Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND COMMITTEE**
MEETING DATE:	**23 JUNE 2023**
TITLE:	**DEATH IN SERVICE POLICY**
WARD:	**ALL**
AN OPEN PUBLIC ITEM	
List of attachments to this report: Exempt Appendix 1 – Mercer report	

1 THE ISSUE

1.1 One of the risks for employers is the possible increase in liabilities arising when an active member dies as their beneficiary will receive a lump sum and spouse's or partner's pension earlier than would otherwise be the case. Although the actuary includes an allowance for 'strain' costs due to Death in Service (DIS) when setting future service contribution rates, the actual strain or indeed saving, is determined by the member's profile which can be far greater (or less) than the allowance assumed by the Actuary.

1.2 If there is a strain, it can significantly increase the liabilities and will feed through into the funding plan at the next valuation. For small employers the higher costs can be difficult to manage especially when they occur close to the employer's exit from the Fund.

1.3 The feasible options to mitigate this risk are (i) captive insurance and (ii) 3rd party insurance. Maintaining the status quo will not manage the risk. The Actuary is proposing the Fund implements a captive insurance arrangement covering all employers within the Fund. The Fund already has a similar arrangement for managing ill-health retirement costs for smaller employers.

1.4 Mercers paper in Exempt Appendix 1 sets out the rationale for such an arrangement and the Committee is being asked to approve implementing a captive arrangement within the Fund.

1.5 Once approved by committee, the Funding Strategy Statement will be updated and a short consultation with employing bodies will be undertaken.

2 RECOMMENDATION

The Committee:

2.1 Approves implementing a captive Death in Service arrangement within the Avon Pension Fund

2.3 Notes that a consultation with employers will be undertaken before the arrangement is implemented

2.3 Delegates updating the Funding Strategy Statement to include the captive arrangement to Officers.

3 FINANCIAL IMPLICATIONS

3.1 There are no extra direct costs as a result of this arrangement as any strain costs are picked up by employers at the subsequent valuation. The captive would aggregate the 'notional premiums' based on the actuarial assumptions and these premiums will be used to meet any future DIS strain costs.

3.2 The costs for advice for this work is provided for in the 2023/24 budget.

4 DEATH IN SERVICE CAPTIVE ARRANGEMENT

4.1 Mercers report in Exempt Appendix 1 sets out the rationale for setting up a captive arrangement in detail.

4.2 A captive arrangement is a cost effective and transparent method of managing this financial risk for smaller employers. However, to ensure the captive arrangement has adequate funds to meet any strain cost that may arise, all employers will be included in the arrangement. As the larger employers determine the

4.3 The captive would work as follows:

(a) Notional average 'premiums' will be paid into a captive fund by all employers, based on same actuarial assumptions. The actuary will monitor the captive and update at each triennial valuation (as they do with the ill health captive arrangement).

(b) The captive is used to meet any strain costs or receive any gains, therefore there is no funding gain or loss on the funding position of employers.

(c) The premium charged will be reviewed each triennial valuation and if excess premiums build up they will be used to offset future adverse experience and/or lower premiums based on the advice of the Actuary. Likewise any excess costs will be recovered via an increase in the premium.

4.4 In the 2022 valuation the average DIS allowance at the overall Fund level was 0.5% of pensionable pay, determined for each individual employer by their member profile. Based on 2022 valuation payroll this is equivalent to £4.14m p.a.

4.5 If only the smallest employers were in the captive, the premium would have to be far higher to cover potential strain costs. Therefore it is proposed that all employers would be included in the captive.

4.6 Alternatives:

The alternatives to a captive arrangement are 3rd party insurance or maintaining the status quo. The main disadvantage of 3rd party insurance is that the spouse's/partner's pension is not normally insurable so the Fund would have to insure a far higher DIS lump sum to cover the costs. The premium would be reset periodically based on experience and demographics which could lead to higher or lower costs. In addition there would be greater governance and admin costs for the Fund. Exempt Appendix 1 covers the 3rd party costs in more detail.

The other alternative is to maintain the status quo. However this will not enable the Fund to manage the risk DIS poses to smaller employers within the Fund.

4.7 Across the LGPS there are different models in place. Some have no arrangement in place (like Avon currently), some pool risks by employer groups and some use captive arrangements. There is no standard approach.

4.8 Having considered the alternatives, officers are recommending that the Fund implements a captive Death in Service arrangement as it is the most efficient approach for the Fund to manage the risk of adverse strain costs for smaller employers.

5 PERIODIC REVIEW OF THE CAPTIVE ARRANGEMENT

5.1 The Fund will review the insurance arrangements at least every 3 years at the time of the triennial valuation. This will include market testing 3rd party prices.

6 FUNDING STRATEGY STATEMENT (FSS)

6.1 The 2022 FSS will be updated to include the Death in Service Captive arrangement. Before it is implemented, employing bodies will be consulted about the change to the FSS. Unless there are significant concerns from employers, the change to the FSS will not revert back to the Committee.

7 RISK MANAGEMENT

7.1 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 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 and is incorporated in the contribution plans.

8 EQUALITIES STATEMENT

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

9 CLIMATE CHANGE

9.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and addresses this through its strategic asset allocation to Paris Aligned Global Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9.2 In terms of the funding strategy, in the 2022 valuation an analysis of different climate change scenarios was undertaken valuation relative to the baseline position assuming that the funding assumptions are played out on a best estimate basis. The analysis considers a projection of the funding levels under the scenarios considered which are designed to illustrate the transition and physical risks over different periods depending on what actions are taken globally on climate change. Further detail is set out in the FSS and the Actuary’s 2022 valuation report.

10 OTHER OPTIONS CONSIDERED

10.1 Are contained in the report.

11 CONSULTATION

11.1 The Council’s Director of One West has had the opportunity to input to this report and has cleared it for publication.

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