**Pension Fund Committee**
Meeting to be held on Friday, 15 September 2017

| Electoral Division affected: (All Divisions); |
|---|

**Lancashire County Pension Fund - Admission and Termination Policy**
(Appendix A refers)


Contact for further information:
Abigail Leech, 01772 530808, Head of Fund,
abigail.leech@lancashire.gov.uk



**Executive Summary**

The termination policy for the fund has been in existence largely in its current form since 2009. Whilst it has been amended to allow for procedural and regulatory changes there hasn't been a fundamental review. The main area that requires a review is the actuarial assumptions which are used to assess the value of the liabilities at the point the employer exits the fund. In discussions with our actuaries it was felt that current methodology did not provide enough protection for the remaining employers from the downside risks and the policy in Appendix 'A' has been updated to provide further protection.


**Recommendations**

1. That the changes to the admission and termination policy, as set out in Appendix 'A' to this report, are approved for consultation with the employers in the Fund.

2. That a further report on the outcome of the consultation specified in 1 above is presented to the Committee on the 23rd March 2018

**Background and Advice**

When an employer leaves the Fund, an assessment needs to be made of the assets and liabilities attributable to it under the Fund. If there is any deficit of assets against liabilities then this needs to be met by the employer. This assessment and payment of any deficit is both a requirement of the LGPS Regulations and sensible financial practice, as otherwise the deficit attributable to the leaving employer would need to be picked up by other employers within the Fund.

Given that employers leaving the Fund can be a regular event, a standardised policy for determining the amount of any deficit would be beneficial even though the existence of such a policy is not a formal requirement of the LGPS Regulations.

Having a policy:

- Provides clarity to all stakeholders.
- Provides a consistent approach, and which is therefore less open to challenge by the leaving employer and their advisers.
- Enables the termination process to be carried out efficiently.

The termination policy has been in existence largely in its current form since 2009. Whilst it has been amended from time to time to allow for procedural and regulatory changes, it was felt due for a more fundamental review.

This is because:

- It is an area where the policy of LGPS Funds generally can move over time.
- General policies have moved on since 2009.
- The current policy is heavily linked to the funding approach used for the actuarial valuation, and that approach has been modified at part of the 2016 actuarial valuation.

The main area for review is the actuarial assumptions which are used to assess the value of the liabilities at the point the employer exits the Fund. These assumptions involve a substantial degree of estimation, because those liabilities are the future benefit payments in relation to the employer's members and former members, and these benefit payments will extend for decades into the future. The key assumption (and therefore the main focus of the review) is the investment return which is assumed to be earned on the investments which back those liabilities over the long-term future. This assumed investment return is normally referred to as the "discount rate".

When setting the discount rate there are a number of options which could be used:

- A "best estimate" of the future investment return on the Scheme's assets.
- Using an approach consistent with that used for the latest actuarial valuation.
- Base it on the yields on long-term gilts at the date of exit.
- Use a "cash flow matching" approach, using the estimated yield on a subset of the scheme's investments which are expected to be broadly in line with the profile of the liabilities.
- Base it on the yields available on corporate bonds at the date of exit.

In considering which option is the most appropriate, it needs to be borne in mind that the termination assessment is a one-off calculation, so to the extent that future investment returns are different from those assumed in the termination assessment this difference falls as a benefit or cost to the other employers in the Fund.

In discussions with the actuaries it was felt that allowance needs to be made for the downside risks in order to protect the remaining employers, so the first two options were eliminated.

Whilst gilt yields are used by a number of Funds as the basis for the assessment, it was recognised that the Fund invests very little in gilts, so such an approach would not match with the Fund's investments. In addition, particularly in current market conditions it tends to produce a very high deficit at the point of exit. Whilst this might seem attractive from the perspective of seeking to reclaim a higher amount of money from the exiting employer, and so protect the remaining Fund employers, it was felt that it would serve to discourage employers from exiting the Fund even in circumstances where it would be in both the employer's and the Fund's interests for exit to take place.

The cash flow matching approach was felt to be the most attractive from a theoretical point of view. However, it suffered from the disadvantage of being more subjective (requiring regular reassessment rather than being based on publically available information), and would therefore make the exit process more cumbersome and less transparent.

At the present time, using yields available on corporate bonds is similar in nature to the cash flow matching approach, and has the advantage of being based on publically available information. It is also an approach used in calculating pension liabilities to be used in employers' accounts and so it is a generally recognised approach. It is used by a number of other LGPS Funds. For these reasons, this is the approach being recommended to the Committee.

In addition a minor amendment is made to the charging structure currently in place for new admission agreements and academies joining the Lancashire County Pension Fund. The standard charges are unchanged however additional interest charges are introduced where initial pension contributions are paid to the fund late. These interest charges are in line with those allowed for under regulation 71 of the LGPS Regulations 2013/2356. This replaces the former doubling of the standard charge for late admissions and more accurately reflects a "late" payment charge, which takes account of the size and delay of a late payment.

It is intended to have a 3 month consultation period with employers on the new policy, and also to give them some lead-in time in case they wish to exit as a result of the change in policy. It is therefore proposed that the new policy will apply to exits with an effective date of 1st April 2018 or later.

**Consultations**

Mercer

**Implications**:

This item has the following implications, as indicated:

**Risk management**

It is good practice to review the policy to ensure it is up to date and that employers in the fund are protected from the downside risk of an employer exiting.

**Local Government (Access to Information) Act 1985**
**List of Background Papers**

| Paper | Date | Contact/Tel |
|---|---|---|
| N/A | | |