

## Bath & North East Somerset Council

MEETING:	AVON PENSION FUND COMMITTEE	
MEETING DATE:	16 MARCH 2012	AGENDA ITEM NUMBER
TITLE:	FUNDING STRATEGY STATEMENT - TERMINATION OF ADMISSION AGREEMENTS	
WARD:	ALL	
<b>AN OPEN PUBLIC ITEM</b>		
List of attachments to this report:  Appendix 1 – Revised Funding Strategy Statement		

### 1 THE ISSUE

1.1 This report concerns the treatment of residual liabilities when an admission agreement terminates. A change is being proposed to the Funding Strategy Statement (FSS) which should be to the benefit of both the Fund and the employing bodies. This is because, in the case of transferee admission bodies, it will provide greater certainty than currently exists, albeit by restricting choice, while, in the case of community admission bodies guaranteed by a scheme employer, where choice will still exist, management of the liabilities will be improved because decisions concerning the residual liabilities will be made upfront.

### 2 RECOMMENDATION

#### That the Committee:-

- 2.1 Approves the revised Funding Strategy Statement as set out in the Appendix.
- 2.2 Delegates authority to the Resources Director in consultation with Chair and Vice-Chair to consider exceptional requests and vary the policy in order to manage exceptional risks which will subsequently be reported to Committee.

### 3 FINANCIAL IMPLICATIONS

3.1 The financial implications associated with the proposed change relate to the transfer of risk from the Fund to the outsourcing scheme employers in the case of transferee admission bodies. However, it is not possible to make any judgement as to who will benefit from the risk transfer because this will depend on what happens in the future to those factors which affect the valuation of pension liabilities.

### 4 BACKGROUND

4.1 At the present time the Fund's policy, as set out in the FSS, is as follows:-

"Unless the liabilities of an admitted body are transferred on closure to another employing body, the residual liabilities will be valued using either:

- an "on-going" valuation basis; consistent with the 2010 actuarial valuation assumptions but updated for market yields/inflation applying at the cessation date, or
- a "corporate bond yield" basis; consistent with the 2010 actuarial valuation assumptions, updated for market yields/inflation applying at the cessation date but with a discount rate based on the long dated Sterling AA Corporate Bond yield,

whichever produces the higher liability value".

(Invariably the "corporate bond yield" basis produces a higher valuation for the liabilities. However, the policy is worded in the way that it is because very occasionally there are market aberrations which undermine this "norm")

### 5 NEED FOR CHANGE

5.1 There are essentially two reasons why the present system needs to change. These are as follows:-

- (i) **Contractual** – commercial contracts should make it clear at the outset on what basis the liabilities are going to be valued when the contract terminates. The present system does not encourage outsourcing employers to address this issue in the contract documentation, given that, so far as the FSS is concerned, this decision can be made at the end of the contract.
- (ii) **Actuarial** – Contribution rates, both at the start of a contract and at actuarial valuations, can be calculated on an informed basis if the actuary knows how the liabilities are to be treated at the conclusion of the admission agreement. At the present time there is a presumption that at the conclusion of a contract the liabilities will be valued on a corporate bond basis when the reality is that in most cases no decision has been taken.

5.2 It therefore makes sense to move to a system where the treatment/valuation of liabilities at the conclusion of a contract is decided **in advance**.

## 6 PROPOSED CHANGE

- 6.1 In the case of transferee admission bodies, specific services are outsourced by a scheme employer to a contractor and it is therefore considered to be feasible for all liabilities at the point of closure to revert to the scheme employer. However, in the case of community admission bodies, the relationship between an admission body and a scheme employer may not always be sufficiently close for the reversion option to be appropriate.
- 6.2 The change which is now being proposed follows discussions with the Fund's actuary. This would involve transferee admission bodies and community admission bodies being treated differently in future, viz.

**Transferee Admission Bodies** – In these cases all liabilities on closure will revert to the outsourcing scheme employer. This reflects the fact that the Transferee Admission Body is discharging a function of the scheme employer.

**Community Admission Bodies** – In these cases the outsourcing scheme employer will continue to have a choice as to whether to take back the liabilities on closure or leave them with the Fund. **However, this choice will need to be exercised before the admission agreement begins.** Where a decision is taken to leave the liabilities with the Fund, contribution rates will be calculated on a corporate bond basis.

## 7 PRACTICAL IMPLICATIONS

- 7.1 As indicated earlier, the way in which liabilities are treated on closure has a direct impact on any commercial or service contract where the pensions risk is transferred. **Where it is not transferred, there will be a presumption in the case of community admission bodies as well as transferee admission bodies that at the conclusion of the contract the liabilities will revert to the scheme employer.**
- 7.2 Where the pensions risk has been transferred, the practical effect of the proposed change is as follows:-
- (i) **Transferee Admission Bodies** – the Fund actuary will calculate a final liability using the on-going valuation basis. If there is a deficit, the transferee admission body will be required to settle this. The payment by the transferee admission body will be credited in the Fund's books to the outsourcing scheme employer. In effect, the liabilities will revert to the scheme employer fully funded.
  - (ii) **Community Admission Bodies** – Where the outsourcing scheme employer has decided that it will accept the liabilities on closure, the procedure will be the same as for transferee admission bodies. Where the outsourcing scheme employer has decided that it does not wish to take back the liabilities onto its own books, the Fund actuary will calculate a final liability using the "exit" basis of valuation (i.e. the discount rate will normally be the corporate bond yield). If there is a deficit, the community admission body will be required to settle this. The payment by the community admission body will then be credited to the Fund and set against the liabilities left with the Fund.

## **8 CONSULTATION**

8.1 It has not been practical to consult all the scheme employers who might be involved in outsourcings. However, the four unitary councils, who are responsible collectively for c. 85% of existing transferee admission agreements, have been consulted. It is hoped that their views will be representative of scheme employers as a whole.

8.2 Bath & North East Somerset Council, North Somerset Council and South Gloucestershire Council are all comfortable with the proposed change. Bristol City Council has no fundamental objection but the Fund has had to address two issues which arose during the course of correspondence with their officers. These were:-

(i) Where a new contract was let to the same transferee admission body as previously, could a deficit be carried forward to the new contract instead of being “crystallised”? The Fund was happy to agree to this.

(ii) Although it was difficult to identify the particular circumstances where such an eventuality would arise, might there not be occasions when it would be reasonable for the residual liabilities to be left with the Fund in the case of a terminated transferee admission agreement? Fund’s response set out in 9.3 below.

## **9 REVISED FUNDING STRATEGY STATEMENT**

9.1 Having taken into account the consultation responses, the FSS will be revised to incorporate the change in policy as proposed in Section 6 above.

9.2 As a result, the Appendix to the FSS will be revised with new paragraphs 12, 13 and 19. The revised FSS including the appendix is attached as Appendix 1 to this report.

9.3 However, in response to the issue raised by Bristol City Council in 8.2(ii) above, as it is not always possible to foresee future scenarios and the service delivery models within the public sector are becoming increasingly complex, it is advisable to have some discretion within the Policy to enable officers to accommodate changed circumstances on the basis that risks to The Fund and employers are always minimised through practical solutions. Therefore, it is requested that delegated authority is given to the Director of Resources in consultation with the Chair and Vice-Chair to (i) consider any exceptional request that could arise in the future that cannot be envisaged at present and (ii) vary the policy accordingly in order to manage exceptional risks. Any variations to policy should subsequently be reported to Committee.

## **10 EXISTING CONTRACTS**

10.1 So far as the existing contracts are concerned, the current arrangements will stand. However, for actuarial purposes, scheme employers will be asked to review these contracts and to let the Fund know how they wish to treat the liabilities when the contracts end.

## **11 RISK MANAGEMENT**

11.1 Although risk reduction was not the primary driver, the proposed change will deliver a reduced risk for the Fund in the sense that it will be left with fewer

“orphan liabilities” (i.e. liabilities for which no scheme employer is responsible) on its books.

## **12 EQUALITIES**

12.1 There are no equalities issues associated with the proposed change.

## **13 CONSULTATION**

13.1 The response from the consultation is discussed in Section 8 of this report.

## **14 ISSUES TO CONSIDER IN REACHING THE DECISION**

14.1 The relevant issues are set out in the report.

## **15 ADVICE SOUGHT**

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

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<b>Background papers</b>	
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