SURREY
COUNTY COUNCIL

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Our Ref: LGPS Changes to the Local Valuation Cycle
Your Ref:

LGF Reform and Pensions Team
Ministry for Housing, Communities and Local Government
2nd Floor, Fry Building
2 Marsham Street
London
SW1P 4DF

29th July 2019

Dear LGF Reform and Pensions Team,

RE: Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk

Surrey County Council (Surrey) welcomes the opportunity to respond to the Government's consultation on proposed changes to the local valuation cycle and the management of employer risk.

Surrey is the Administering Authority for the Surrey Pension Fund (the Fund) as part of the Local Government Pension Scheme (LGPS). The Fund has assets of over £4billion and includes nearly 300 employers.

We are supportive of many of the Government's proposals, but, have some reservations about the proposed change to the local valuation cycle and the proposal to exclude new membership in the further education college sector.

1.1 Changes to the local fund valuation cycle

Question 1

9 **As the Government has brought the LGPS scheme valuation onto the same quadrennial cycle as the other public service schemes, do you agree that the LGPS fund valuations should also move from a triennial to a quadrennial valuation cycle?**

Surrey understands the rationale of the Government to move LGPS fund valuations from a triennial to a quadrennial valuation cycle in order to provide consistency with other public sector schemes. However, we would argue that the uniquely funded nature of the LGPS when compared to the unfunded basis of other public sector schemes is in itself an argument against a uniform approach. As a funded scheme the LGPS has a need for regular monitoring and assessments of funding positions due to the movements in asset and liability values, to take account of changes in employer covenant or to reflect external factors; such as the recent McCloud judgement.

The existing triennial valuation cycle has worked effectively for many years to manage risks, which have included volatile times in the financial markets and in local government finances. Throughout this period the LGPS has been able provide stable contribution rates for employers, whilst protecting funding levels of the scheme.

Question 2
Are there any other risks or matters you think need to considered, in addition to those identified in section 1.1, before moving funds to a quadrennial cycle?

Smaller employers may not be as engaged with the pension fund as their larger counterparts and this could lead to a failure to monitor their employer costs, leading to a possible cliff-edge change to contribution rates in a longer valuation cycle. Conversely, employers may opt to consider requesting interim valuations to take advantage of speculative market conditions, directly against the need to ensure stable contribution rates.

Before moving to quadrennial cycles, further information needs to be gained from the public sector accountancy and audit community. The current triennial valuation cycle means actuaries use approximate assessments for the intervening years. Lengthening the cycle may result in auditors being less willing to provide assurance (recent experience with the McCloud case has highlighted the sensitivity of this issue).

The Government suggests that “Moving the LGPS local fund valuations to quadrennial cycles would deliver greater stability in employer contribution rates and reduce costs”. It is our view that the opposite is the case.

The administrative complexity involved in making the necessary changes to move to a quadrennial cycle will incur increased costs in administration, as would the management of interim valuations. This inevitable need for interim valuations could increase actuarial and audit costs.

Question 3
Do you agree the local fund valuation should be carried out at the same date as the scheme valuation?

We are supportive of the alignment of local and scheme valuations, if meaningful information from these exercises can inform improvements to the scheme. We believe that the case for this has yet to have been successfully made by the Government.

1.3 Transition to a new LGPS valuation cycle

Question 4
Do you agree with our preferred approach to transition to a new LGPS valuation cycle?

Notwithstanding our earlier comments and while recognising the significant additional administrative burden on authorities, Surrey supports the three year plus two year transition (option b). This is due to a strong view that a five year transition (option a) is too long a valuation period, consistent with our earlier comments regarding the proposals to extend from a three to four year cycle.

2.1 Ability to conduct an interim valuation of local funds

Question 5
Do you agree that funds should have the power to carry out an interim valuation in addition to the normal valuation cycle?

On the basis that the valuation cycle is extended to four years, Surrey supports the proposal to give funds the power to carry out interim valuations. Interim valuations will be key to ensuring that employer and fund risks can be monitored and managed in a timely and effective way.

A strong governance framework is an essential requirement to support this process and we are supportive of the proposal that Funds include the conditions under which interim valuations may be considered appropriate in their local Funding Strategy Statements, with due regard to their actuary and Local Pension Board. We are also in agreement with the principle of Secretary of State intervention in exceptional circumstances, on the basis that clear statutory guidance is produced in consultation with funds to define what these circumstances are.

Question 6
Do you agree with the safeguards proposed?

With reference to our answer to question 5, we are in agreement that suitable governance provides appropriate safeguards.

2.2 Review of employer contributions

Question 7
Do you agree with the proposed changes to allow a more flexible review of employer contributions between valuations?

Surrey is supportive of the proposed changes to allow a more flexible review of employer contribution rates. This would be appropriate should employers wish to inject additional cash, or if their membership profile changes. It would also allow Funds to react to a change in the covenant strength of employers.

The parameters under which contributions may be reviewed should be included in the Funding Strategy Statements of Funds to guard against any increased risk to the fund and employers.

2.3 Guidance on setting a policy

Question 8

9 **Do you agree that Scheme Advisory Board guidance would be helpful and appropriate to provide some consistency of treatment for scheme employers between funds in using these new tools?**

Surrey is very supportive of Scheme Advisory Board (SAB) advice in this area to provide some consistency of treatment for scheme employers. However, individual funds should retain sufficient levels of discretion to allow a flexible approach which is appropriate to the profile of local funds.

Question 9
Are there other or additional areas on which guidance would be needed? Who do you think is best placed to offer that guidance?

Guidance on the pace of funding would be helpful in the context of contributions. Employers may not be aware of the interest savings available by accelerating funding contributions.

3.2 Flexibility in recovering exit payments

Question 10
Do you agree that funds should have the flexibility to spread repayments made on a full buy-out basis and do you consider that further protections are required?

The consultation states that “employer debt is calculated at a full buy-out basis”. This is not an accurate understanding of the treatment of “exiting employers” in the LGPS Regulations.

Regulation 64 (2) of the LGPS Regulations 2013 is not categorically defined in the LGPS Regulations, instead this is at the discretion of the Fund. Exit payments are defined in the regulations as follows:

“exit payment" means the assets required to be paid by the exiting employer over such period of time as the administering authority considers reasonable, to meet the liabilities specified in paragraph (2);”

It is misleading to describe exit payments as “a full buy-out basis” as liabilities in the LGPS cannot be transferred to insurance companies in the way in which buy out (or buy in) is understood in defined benefit schemes in the private sector. Full exit payments in the LGPS are normally calculated on what the Fund actuary determines to be a prudent basis, which can vary from fund to fund.

Surrey recognises the employer experiences as laid out in the consultation and is supportive of the proposal that Funds should have flexibility to spread exit repayments. We would also welcome this being put in legislation.

However, it should also be noted that regulation 64(4) of the LGPS Regulations 2013 does allow some flexibility for employer repayments to be paid beyond the effective exit date. Any new regulations should recognise this fact.

3.3 Deferred employer status and deferred employer debt arrangements

Question 11
Do you agree with the introduction of deferred employer status into the LGPS?

Surrey is very supportive of the principle of the introduction of a deferred employer status into the LGPS, subject to satisfactory deferred debt arrangements being agreed.

Question 12
Do you agree with the approach to deferred employer debt arrangements set out in section 3.3? Are there ways in which it could be improved for the LGPS?

Surrey is supportive of a deferred debt arrangement and the use of the S75 model used by DWP in private sector pension schemes as a template. However, we believe that this will introduce a new layer of complexity in to LGPS, including the need for knowledge, understanding and expertise in the assessment of covenant strength.

The need for guidance in this area is essential and we would recommend that both the SAB and CIPFA be involved in the drafting of this.

As a deferred debt arrangement is effectively a loan, we believe it can be improved for the LGPS by allowing funds to formally securitise this loan; this could take the form of taking a legal charge over the assets of employers. The legal permission for this should be enforceable through legislation. This will prevent employers from prioritising other financial obligations over the charge of LGPS funds.

3.4 Proposed approach to implementation of deferred employer debt arrangements

Question 13
Do you agree with the above approach to what matters are most appropriate for regulation, which for statutory guidance and which for fund discretion?

As noted in our previous answer we believe that the legal status of deferred debt arrangement, including the key obligations and entitlements of all parties should be included in the regulations.

We are in agreement that questions of risk and the competing interests of stakeholders should be included in guidance and believe that the SAB and CIPFA are best placed to consult with funds in the production of this.

3.5 Summary of options for management of employer exits

Question 14
Do you agree options 2 and 3 of Section 3.5 should be available as an alternative to current rules on exit payments?

We agree with the introduction of both option 2 & 3 and are supportive of these options being available to funds in addition to current rules on exit payments (option 1).

Question 15
Do you consider that statutory or Scheme Advisory Board guidance will be needed and which type of guidance would be appropriate for which aspects of these proposals?

Comprehensive guidance on all aspects of the management of employer exits should be provided. As noted in our previous answer, SAB and CIPFA are best placed to consult with funds in the production of this.

4.3 Proposal to amend LGPS Regulations

Question 16
Do you agree that we should amend the LGPS Regulations 2013 to provide that administering authorities must take into account a scheme employer's exposure to risk in calculating the value of an exit credit?

This would remove one of the unintended consequences of the introduction of exit credits.

Surrey is in agreement that the Government should amend the LGPS Regulations 2013 to provide that administering authorities must take into account a scheme employer's exposure to risk in calculating the value of an exit credit.

Question 17
Are there other factors that should be taken into account in considering a solution?

Side agreements can include details of a pension exit credit of an admitted body being credited to the original transferring scheme employer. Examples of this and the tax treatment of this credit payment should be taken account of in the solution.

There may also be may be a potential conflict of interest if the administering authority is also a scheme employer with a financial interest in the outcome of the exit credit assessment. An appropriate way of managing this conflict should be considered as part of the solution.

A way of managing the issue of funds already having paid an exit credit to an employer should be included when considering a solution. One way of achieving this would be for the amendment to be extended so that the existing exit credits legislation is restricted to apply only to new contracts set up after 14 May 2018.

It is noted in the consultation that provisions of the (presumably amended) LGPS Regulations 2013 you be relied upon in the event of a dispute or disagreement. This should include clear direction in the cases where a side agreement, or even admission agreement, is absent.

5.1 Further education corporations, sixth form college corporations and higher education corporations

Question 18
Do you agree with our proposed approach?

Surrey is of the view that the proposed approach has the potential to create a two tier workforce for this cohort of employers.

The proposed approach would also have an impact on future cash flows of funds and current employer contribution rates for the scheme employer, as the fund would be required to consider them as a "closed employer". This could have an impact on the way in which their liabilities are valued. It would also bring forward the point at which these institutions become an exiting employer, with the financial impact of the crystallisation of their pension liabilities.

We are aware of the SAB's Tier 3 project which was commissioned to investigate, report and make proposals on issues such as the status of higher and further education establishments and we would recommend waiting for the conclusions of this work before committing to an alternative approach.

6.1 Consideration of equalities impact

Question 19
Are you aware of any other equalities impacts or of any particular groups with protected characteristics who would be disadvantaged by the proposals contained in this consultation?

The workforce represented in the Further Education Corporations, Sixth Form College Corporations and Higher Education Corporations are predominantly female and part time.

Surrey welcomes a number of proposals that are included in this consultation, particularly concerning changes to the management of exit payments. However, we advise caution in reference to the proposals concerning a change to the category of employers that are currently required to offer the LGPS to a proportion of their staff. In addition, with regards to proposals to extend the valuation cycle we would venture to suggest that the current triennial cycle is not broken and does not require fixing.

Yours sincerely

Anna D'Alessandro
Director of Corporate Finance

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