund must have regard to when making its determination as to the amount of the exit credit.

Notification
The Fund will notify its intention to make a determination on whether to pay an exit credit to:

- the exiting employer
- where the exiting employer is a ‘transferee’ admission body, the scheme employer in connection with that body (i.e. the letting authority)
- where the exiting employer is an admission body of any type, any other body that has given a guarantee in respect of the admission body

Determination
In accordance with Regulation 64 (2ZAB) of the 2013 Regulations (as amended), Derbyshire Pension Fund (the Fund) will determine the amount of any exit credit (which may be zero) taking into account the following factors:

- the extent to which the exiting employer’s assets in the Fund are in excess of its liabilities (in relation to benefits in respect of the exiting employer’s current and former employees)
- the proportion of this excess of assets which has arisen because of the value of the exiting employer’s contributions
- any representations made by the exiting employer and, where the employer participates in the scheme by virtue of an admission agreement, any body that has acted as a guarantor for the employer’s pension liabilities (in many cases this will be the letting authority)
- any other relevant factors

In determining whether an exit credit may be payable, Derbyshire Pension Fund, will review each case on its own merits and will apply the following guidelines:

1. For pre -14 May 2018 admissions, the Fund will take into account the fact that original commercial contracts between admission bodies and letting authorities/guarantors could not have been drafted with regard to the May 2018 regulation changes that implemented exit credits retrospectively. Subject to any representations to the contrary, it will be assumed that the employer priced the contract accordingly and that no subsequent agreements covering the ownership of exit credits have been negotiated.

2. The basis for calculating an employer’s pension liabilities to determine the level of any exit credit, will generally be as set out in the Fund’s Funding Strategy Statement.

3. No exit credit will be payable to an admission body which participates in the Fund via an agreed fixed contribution rate throughout its participation in the Fund as in this case the pensions risk ‘passes through’ to the letting authority.

4. The Fund may undertake an exit credit calculation which reflects any contractual pension risk sharing provisions between the exiting employer, the letting authority/guarantor and/or any other relevant body with respect to pension risk sharing. This information, including confirmation of which party is responsible for which funding risk should be provided to the administering authority within one month of the exiting employer ceasing participation in the Fund.

5. Where a guarantor or similar arrangement is in place, but no formal risk sharing arrangement exists, the Fund will take into consideration how the approach to setting contribution rates payable by the employer during its participation in the Fund reflects which party is responsible for funding risks. This may inform the determination of the value of any exit credit.

6. If an employer leaves on the 'gilts exit basis' as set out in the Funding Strategy Statement, any exit credit will normally be paid in full to the employer, subject to consideration of the individual circumstances.

7. If an admission agreement ends early, the Fund will consider the reason for the early termination, and whether that should have any relevance on the Fund's determination of the value of any exit credit payment.

8. If a scheduled body or resolution body becomes an exiting employer due to a reorganisation, merger or take-over, no exit credit will generally be paid.

9. If there is any doubt about the applicable LGPS benefit structure at the date of exit (e.g. McCloud remedy), the Fund's actuary may include an estimate of the possible impact of any resulting benefit changes when calculating an employer's pension liabilities to determine the level of any exit credit.

10. The Fund will take into account whether any outstanding contributions or other payments are due to the Fund at the cessation date. Any outstanding payments will be notified to the exiting employer and will be deducted from any exit credit payment.

11. The Fund will consider any representations made by the letting authority and/or any other relevant scheme employer regarding monies owed to them by the exiting employer in respect of the contract that is ceasing. Representations regarding any such outstanding payments should be made to the Fund within one month of the exiting employer ceasing participation in the Fund.

12. The Fund's final decision will be made by the Director of Finance & ICT with advice from the Head of Pension Fund, and where necessary with advice from the Fund's actuary, and/or legal advisors, in consideration of the guidelines set out in this policy.

13. There may be some situations which are bespoke in nature. In these situations, the Fund will take into account the factors it considers to be relevant in determining whether an exit credit is payable, including representations from relevant parties. The Fund's decision on how to make an exit credit determination in these instances will be final.

14. The Fund will inform the exiting employer of any exit credit amount due to be paid and seek to make payment within six months of the exit date. In order to meet the six month timeframe, the Fund will require prompt notification of an employer's exit and all data and relevant information as requested. The Fund will be unable to make an exit credit payment until all the requested data and information has been received. Agreement to an extension of the timeframe will be deemed where data and information have not been provided on time.

Appeals

If a party involved in the exit credit process set out in this Policy wishes to dispute the Fund's determination, this must be routed through the Fund's internal dispute resolution procedure (application for adjudication of disagreements procedure - AADP). A copy of the AADP is available here: AADP

If the relevant party is still unhappy with the exit credit determination, having gone through all the stages of the AADP, they may be able to take a complaint to the Pensions Ombudsman.

Review

This Exit Credits Policy will be reviewed at least every three years as part of the triennial valuation process or following any relevant changes in the LGPS Regulations.