SOUTH YORKSHIRE
PENSIONS AUTHORITY

Consultation with Employers on the Framework for Valuation 2019

November 2018

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Foreword

This document sets out the Pensions Authority's proposals for:

- The key assumptions to be used in valuing the Fund's liabilities as part of the 2019 actuarial valuation.
- A number of proposed changes in policy related to the valuation and the Funding Strategy.

We are consulting on these issues now to ensure that we are able to properly give consideration to the views of employers prior to the commencement of detailed work on the 2019 valuation and the preparation of the new Funding Strategy Statement which we are required to produce following the completion of the valuation.

The issues on which we are seeking views have the potential to make a significant difference to individual employers and it is therefore important that employers take the opportunity to respond so that the Pensions Authority can understand how different groups are affected by specific proposals.

Responses can be sent to:

The Fund Director
South Yorkshire Pensions Authority
Floor 8
Gateway Plaza
Sackville Street
BARNSLEY
South Yorkshire
S70 2RD

or by email to: FundDirector@sypa.org.uk

Responses should be submitted by 14th February 2019

If you would like further information or to discuss specific issues concerned with this consultation with someone please contact the email address above.

1 Valuation Assumptions

1.1 There are a number of key assumptions which need to be made as part of the valuation process. For technical reasons a number of these are finalised later in the process in the light of market conditions and updated information. However, the Fund's initial proposals with regard to these assumptions are as follows, it should be borne that these assumptions are averages across the whole life of the Fund's liabilities which will be in excess of 60 years:

- **Pay Growth** - Long Term Pay Growth assumptions are based on long term statistical trends which currently produce a figure of 3.55% pa. This will be reduced to 2% for local authority employers (District Councils, Police, Fire, PTE, Pensions Authority and Combined Authority) for the first three years of the valuation, reflecting current pay awards in the sector. Evidence indicates that pay growth for other employers has consistently been above that experienced by local authorities and it would add a risk for smaller employers to reflect pay restraint in the early part of the valuation.
- **Inflation** - The forecast for CPI Inflation is 2.3% pa based on an analysis of inflation rates implied by the yields on fixed interest and index linked government bonds, with an allowance for the basis difference between CPI and RPI inflation of 1%.
- **Demographics** - The actuary proposes to apply current demographic data, which indicate that the rate of increase in life expectancy is slowing adjusted for local experience.
- **Commutation of Pension to Lump Sum** - It is proposed to move to an assumption based on the level of commutation actually experienced within the South Yorkshire Fund. As this is higher than the current assumption this change is likely to reduce the value of liabilities.
- **Discount Rate / Investment Return** - The actual level will be determined later in the process. However, the actuary's view is that the overall environment is one where the levels of return achievable on a consistent basis are reducing and that this should be reflected in this assumption. Clearly this assumption can have a significant effect on the outcome of the valuation and will be the subject of much discussion between the actuary, the Fund and employers over the course of the valuation work. The actuary makes different assumptions in relation to past service liabilities which have already built up and which therefore require a higher certainty of return, and for future service liabilities which are not yet certain and for which a less certain rate of return is therefore possible.

1.2 The Fund is interested in receiving employers' views on these assumptions and would be particularly keen to know whether there are other employer groups who can provide evidence which could support an assumption around short term pay restraint.

1.3 In addition to this the ill health captive arrangement will remain in place and will be reassessed in the light of experience over the last three years.

2 Deficit Recovery Arrangements and Management of Surpluses

2.1 Current estimates are that the Fund has a small surplus overall. It is wholly possible that this position will change between now and the valuation point, particularly if there is some disruption in financial markets and while the Fund has taken steps to insulate itself against such movements no protection of this sort can entirely protect the Fund. However, should the current position be maintained then while there may be an overall surplus some employers may still have a deficit, which will continue to need to be recovered.

2.2 Where an employer continues to have a deficit there are three main options:

a) Continue the current recovery plan and the current level of deficit contributions meaning that the employer receives no benefit from the investment returns which have brought the overall deficit down, although the recovery period will be significantly shorter if current levels of deficit payment are maintained which benefits the Fund at the expense of the employer.

b) Reduce deficit contributions to reflect the reassessed deficit being recovered over the revised recovery period of 16 years (down 3 years from the last valuation), which while benefiting the employer does not provide a benefit to the Fund through being able to eliminate employers' deficits more quickly as a result of improved investment returns.

c) Some combination of the two approaches which would freeze the annual level of cash being contributed by the employer (both deficit and future service contributions) at the current level and treat the excess over any new future service rate as being available for the deficit with the recovery period being the mathematical outcome of the rate at which the available cash pays off the deficit. This shares the benefit of the improvement in funding position between the Fund and the employer.

2.3 In addition for relatively small deficits it may be appropriate to negotiate the terms of a one off payment between the Fund and the employer.

2.4 The Fund's preferred option for addressing remaining deficits is option c, above as this shares risk between the Fund and employers and we would like to receive views on the practicality of this as an approach.

2.5 At present it seems likely that any surplus at whole fund level is likely to be relatively small, and would have a negligible impact on employer contributions if reflected as an adjustment over the recovery period of 16 years. Therefore it is proposed that any surpluses at this valuation are retained within the Fund as a contingency against potential negative market movements and negative experience in areas such as ill health retirement. This is likely to create a greater long term benefit for employers than a very small rebate against future service contributions. The Fund would be interested in employers' views on this position.

3 Exit Credits

3.1 This is an issue which arises from a change in the LGPS Regulation during 2018. Previously when an employer exited the scheme through the termination of an admission agreement, for example at the end of a contract involving the TUPE transfer of staff any surplus remained within the Fund. The change in regulations, however, allows for surpluses to be repaid to the employer leaving the Fund in these circumstances.

3.2 In some circumstances employers leaving the Fund will have borne all the risk around surpluses and deficits and in these circumstances it seems reasonable for them to receive any benefit. However, there are many cases where the original employer (the organisation that let the contract for example) has provided some form of guarantee that it will assume any deficit at the end of the contract and has transferred staff on a fully funded basis. In these circumstances the risk around surpluses and deficits has been borne by the original employer and it therefore seems unreasonable for any surplus not to pass to them. Consequently the Fund proposes with effect from **1st April 2019** to amend the current Funding Strategy Statement to provide for exit credits where a guarantee of this sort is in place to be transferred into the original employer's portion of the Fund. We are interested in receiving employers' views on this, and in particular whether there are any other circumstances where the payment of exit credits may result in inequity between the employer leaving the Fund and the original employer.

4 Academies

4.1 Currently each Academy within the Fund is treated as a separate employer, although Multi-Academy Trusts do have the option of being treated as a single employer, an option which some have taken and some have not. Nationally the direction of travel is to arrive at a position where as a minimum every academy within each LGPS fund pays the same future service contribution rate, although no formal policy announcements have yet been made.

4.2 In order for Academies to have a single future service rate they would have to be treated as a "pool" within the Fund. Each Academy would still have to pay its own specific deficit contributions if applicable. Given the significant change in the overall funding position it may be that it is less disruptive to move to this sort of arrangement at this valuation rather than waiting for a change to be imposed at a later stage. Any change of this sort will only be undertaken if there is a demand for it from Academies, and the Fund would like to hear from Academies whether they would like us to pursue this option.

4.3 Implementing this option is not without risk for individual Academies as different schools may have different experiences in terms of membership (either favourable or unfavourable) which are then averaged over all the relevant schools. However, by in effect becoming part of a larger single employer for this purpose the challenges sometimes posed to small employers by a one off event are reduced. In addition the ill health captive arrangement would remain in place thus reducing the risk of any single Academy's ill health experience impacting on others.

5 Employer Covenant

5.1 The Fund is made up of nearly 500 different employers varying significantly in scale and financial resources. Each employer faces different risks from their participation in the Fund and poses different risks to the Fund as a whole through their participation. For some employers the actuary may make particularly conservative assumptions so that the risk they pose to the Fund is minimised.

5.2 The Fund needs to understand the risk represented by each employer's participation in the Fund and will be seeking to use publicly available information such as accounts to begin a process of understanding this. Once we have arrived at an overall picture, which will probably involve identifying employers in groups according to the risk posed to the Fund we will be in a position to start a conversation with employers about steps they can take which would reduce the risk to the Fund, and in effect to other employers. Such steps might include seeking a guarantee from a parent organisation or from an organisation with tax raising powers, or an employer giving the Fund a charge over specific assets instead of a guarantee.

5.3 At this stage we have no specific proposals, because we need to gather much more information before formulating specific proposals. However, we welcome discussions with employers about how the scheme impacts on their financial position and also on the options which they have in terms of their ongoing participation in the scheme. We would also welcome information which employers feel justifies either treating them individually or as a group (for example housing associations) in a particular way.

6 Recovery of Costs

6.1 At present the Fund does not recover all the actuarial costs that it is allowed to and has arrangements for newly created academies which are significantly different from the norm across LGPS. By not recovering all costs of this sort these costs in effect fall on all employers in the Fund which is not equitable as they are costs which arise from the actions of individual employers rather than the collective of all employers. In the case of academies the current arrangements are unnecessarily administratively complex, particularly when the costs involved are fully supported in the Academy set up grant.

6.2 The Fund therefore proposes to pass on to employers any actuarial costs which are incurred specifically on their behalf. This will include costs associated with cessation valuations whether there is a surplus or a deficit and the costs associated with negotiating bulk transfers. These costs will be recovered through a single invoice. Before any work is undertaken an estimate of the costs involved will be provided up front. We appreciate that budgets are tight across the board, however, in order to ensure that costs incurred on behalf of one employer are not borne by all employers we need to put these arrangements in place.

6.3 For academies currently paying actuarial costs by instalments these arrangements will continue until completed.

7 Ill Health and Voluntary Early Retirement Allowances and Strain Payments

7.1 Some employers who are not part of the ill health captive arrangement have maintained the practice of including a cash value allowance for the costs of ill health retirements within their valuation assumptions. This allowance is then monitored through the valuation period, which creates an administrative burden for both the employer and the Fund. This is a practice that most other funds abandoned some time ago, and we propose to end this practice which applies to a relatively small number of employers. Any costs relating to ill health retirements will be picked up in the following valuation.

7.2 We also propose to end the arrangement whereby some employers maintain an allowance (as for ill health) for voluntary early retirement within their contribution rate. This is a practice that has been abandoned by most funds as it dilutes transparency and accountability for early retirement decisions and to some extent hides the costs. Any costs relating to early retirement (strain costs) will need to be paid over to the Fund on receipt of an invoice in the year in which the early retirement takes place. Currently where strain costs are payable an instalment arrangement is allowed. Such arrangements are increasingly rare across the LGPS and while it is accepted that this might present some issues for employers this change means that the payment is matched with the crystallisation of the Fund's liability to pay pension. As cashflow within the Fund becomes increasingly negative it becomes more and more important for the Fund to realise contribution income of any sort at the earliest opportunity, and this proposal allows us to do this.

7.3 The Fund is interested in hearing employers' views on whether this proposed approach will cause any specific issues.

7.4 Do you support the proposal to retain any relatively small surplus within the Fund as a form of contingency against potential negative experience over the next valuation period?

7.5 Do you support the changes proposed by the Fund in relation to Exit Credits?

7.6 Would you support the treatment of academies as a single "pool" within the Fund? (To be answered by academies only)

7.7 Can you identify any specific evidence which might support the assessment of the covenant of your organisation as an employer within the Fund?

7.8 Do you foresee any practical issues with regard to the proposals for increasing cost recovery set out in this document?

7.9 Do you foresee any specific difficulties arising from the withdrawal of cash value allowances for ill health and voluntary early retirement?

7.10 Do you foresee any particular issues arising from the need to make strain payments as a single lump sum rather than by instalments?

Produced by South Yorkshire Pensions Authority ·

Floor 8, Gateway Plaza ·

Sackville Street ·

Barnsley ·

S70 2RD ·