

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND COMMITTEE	
MEETING DATE:	28 June 2021	AGENDA ITEM NUMBER
TITLE:	FUNDING & EMPLOYER UPDATE	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Exempt Appendix 1 – Covenant Tool Employer Risk Ratings Exempt Appendix 2 – KPI analysis for an Employer - example		

1 THE ISSUE

- 1.1 A key risk to the Fund is the inability of an individual employer to meet its liabilities. The Funding Strategy is designed to manage this risk to ensure the Fund achieves full solvency over an appropriate period. Assessing the strength of an employing body's covenant is also a crucial component in managing the potential risk of default to the Fund. Accordingly, a covenant assessment framework has been developed by the Fund.
- 1.2 To provide the Committee with an overview of the covenant assessment framework developed by the Fund to monitor employer risk. This framework helps direct resources where closer monitoring and possible intervention is required and enables the Fund to identify any emerging risks early so that appropriate actions can be taken to prevent sub optimal outcomes for the Fund and employer.
- 1.3 Assessing and regularly monitoring the major employers covenant will help to decide the appropriate level of risk when setting the investment strategy and funding strategy.

2 RECOMMENDATION

2.1 The Committee notes the report.

3 FINANCIAL IMPLICATIONS

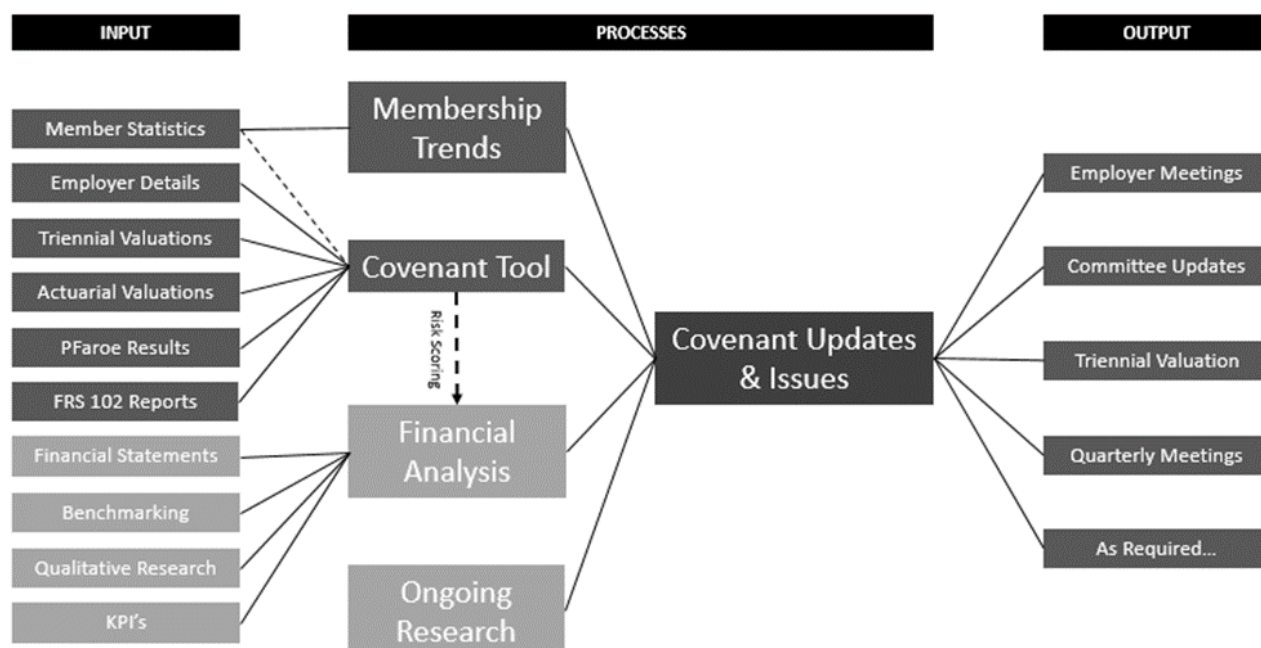
- 3.1 An interim valuation at the whole fund level will take place at 31 March 2021. The interim valuation will provide the Fund and major employers with an indication of the potential future changes in employer contributions. This will be particularly important in view of the financial implications resulting from the pandemic. Covenant information will be considered alongside the Interim Valuation results to determine the affordability of contributions at the next valuation at both the Fund level and employer level.

4 REGULATORY AND POLICY FRAMEWORK

- 4.1 The government amended the LGPS Regulations 2013 in September 2020 to introduce new powers for administering authorities to review employer contributions, spread exit payments and set up Deferred Debt Agreements (DDA). The Ministry for Housing Communities and Local Government provided statutory guidance to assist Administering Authorities who wish to use the new powers. Part of this guidance requires that the Administering Authority take actuarial, covenant, legal and other advice in considering cases.
- 4.2 The Pensions Regulator defines employer covenant as “the covenant is the employer’s legal obligation and financial ability to support their defined benefit scheme now and in the future.” This definition refers to the “legal obligation” which includes aspects such as the legal basis for the employer participating in the Fund, guarantor arrangements and security agreements. The definition also refers to the “financial ability...now and in the future” which requires financial review. With 400 employers in the Fund resources are focused on employers who pose a risk to the current funding plans or a risk of default to the Fund.
- 4.3 The Fund’s Covenant Assessment and Monitoring Policy is set out in Appendix H of the Funding Strategy Statement.

5 EMPLOYER COVENANT PROCESS OVERVIEW

- 5.1 The monitoring of covenant strength along with the funding position (including on the termination basis) enables the Fund to anticipate and pre-empt employer funding issues and thus adopt a proactive approach. An overview of the employer covenant process is set out in the diagram below.
- 5.2 Monitoring membership trends is a simple process which can detect changes at an employer which the Fund may not have been informed about.
- 5.3 The Fund holds information on every employer and the Covenant Tool has been developed internally to bring all this information together. In order to objectively monitor the strength of an employer’s covenant a number of fundamental metrics are scored to develop a summary of the employer’s risk (to the Fund), and a score is applied using a Red/Amber/Green (RAG) rating structure. This analysis identifies the priorities for the Fund in terms of monitoring. It does not take any financial analysis of the scheme employer into account this stage. A table summarising the employer ratings from the Covenant Tool can be found in Exempt Appendix 1.



5.4 Academies have a government guarantee so pose a low risk to the Fund. Some Community Admission Bodies (CAB's) have a guarantor and pose little risk, others are unguaranteed and present a higher risk, albeit they are in general small employers in terms of liabilities within the Fund. Designating bodies are mainly Parish and Town Councils which have precept raising ability and other Designated bodies are guaranteed, therefore the risk to the Fund is considered low. The Further and Higher Education (FE and HE) employers pose a risk to the Fund as they are not guaranteed, therefore if they defaulted or their funding plans are put at risk, the impact would be significant due to their size within the Fund. (Note that Avon Pension Fund has a greater number of FE and HE employers than most LGPS funds). Although the Principal Councils have tax raising powers, as they represent 73% of the Fund they are also kept under review. As all TAB's are guaranteed or have a bond in place to provide security to the Fund, they are not considered to pose a significant risk.

5.5 Detailed financial analysis is then undertaken for all employers rated red and, due to the scale of obligations to the Fund Principal Councils are also reviewed regardless of rating. Detailed financial analysis is then visually presented as 'Dials' to highlight the key performance indicators (KPI's) (see Exempt Appendix 2). As the Fund has been monitoring its employers for six years it has good evidence of data trends. For FE and HE employers and Principal Councils the financial analysis is benchmarked against similar organisations in each sector for comparative purposes. Qualitative research is also undertaken on the internet to identify any issues in the public domain related to the employer or sector.

5.6 A summary of findings, issues and actions required is used at quarterly reviews with the Head of Pensions. The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is undertaken.

5.7 Employer meetings are arranged with red rated employers and large employers at regular intervals or on a priority/ employer requirement's basis. Before covenant meetings, budgets and forecasts are requested and reviewed so that forward looking discussions take place.

5.8 Fund Officers are monitoring and actively working with employers where there is an identified risk to the Fund. The Actuary is involved in these cases. Mechanisms that are explored to reduce the risk to the Fund include but are not limited to:

1. Parental Guarantee and/or Indemnifying Bond
2. Transfer to a more prudent actuarial basis (e.g. the termination basis)
3. Shortened recovery periods and increased cash contributions
4. Managed exit strategies including DDA's and payment plans
5. Contingent assets and/or other security such as escrow accounts

6 RISK MANAGEMENT

6.1 A key risk to the Fund is the inability of an individual employer to meet its pension liabilities, especially when it ceases to be an employing body within the Fund. The covenant work is a crucial component of managing this risk to minimise the risk of an employer defaulting on its pension liability to the Fund.

7 EQUALITIES STATEMENT

7.1 A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

8 CLIMATE CHANGE

8.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change addresses this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9 OTHER OPTIONS CONSIDERED

9.1 None – report for information only.

10 CONSULTATION

10.1 The Council's Monitoring Officer and Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

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Background papers	Funding Strategy Statement
Please contact the report author if you need to access this report in an alternative format	