

Pensions Committee

2.30pm, Tuesday, 23 September 2014

Update on Employers Participating in Lothian Pension Fund

Item number	5.7
Report number	
Wards	All

Links

Coalition pledges

Council outcomes

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

Single Outcome Agreement

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Executive summary

Update on Employers participating in Lothian Pension Fund

Summary

This report provides updates on:

- employers who are currently looking to join the Fund;
- employers leaving the Fund; and
- other current matters including an update on the review of the covenant of individual employers.

Recommendations

To recommend that the Pensions Committee:

1. note the changes to the employers participating in Lothian Pension Fund; and
2. the work being carried out to review the covenant of employers and its use in the 2014 actuarial valuation.

Measures of success

Employers continue to take decisions in full knowledge of Local Government Pension Scheme (LGPS) regulations and with awareness of policies put in place by the Fund to protect the Fund as a whole.

Financial impact

There is no financial impact arising directly from this report. However proactive monitoring of employers participating in the Fund and appropriate admission agreements for employers helps to protect the financial position of the Fund and the other employers in the Fund.

Equalities impact

There is no equalities impact as a result of this report.

Sustainability impact

There is no sustainability impact arising from this report.

Consultation and engagement

The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to governance.

The Fund engages with employers on a regular basis as follows:

- monthly bulletins are issued to employers highlighting relevant issues;
- employer events are held throughout the year; and
- dedicated resource in the Fund in the form of an Employer Relations Officer.

Changes to relevant regulations and policies and the implications of these changes are communicated to employers, with consultation exercises carried out where appropriate.

On an annual basis the Fund writes to employers with less than five active members to remind them of the provisions which will apply if/when their last member leaves the Fund. In these circumstances, as required by the Scheme regulations and the Fund's Funding Strategy Statement, a cessation valuation will be carried out to establish the value of any surplus or deficit.

We continue to remind employers at events and via the employer bulletin of the importance of this keeping the Fund informed of any changes that could have an impact on their pension arrangements.

Background reading / external references

None.

Update on Employers participating in Lothian Pension Fund

1. Background

- 1.1 Responsibilities of both the Council, as administering authority of Lothian Pension Fund ('the Fund') and the participating employers are set out in the Funding Strategy Statement and the Pensions Administration Strategy. Both these documents have been previously approved by Committee.
- 1.2 The Funding Strategy Statement includes the 'Admission Policy' (for employers joining the Fund), the 'Policy on Employers leaving the Fund' (cessation policy) and the 'Charging Policy' outlining when charges will be levied by the Fund.
- 1.3 The Pensions Administration Strategy sets out standards for exchange of information, including the requirement for the employer to keep the Fund informed about planned changes to their pension provision, including bulk transfers of staff and any outsourcing.

2. Main report

Employers joining the Fund

- 2.1 Since the last report to Committee in March 2014, no employers have joined the Fund.

Employers leaving the Fund

- 2.2 As noted in the March 2014 report to Committee, the only member employed by Mitie (PFI) under their contract with West Lothian Council left employment in October 2013. The admission agreement was set up as a 'closed' admission agreement and therefore no further members will join. With no active members, the admission agreement with the Fund was terminated. A cessation valuation was calculated by the Fund's Actuary which confirmed that there was no deficit on a cessation basis and no payment due to the Fund.

Forth Estuary Transport Authority (FETA)

- 2.3 Discussions continue with Transport Scotland with regard to the dissolution of FETA from June 2015. The Fund is working with legal advisers to produce documentation reflecting the provisions of the Forth Road Bridge Act 2013. This provides for the transfer of liabilities to the Scottish Government who have agreed to act as guarantor for the legacy pension liabilities.
- 2.4 Following the dissolution of FETA, a new contractor will be appointed to operate both the Forth Bridge and the new Forth crossing. Current employees of FETA are expected to transfer to this organisation under TUPE and the contractor is expected to apply for admission on a 'closed' basis (that is, no other employees working on the contract will be permitted to join the Fund). Again, the Scottish Ministers have indicated that they will act as guarantor for the new contractor and admission documentation is in the process of being prepared.

Citadel Youth Centre

- 2.5 Discussions continue with Citadel Youth Centre over a revision to their admission agreement to take into account their imminent change from an unincorporated body to a Scottish Charitable Incorporated Organisation (SCIO).

Other employer changes

- 2.6 The Fund is aware of the integration of councils' Health & Social Care services with the National Health Service. Such a review could have pensions implications if there are staffing or organisation changes and this will continue to be monitored.
- 2.7 The Fund has been advised by the City of Edinburgh Council of 4 ongoing staff transfer exercises within the Services for Communities department. These exercises could potentially result in a total of up to 83 staff transferring to the Council, and 1 individual moving to an outside body. These transfers are scheduled for completion over the next financial year.

Review of Employer Covenant

- 2.8 As noted in the March 2014 report to Committee, the Fund has carried out a review of the covenant for employers who are part of the Fund. This work included an analysis of financial and membership information, the responses from the employer funding survey and other information obtained from ongoing monitoring. Using a 'traffic light' system, each employer has been allocated a financial and non-financial rating, as well as an overall indicator to indicate the strength of their covenant.
- 2.9 The rational and parameters for the covenant assessment are outlined in the Appendix to this report.

- 2.10 The results will be used to inform the 2014 actuarial valuation process including the extent to which employers can be provided with stability of employer contributions. Decisions will be taken following consultation with the Fund's Actuary.
- 2.11 Over the coming months, each employer will be provided with their individual results from the covenant assessment as part of the engagement and communication on the actuarial valuation.
- 2.12 Results will also be shared with larger employers (Councils and Scottish Government), which have previously either signed guarantor documents with smaller employers, or agreed previously that liabilities can be aligned, in order to obtain their agreement with any decisions on contribution stability.
- 2.13 Monitoring of the employer covenant will continue, as it is recognised that circumstances can change and therefore an employer's risk profile can also change.

3. Recommendations

To recommend that that the Pensions Committee note

- 3.1 the changes to the employers participating in the Fund, and;
- 3.2 the work being carried out to review the covenant of employers and its use in the 2014 actuarial valuation.

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Appendices Assessment of Employer Covenant

ASSESSMENT OF EMPLOYER COVENANT

1. INTRODUCTION

This document sets out the Lothian Pension Fund's approach to managing the risks associated with employers being unable to finance their pension liabilities.

1.1 Types of Employers

There are three types of the employers participating in the Lothian Pension Fund:

Scheduled bodies: these bodies are defined in Local Government pension regulations and are required to offer membership of the Lothian Pension Fund to (some of) their employees.

Under the Local Government Pension Scheme (LGPS) (Scotland) Regulations, certain employers are allowed to participate in the Lothian Pension Fund (the Fund) if they satisfy the relevant criteria. These are known as admission bodies. An admission body is required to have an 'admission agreement' with the Fund. In conjunction with the regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.

Transferee admission bodies: these bodies generally will have a guarantor in the Fund since the regulations require that, in the event of any unfunded liabilities on termination of the admission, the contribution rate for the relevant Scheme employer should be revised.

Community admission bodies: In some cases these bodies (in particular historical cases) have no guarantor in the Fund so any unfunded liabilities on termination would be the responsibility of the whole Fund and therefore all employers. In this respect, please note the Fund has a policy of prior alignment of such liabilities to the relevant Council(s) or Scottish Government, where clear linkage can be established.

The Fund's policy on admitting employers to the Fund is contained in its Funding Strategy Statement which can be found on its website www.lpf.org.uk.

1.2 Employer covenant

An employer's covenant underpins its legal obligation and ability to fund pension obligations now and in the future. The strength of covenant depends upon the robustness of the legal arrangements in place and the likelihood that the employer can meet them. The covenant effectively reflects the risk to which the Fund, and all other employers in the Fund, is exposed.

2. EMPLOYER RISK MANAGEMENT

The employer covenant should be assessed objectively and the ability of employers or guarantors to meet their obligations should be viewed in the context of the Fund's exposure to risk and volatility, while preserving the interests of other employers within the Fund.

The monitoring of covenant strength by itself does not strengthen the Fund's security; however, it should enable the Fund and employers to anticipate and pre-empt funding issues and thus adopt a proactive approach to manage risk.

2.1 Current Employer Risk Mitigations

The Lothian Pension Fund current approach to managing risk associated with employers being unable to meet their pension liabilities:

- New admission agreements include a guarantor
- New employers are required to sign that they have read the Funding Strategy Statement;
- 'Alignment' of employers with funding bodies:

The Fund has previously established an "alignment" of community admission bodies to the relevant local authority employer, where a clear linkage can be demonstrated. This can include a proportionate alignment of liabilities for community admission bodies, typically charitable organisations, whose activities are regionally based and therefore span more than one local authority area. Similarly, certain national bodies are aligned to the Scottish Government.

- Ongoing communication with employers in relation to funding and other obligations;
- Monitoring of numbers of active members and closer liaison when fewer than 5 active members;
- Prudent cessation valuation and payment of any deficit
- Dedicated employer relations resource and regular contact with employers.
- "Strain on fund" costs, which arise from an employer's granting of early retirement or redundancy, are payable in full on member retirement.

In addition, different characteristics of employers are taken into account in the funding strategy and the actuarial valuation:

- Bespoke funding calculation for most large employers, reflecting their employee experience;
- Allowance for employers who are open/closed to new members;
- Operation of pools of smaller employers and reviews of the criteria for remaining in the pool;
- Shorter deficit recovery periods reflecting the employer's commitment to the Fund (finite participation)

2.2 Strengthening Employer Risk Mitigation

Lothian Pension Fund is undertaking more detailed analysis on employer covenant to further reduce the risk of employers not being able to meet liabilities. This will be based on information from a number of sources and will inform the review of the funding strategy during the 2014 actuarial valuation process.

Financial

In order to objectively monitor the strength of an employer's covenant, the proposal is for a number of fundamental metrics to be appraised to develop an overview of the employer's stability as follows:

- Employer's pension funding position relative to size of its financial metrics using:
 - Actuarial valuation basis (gilts basis)
 - Actuarial valuation basis (ongoing basis)
 - Accounting (FRS17/IAS19) if available
- Net current assets
- Pension contributions relative to the employer's current assets.
- Late payment of contributions to the Fund

Non financial

Other non-financial data could also be important in considering an employer's position in the Fund, as follows:

- Does the employer's agreement include a guarantor with strong covenant?
- Whether any organisational changes are planned (such as restructures etc)
- Whether there are plans for large scale workforce changes, e.g. redundancies, outsourcing
- Change in the payroll of active members (a falling payroll could have an impact on the ability to fund pensions)
- Whether membership of the LGPS is open or closed to new members of staff
- Number of active members (a small number of members will bring the organisations's end date closer and therefore a requirement for a cessation valuation)
- Time until the last active member is expected to retire
- Completion of the Fund's employer covenant survey
- Type of organisation (this will impact on the duration of the employer: Scheduled Bodies, in general, will have no end date, whereas a contractor may only be expected to participate in the Fund for a limited time)
- If the organisation is dependent on grant-aided funding
- Whether an employer has enquired about exiting the Fund

Each employer will be assessed against these indicators using a traffic-light scoring system. Based on the results a financial rating, non-financial rating and overall rating is derived based on the following:

Non-Financial			
Indicator	RED	AMBER	GREEN
Closed to new entrants	Closed	Potential (enquiry received)	Open
Guarantor in place	No guarantor	Council agreed to guarantee	Signed guarantor agreement
Guarantor/aligned body covenant strength	Other	Universities/Colleges	Council/Scottish Government
Dependency on grant aided funding	Wholly Dependent	Partially	Not dependent
Membership numbers	Less than 5 actives	5-10 actives	Over 10 actives
Date last member due to retire	Less than 3 years	3-6 years	> 6 years
Is organisation a TAB?	Yes		No
Survey	No response	Queries/incomplete	Complete survey, no queries
Organisational restructure planned	Yes		No
Payroll reduction AV2011-AV2014	Over 10%	5-10%	0-5%
Request/Enquiry for cessation valuation	Yes		No
Financial			
Indicator	RED	AMBER	GREEN
Late payment of contributions 12/13	>1	1	None
Contributions over Net Current Assets 2012/13 (if Net Current Assets are positive)	>50%	>20% and <50%	<20%
2011 Valuation Surplus (Deficit) over Pay at 2011 Valuation	<-200%	>-200% and <-30%	>-30%
2013 FRS17/IAS19 Surplus (Deficit) over Pay at AV2011	<-250%	>-250% and <-50%	>-50%
2011 Gilts Surplus (Deficit) over Pay at AV2011	<-350%	>-350% and <-100%	>-100%
C Net Current Assets / (Liabilities) 2012/13	<0		
No Financial Information	0		

2.3 Ongoing monitoring

The strength of employer covenant is expected to vary over time and clearly some of the risks identified are beyond the control of the Fund. Therefore it is imperative that the Fund undertakes monitoring on a regular basis and that all employers engage with the Fund as circumstances change.

The intention is to undertake a formal covenant assessment on an annual basis. Interim liaison with employers will remain an integral part of the Fund's approach to managing the risks.

2.4 Employer Engagement

Meetings will be scheduled with those organisations where there is a particular concern over strength of their covenant, including concerns over any of the factors noted above and/or where there is a need to gain a better understanding of their financial position.

It is recognised that meetings will be tailored to each employer's needs, in conjunction with the Fund's assessment of that organisation; however, it is anticipated that the payment of pension liabilities on termination will feature heavily in these discussions.

3. OUTCOMES

The potential outcomes of the Employer Covenant monitoring process are set out below.

- Improved risk analysis and opportunities to reduce the risk of employers being unable to meet pension obligations;
- Pension fund stakeholders better informed of the risks;
- Greater awareness across the employer membership of the respective and proportionate obligation to meet liabilities in the event of default by any other Fund employer;
- Greater awareness of employers of their specific funding issues;
- Greater awareness by the larger employers of the pension liabilities and associated risk profile of those smaller employers to which either guarantees have been provided, or to which, in the event of default, such liabilities are aligned by the Fund. Such implications, for example, may influence grant funding considerations;
- The process will inform the 2014 actuarial valuation process, the Funding Strategy for the Fund and employer contributions;
- Review of admission agreement, if appropriate;
- An opportunity for guarantor and/or contingent assets to be put into place to provide assurance and to strengthen the employer covenant;
- Review of the suitability of the Fund's overall investment strategy for the specific circumstances of the employer;
- Constructive discussion with those employers who are investigating potential termination of admission agreement.