

Bath & North East Somerset Council			
MEETING:	AVON PENSION FUND COMMITTEE		
MEETING DATE:	24 MARCH 2017	AGENDA ITEM NUMBER	11
TITLE:	Ill Health Insurance		
WARD:	ALL		
AN OPEN PUBLIC ITEM			
List of attachments to this report:			
Exempt Appendix 1 – Policy Options			

## 1 ISSUE

- 1.1 When a scheme member is granted early retirement on the grounds of permanent ill health they receive earlier than expected payment of accrued benefits, including an enhancement to accrued membership, the value of the enhancement being dependent on the category of ill health.
- 1.2 The increased liabilities associated with ill health retirement can place a considerable strain on employers especially those with fewer active members.
- 1.3 Currently an ill health pension strain is met by an ill health allowance included in each employer's future service contribution rate. Actual ill health experience may vary considerably from the ill health allowance, resulting in some cases significant increases in employer contributions at the subsequent triennial valuation.
- 1.4 As part of the Funding Strategy Statement consultation, a number of employers supported the Fund's view that options for insuring ill health retirement costs should be explored in order to mitigate the risk to smaller employers.
- 1.5 This report provides a summary of the ill health risk and the options to manage this risk more effectively for smaller employers.

## 2 RECOMMENDATION

**That the Committee**

- 2.1 Approves the recommendation to implement an internal captive ill health insurance arrangement with effect from 1 April 2017 (when the new rates from the 2016 valuation commence).**

### **3 FINANCIAL IMPLICATIONS**

- 3.1 The allowance for ill health retirements is currently included in each employer's future service rate (FSR). Actual experience is adjusted for at the subsequent valuation.
- 3.2 Under either option to insure this risk there will be no change to the employers FSR for the three years effective from 1 April 2017.

### **4 ILL HEALTH RISKS**

- 4.1 When a scheme member is awarded early retirement on grounds of ill health there is an increase in the pension liability for the participating employer (the strain cost). This results from an early payment of the pension, and an increase in the benefits payable to the member through augmentation awarded on ill health retirement.
- 4.2 The cost of the retirement depends on the ill health tier awarded to the member. Tier 1 early retirement is based on full prospective service while Tier 2 early retirement is based on 25% of prospective service. Whilst Tier 1 & 2 ill health early retirements are relatively rare, when they occur they can generate a significant cost to the employer, especially those with fewer active members.
- 4.3 As part of the consultation on the Funding Strategy Statement, smaller employers were interested in exploring options for insuring against this risk. In addition, from the Fund's perspective this is becoming a more significant employer risk given the scope of employers now participating in the scheme.
- 4.4 Currently an ill health pension strain has been met by an ill health allowance being included in each employer's contribution rate. The cost of actual ill health experience may vary considerably from the ill health allowance, resulting in potentially large increases in employer deficit contributions at the next triennial valuation.
- 4.5 At present the Fund's approach is that employers effectively self-insure against ill health retirement costs via a portion of their contribution rate; the amount varies from employer to employer depending on membership profile.
- 4.6 Whilst this arrangement works for larger employers such as the local authorities, colleges and universities who all have significant pensionable payroll to absorb the cost, it can create financial stress for smaller employers. There is a risk that some employers in the Fund may be unable to meet the strain cost arising from an ill health early retirement. In the worst case the increased deficit contributions could force a scheme employer into insolvency.
- 4.7 For a captive or external arrangement to be cost effective a critical mass of premiums is required. As a result the employers that would be covered by the insurance arrangements include the following:
  - Town & Parish Councils
  - Other Designating Bodies
  - Small Community Admission Bodies
  - Academies
  - Transferee Admission Bodies where the outsourcing body is in the arrangement (e.g. outsourcings from academies).

## 5 POLICY OPTIONS

- 5.1 The two options considered by the Fund are 3<sup>rd</sup> party external insurance and captive internal insurance. Both options are explored in the summary paper by Mercers (see Exempt Appendix1).
- 5.2 The advice has taken into account the cost of the insurance premium under both options over the longer term, operational administration implications and governance considerations.
- 5.3 Under a 3<sup>rd</sup> party external arrangement, the Fund would be the party being insured so all administration of claims (including any challenges from the insurer about a claim) would be the responsibility of the Fund. Therefore from the Fund's perspective the operational administrative implications need due consideration.
- 5.4 The captive arrangements would be relatively simple to administer as it would only entail a notional payment of premiums by employers which will be tracked within the actuarial model and by the fund. Each valuation the employer's FSR would be adjusted to ensure the captive has sufficient funds to meet the costs. **Importantly, this will ensure that the captive is self-financing over time.**
- 5.5 The external market for insuring this risk within the LGPS is not particularly well developed giving rise to risk that future pricing will not be competitive. In addition, the extra administration cost that would be charged to participating employers by the Fund would partially offset any benefit of lower costs of external insurance.
- 5.6 Mercers recommend that the Fund implements an internal captive arrangement due to the uncertainty over the level of the 3<sup>rd</sup> party insurance premium over the medium term, the increased administrative costs of 3<sup>rd</sup> party insurance to the Fund (and thus employers) and the more simple operational aspects of the captive arrangement.
- 5.7 Following the Committee's decision, scheme employers will be informed as to how this policy will be implemented. Under either option there will be no change to contribution rates for the three years from 1 April 2017; any adjustment will be reflected in 2019 valuation results.

## 6 EQUALITIES

- 6.1 An equalities impact assessment is not necessary.

## 7 CONSULTATION

- 7.1 N/A

## 8 ISSUES TO CONSIDER

- 8.1 Are included in the report.

## 9 ADVICE SOUGHT

- 9.1 The Council's Monitoring Officer (Divisional Director – Legal & 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	
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