

Cessation Valuations and Contribution Certificates... some tweaks required?

In February 2014, changes to the Local Government Pension Scheme 2008 introduced revised regulatory requirements for dealing with the deficits of employers exiting the Local Government Pension Scheme (LGPS). In particular, Regulation 38 was amended to provide more detailed prescription around the valuation to be carried out at the point of exit, commonly known as the 'cessation valuation' and how it could be paid.

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These new provisions were then carried forward into the Local Government Pensions Scheme Regulations 2013 and hence into the new LGPS effective from 1 April 2014. Under the 2013 Regulations the relevant regulation is number 64.

Regulation 64 says that when a scheme employer no longer has an active member contributing to a fund (becomes interesting if the employer participates in more than one fund!) they are then badged as an 'exiting employer' and the fund has to ask their actuary to carry out a cessation valuation.

The actuary then determines what, if anything, needs to get paid into the fund to fully fund the liabilities and once the exiting employer pays that amount they can 'walk away' with no further requirement to ever pay anything again, despite the fact that there are still liabilities in the fund in respect of the pension promises they made to former employees and that their funding provision is ever changing.

The regulations also state that the administering authority may determine a period over which the amount required can be paid.

The changes have resulted in some confusion over whether it is possible to make a payment plan to meet any deficit attached to the exiting employer in such a way that the value of the deficit may be revisited by further valuations. Various opinions and solutions abound, and a conclusion remains elusive.

In this briefing note, we look at what we believe administering authorities and employers would like to be able to do in dealing with outstanding employer liabilities at exit, what the regulations may allow, and what the solution may be. We also look at Rates and Adjustments Certificates.

The objective - what do stakeholders want?

The objective of a fund could be summarised as to obtain sufficient monies to cover the liabilities until the last benefit has been paid out, thereby reducing any requirement on the remaining employers and/ or Council Tax payers to contribute towards orphaned liabilities.

The objective of the exiting employer is often to maximise their cashflow by minimising the payment out of large lump sums.

Subject to the assessment of the exiting employer's covenant and obtaining security where it is possible to do so, flexible payment plans can work in everyone's interests, meeting the objectives of all parties.

In particular, the ability to revisit the amount remaining due via a revised valuation of the employer's liabilities and assets at various points may:

- help investments or member experience to meet some of the payment requirements of the employers; and
- the pension fund to return to the employer for further monies should investments not have performed as expected or should longevity have further increased for example.

Once the cessation deficit plan has been completed, then no further request for funds may be made to the exited employer and the cessation is complete.

The regulations – what do they let us do?

We are pensions consultants and actuaries, rather than lawyers, and to our non-legal eye it would appear that the regulations are a little tightly drawn. While they allow the exiting employer to make payments over such time as the administering authority considers reasonable, they appear to fix the amount payable to that calculated in the original Regulation 64 valuation. Regulation 64 (2) repeated below refers.

Whilst this provision is helpful in making it explicit that payments may be spread, enabling employers who may otherwise be bankrupted or seriously affected by a requirement to pay a one off lump sum to manage their cashflow and the fund to perhaps receive more cash than it otherwise would have done, it could go further to protect the fund and the remaining employers, and to assist the exiting employers.

As noted above, there are a number of good reasons why many employers and administering authorities would like the ability to be extended to enable the amount of the exit payment to be kept under review while the cessation payment plan is ongoing. There is of course no guarantee that even once the full cessation payment is made, it will actually turn out to be enough.

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The solution – what do we think is required?

While ‘work arounds’ are being investigated by differing parties, we believe that a change to the regulations would be the simplest and most straight forward solution. This could be simply achieved by an adjustment to the definition of ‘exit payment’ in Regulation 64 (8) from its current form of:

‘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).

The liabilities specified in paragraph 2 being:

- 2) When a person becomes an exiting employer, the appropriate administering authority must obtain:
 - a) an actuarial valuation as at the exit date of the liabilities of the fund in respect of benefits in respect of the exiting employer’s current and former employees; and
 - b) a revised rates and adjustments certificate showing the exit payment due from the exiting employer in respect of those benefits.

To something like:

*‘exit payment’ means the assets required to be paid by the exiting employer over such period of time and **on such terms** as the administering authority considers reasonable.*

Interpreting ‘assets’ to include a stream of future contribution amounts (including just the one and possibly subject to review at future valuations) and subject to legal consideration, this might possibly resolve the issue.

While we are on the subject of Rates and Adjustment Certificates, it would be helpful to have the ability to charge exited employers, in some cases employers who exited many years ago without a cessation valuation but who continue to exist as a legal entity, ongoing deficit contributions over the longer term.

Rates and Adjustments Certificates

Regulation 62 says Rates and Adjustments Certificates must certify a primary rate and a secondary rate.

62(5) says:

The primary rate of an employer’s contribution is the amount in respect of the cost of future accruals which, in the actuary’s opinion, should be paid to a fund by all bodies whose employees contribute to it so as to secure its solvency, expressed as a percentage of the pay of their employees who are active members.

62(7) says:

The secondary rate of an employer’s contributions is any percentage or amount by which, in the actuary’s opinion, contributions at the primary rate should, in the case of a scheme employer, be increased or reduced by reason of any circumstances peculiar to that employer.

The challenge could be that you need to have active members for the primary rate to apply. The secondary rate (which in an exited employer's case would be the cash amounts) is essentially an adjustment to the primary rate. Can you adjust something that (arguably) doesn't apply in the first place?

And while we are discussing Regulation 62, 62 (6) mentions about keeping the 'common' rate as stable as possible which we take to mean the primary rate. However, in our experience it is the total contribution that employers prefer to be stable not just one component of their pension costs.

A quite simple solution to all of this would be amend Regulation 62 to say something like:

Actuarial valuations of pension funds

62. (1) An administering authority must obtain:
- (a) an actuarial valuation of the assets and liabilities of each of its pension funds as at 31 March 2016 and on 31 March in every third year afterwards;
 - (b) a report by an actuary in respect of the valuation; and
 - (c) a **contribution** certificate prepared by an actuary.
- (2) Each of those documents must be obtained before the first anniversary of the date ('the valuation date') as at which the valuation is made or such later date as the Secretary of State may agree.
- (3) A report under paragraph (1)(b) must contain a statement of the demographic assumptions used in making the valuation; and the statement must show how the assumptions relate to the events which have actually occurred in relation to members of the Scheme since the last valuation.
- (4) A **contribution** certificate is a certificate certifying levels of employer's contributions for all employers with liabilities in the fund for the three years beginning 1 April 2017 and every three years thereafter, which in the actuary's opinion will be sufficient to ensure that the assets will be sufficient to meet the existing and prospective liabilities.
- (5) The actuary must have regard to the current version of the administering authority's funding strategy mentioned in Regulation 58 (funding strategy statements).
- (6) A contribution certificate must contain a statement of the assumptions on which the certificate is given as respects:
- (a) the number of members who will become entitled to payment of pensions under the provisions of the scheme; and
 - (b) the amount of the liabilities arising in respect of such members, during the period covered by the certificate.
- (7) The administering authority must provide the actuary preparing the contribution certificate with the consolidated revenue account of the fund and such other information as the actuary requests.

In reality that's how we go about setting contribution rates. The Funding Strategy Statement (FSS) can cover issues such as desirability of the stability of contributions (for whatever employer types this is deemed desirable), what to do with exiting employers whether admission bodies, exited employers, statutory bodies in the wrong funds, etc. Each FSS can also be worded to suit local circumstances rather than trying to have a catch all regulation (which is much more difficult as we know!)

It might also then be possible to delete or substantially trim Regulation 64 albeit there will be a need to beef up Regulation 58 or the statutory guidance about what an FSS should include – most these days include what happens with exiting employers and it would be easy enough to include who picks up any unfunded liabilities when an employer becomes an exiting employer.

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It is hoped that a satisfactory solution will shortly emerge.

Conclusion

It would appear that both participating employers in the pension funds and the administering authorities themselves would like the ability to have flexible cessation payment plans and that uncertainty currently exists over what may be possible.

Planned sensibly, with the provision of security where available, flexible cessation payment plans can enable the monies paid to the pension funds against an employer's pensions deficit to be adjusted to the benefit of the departing employer, the fund and the other employers who meet in the first instance any orphaned underfunding of former employers' liabilities.

We will continue to discuss this issue with the Department for Communities and Local Government, along with a request to enable deficit contributions to be paid where there are no actives remaining as referred to in our suggested Regulation 62 changes above and a cessation valuation has not been paid, and a relaxing of Regulation 64 (1) (b) which requires the cessation valuation to take place when the last active member departs, hopefully also clarifying that the departure is from a particular fund and not from the last fund in which the employer participates, to provide flexibility where an employer may have a short break between active membership. It is hoped that a satisfactory solution will shortly emerge.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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