

SURREY COUNTY COUNCIL

SURREY PENSION FUND COMMITTEE

DATE: 13 MAY 2016

LEAD OFFICER: SHEILA LITTLE, DIRECTOR OF FINANCE

SUBJECT: POOLED ILL HEALTH RETIREMENT SELF INSURANCE



SUMMARY OF ISSUE:

This report puts the case for pooled ill health retirement (IHR) self insurance as an efficient and cost effective method of mitigating IHR risk to the Fund.

RECOMMENDATIONS:

It is recommended that the Pension Fund Committee:

1. Approve the implementation of pooled IHR self insurance.

REASON FOR RECOMMENDATIONS:

The costs associated with IHR can be substantial and have serious financial implications for individual employers and potentially for all Fund employers.

The inability of a single employer to meet IHR costs could mean that this liability ultimately falls on other employers in the Fund. This risk has increased as the number of employers in the Fund has proliferated.

In previous reports to the Pensions Committee, the relative merits of mitigating IHR risk were documented and the purchase of an insurance product was recommended. However, this was subsequently discounted due to substantial premium costs among other concerns.

It was agreed to revisit the Fund's approach to the mitigation of IHR risk, once data providing evidence of IHR experience relevant to the LGPS 2014 scheme had been assessed.

DETAILS:

Background

1. In a report to the Pension Fund Committee on 14 February 2014, the relative merits of mitigating IHR risk were documented and the purchase of an insurance product to mitigate this risk were approved, subject to confirmation from the Head of Legal Services that the Council would not breach any procurement regulations by taking out the insurance policy with Legal & General.

2. The preferred option was that an ill health insurance policy with Legal & General at a reasonable premium cost of 0.63% of payroll, when compared with the five-year average experienced strain for Tiers 1 and 2 IHRs of 0.51% of payroll from 2008/09 to 2012/13 (which included a peak of 0.82% of payroll in 2011/12).
3. Officers consulted with procurement and legal colleagues and on 3 September 2014 published a voluntary ex ante transparency (VEAT) notice, advising the intention of the administering authority to enter into a contract with Legal & General.
4. Given the delay which resulted from a protracted procurement process, it was necessary to resubmit fund data to Legal & General for a revised quotation.
5. Legal & General produced a revised quotation on 28 January 2015, based on the same sum assured but, taking into account revised data and conditions in the ill health insurance market, the new quotation had an increase in premium from 0.63% to 0.88%.
6. Due to the increase in the premium quoted by Legal & General, the Pension Fund Committee did not approve the purchase of IHR insurance until such time that it has been possible to assess the impact of the new scheme rules on the costs of IHR to the Fund and the associated value for money of the Legal & General insurance contract.

Update

7. Data from 2014/15 and 2015/16 shows that Tiers 1 and 2 ill health retirement experience over this period continues to be a significantly less than the ill health insurance premium of 0.88% of payroll; as shown in the Table 1 below:

Table 1: Ill Health Retirement 2011/12 to 2015/16

Financial Year Ending	Total Payroll £m	Annual Premium @ 0.63% £m	Annual Premium @ 0.88% £m	Total Tier 1 and 2 strain £m	Strain and Premium Difference £m	Equivalent premium rate of Tiers 1 and 2 strain
31/03/2016	574		5.05	2.00	-3.05	0.35%
31/03/2015	542		4.77	1.79	-2.98	0.33%
31/03/2014	517	3.26		2.72	-0.54	0.53%
31/03/2013	489	3.08		2.30	- 0.78	0.47%
31/03/2012	465	2.93		3.79	0.86	0.82%
Total	2,587	19.09		12.6	- 6.49	0.49%

Pooled ill health self insurance

8. Currently, employers in the Fund effectively self insure against IHR risk, with the actuary allocating an allowance in accordance with member experience. This ranges from 0.1% to 4.3% of payroll, with the whole of fund average being 2% of payroll. The figures are backwards looking and will require updating for the 2016 valuation, with a likely reduction to reflect recent experience.

9. This approach continues to expose the Fund to a financial risk as the failure of a single employer to meet IHR costs could mean that this liability ultimately falls on other employers in the fund.
10. The Fund has discounted ill health insurance as a method of mitigating this risk as the costs are prohibitive and do not offer value for money.
11. An alternative approach is to continue to self insure but reduce risk by operating this on a pooled basis.
12. The purpose of this approach is to create a pool of assets that would recompense participating employers for the strain costs associated with IHRs. This would be achieved through:
 - Collecting a proportion of employers' contributions as premiums.
 - Allocating these contributions to a segregated sub fund(s) within the unitisation system.
 - The segregated sub fund will be invested in accordance with the Funding Strategy Statement.
 - The segregated sub fund will be capped at the amount of assets required to pay three years of expected claims.
 - When IHRs occur for a participating employer, the strain cost will be met from the segregated sub fund.
13. The calculation of the employer premiums will be the average of the current ill health allowance. This is currently 2% per employer. However, this will require revision to take account of recent IHR experience as previously detailed.
14. This approach does present the possibility that the segregated sub fund will be over or under funded. In each case, the following action will result:
 - Overfunding: any overfunding will be redistributed to employers through reducing or suspending premiums.
 - Underfunding: premiums would effectively be 'borrowed' from employer assets.

Pros and cons of the pooling ill health insurance

15. **Pros**
 - Benefit to the fund of a possible low claim environment.
 - Stability of employer contribution rate.
 - Mitigation of the risk of catastrophic ill health experience for small employers.
16. **Cons**
 - Risk remains with Fund if the cost of IHRs is higher than expected.
 - Subsidy by the IHR pool of those employers with above average IHR experience
 - The potential for some increased actuarial administration

Conclusion

17. The financial risk of IHR, heightened for smaller employers, is acknowledged. The Fund currently operates effective self insurance by employer experience but this does not eliminate the risk of IHR experience for individual employers.
18. The Fund has explored ways of mitigating IHR risk and has previously discounted third party IHR insurance due to cost until further data on recent IHR experience was understood.
19. Recent experience of IHR experience does not show that IHR strain has increased in line with the LGPS 2014 scheme. Indeed, the opposite has been true with the rolling five-year average reducing since the introduction of the new scheme. There has been no equivalent reduction in third party IHR insurance premiums.
20. An alternative method of mitigating IHR risk is through pooled self insurance. This operates in the same way as exists currently but, rather than ill health allowance being allocated by employer, it is instead charged on a whole of fund basis.
21. It is proposed that pooled IHR insurance be implemented for employers from the 2016 valuation on a non-discretionary basis.
22. IHR experience should be reviewed annually.

CONSULTATION:

23. The Chairman of the Pension Fund Committee has been consulted on this report.
24. Scheme employers will be consulted prior to implementation.

RISK MANAGEMENT AND IMPLICATIONS:

25. Risk related issues have been discussed and are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

26. Financial and value for money implications are discussed within the report.

SECTION 151 OFFICER (DIRECTOR OF FINANCE) COMMENTARY

27. The Section 151 Officer (Director of Finance) is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

28. There are no legal implications or legislative requirements.

EQUALITIES AND DIVERSITY

29. The approval of the various options will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

30. There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

31. The following next steps are planned:
- Consultation with scheme employers.
 - Implementation of the pooled ill health retirement from the 2016 valuation to take effect from 1 April 2017.

Contact Officer:

Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:

Pension Fund Committee Chairman

Sources/background papers:

None

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