HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Panel:	Pension Fund Panel and Board
Date:	12 July 2019
Title:	Governance: Proposed changes to the current grouping arrangements in the Fund
Report From:	Director of Corporate Resources

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Purpose of this Report

1. The purpose of this report is to seek approval from the Panel and Board on proposed changes to the way in which employers are grouped for funding purposes.

Recommendation(s)

2. It is recommended that the Panel and Board:
   - having noted and considered the responses set out in Appendix 3, approve the proposed changes to the way in which employers are grouped for funding purposes, as set out in paragraph 7 of this report
   - delegate authority to the Director of Corporate Resources to agree with the Fund Actuary the methodology for calculating the discount given to employers who pre-pay contributions.

Executive Summary

3. The Panel and Board gave their approval for the Director of Corporate Resources to consult with employers on options for changing the way in which they are grouped together for funding purposes with effect from the 2019 triennial valuation.

4. The 2019 triennial valuation provides an opportunity to make these structural changes because there has been a material improvement in the funding level since the last valuation. It has not been possible to recommend changes at

earlier valuations, despite the pressure on the grouping mechanism, because of the material impact of the allocation of the deficit on employers. This effect is vastly reduced as the fund becomes fully funded.

5. A suite of proposed changes were drafted by officers on the advice of the Fund Actuary. A briefing note which set out the reasons for change and the impact on each type of employer was sent to all employers in April, with an invitation for employers to attend a workshop led by the Fund Actuary in May. Following the communication of the proposals, responses to the consultation were received from 30 employers.

6. The decision to proceed with the proposed changes has to be taken in advance of the valuation work being carried out. This means that employers were asked to respond to the consultation without knowing the impact of the changes on their own employer contribution rates. However, the message has been given throughout the consultation exercise that employers should not expect to see material increases to contributions as a result of these changes, and may well see a decrease.

7. As a result of the consultation exercise, the final proposals for consideration by the Panel and Board are to:
   a) disband the Scheduled Body Group (SBG) at the 2019 valuation and,
   b) establish an academies pool for all academies and free schools covered by the DfE guarantee
   c) establish a Town and Parish Council (TPC) pool
   d) allow any TPC who elects to do so, to not be part of the TPC pool, and to instead have an individual contribution rate
   e) calculate an individual contribution rate for all the remaining scheduled body employers who are currently part of the SBG
   f) change the operation of the Admitted Body Group (ABG) so that employers are allocated assets at an individual level to enable different deficit recovery periods to be used
   g) remove the two employers currently in the ABG who do not have a subsumption commitment from a local authority and instead calculate an individual rate for them
   h) allow any employer with an individual rate to pre-pay contributions in return for a discount, under a methodology agreed with the fund actuary
   i) allow any employer with an individual rate or an employer in the TPC pool or the ABG to pay additional contributions towards their deficit if desired.

8. The remainder of the report sets out the proposals and the consultation process in more detail.

Proposed changes to the structure of the Hampshire Pension Fund

Reasons for change

9. At the meeting on 29 March, members gave their approval for the Director of Corporate Resources to consult with employers on potential options for changes to the way in which they are grouped for funding purposes.

10. The Fund Actuary recommended changes because the grouping arrangements have been under strain for over a decade as employers have sought to make efficiencies through outsourcing, restructuring and creating trading companies. Whilst the Fund Actuary has been able to accommodate these different approaches, it is increasingly difficult to sustain, and to justify, the grouped approach. This is particularly of concern as LGPS funds come under greater scrutiny and employers are under greater pressure to explain their own pension costs.

11. Dismantling the Scheduled Body Group (SGB) will result in 'winners' and 'losers' as it reveals the cross subsidies within the group and a fair decision has to be made as to the allocation of any deficit when the group is dismantled. However, this effect is drastically reduced if the group is dismantled at the point it is near 100% funded.

12. There has been material improvement in the funding level for the HPF since the 2016 valuation which means that overall contributions are not expected to rise, and may even fall for employers in the SBG. By taking the opportunity to dismantle the groups at the 2019 valuation, employers are more than likely to find that even if their future service rate increases as a result of de-grouping (if their membership is older than the group average) their overall contribution rate will be stable or reduce.

13. The current arrangement by which the costs of death in service and ill health retirements are shared by all employers in the Fund (not just within groups) will be retained, regardless of the outcome of the consultation. This change was intended to offer greater protection for smaller employers against the volatility of their funding position that deaths-in-service or ill-health retirement can cause.

Changes that were consulted on

14. Employers were consulted on proposed changes which are described in paragraphs 15 - 32 below. In summary the proposed changes were to:
    - Remove the academies from the Scheduled Body Group and create an academies pool (paragraphs 15 - 18)
    - Create a Town and Parish councils pool (paragraphs 19 – 22)

- Set up the remaining scheduled body employers on an individual basis (paragraphs 23 – 27)
- Change the way in which the grouping works for the Admitted Body Group to enable different recovery periods to be used in light of different potential terms to exit (paragraphs 28 - 32)

Employers who would become stand alone under the proposals were also asked to comment on the desirability for them to pre-pay contributions or be allowed to make additional contributions towards their deficit.

Academies

15. Academies are currently part of the scheduled body group (SBG) and therefore already pay a common contribution rate. In the absence of a decision at the national level, the proposal was to remove the academies from the SBG and create an academies pool. The reason for not proposing individually assessed contribution rates at this valuation was because there is uncertainty over the timing and contents of any future guidance from the Scheme Advisory Board in relation to academy funding, which may encourage (or even require) pooling within Funds as a preferred solution. It would put at risk the stability of academy contribution rates if academies were individually assessed in 2019 only to be pooled again at the next valuation.

16. Under the proposal, Academies would pay deficit contributions based on their proportion of the group's liabilities and would pay a common future service rate. It is likely that overall contributions would be lower than present due to the overall improvement in funding level (as this will lead to lower deficit contributions).

17. Pooling academies together would aid any future call on the Department for Education (DfE) guarantee in the event of failure, because it would be clearly demonstrable that there were no cross subsidies to or from outside the academy sector.

18. However, if there is no national approach before the next valuation, the decision to maintain a group for academies would be revisited prior to that valuation, in consultation with the academies and in light of any stated preferences from the DfE.

Town and Parish Councils

19. Town and Parish Councils (TPCs) are resolution bodies who have the choice of designating membership to the LGPS and therefore participate in the Fund on a different basis to scheduled bodies who must offer the LGPS to all their employees. Therefore the membership of TPCs can be transient and result in an employer joining and exiting the Fund multiple times. This means that some TPCs join the Fund as a new employer without historic deficit

contributions, whilst others continue to pay deficit contributions because they joined the SBG before the 2010 valuation when the layered deficit recovery plan was introduced[1]. More generally, the participation of 'new' (post 2010) employers in the SBG is inconsistent with the other employers in the group who all contribute towards paying off the group's deficit.

20. Although there are 60 TPCs in the Fund, they represent only 271 active employees, 154 deferred members and 157 pensioners. Membership of the SBG has ensured that TPC contributions are much more stable than if their contributions are assessed on an individual basis. It is therefore considered appropriate that some version of grouping is retained for TPCs. Two of the risks to which TPCs would be vulnerable if they are not grouped are ill health and death in service pension costs, but since 2016 these risks are shared across all employers in the Fund. The biggest remaining variable is the age of the TPC's membership which, if they only have one active member, could result in huge changes in contribution rates over time.

21. It was therefore proposed that the TPCs would be pooled together in a Town and Parish Councils Group and pay a common primary contribution rate. However, it was also proposed that assets of the pool are allocated at employer level to enable the Fund Actuary to certify individual deficit contributions reflective of the TPC's expected future participation in the Fund, and so that exit calculations are based on the TPC's own assets and liabilities. Deficit recovery periods will be reduced, but this will be accommodated within the overall savings likely to be generated by the improved funding position (i.e. a reduced deficit) to avoid any contribution increases.

22. In recognition of the relatively small size of most of the TPCs, a commitment was made to ensure that the changes are delivered within the same overall cost that each TPC would have paid from 2020 if no changes had taken place (i.e. after allowing for the planned increases in primary and secondary rates from previous valuations).

Remaining scheduled body employers

23. Once academies and TPCs are removed from the SBG, the remaining employers are mainly the local councils, and associated employers such as the Cultural Trust. Under the proposals, these employers would be given their own contribution rate at the 2019 valuation, based on their membership profile and a share of any remaining deficit in the SBG, based on their liabilities. Associated employers (including maintained schools which have a

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[1] The LGPS regulations allow the Fund to suspend the requirement for an exit payment if the TPC has a further active member joining within three years of ceasing active membership, which reduces the administrative burden and potential financial implications of a pre-2010 TPC exiting the Fund.

separate employer number to their local authority for historic administration purposes) would be grouped with their local authority.

24. All employers would continue to have the same funding target and deficit recovery period at the 2019 valuation, although this could be varied at future valuations.

25. A key benefit of having individually assessed rates is that employers can pay additional contributions or pre-pay contributions to benefit from a discount. This is not possible as part of the existing SBG group as contributions are not allocated to individual employer – where "full" grouping is in place (as was the case for the SBG and is proposed for the new academies pool) assets are only tracked at group level so contributions paid affect the group position and are not allocated to an individual employer.

26. As there has been a material improvement in the funding level for the HPF since the 2016 valuation, it is anticipated that overall contributions will not rise, and on balance are more likely to reduce, before allowing for any changes to the group arrangements.

27. By taking this opportunity to dismantle the SBG at the 2019 valuation, SBG employers are more than likely to find that even if their future service rate increases as a result of de-grouping (if their membership is older than the group average) their overall contribution rate will be stable or reduce as a result of a significantly reduced deficit stream payment.

Admitted body group

28. Work has already been carried out to secure a commitment from the relevant local authorities to subsume the assets and liabilities of the charitable employers in the admitted body group (ABG) when they exit the Fund. This will enable the continuation of a long term funding strategy for those employers' liabilities without having to increase funding to the level required for orphan liabilities within the Fund. The two bodies without this commitment will be de-grouped at the 2019 valuation and set their own contribution rate and recovery period, based on their financial strength and likely length of participation in the Fund.

29. Due to the disparate membership profiles of employers in the group, there would be a wide range of future service rates at employer level if the group was dismantled and rates were set individually. Some employers would experience significant increases in rates and others significant decreases. Many of the employers in the group have alerted the administering authority to affordability constraints which would suggest that setting individual rates for some employers could have a significantly detrimental impact to their ongoing viability.

30. The proposal the remaining employers were consulted on was for them to continue to share all risks within a reformed admission body group, so as not to disturb current risk/cost sharing arrangements which currently protect a number of the employers. The operation of the group funding arrangements would be changed so that assets are allocated to individual employers at the 2019 valuation to enable different recovery periods to be used in light of different potential terms to exit (based on the working lifetimes of their active members). The aim is to avoid contribution increases and make these changes within the cost envelope provided by the improvement in the funding level since 2016.

31. To keep the funding strategy simple, employers may be allocated into short, medium and long-term brackets for recovery plans.

32. This approach will eradicate the issue which currently exists whereby there is an inconsistency between the amounts employers pay in deficit contributions whilst members of the fund, and the amounts they are asked to pay on exit. This is because active employers pay a share of the group's deficit contributions in proportion to their relative payrolls in the group but, as and when they exit the Fund, they are allocated a different share of the group's deficit, in proportion to liabilities. This current operation is a natural outcome of the existing grouping arrangements in which cross-subsidies are unravelled on exit. In some cases this can (and has) caused an unexpected significant exit payment for the exiting employer (to the gain of the other group employers), and in other cases it could see a lower than expected exit payment for the exiting employer (but to the detriment to the other group employers). Setting individual deficit contribution rates for ABG employers ensures the fair allocation of the total ABG deficit across its members and consistency with valuations undertaken on exit.

Employer consultation

33. Following a meeting on 3 April where officers agreed the proposals with the Fund Actuary, employers were sent a briefing note (Appendix 1) on the proposed changes and were invited to a workshop presented by the Fund Actuary. Four separate workshops were held (one for TPCs, one for Admitted Bodies, one for Academies and one for the other Scheduled Bodies) so that the Actuary could set out the implications of the proposals on their particular employer type.

34. At the workshops, the Fund Actuary presented the proposals to the employers and then answered any questions arising. The workshops were attended by 52 employer representatives in total. The list of attendees is attached in Appendix 2. The presentation was recorded and a video was

shared with all employers, together with a copy of the slides so that all employers could see what was said, even if they had not been able to attend.

35. Employers were asked to comment on the changes based on the principles of the proposals, rather than how it would affect their own individual organisation. The decision on whether to go ahead with the proposals has to be done prior to the 2019 valuation being carried out as the agreed structure of the Fund will form the basis of the Actuary's calculations. There was reluctance from some employers to respond on this basis because they wouldn't know the impact on them as an individual employer, despite the overall message from the Actuary that most employers could expect contributions that were no greater than they were currently paying, and in each presentation the overall impact of the change on the employer category was discussed.

36. Employers were asked for their response to the proposed changes by 26 June, and copies of all the feedback that has been received has been attached as Appendix 3. In total there were 30 responses from the 176 employers who would be impacted by these proposals.

37. There has been broad support from the local councils and other scheduled bodies who would become stand alone employers under the proposed changes. However the Town and Parish Councils have been less positive about the impact of them being removed from the Scheduled Body Group. There were two responses from academies but none from the admitted body employers.

Proposed way forward

38. The Panel and Board need to act in the best interests of all the employers in the Fund, and the suite of proposals was designed with this objective in mind.

39. The strongest objection to the proposals has come from the TPC group (albeit that there were only 21 responses from the 61 TPC employers affected, and 2 of these were positive). The preference for TPCs would be for no changes to be implemented so that they can continue in the Scheduled Body Group and receive the benefit of the cross subsidies from the larger employers (as the TPC group has an older than average membership). However the responses from the larger scheduled employers has indicated that they would welcome becoming individually assessed. Clearly it is not possible to accommodate these two opposing positions.

40. The proposed approach of setting up a TPC group already mitigates the biggest risk to large changes in the TPC future service rate by allowing them to pay a common future service rate based on the average age of the group. The existing arrangement of sharing the cost of ill health retirements and

death in service across all fund employers would be kept in place. In addition, a commitment has been made which will mean that no TPC will pay more in contributions following the 2019 valuation than they would have done had the 2016 valuation still applied. It is not in the longer term interest of the TPCs to remain in the existing SBG arrangement as TPCs would continue on average to underpay contributions which will lead to much larger exit deficits when their last employee leaves the scheme. It would not be good governance to allow these employers to continue to underpay contributions to this extent.

41. Several of the TPC responses suggest an alternative would be for them to be pooled with the councils, either with their 'parent' district or borough or for all the TPCs to be part of a Hampshire County Council pool. This option has not been explored with the councils as it does not achieve the objective of removing the cross subsidies which exist in the current SBG, and would still see TPCs underpaying relative to the potential exit deficit they would face if their last active member leaves the scheme. Continuing to pool the TPCs within the SBG would mean that their pension costs would be understated, with the outcome that other employers in SBG would be providing a cross subsidy which ultimately impacts on the council tax of those bodies, and means that the true costs of TPCs LGPS membership is not fully reflected within their own precepts.

42. Almost all the TPC responses cited the lack of financial information as a reason they could not provide a considered and final response to the consultation. The TPC workshop was the first one to take place and in hindsight, more time should have been given to explain the reason for the timing of these proposed changes which necessitates a decision being made prior to the valuation calculations being undertaken. The grouping mechanism has been under pressure for over a decade but it has not been viable to de-group employers at previous valuations because of the overall deficit position of the Fund. It is only possible to make such structural changes at a valuation and so there is only an opportunity once every 3 years to consider this option. There is also then only a narrow window of time when the likely funding position at the next valuation becomes clear. This means that the decision has to be taken on principles, rather than assessing the individual winners and losers, and in tight timescales. The material improvement in the funding position since the last valuation provides a unique moment in time for the scheduled body group to be dismantled.

43. It is therefore recommended that the proposed changes are implemented as set out above, despite the 19 TPC responses which would rather see the continuation of the SBG in its current form. A TPC pool, despite its relatively small membership will still protect TPCs from the volatility of contributions caused by the aging/changing of its employees. However given the feedback received, the Panel and Board are asked to consider a further option to allow any Town and Parish Council who would rather become an individually assessed employer to do so.

44. If the Panel and Board agree to allow TPCs the option to become a standalone employer rather than part of the TPC pool, any TPC wishing to do so would have to make a positive election to become stand alone by 15 August 2019 so that the change could be included in the valuation calculations. There would be an opportunity at each subsequent valuation for a TPC in the pool to come out, but once an employer has an individual rate they will not be allowed back into the TPC pool.

Final proposals

45. For clarity the final suite of proposals that the Panel and Board is asked to consider is to disband the scheduled body group at the 2019 valuation and instead:

- Establish an academies pool for all academies and free schools covered by the DfE guarantee. Academies would pay a common future service rate and a share of the pool's deficit in proportion to their share of the pool's liabilities.
- Establish a Town and Parish Council (TPC) pool. TPCs would pay a common future service rate but an individually assessed deficit contribution based on their own liabilities and likely future participation in the fund.
- Allow any TPC who irrevocably elects to do so by 15 August 2019 to instead become a standalone employer with a future service rate and deficit contribution based on their membership profile
- Calculate an individual contribution rate and a share of any remaining deficit for all the remaining scheduled body employers based on their membership profile. Retain the same funding targets and deficit recovery periods for these employers at this valuation but with the option to vary them in the future
- Change the operation of the Admitted Body Group (ABG) so that employers are allocated assets at an individual level to enable different deficit recovery periods to be used
- Remove the two employers in the ABG who do not have a subsumption commitment from a local authority and set them up as standalone employers with a future service rate and deficit contribution based on their membership profile
- Allow any employer with an individually assessed contribution rate to pre-pay contributions
- Allow any employer with an individually assessed contribution rate, or an employer in the TPC pool or an employer in the ABG, to pay one off additional contributions towards reducing their deficit.

Next steps

46. Following this meeting, a communication will be sent to all affected employers to inform them of the Panel and Board's decision. This communication will include the offer to each TPC to elect to become a standalone employer at the 2019 valuation, if this recommendation is approved.

47. If the Panel and Board agree to the recommendations, then a methodology for calculating the discount given to employers who pre-pay contributions needs to be established. The Panel and Board are asked to delegate authority to the Director of Corporate Resources to work with the Fund Actuary to agree this methodology and process by which employers can enter into a pre-payment agreement.

48. If the Panel and Board agree the changes to the way in which employers are assessed for funding purposes, the Funding Strategy Statement (FSS) will be revised to reflect the new arrangements and this will be presented to the Panel and Board for approval in September, prior to being issued to employers for consultation following the Annual Employer Meeting in October. The Fund Actuary will use the new FSS in setting contribution rates for employers in the 2019 valuation.

Update on the 2019 triennial valuation

49. Work to provide the Fund Actuary with the necessary information to complete the 2019 triennial valuation has continued and a report setting out the approach to the 2019 valuation will be considered by the Panel and Board at its next meeting on 26 July.

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	yes/no
People in Hampshire live safe, healthy and independent lives:	yes/no
People in Hampshire enjoy a rich and diverse environment:	yes/no
People in Hampshire enjoy being part of strong, inclusive communities:	yes/no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because the Pension Fund Panel and Board need to approve changes to the way in which the Fund is structured.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document	Location
None	

EQUALITIES IMPACT ASSESSMENT:

1. **Equality Duty**

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionally low.

2. **Equalities Impact Assessment:**

Equality objectives are not considered to be adversely affected by the proposals in this report as the proposals benefit all scheme members.