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Dear Sirs

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

I refer to the above mentioned consultation document and I am responding to the invitation for comments on behalf of Wirral Council in its capacity as the Administering Authority for Merseyside Pension Fund (MPF).

The Fund is part of the Local Government Pension Scheme (LGPS) and the 4th largest of the 88 funds in England and Wales, with assets of £8.5bn. MPF undertakes the LGPS pension administration and investments on behalf of the five Merseyside district authorities, over 180 other employers on Merseyside and elsewhere throughout the UK. The Fund has over 130,000 active, deferred and pensioner members.

1/ Our Response

Principally MPF supports the overall intent of the proposals as generally the changes appear sensible and introduce flexibility for employers in managing their exits from the scheme.

A proposal on which we do not agree, is the transition of the local valuation to a four-year cycle. It is our opinion that this will weaken the ability of the Administering Authority to govern the Fund and manage risk effectively. Equally, our recent engagement with employers demonstrates their expectation for more dynamic techniques to manage the cost of the scheme; extending the valuation period is counter to this expectation.

Furthermore, as the LGPS is a funded scheme, the investment strategy is aligned to the actuarial valuation and less frequent reviews may lead to missed opportunities to refine the strategy leading to a cost to both employers and taxpayers.

Whilst we do not agree with a four year valuation cycle, the additional flexibility to undertake interim valuations would be acceptable on the basis that the ability to review employer contributions is not overly prescriptive and the associated guidance affords local flexibility when formulating policies to manage funding, investment and covenant risk.

2/ Specific Questions within the Consultation

CHANGES TO THE LOCAL FUND VALUATION CYCLE

Q 1	RESPONSE
<p>As the Government has brought the LGPS scheme valuation onto the same quadrennial cycle as the other public service schemes, do you agree that LGPS fund valuations should also move from a triennial to a quadrennial valuation cycle?</p>	<p>As a funded scheme, we do not believe it is appropriate for funding and risk management policies for the LGPS to be set by reference to what happens in the unfunded schemes. Our preference would be to retain the existing three-year cycle, as we feel this is an appropriate period over which to set the contribution rates for employers and manage the resultant risks, before reviewing them again at the next actuarial valuation. MPF has developed a number of robust risk management strategies and moving to a quadrennial valuation does not align conceptually with the strategic objectives of reducing volatility in funding plans.</p> <p>However, when combined with the other measures in this consultation around interim valuations and reviewing employer contributions in between formal actuarial valuations the proposal is in our view acceptable overall as long as the ability to undertake interim valuations is not overly constrained</p>
<p>Are there any other risks or matters you think need to be considered, in addition to those identified above, before moving funds to a quadrennial cycle?</p>	<p>The accounting standards IAS19 and FRS102 normally require figures to be based on actuarial valuations carried out at least triennially, and as a result, auditors would require the accounting liabilities to be assessed more accurately. Further, as a result of pressure from the FRC, auditors are becoming more prescriptive about the approaches they will accept, and this also adds some weight to valuation cycles not being extended. Even if CIPFA were to relax their own requirements it is unlikely that any such relaxation could be extended to employers other than councils/authorities as CIPFA does not have jurisdiction for such employers. There is therefore a risk that, in effect, auditors will require interim valuations perhaps every two years offsetting any marginal savings from extending out the valuation cycle.</p> <p>The move to a 4-year cycle for the statutory valuation will by nature mean that governance is weakened unless a LGPS Fund's policy in relation to interim valuations is robust and fit for purpose. It is therefore critical that the guidance encourages the adoption of robust policies for all Funds to improve the governance for the LGPS generally and is fair to employers in relation to managing risk on their behalf.</p>
<p>Do you agree the local fund valuation should be carried out at the same date as the scheme valuation?</p>	<p>We do not see any reason why this is necessary and do not subscribe to the view that it allows the quality of the data provided to the GAD to be better improved as the majority of LGPS Funds have improvement plans over much shorter timescales. We appreciate that the cost management process may cause changes in benefits or member contributions outside the actuarial valuation cycle, but this is something which Funds have to contend with in any event (e.g. changes due to GMP equality issues, changes in State Pension Ages and court/tribunal cases such as McCloud can all give rise to changes in benefits or member contributions outside of a normal actuarial valuation). A simpler solution in our view would have been to retain the three-year cycle and introduce the ability to review contribution rates for any changes from the cost management process.</p>

TRANSITION TO A NEW LGPS VALUATION CYCLE

Q 4	RESPONSE
Do you agree with our preferred approach to transition to a new LGPS valuation cycle?	If it is decided that four-year cycles will be introduced from 2024 then we agree with the preferred approach to transitioning by doing a valuation at 2022 and then 2024. A five-year contribution schedule has disadvantages relating to scheme governance and potential larger changes in contribution rates due to additional inter valuation experience. If the outcome was to move to a five-year gap between valuations, a full interim review would be required to align with our existing risk management strategy to protect employers within the Fund.

ABILITY TO CONDUCT AN INTERIM VALUATION OF LOCAL FUNDS

Q 5	RESPONSE
Do you agree that funds should have the power to carry out an interim valuation in addition to the normal valuation cycle?	Yes, irrespective of the 4-year cycle change, we feel it is essential to Funds' governance and procedures that there should be a mechanism for reassessing employer funding positions and contribution outcomes when the circumstances warrant it. The Fund is managing a complex set of risks and the level of employer contributions is a key component of the effective management in conjunction with the employers.
Q 6	
Do you agree with the safeguards proposed?	<p>We do agree that there should be some safeguards but care needs to be taken on how these are applied consistently. At a high level, the facility needs to be sufficiently flexible that it can be called on in the event that there is a significant change in financial markets or Scheme benefits, to the extent that an interim valuation/funding update is merited. However, there need to be safeguards on the governance of the arrangements. For example, it would be wrong to perform an interim valuation to ease employer budgets when the outcome is expected to be favourable but never when the outcome is less favourable.</p> <p>The safeguards proposed are that the valuation/update should only be permitted in the circumstances set out in the Funding Strategy Statement, (FSS) but with some additional flexibility in the event of exceptional circumstances. In our view, this is correct, but the guidance needs to ensure its clear that Funds need to be robust in determining the criteria in conjunction with their Actuary. This will need to be documented in the FSS at the 2019 valuation if the proposal in the consultation proceeds so timing of any guidance needs to be finalised before the FSS is finalised to avoid having to update the FSS soon after the valuation is signed off.</p>

REVIEW OF EMPLOYER CONTRIBUTIONS

Q 7	RESPONSE
<p>Do you agree with the proposed changes to allow a more flexible review of employer contributions between valuations?</p>	<p>We strongly support the principle of allowing more frequent reviews of employer contribution rates. Again, at a high level, the facility needs to be sufficiently flexible that it can be called on in the event that there is a significant change in financial markets, Scheme benefits or employer circumstances e.g. change in covenant, to the extent that a review is merited.</p> <p>In line with the proposed approach for interim valuations we believe that the Funding Strategy Statement should set out the circumstances in which a review of employer contributions can or should be carried out. These circumstances might be wider than as outlined in the consultation document, which focuses strongly on changes in employer covenant, and we would suggest that other areas that materially affect the cost (for the employer) and risk (to the Fund) should be included. This can be such aspects as a significant change in market outlook, changes in Scheme benefits and change in affordability of contributions which could be to the detriment of the viability of an organisation.</p>

GUIDANCE ON SETTING A POLICY

Q 8	RESPONSE
<p>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?</p>	<p>Our preference would be for Funds to have the flexibility to set the parameters for carrying out interim valuations and/or employer contribution reviews within their Funding Strategy Statements, which would lead to an open and transparent approach. However, guidance would be helpful to provide consistency of treatment as well as ensuring all Funds do apply a common level of governance in managing the overall financial risks. It would be more practical if all the principle-based guidance on the FSS were in the same place, ideally provided by CIPFA in accordance with Regulation 58.</p>
<p>Q 9</p> <p>Are there other or additional areas on which guidance would be needed? Who do you think is best placed to offer that guidance?</p>	<p>It is important that it is clear that administering authorities and not employers have the final say on reviewing employer contributions. Employers may request interim valuations for accounting purposes and administering authorities should be able to accede to those requests without then being obliged to review the employer's contributions.</p>

FLEXIBILITY ON EXIT PAYMENTS

Q 10	RESPONSE
<p>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?</p>	<p>First of all, it is important to bear in mind that no Fund calculates exit payments on a “full buy-out basis” as far as we are aware which is a term used where a scheme insures the benefits with a third-party insurance company. To avoid confusion going forward in any guidance or explanatory literature we would recommend that this terminology is dropped and replaced by “termination basis” given Funds do not all use the same approach. The approach depends on the policy adopted by the individual Fund and MPF’s aligns the investment strategy backing the exit liabilities. In relation to the specific question on flexibilities we agree that flexibility is very important as circumstances are very varied, although we would note that there are already flexibilities for the spreading of exit payments and adjustment of contributions in the run-up to exit. These are covered in Regulation 64(4) and the definition of “exit payment” within Regulation 64, so we do not think there any is necessity for further material regulation change in this particular area except to allow a review of the exit payments over the spread period to reflect any change in circumstances e.g. market conditions or employer circumstances.</p> <p>We do not believe any other protections are required as the critical aspect is the ongoing assessment of the covenant to ensure the exit payments are recovered.</p>

DEFERRED EMPLOYER STATUS AND DEFERRED EMPLOYER DEBT ARRANGEMENTS

Q 11	RESPONSE
<p>Do you agree with the introduction of deferred employer status into LGPS?</p>	<p>Yes, as this will allow us to better manage our employer risk and therefore risk to taxpayers in conjunction with the employer. Provided that the administering authority is given sufficient flexibility to be able to manage such provisions and these are documented in the Fund policies we believe this will be an extremely valuable addition to the Regulations which will help both Funds and employers.</p>
Q 12	
<p>Do you agree with the approach to deferred employer debt arrangements set out above? Are there ways in which it could be improved for the LGPS?</p>	<p>In general, yes we agree with the proposed approach. However, there appears to be an over emphasis on employer covenant, and whilst important it is not the only factor that should determine the approach to deferred debt arrangements – for example also adopting a lower risk investment strategy would assist in the overall management of risk in a deferred debt arrangement. We would prefer Funds to be allowed to set their own policies and guidance around this arrangement to ensure sufficient safeguards are available for the administering authorities</p>

PROPOSED APPROACH TO IMPLEMENTATION OF DEFERRED EMPLOYER DEBT ARRANGEMENTS

Q 13	RESPONSE
Do you agree with the above approach to what matters are most appropriate for regulation, which for statutory guidance and which for fund discretion?	We agree that the Regulations should be “enabling” in nature only, and not prescriptive or restrictive. We agree that statutory guidance will be helpful in some cases in ensuring that Funds are able to take a sufficiently robust approach with employers as long as this is on a principle-basis. The more detailed operational aspects should be covered in each Fund’s policies in line with these principles. Ultimately it should be for administering authorities, having taken appropriate advice, to weigh up the risks and competing interests of stakeholders so it is fitting that these matters should be for fund discretion.

SUMMARY OF OPTIONS FOR MANAGEMENT OF EMPLOYER EXITS

Q 14	RESPONSE
Do you agree options 2 and 3 should be available as an alternative to current rules on exit payments?	Yes, we agree that these options should exist as alternatives. However, we believe that administering authorities should be able to determine the circumstances in which option 3 may apply and covenant is critical to this. We also believe that under option 2 the repayment schedule can be periodically reviewed if circumstances warrant it e.g. a significant change in market conditions and/or affordability of the repayments.
Q 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?	Statutory guidance will be helpful in ensuring that Funds are able to take a sufficiently robust approach with employers on a principle-based approach. More detailed operational aspects can be covered in Fund policies.

EXIT CREDITS UNDER THE LGPS REGULATIONS 2013

Q 16	RESPONSE
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?	We are in absolute agreement as this is fair in the context of the overall responsibility of cost and risk between the exiting employer and the scheme employer. However, we believe that there should be a regulatory provision for the Scheme employer to ensure the information on these risk sharing arrangements is supplied to the Administering Authority so the correct treatment can be applied in a timely manner. This will avoid any conflict between the scheme employer and fund over the inadvertent incorrect application due to lack of provision of the information.
Q 17	
Are there other factors that should be taken into account in considering a solution?	No

FURTHER EDUCATION CORPORATIONS, SIXTH FORM COLLEGE
CORPORATIONS AND HIGHER EDUCATION CORPORATIONS

Q 18	RESPONSE
Do you agree with our proposed approach?	We regard the determination of the employers which are required to offer LGPS membership as being a policy area for Government (and each individual employer), and in particular those areas of Government which provide funding to those specific employers. The effect will vary from Fund to Fund but it will need to be noted that this proposal will lead to a gradual maturing of those employers' LGPS liabilities. This will generally increase contribution rates initially for these employers due to the closed nature of the membership. Equally the cash flows for these employers and the Fund will be affected over time.

PUBLIC SECTOR EQUALITY DUTY

Q 19	RESPONSE
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?	No equality issues occur to us in the context of our operation of the Fund. The change in the status of the education employers as per Q18 would create inequality at an employer level but that is a matter for the employers.

3/ Conclusion

As the main focus of the proposal centres around the transition of the local valuation cycle from triennial to quadrennial, we are of the opinion that the rationale is tailored for long-term, secure employers fully backed by taxpayers.

In reality, LGPS funds have a larger number of employers without tax raising powers, principally community admission bodies and HE/FE bodies, some of which are increasingly short-term in nature and whose covenant is liable to rapid change. To effectively manage the risk of these employers more frequent assessments of liabilities and the flexibility to review contributions is required.

Following recent engagement with long term statutory employers, it is our opinion that flexibility to perform more frequent assessment of contributions is necessary to align with short-term budget setting in order to manage service demands. As such it is questionable whether a fixed four year cycle would provide a sufficient level of confidence in the governance of financial plans for all constituent employers. It is also imperative that the Fund is able to monitor cashflow and funding plans with the flexibility to change employer contributions as appropriate in between the formal valuation cycle in order to continue to develop its risk management policies.

Yours faithfully



Yvonne Murphy
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