South Yorkshire Pension Fund

Policy on ill health risk management

Effective date of policy	
Date approved	
Next review	

1 Introduction

The purpose of this policy is to set out the administering authority's approach to managing the risk arising due to ill health retirements.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

1.1 Aims and objectives

The administering authority's aims and objectives related to this policy are as follows:

- To explain the approach taken to manage ill health risk
- To specify circumstances where a review of experience may lead to additional contributions.
- To outline the key risks and benefits to this arrangement.

1.2 Background

Additional liabilities can arise following the retirement of members due to ill health. These additional liabilities can include the unreduced early payment of pension benefits and the award of additional service. The level of pension benefits paid on ill health depends on the severity of the member's condition.

The LGPS Regulations require the additional liabilities to be funded by way of payments from employers. Payment of large lump sums to meet strains as and when they arise can lead to unexpected payments and put significant strain on employers' budgets. LGPS funds are able to put arrangements in place which mitigate the risk of having to pay a large cash sum due to an ill health retirement strain.

To mitigate this risk to employers and to evidence good governance and risk management, the decision has been taken to operate a captive insurance arrangement within the Fund.

1.3 Guidance and regulatory framework

The Local Government Pension Scheme Regulations 2013 (as amended) set out the benefits payable to members and the way in which additional benefits (such as those arising on ill health early retirement) should be funded. These include the following:

- Regulation 35 – permits the early retirement of pension on ill health grounds.
- Regulation 39 – sets out the calculation of the pension payable in the instance of ill health retirement.
- Regulation 68 – sets out the additional contributions payable by the employer to meet the liability strain caused by a member retiring through ill health.

2 Statement of principles

This statement of principles covers the captive insurance arrangement in place to manage the risks created by ill health retirements. In general:

- This arrangement applies to all employers in the Fund (expect the secure major employers).
- Eligible employers are unable to opt out of this arrangement.
- A separate pot of assets (the ‘captive fund’) will be maintained to meet the cost of ill health retirement strains.
- Regular contributions payable by employers will include amounts equal to the expected cost of assumed ill health retirements. These amounts will be paid into the captive fund, and will be reassessed at each triennial actuarial valuation.
- Eligible employers will not be required to pay lump sum amounts to meet ill health retirement strains (in the normal course of events).
- Both Tier 1 and Tier 2 ill health retirement strains will be covered by this arrangement.
- The fund will look to protect eligible employers against the risk of unusually high ill health retirement experience of other employers.
- Employers not eligible to join the captive arrangement (i.e. secure long-term employers) will be responsible for meeting their own ill health retirement experience.

3 Policy

3.1 Purpose

The purpose of this captive insurance arrangement is to share the cost of ill health retirement experience across all small employers.

3.2 Eligibility

Eligible employers are:

- Academies and former grant-maintained schools
- All admitted bodies (including those legacy admitted bodies referred to as Community Admission Bodies and Transferee Admission Bodies)
- Designating / resolution bodies
- Other scheduled bodies as determined by the administering authority
- All other bodies with less than 100 members.

All ill health experience since 1 October 2014 is pooled as per the captive insurance arrangement.

3.3 Operation

The captive arrangement works as follows:

- Contribution rates are set by the Fund Actuary every three years as part of the triennial valuation. Primary contribution rates include allowance for the expected cost of assumed ill health retirements (expressed as a percentage of payroll) – this is referred to as the ‘ill health premium’).

- Ill health premiums are paid into the ‘captive fund’ – this is a separate pot of assets which is tracked by the Fund Actuary at each triennial valuation.
- All ill health retirement strains arising in respect of eligible employers are then met by the captive fund. In practice, assets equal to the strain payment due would be transferred within the fund from the captive fund to the employer’s asset share.
- Note that this arrangement covers the initial employer strain cost, and does not monitor the actual cost of ill-health early retirements thereafter: in effect, each employer bears the risks (and receives the potential benefits) of its ill-health members incurring a higher or lower cost over the years than was anticipated by the strain cost.
- The ill health premiums will be reviewed at each triennial valuation with a view to ensuring that the captive fund is sufficient to meet the cost of ill health retirement strains over time. This review will consider the expected level of future ill health retirements and recognise the effect of any adverse/favourable ill health retirement experience. Advice will be taken from the Fund Actuary in the review of ill health premia, but in general:
    - Where a shortfall exists in the captive fund, this shortfall may be allocated across all eligible employers and/or this may lead to an increase in ill health premiums following the next triennial valuation.
    - Where excess funds exist in the captive fund, these may be used as a buffer against future adverse experience. Excess funds may be transferred to the eligible employers at the discretion of the administering authority.

The ill health retirement experience across eligible employers is likely to differ. This introduces cross-subsidies, in particular where the experience of one employer is very high compared to that of another. This is a feature of the captive insurance arrangement in place and no asset recalibration will take place to address such cross subsidies.

3.4 Review and additional contributions

The administering authority will review the level of ill health experience across all employers at each triennial valuation.

If an employer has an unusually high incidence of ill health retirement over the previous inter-valuation period, the administering authority will engage with the employer to understand the reasons for this. In the event of concerns around the eligibility criteria applied by the employer in granting ill health retirements, this could lead to the need for the employer to pay additional contributions to the fund (which would then be shared across all other employers as recompense for meeting this unusually high level of ill health retirement strains).

3.5 Costs

The costs of operating the captive insurance arrangement will be met by the fund.

3.6 Ineligible employers

Secure, long-term employers (such as Local Authorities) are not eligible to join the captive arrangement.
For these ineligible employers, regular contributions paid include the expected cost of assumed ill health retirements. No additional contributions would be required from these employers as a result of actual ill health retirement experience. A review of experience will be carried out each triennial valuation, which will be used to set the assumptions underlying the calculation of contribution rates payable.

4 Related Policies

The fund's approach to setting regular employer contribution rates is set out in the Funding Strategy Statement, specifically "Section 2 – How does the fund calculate employer contributions?".