Housing Bulletin – June 2019
LGPS Funding Agreements

Organisations participating in the Local Government Pension Scheme (the "LGPS") will be aware that the latest triennial valuation is now underway with the results for each fund expected to be published later in 2019. Although the headline results from the valuation will be your funding deficit and future contribution requirements, employers will also see details of their "Cessation Debt" valuation. This debt can be a significant 'one-off' cash call and is a liability which needs to be controlled and planned for as part of an organisation's strategic governance.

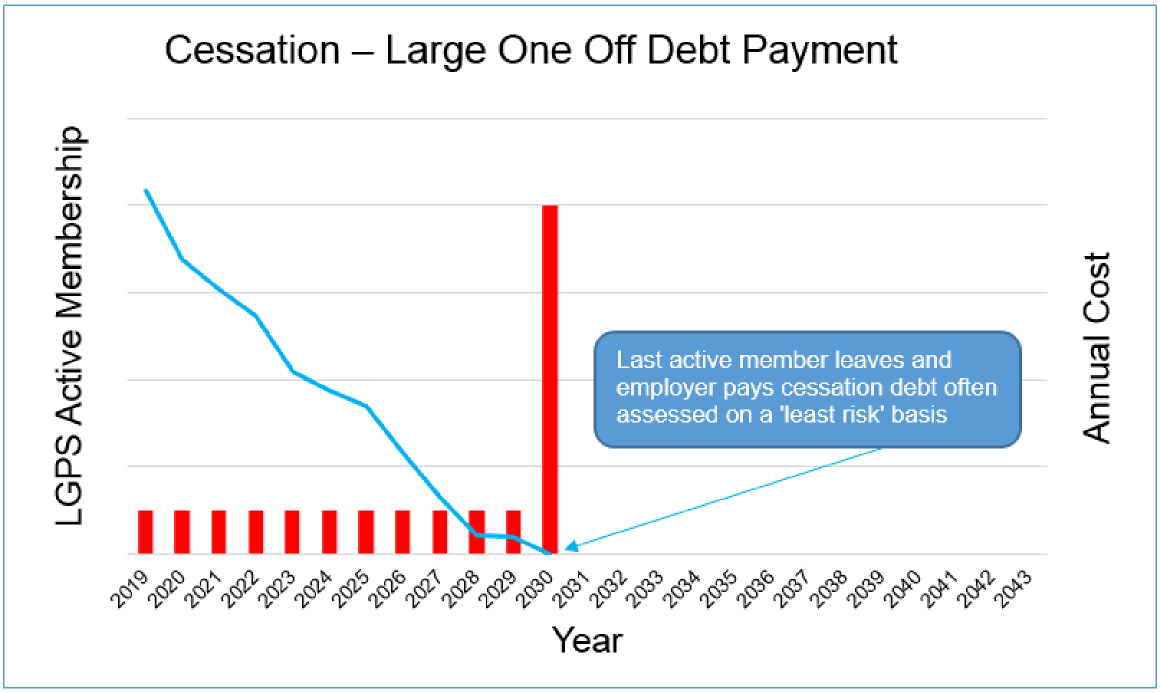
Cessation Debts – a reminder

LGPS regulations mean that an employer whose scheme participation 'ceases' (e.g. when its last active contributing member leaves) automatically triggers a Cessation Debt. This debt is often assessed on a 'least risk' basis (broadly equivalent to a 'gilts based' buyout cost) and can be a significant multi-million-pound one off cash payment. Obviously, for employers that have closed the LGPS to new members, this eventual cessation trigger is inevitable.

LGPS funds will often state that the reason for imposing a cessation debt on departing employers is to protect the position of the remaining employers (i.e. ensuring that the liabilities relating to the departing employer can reasonably expect to be funded). This assurance is often achieved by imposing a very prudent 'least risk' basis for calculating the debt.

Of course, the "flip side" to this prudent approach is that there is a high probability that the assets built up following cessation are significantly more than that required to meet the benefits due. In effect, the departing employer is expected to pay more, often significantly more, than is strictly needed.

The chart below illustrates a typical position with a declining LGPS active membership eventually leading to a significant one-off debt payment being required from the employer. This debt often being required to be paid in one financial year based on a timing (and hence financial conditions) which the employer has no control over.



Funding Agreements

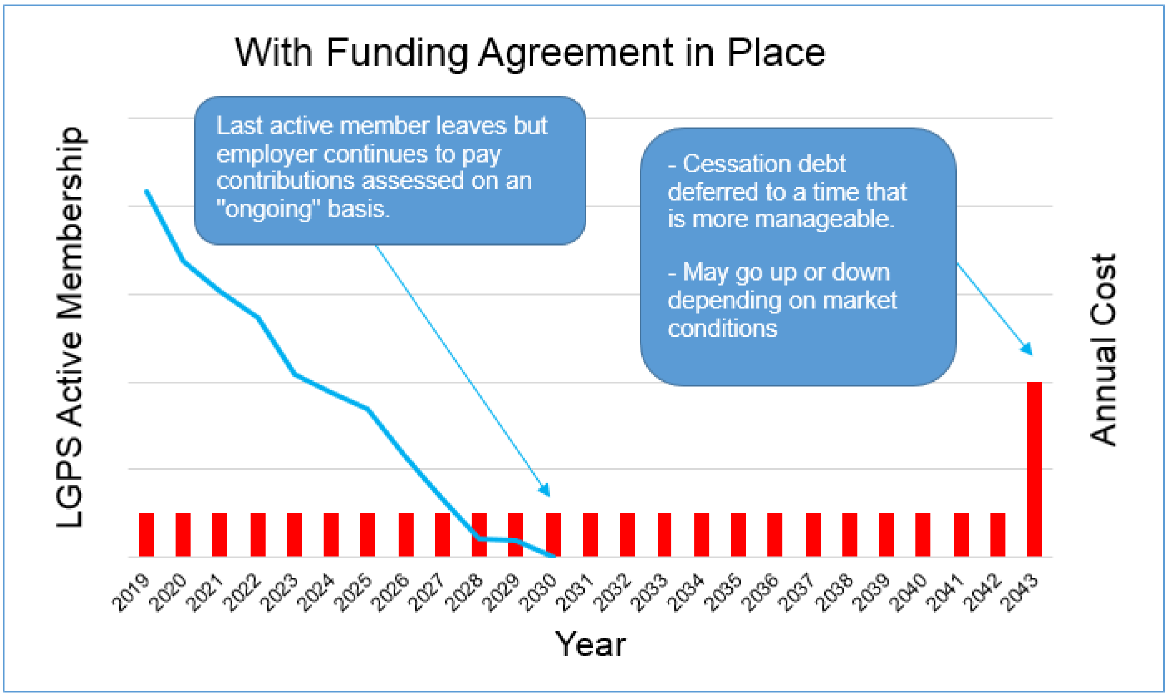
Given the level of cessation debt payments (and their size relative to the standard funding basis), in recent years many LGPS funds have been prepared to negotiate on either the level of the debt, or the timing of the debt payment. The results of these negotiations are often formalised by putting a ‘Funding Agreement’ in place.

A Funding Agreement would be expected to set out the terms that would apply when the cessation trigger occurs. This can give protection to the departing employer and enable liabilities to be planned for. It is important to stress that an employer putting in place a Funding Agreements is not trying to avoid its liabilities but is aiming to meet these in a controlled way at a reasonable cost. It also gives the employer the ability to spread payments over a reasonable period rather than a ‘one-off hit’.

First Actuarial is a market leader in helping housing employers arrange LGPS Funding Agreements and has successfully achieved this for many of our clients.

We have been instrumental in developing innovative solutions which now include arranging for all pension liabilities and assets to be passed back to the original council. This effectively removes any cessation liability risk for the employer.

The chart below illustrates how a cessation debt could potentially be managed. In this example the cessation debt is not triggered when the last active member leaves and is only triggered (at a much lower level) when the employer decides that it is an optimum time to do so. Before deciding to trigger the debt, the employer would continue to fund any deficit payments required either on the normal ongoing scheme valuation basis or on an accelerated basis as agreed with the LGPS.



By entering into a funding agreement, the employer will be able to monitor the size of any cessation debt on a regular basis and, if the size of the debt reduces, the employer can decide to end the funding agreement at that time and usually settle the debt as a (significantly lower) single payment.

Types of Funding Agreement - How First Actuarial has helped our clients

Set out below are a few examples of LGPS funds where we have negotiated agreements for our clients and a brief explanation of the terms of the funding agreement that has been put in place.

Home Counties (West) LGPS Fund – in advance of the last active member leaving the fund, a funding agreement was agreed and put in place which effectively defers payment of the least risk cessation debt indefinitely (with simply normal funding requirements ongoing even after active membership ceases). This was achieved based on the clear financial strength of the employer evidenced by accounting information and agency ratings. Fund was happy to agree this without any physical security being put into place. This could be described as the 'holy grail' of Funding Agreements as it did not tie up any capital, avoided significant debt payments in one year and gave the employer the flexibility to wait for the optimum time to pay its debt.

We have now used the same terms as this agreement for 3 different Funding Agreements. The first of these set up 4 years ago (with the employer monitoring its funding position and recently electing to pay the debt at a fraction of the original amount)

London LGPS Fund – for a number of London based funds we have negotiated agreements similar to the Funding Agreement referred to above. However, each LGPS fund is different and can adopt different policies. In general, this has meant that some form of security is required to underpin the agreement. This could be a charge over non-housing stock assets, cash escrow account or a bond. However, other types of security are possible.

Note: A charge over social housing stock is now theoretically allowed but our experience is that the vast majority of housing associations would not want to take this route.

Southern LGPS Fund – again, in advance of the last active member leaving the fund, a funding agreement was put into place which meant that the employer is only required to pay the excess of the cessation debt over the funding debt when the last active member leaves. Remaining debt is then paid over an agreed period.

Home Counties (North) LGPS Fund – often the original council is acting as a guarantor to the employer's participation in the LGPS Fund. This means that it is already standing behind the employer both to support its participation in the LGPS and as a partner to the work being carried out in the community. With this type of working relationship, we are exploring ways in which the pension scheme assets and liabilities are passed back to the council. In this way no cessation debt is ever payable, and the employer retains valuable cash to invest in the community.

We are currently working with three different LGPS funds in this regard and, whilst details are currently confidential, we would be happy to discuss the general principles with any of our clients who are in a similar position.

West Midlands LGPS Fund – this was one of the very first Funding Agreements seen in the UK and First Actuarial were instrumental in negotiating terms. The agreement deferred payment of the least risk cessation with the employer continuing to fund past and future benefits on an ongoing basis until 31 March 2029.

Government consulation on LGPS Exit Payments

In May 2019, the government begun a consultation on a number of matters relating to LGPS. These include:

- moving from the current 3-year valuation cycle to a 4-year valuation cycle;
- a number of measures aimed at mitigating the risks of moving from a 3-year to a 4-year valuation cycle;
- proposals for greater flexibility on exit payments from LGPS;
- proposals for further policy changes to exit credits; and
- proposals for policy changes to employers required to offer LGPS membership.

First Actuarial will be responding to this consultation which ends on 31 July 2019. We will keep you updated on the outcome and how this will affect you.

How First Actuarial can help

First Actuarial provides pensions advice to more housing associations than any other firm. We therefore have the experience to help you meet your objectives and make a real difference to your strategic planning. To discuss this bulletin, or any other pension matters, please contact your usual First Actuarial consultant, or any one of our nationwide team of housing consultants.

PETERBOROUGH **Neal Thompson** Email: neal.thompson@firstactuarial.co.uk Tel: 01733 447 657 or 07429 118 877	**MANCHESTER** **Rob Hammond** Email: rob.hammond@firstactuarial.co.uk Tel: 0161 348 7440 or 07479 494 030
BASINGSTOKE **Colin Freeman** Email: colin.freeman@firstactuarial.co.uk Tel: 01256 297 779 or 07456 811 791	**TONBRIDGE** **Tony Barnard** Email: tony.barnard@firstactuarial.co.uk Tel: 01732 207 510 or 07472 302 508