CLWYD PENSION FUND

CONSULTATION - CHANGES TO THE LOCAL VALUATION CYCLE AND THE MANAGEMENT OF EMPLOYER RISK

This response is from Flintshire County Council as Administering Authority of the Clwyd Pension Fund. Our response has been agreed by the Pension Fund Committee on 12th June 2019 after taking professional advice from our Actuary (Mercer Ltd).

We set out below our response to each of the questions posed in the consultation document issued on 8 May.

A summary of the proposals is follows:

- to amend the local fund valuation cycle of the LGPS from the current three year (triennial) cycle to a four year (quadrennial) one with effect from 2024. The MHCLG's preferred option for transitioning into this is to allow the 2019 valuation to complete as anticipated (with an output of three years' contribution requirements), and then have an out-of-cycle valuation performed in 2022 (with an output of two years' contribution requirements).
- the introduction of a power for LGPS funds to undertake interim valuations (in full or in part).
- the widening of the power that allows LGPS administering authorities to amend an employer's contribution rate in between valuations.
- the introduction of a 'deferred employer' status that would allow funds to defer the triggering of an exit payment for certain employers who have a sufficiently strong covenant.
- allowing an exit payment calculated on a full buy-out basis to be recovered over a period of time for cases where 'deferred employer' status might not be appropriate.
- a review of the arrangements for paying exit credits in cases where risk sharing provisions exist within the contractual agreements with an employer.
- a removal of the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer membership of the LGPS to their non-teaching staff for new entrants. There are no changes for further education corporations and higher education corporations in Wales (and, by implication sixth form colleges in Wales, although there are very few of these in practice).

For the most part, these seem to us sensible proposals although there are some aspects which are Government policy which is outside the remit of the role of the Administering Authority. When taken in isolation we do not agree with moving the local valuations on to a four year cycle, as we believe it is a weakening of the ability of the Administering Authority to govern the Fund and manage risk effectively. Equally, we believe employers (including public sector bodies) are demanding a more dynamic approach to managing risk and cost effectively on their behalf and extending out the valuation period does not help us achieve this. However, when coupled with the additional flexibility around additional valuations and reviewing employer contribution rates, we feel it is an overall approach which is acceptable as long as the ability to review contributions is not overly constrained and we can formulate a policy which suits the objectives of our Fund which is to manage cost and risk dynamically as we have been doing for many years through our Flightpath strategy which manages funding, investment and covenant risk. Therefore, it is critical that the guidance expected is flexible enough for us to achieve these objectives.

We have followed the format of the consultation document in our response.

CHANGES TO THE LOCAL FUND VALUATION CYCLE

Q1	RESPONSE
As the Government has brought the LGPS scheme valuation onto the same quadrennial cycle as the other public service schemes, do you agree that LGPS fund valuations should also move from a triennial to a quadrennial valuation cycle?	Being a funded scheme, we do not believe it is appropriate for funding and risk management policies for the LGPS to be set by reference to what happens in the unfunded schemes. Our preference would be to retain the existing three year cycle, as we feel this is an appropriate period over which to set the contribution rates for employers and manage the resultant risks, before reviewing them again at the next actuarial valuation. Equally, we believe employers (including public sector bodies) are demanding a more dynamic approach to managing risk and cost effectively on their behalf and extending out the valuation period does not help us achieve this. In our view, four years is too long a period for both the Fund and employers to manage cost and risk effectively. However, when combined with the other measures in this consultation around interim valuations and reviewing employer contributions in between formal actuarial valuations the proposal is in our view acceptable overall as long as the ability for us to do this is not overly constrained (further comments are made in response to later questions).

Q2	RESPONSE
Are there any other risks or matters you think need to be considered, in addition to those identified above, before moving funds to a quadrennial cycle?	The accounting standards IAS19 and FRS102 normally require figures to be based on actuarial valuations carried out at least triennially, and as a result auditors would require the accounting liabilities to be assessed more accurately as a result . Further, as a result of pressure from the FRC auditors are becoming more prescriptive about the approaches they will accept, and this also adds some weight to valuation cycles not being extended. Even if CIPFA were to relax their own requirements it is unlikely that any such relaxation could be extended to employers other than councils/authorities as CIPFA does not have jurisdiction for such employers. There is therefore a risk that, in effect, auditors will require interim valuations perhaps every two years after the formal one so we could end up by default in a situation where biennial valuations (albeit more limited in scope) are required. This would go some way to offset any marginal savings from extending out the valuation cycle. The move to a 4 year cycle for the statutory valuation will by nature mean that governance is weakened unless a LGPS Fund's policy in relation to interim valuations and/or review of employer contribution rates is robust and fit for purpose. It is therefore critical that the guidance encourages the adoption of robust policies for all Funds to improve the governance for the LGPS generally and is fair to employers in relation to managing risk on their behalf.

Q3	RESPONSE
Do you agree the local fund valuation should be carried out at the same date as the scheme valuation?	We do not see any reason why this is necessary and do not subscribe to the view that it allows the quality of the data provided to the GAD to be better improved as the majority of LGPS Funds have improvement plans over much shorter timescales. We appreciate that the cost management process may cause changes in benefits or member contributions outside the actuarial valuation cycle, but this is something which Funds have to contend with in any event (e.g. changes due to GMP equality issues, changes in State Pension Ages and court/tribunal cases such as McCloud can all give rise to changes in benefits or member contributions outside of a normal actuarial valuation). A simpler solution in our view would have been to retain the three year cycle and

	introduce the ability to review contribution rates for any changes from the cost management process (or other changes).

TRANSITION TO A NEW LGPS VALUATION CYCLE

Q4	RESPONSE
Do you agree with our preferred approach to transition to a new LGPS valuation cycle?	If it is decided that four year cycles will be introduced from 2024 then we agree with the preferred approach to transitioning by doing a valuation at 2022 and then 2024. Indeed, if the outcome was to not do this and have a five year gap between valuations we would intend to perform a full interim review valuation in any event as we would need to do this to fit in with our existing flightpath strategy to manage risk and cost effectively,

ABILITY TO CONDUCT AN INTERIM VALUATION OF LOCAL FUNDS

Q5	RESPONSE
Do you agree that funds should have the power to carry out an interim valuation in addition to the normal valuation cycle?	Yes, irrespective of the 4 year cycle change, we feel it is essential to Funds' governance and procedures that there should be a mechanism for reassessing employer funding positions and contribution outcomes when the circumstances warrant it. The Fund is managing a complex set of risks and the level of employer contributions is a key component of the effective management in conjunction with the employers. We think it is essential that Funds are given the flexibility to do this when the circumstances warrant it. We do not believe however that the only option for reviewing the statutory employer contributions would be through a full interim valuation.

Q6	RESPONSE
Do you agree with the safeguards proposed?	We do agree that there should be some safeguards but care needs to be taken on how these are applied consistently. At a high level the facility needs to be sufficiently flexible that it can be called on in the event that there is a significant change in financial markets or Scheme benefits, to the extent that an interim valuation/funding update is merited, yet there need to be safeguards on the governance of the arrangements. For example, it would be wrong to perform an interim valuation to ease employer budgets when the outcome is expected to be favourable but never when the outcome is less favourable. The safeguards proposed are that the valuation/update should only be permitted in the circumstances set out in the Funding Strategy Statement, (FSS) but with some additional flexibility in the event of exceptional circumstances. In our view, this is correct but the guidance needs to ensure its clear that Funds need to be robust in determining the criteria in conjunction with their Actuary. This will need to documented in the FSS at the 2019 valuation if the proposal in the consultation proceeds so timing of any guidance needs to be formatted before the FSS is finalised to avoid having to update the FSS soon after the valuation is signed off.

REVIEW OF EMPLOYER CONTRIBUTIONS

Q7	RESPONSE
Do you agree with the proposed changes to allow a more flexible review of employer contributions between valuations?	We strongly support the principle of allowing more frequent reviews of employer contribution rates. Again, at a high level the facility needs to be sufficiently flexible that it can be called on in the event that there is a significant change in financial markets, Scheme benefits or employer circumstances e.g. change in covenant, to the extent that a review is is merited. In line with the proposed approach for interim valuations we believe that the Funding Strategy Statement should set out the circumstances in which a review of employer contributions can or should be carried out. These circumstances might be wider than as outlined in the consultation document, which focuses strongly on changes in employer covenant, and we would suggest that other areas that materially affect the cost (for the employer) and risk (to the Fund) should be

	included. This can be such aspects as a significant change in market outlook, changes in Scheme benefits and change in affordability of contributions which could be to the detriment of the viability of an organisation. In practice, the distinction between an interim valuation and a review of employer contributions across the entire employer types is very small although the triggers for a review will vary between employer depending on circumstances. A simpler route would be to allow the more general power of reviewing contributions to apply to any employer or group of employers. The criteria for doing this would be set out in the FSS in line with the relevant guidance. We feel this would achieve the desired objectives in the consultation as well as being simpler to implement from a regulatory and guidance viewpoint as you would cover all aspects. With regards to costs the proposals in the consultation seem to us to strike an appropriate balance.

GUIDANCE ON SETTING A POLICY

Q8	RESPONSE
Do you agree that Scheme Advisory Board guidance would be helpful and appropriate to provide some consistency of treatment for scheme employers between funds in using these new tools?	Our preference would be for Funds to have the flexibility to set the parameters for carrying out interim valuations and/or employer contribution reviews within their Funding Strategy Statements, which would lead to an open and transparent approach. However, SAB guidance would be helpful to provide consistency of treatment as well as ensuring all Funds do apply a common level of governance in managing the overall financial risks. We would therefore be happy to have SAB guidance in the areas suggested in the consultation. However we would have a very strong preference for this to be principle based and not prescriptive to allow us to apply to our own specific circumstances.

Q9	RESPONSE
Are there other or additional areas on which guidance would be needed? Who do you think is best placed to offer that guidance?	There are no additional areas that need covering on the basis that the guidance is principle based and these principles would form the basis for each Fund agreeing the parameters to trigger and interim valuation and/or an employer contribution rate review. We would strongly prefer that any such guidance should take the form of being enabling, and avoid being overly prescriptive/restrictive. It would seem that the SAB would be best placed to provide this guidance given its overarching governance role for the LGPS. We would also recommend that our Actuary (Mercer) has significant input into the formation of the guidance so it is comprehensive and practical to implement.

FLEXIBILITY ON EXIT PAYMENTS

Q10	RESPONSE
Do you agree that funds should have the flexibility to spread repayments made on a full buy-out basis and do you consider that further protections are required?	First of all, it is important to bear in mind that no Fund calculates exit payments on a “full buy-out basis” as far as we are aware which is a term used where a scheme insures the benefits with an third party insurance company. To avoid confusion going forward in any guidance or explanatory literature we would recommend that this terminology is dropped and replaced by “termination basis” given Funds do not all use the same approach. The approach depends on the policy adopted by the individual Fund and in some cases the investment strategy backing the exit liabilities.. In relation to the specific question on flexibilities we agree that flexibility is very important as circumstances are very varied, although we would note that there are already flexibilities for the spreading of exit payments and adjustment of contributions in the run-up to exit. These are covered in Regulation 64(4) and the definition of “exit payment” within Regulation 64, so we do not think there any is necessity for further material regulation change in this particular area except to allow a review of the exit payments over the spread period to reflect any change in circumstances e.g. market conditions or employer circumstances.

	We do not believe any other protections are required as the critical aspect is the ongoing assessment of the covenant to ensure the exit payments are recovered.

DEFERRED EMPLOYER STATUS AND DEFERRED EMPLOYER DEBT ARRANGEMENTS

Q11	RESPONSE
Do you agree with the introduction of deferred employer status into LGPS?	Yes as this will allow us to better manage our employer risk and therefore risk to taxpayers in conjunction with the employer. Provided that the administering authority is given sufficient flexibility to be able to manage such provisions and these are documented in the Fund policies we believe this will be an extremely valuable addition to the Regulations which will help both Funds and employers.

Q12	RESPONSE
Do you agree with the approach to deferred employer debt arrangements set out above? Are there ways in which it could be improved for the LGPS?	In general, yes we agree with the proposed approach. However, there appears to be an over emphasis on employer covenant, and whilst important it is not the only factor that should determine the approach to deferred debt arrangements – for example also adopting a lower risk investment strategy would assist in the overall management of risk in a deferred debt arrangement. We would prefer Funds to be allowed to set their own policies and guidance around this could easily be included in the guidance on the arrangements). One particular aspect of the current arrangements is that employers will sometimes retain a single active member under an admission agreement in order to avoid triggering an immediate exit payment. A properly implemented deferred debt arrangement could avoid this artificial approach and assist Funds and employers in properly managing the risks around exit.

PROPOSED APPROACH TO IMPLEMENTATION OF DEFERRED EMPLOYER DEBT ARRANGEMENTS

Q13	RESPONSE
Do you agree with the above approach to what matters are most appropriate for regulation, which for statutory guidance and which for fund discretion?	We agree that the Regulations should be "enabling" in nature only, and not prescriptive or restrictive. We agree that statutory guidance will be helpful in some cases in ensuring that Funds are able to take a sufficiently robust approach with employers as long as this is on a principles basis. The more detailed operational aspects should be covered off in each Fund's policies in line with these principles.

SUMMARY OF OPTIONS FOR MANAGEMENT OF EMPLOYER EXITS

Q14	RESPONSE
Do you agree options 2 and 3 should be available as an alternative to current rules on exit payments?	Yes, we agree that these options should exist as alternatives. However, as highlighted above we believe that administering authorities should be able to determine the circumstances in which option 3 may apply and covenant (including ongoing review) is critical to this. We also believe that under option 2 the repayment schedule can be periodically reviewed (as opposed to being fixed) if circumstances warrant it e.g. a significant change in market conditions and/or affordability of the repayments.

Q15	RESPONSE
Do you consider that statutory or Scheme Advisory Board guidance will be needed and which type of guidance would be appropriate for which aspects of these proposals?	As covered in our response to question 13, we believe that statutory guidance will be helpful in some cases in ensuring that Funds are able to take a sufficiently robust approach with employers on the basis that this is a principle based approach only. More detailed operational aspects can be covered off by Fund policies.

EXIT CREDITS UNDER THE LGPS REGULATIONS 2013

Q16	RESPONSE
Do you agree that we should amend the LGPS Regulations 2013 to provide that administering authorities must take into account a scheme employer's exposure to risk in calculating the value of an exit credit?	Yes we are in absolute agreement as this is fair in the context of the overall responsibility of cost and risk between the exiting employer and the scheme employer. However, we believe that there should be a regulatory provision for the Scheme employer to ensure the information on these risk sharing arrangements is supplied to the Administering Authority so the correct treatment can be applied in a timely manner. This will avoid any conflict between the scheme employer and fund over the inadvertent incorrect application due to lack of provision of the information.

Q17	RESPONSE
Are there other factors that should be taken into account in considering a solution?	No other factors come to mind.

FURTHER EDUCATION CORPORATIONS, SIXTH FORM COLLEGE CORPORATIONS AND HIGHER EDUCATION CORPORATIONS

Q18	RESPONSE
Do you agree with our proposed approach?	Given that there are no material changes in relation to Wales, this is not an area in which we have a particularly strong view at the current time. We note that the consultation is silent on the issue of sixth form colleges in Wales (we therefore presume there are no changes proposed for them), but again we do not have a particular view as this does not affect our Fund. However, we would make some general comments in the interests of developing the policy for the LGPS as a whole in England. We regard the determination of the employers which are required to offer LGPS membership as being a policy area for Government (and each individual employer), and in particular those areas of Government which provide funding to those specific employers. The effect will vary from Fund to Fund but it will need to be noted that this proposal (if enacted), if

	employers decide to adopt this approach, will lead to a gradual maturing of those employers' LGPS liabilities. This will generally increase contribution rates initially for these employers due to the closed nature of the membership. Equally the cash flows for these employers and the Fund will be affected over time and the impact will depend on the relative size of these employers in a particular Fund. A Fund will need to ensure that their existing employer risk management policies are sufficiently robust to deal with this change. We believe that if the existing and new policies that could be implemented as part of this consultation are introduced then this would sufficiently allow for this issue to be managed effectively.

PUBLIC SECTOR EQUALITY DUTY

Q19	RESPONSE
Are you aware of any other equalities impacts or of any particular groups with protected characteristics who would be disadvantaged by the proposals contained in this consultation?	No equality issues occur to us in the context of our operation of the Fund. The change in the status of the education employers as per Q18 would create inequality at an employer level but that is a matter for the employers not our Fund.