MERSEYSIDE PENSION FUND

FUNDING STATEGY STATEMENT - CONSULTATION

The Funding Strategy Statement (FSS) consultation commenced on 6 July 2018 and closed on 6 August 2018 and in this time the Fund received a number of responses from employers. This document summarises the questions and concerns raised by employers and the Independent Chair of the Pension Board during the consultation period along with a response from the Fund.

For those employers who have responded to the consultation, the responses in general support and welcome the need to revise the FSS in the light of the updated Local Government Pension Scheme (Amendment) Regulations 2018.

The majority of the issues raised related to the treatment of employers who have a guarantor within the Fund at the time of termination. Whilst those employers that responded were largely in agreement that the surplus or deficit on termination should be subsumed by the guarantor where all parties agree, the main area of concern was what would happened in the event that all parties did not agree.

The issues raised and the responses from the Fund are summarised below.

1. Is it correct that in the case where an employer has a guarantor but all parties do not agree to subsume the surplus, the default position in the FSS is for the exiting employer to receive the surplus?

Yes. In the event that an employer exits the Fund with a surplus position on termination, the default position in the FSS is that if all parties do not agree that the guarantor can subsume the surplus, then the Fund will pay out the surplus to the exiting employer.

Ultimately the Fund is required to comply with the Regulations which state that upon termination, the exit credit must be paid to the exiting employer (see Regulation 64(2) LGPS Regulations 2013 as amended by Regulation 13(c) LGPS (Amendment) Regulations 2018). It is this requirement under the Regulations which has meant that the FSS has been drafted in this way.

2. Is it possible to change the FSS to have a default position whereby the guarantor subsumes the surplus? This would avoid a situation whereby the exiting employer picks and chooses based on the funding position at termination, for example:

- **if the exiting employer agrees to subsuming the deficit then they do not have to pay any money**
- **however, if the exiting employer disagrees to subsuming the surplus then they receive the exit credit.**

As stated above because the Fund is required to comply with the Regulations, it is not possible to have a default position whereby the surplus is automatically subsumed by the guarantor.

In the event that an exiting employer disagrees with the guarantor subsuming the surplus, under the Regulations the Fund will have to make a payment to the exiting employer. In this situation the Fund would inform the guarantor of this before making payment of the refund.

It would then be up to the guarantor to contest the surplus payment citing the commercial contract and the desire for equal treatment in the event of a deficit (i.e. if the guarantor would have been responsible for a deficit but does not receive the surplus).

The Fund accepts that the new provision could be inequitable as the guarantor could absorb any irrecoverable debt from the exiting employer, whereas any surplus could ultimately be paid to the contractor if requested.

It is therefore crucial for employers to revisit their historic commercial contracts and adjust their future commercial contracts to ensure that they are explicit around the potential treatment of any surplus at the end of the contract and that all parties are clear what the agreement is and how it works.

3. Please can you update the FSS to confirm what will happen in the event where an employer is exiting the Fund and there is a guarantor but all parties do not agree to the surplus or deficit being subsumed by the guarantor?

It might be useful to also highlight in the FSS the need for employers to consider both the surplus and the deficit position in the contract / partnership discussions in the future.

We agree that it would be helpful to clarify this within the FSS. The Funding Strategy Statement will therefore be updated as follows:

> *If all parties do not agree then the surplus will be paid directly to the exiting employer within 3 months of cessation (despite any other agreements that may be in place). In maintaining a consistent approach, the Fund will seek to recover the deficit from the exiting employer in the first instance. However, if this is not possible, the deficit will be subsumed by the guarantor and all remaining assets and liabilities will then be subsumed by the guarantor.*
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> *The Fund will inform the guarantor of the exiting employer's request to receive the surplus before making payment of the exit credit. However the Fund will not become embroiled in any disagreement over the refund of any surplus which is contrary to commercial agreements.*
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> *Ultimately the Fund will have to comply with the Regulations and therefore pay any exit credit. It is then up to the guarantor to contest the surplus payment citing the commercial contract in place and the desire for equal treatment in the event of a deficit.*

4. In the case where an employer has a guarantor and agreement has been reached that any deficit or surplus is to be subsumed at exit, is there anything specific in how the agreement should be communicated and documented to the Fund?

Ultimately it is up to the guarantor and contractor to have in place their own specific legal agreements on how any surplus or deficit should be treated at exit. As a Fund we are unable to give legal advice on how these agreements/contracts should be set up.

In the case of historic arrangements we note that the contracts may not contain any detail around the specific treatment of a refund of surplus. In this case we would suggest that guarantors and employers look to update the contract or where a variation to the contract is not possible, we would suggest that the guarantor should seek a legal letter from the exiting employer setting out the agreed position on the treatment of any surplus at the end of the contract.

For any commercial agreements and contracts drawn up since the new Regulations have been in force (since May 2018), we would expect these to include agreement on how surpluses and deficits are to be treated on exit in view of the new regulations.

We would recommend that future contracts cover the allocation of pension risk and they should be written with the Funding Strategy and new Regulations in mind. Therefore the Fund would expect guarantors to address the issues of exit credits and align future contractual arrangements with the new regulatory provision and the Fund's termination policy.

5. Will these new arrangements be captured within the Admission Agreement for employers with a guarantor? For example, as an addendum to the Admission Agreement which clearly states the potential implications of the employer exiting the fund and acts as a legally binding condition that the employer pays any deficit (if applicable).

Our view is that any agreements on how pension risk should be allocated should be documented via the commercial and contractual agreements not the admission agreements but this is something that guarantors and employers should take their own legal advice on.

It is not appropriate for the Fund to determine aspects of the commercial arrangements and risk transfer with regard to pension costs in isolation as this may be counterintuitive to the guarantor receiving the most economically advantageous contract price. Furthermore it may not provide the contractor with transparency when agreeing costs and transfer of risk.

6. Are the changes to the Funding Strategy policy subject to agreement from all interested parties or is it the application of the new policy on a case by case basis that is subject to agreement from all interested parties

The requirements in respect of preparing and changing the Funding Strategy Statement (FSS) are set out in Regulation 58 of the LGPS Regulations 2013. This requires that the Fund (Administering Authority) consult with relevant parties but that after such consultation *“prepare, maintain and publish a written statement setting out its funding strategy”* Therefore, after due consultation it is the responsibility of the Fund to determine the Funding Strategy Statement (FSS).

Agreement to the FSS - The Fund has a statutory duty to work collaboratively with employers on the proposed methodology of the FSS. As such the Fund met with the chief financial officers of the major employers (those to who the new Regulations would have the biggest impact on) on 12 June 2018 to discuss its proposals to deal with exit credits in accordance with the LGPS (Amendment) Regulations 2018. The aim of the discussion was to ensure that the employers who were likely to be the most affected understood the position in relation to the FSS and also afford them with the opportunity to comment upon the methodologies and raise awareness of the need to align commercial contracts with the new regulatory provisions and fund policy.

The Fund then prepared the draft FSS taking into account the views that were discussed at the meeting. This was then circulated to all participating employers for comment. All responses to the consultation will be fully considered but ultimately responsibility for finalisation and publication of the FSS rests with the administering authority as set out in the LGPS Regulations 2013.

Agreement to the treatment of exit credits – At the point that an employer exits the Fund (with a guarantor), agreement will be needed by all parties (on a case by case basis) as to whether the surplus or deficit should be subsumed by the guarantor or paid to / by the exiting employer. Where there is not agreement by all parties the default position is that any surplus is paid to the employer as set out in Regulation 64(2) LGPS Regulations 2013 as amended by Regulation 13(c) LGPS (Amendment) Regulations 2018.

7. Is it possible to adjust the actuarial assumptions for cases where a surplus is identified at termination so that the calculation is based on a more prudent set of assumptions?

The Fund is required to treat employers consistently and the termination policy must apply to all employers. Applying a more prudent termination basis would therefore reduce the surplus for some employers but could also significantly increase the deficit that the exiting employer would be required to pay. Particularly in cases where the exiting employer is responsible for the surplus/deficit rather than the guarantor, such employers could argue that the initial allocation of assets was insufficient.

In addition, it would not align with the treatment of the employer at the outset of the contract or the contract pricing. This is therefore not an option for the Fund.