

HAMPSHIRE COUNTY COUNCIL

Decision Report

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| Decision Maker: | Pension Fund Panel and Board |
| Date: | 15 December 2017 |
| Title: | Governance: Funding Strategy Statement and Employer Policy |
| Report From: | Director of Corporate Resources |

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1. Recommendation(s)

1.1. It is recommended that the Panel and Board approve for consultation, the changes to the Funding Strategy Statement and Employer Policy.

2. Executive Summary

- 2.1. The purpose of this paper is to seek approval from the Panel and Board for proposed changes to the Funding Strategy Statement (FSS) and Employer Policy in relation to the treatment of wholly owned companies and funding targets for new admission bodies.
- 2.2. Employers will be consulted on the proposed changes in the new year and a final version of the FSS and Employer Policy will be brought back to the Panel and Board at the next meeting in March 2018.

2. Contextual information

- 2.1. The Funding Strategy Statement (FSS) describes the Fund's processes by which employer's pension liabilities are met and contribution rates are set. The Fund must keep this statement under review and, after consultation with appropriate people, make revisions to reflect any material changes in policy.
- 2.2. The purpose of the Employer Policy is to set out the Fund's policies and procedures in the treatment of employers including the admission and exit of employers, and is designed to be read in conjunction with the FSS.
- 2.3. Both of these documents need to be updated so that they clearly set out the treatment of wholly owned companies in the Fund. Additionally, the Fund actuary has advised that a change is needed in the approach used to set funding targets for new short term admitted bodies because of inconsistencies between the calculation of the contribution rate and the exit valuation.

3. Wholly owned companies

- 3.1. Several employers have approached Pensions Services to understand the pension implications if they were to set up wholly owned companies. Although there is already one wholly owned company in the Fund, there is no formal policy in place which addresses the treatment of these type of employers.
- 3.2. Under the LGPS regulations, wholly owned companies are Part 2, Schedule 2 employers, known as 'designating' employers. These employers have a right to be a scheme employer and can designate which of their employees can access the LGPS (unlike a Part 1, Schedule 2 employer who has to allow access to all its employees).
- 3.3. The regulations do not give the Administering Authority the same power to determine the terms of membership for a wholly owned company as it does for admitted bodies, and the regulations do not automatically place the controlling employer as a guarantor. Under the regulations, any outstanding liability associated with a wholly owned company would be spread across all employers in the Fund.
- 3.4. This risk therefore needs to be addressed through the FSS and Employer Policy to establish a higher contribution rate for the wholly owned company due to the greater risk it presents to the Fund and/or require the controlling employer to be the guarantor.
- 3.5. The policy also needs to give consideration to the circumstances of the employer setting up the company. This is because even though wholly owned companies can only access the LGPS if they are set up by a Part 1, Schedule 2 employer, these employers are not all considered to have the same risk profile and financial covenant.
- 3.6. In revising the Employer Policy to take account of wholly owned companies, the key principles are:
 - in all cases, the controlling employer would be a guarantor to the wholly owned company
 - the default arrangement would be for the wholly owned company to be a standalone employer, subject to the ongoing orphan funding target with an exit valuation on a low risk (gilts) basis
 - to allow the use of the Scheduled Body Group funding target for companies set up by tax raising authorities who provide a subsumption commitment
 - to allow ungrouped employers to pool with their wholly owned company so they share a funding target, provided this arrangement does not materially increase the risk to the Fund.
- 3.7. The revised Employer Policy is shown in Appendix 1, with changes highlighted on pages 3,5-6,8 and 10-12. The table in Appendix 2 sets out the intended outcome for some of the most likely scenarios in the Fund.

4. Funding targets for new admitted body employers

- 4.1. The Fund actuary has advised a change in the approach to setting funding targets for admitted body employers. The current policy allows most letting authorities to have the choice of whether the admitted body is placed on the ongoing orphan funding target (with an exit valuation carried out on the low risk gilts basis) or of offering a subsumption commitment (with the letting authority subsuming the assets and liabilities on exit). The main exception is for academies, where the outsourced employer is placed on the orphan funding target as the default because the new admitted body is not covered by the Department for Education guarantee.
- 4.2. Due to the historically poor performance of gilts, there is an emerging gap between the funding secured over the lifetime of the admitted body on the ongoing orphan funding target, and the low risk gilts exit position. This means that the assets notionally transferred at the start of the contract are insufficient to meet the liabilities at exit, and so the exit payment is larger than anticipated. Whilst this has not yet caused an issue, for example of a contractor refusing to pay, it is an unintended impact and should be mitigated.
- 4.3. To stop this situation occurring, the actuary is recommending that tax raising authorities are required to provide a subsumption commitment to their associated admitted bodies. There would be no change to the requirement for admitted bodies associated with academies to be on an orphan funding target. However if the academy still exists as a scheme employer at the end of the contract, subsumption can then be offered by the academy (and the extent to which the admitted body had overpaid would be reflected in the reduced exit payment).
- 4.4. The amended FSS which reflects this change is shown in Appendix 3 with changes highlighted on pages 2,3 and 4.
- 4.5. The situation with existing admitted employers on the ongoing orphan funding target will be addressed as a separate exercise, with the letting authority being given the option to offer a subsumption commitment or to manage expectations through communications with the admitted body.

5. Next steps

- 5.1. If the Panel and Board approve the changes to the FSS and Employer Policy, it is proposed that employers will be consulted on the changes in the new year, allowing a sufficient period for employers to understand the impact of the proposals.

CORPORATE OR LEGAL INFORMATION:**Links to the Strategic Plan**

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| Hampshire maintains strong and sustainable economic growth and prosperity: | no |
| People in Hampshire live safe, healthy and independent lives: | no |
| People in Hampshire enjoy a rich and diverse environment: | no |
| People in Hampshire enjoy being part of strong, inclusive communities: | no |
| OR | |
| This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because an action is required by the Pension Fund Panel and Board as the Administering Authority for the Hampshire Pension Fund. | |

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.)

DocumentLocation

None

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. 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 under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

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

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

1.1. Equalities Impact Assessment:

1.2. Equality objectives are not considered to be adversely affected by the proposals in this report.

2. Impact on Crime and Disorder:

2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

3. Climate Change:

3.1. How does what is being proposed impact on our carbon footprint / energy consumption?

No specific impact.

3.2. How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.

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No specific impact