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<tr><th colspan="3">Bath & North East Somerset Council</th></tr>
<tr><td>MEETING:</td><td colspan="2">AVON PENSION FUND COMMITTEE</td></tr>
<tr><td>MEETING DATE:</td><td>26 SEPTEMBER 2014</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td colspan="2">TERMINATION POLICY FOR SCHEME EMPLOYER EXITS</td></tr>
<tr><td>WARD:</td><td colspan="2">ALL</td></tr>
<tr><td colspan="3">AN OPEN PUBLIC ITEM</td></tr>
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Appendix 1 – Mercer paper on Termination Policy</td></tr>
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1 THE ISSUE

1.1 The Funding Strategy Statement sets out the basis for valuing assets and liabilities in the event of a scheme employer terminating its participation in the fund. The policy is designed to be equitable to both the exiting employer and the continuing employers within the Fund.

1.2 Mercer have provided advice to the Administering Authority following recent changes in the LGPS Regulations governing the options and treatment available to Administering Authorities either at termination, or prior to an expected termination at some point in the future. Mercer's advice is contained in Appendix 1.

1.3 The main changes relate to how a termination assessment can be triggered and the repayment plan to be set by the Administering Authority. This has implications for the basis on which the termination value is assessed.

1.4 In addition to the Actuary's advice, the Fund has obtained legal advice on the recent changes to the regulations. The legal advice is in line with that from the actuary.

2 RECOMMENDATION

The Committee:

2.1 Approves the recommended changes to the termination policy with regard to:

i. Repayment plans as set out in paragraph 5.2

ii. The margin for adverse demographic risk factors as set out in paragraph 5.7.

3 FINANCIAL IMPLICATIONS

3.1 When an employer leaves the Fund, there is no further recourse to that body if the accumulated assets notionally allocated to that body at the exit date prove to be inadequate in meeting future benefit payments. As the body supporting these liabilities will have no ongoing responsibility in respect of these liabilities once they have left the Fund, the residual liabilities will then become the responsibility of any existing guarantor in the Fund or by the Fund as a whole (i.e. all participating employers), in which case they become known as "orphan liabilities".

3.2 Therefore an exit contribution payment will be requested from the outgoing employer (unless the deficit passes to the guarantor within the Fund). The exit payment is assessed on the exit or termination basis which values the liabilities using corporate bond yields. This more prudent basis is used to provide protection to the other scheme employers from adverse movements in the financial markets after the exployer exits the Fund.

4 CURRENT TERMINATION POLICY

4.1 As set out in the Funding Strategy Statement, the termination deficit is assessed using market conditions at the exit date i.e. based on corporate bond yields and market implied inflation expectations applying at that date. The use of corporate bond yields as the basis for determining the termination deficit provides a contingency margin against adverse changes in market conditions.

4.2 The termination basis uses the other non-financial assumptions from the latest triennial valuation to value the liabilities. The Fund does not make any adjustment to these (mainly demographic) assumptions.

4.3 The Fund agrees a payment plan with the exiting employer. If an instalment plan is agreed, the plan can be reassessed at subsequent valuations until it has be repaid.

5 CHANGES TO LGPS REGULATIONS AND REVISED FUND POLICY

Termination Payment Plans:

5.1 The Regulations have been amended so that termination calculations are triggered for any employer when the last active member leaves. The regulations give power to the Fund to set a payment plan to recover the outstanding debt at its discretion. However, under the new regulations, once set this plan is fixed it cannot be adjusted at subsequent valuations.

5.2 The Fund's recommended policy for termination payment plans will be as follows:

i. The default position is for exit payments to be paid immediately in full.

ii. Instalment plans over a defined period will only be agreed when there are issues of affordability that risk the financial viability of the organisation and the ability of the Fund to recover the debt.

5.3 The Fund consulted its legal advisor about the changes to the regulations and the operational impact on the setting of repayment plans. Their advice concurred with that of the actuary.

Funding Basis:

5.4 The Actuary has advised that the use of the corporate bond funding basis is appropriate for assessing liabilities on termination. This basis mitigates against financial market risks as an investment strategy to run off these liabiltiies could be constructed to minimise fluctuations due to market shifts. We do not do this at the current time due to the relatively small exposure which was c. 1.8% of liabilities at the 2013 valuation. We would review this overtime if the exposure increased markedly but this is unlikely given the nature of the Fund. To put this into context the liabilities of the community admission bodies, including those with guarantees, were 5.7% of total liabilities (or £229m) at the 2013 valuation.

5.5 However, it does not provide against future adverse demographic experience relative to the assumptions which could emerge at future triennial valuations. Historically, there have been few large scheme employers that have left the scheme (and where this has happened, it was mainly been due to service reorganisations). However, with the advent of autoenrolment and a difficult funding environment, more admission bodies are reconsidering their participation in the scheme   In this environment there is a increased risk that adverse movements in the funding assumptions could have a more significant impact on the remaining participating employers over time if demographic experience turns out worse than expected. Therefore the Actuary feels it is appropriate to include a higher level of prudence in the demographic assumptions on termination to further protect the remaining employers.

5.6 The Actuary advises a reasonable adjustment is made to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to 2% p.a. in relation to the termination assessement for an outgoing employer from 1.5% used in the 2013 valuation for ongoing funding and contribution purposes.

5.7 The Fund's recommended policy for the termination funding basis will be as follows:

i. Use a 2% p.a. long term rate for longevity improvement.

5.8 The Actuary's advice is in Appendix 1. Any changes to policy will be incorporated in the next review of the FSS.

6 RISK MANAGEMENT

7 A key risk to the Fund is the inability of an individual employer to meet its liabilities, especially when it ceases to be an employing body within the Fund. The assessment of termination liabilities that is equitable to all scheme employers is crucial part of the risk management process. Ongoing assessment of the strength of an employing body's covenant is another component in managing the potential risk of default to the Fund. Within the Investments Team there are officers with responsibility for monitoring the employers' financial position and to support the Investments Manager in managing the financial and liability risks, both on-going and at termination.

8 EQUALITIES

8.1 Not relevant as regarding the implementation of policy.

9 CONSULTATION

9.1 Not relevant as regarding the implementation of policy.

10 ISSUES TO CONSIDER IN REACHING THE DECISION

10.1 The relevant information is set out in the report.

11 ADVICE SOUGHT

11.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

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Background papers	Correspondence with legal advisor
Please contact the report author if you need to access this report in an alternative format	