

**Pension Committee**

**Date:** 22 October 2015

**Report by:** Deputy Head of Pensions

<b>Subject:</b>	<b>Cessation Funding Considerations and Treatment of Orphan Liabilities</b>
<b>Purpose of the Report</b>	<b>To provide assurance to the Committee over the scale of the potential liability that could fall on the whole Fund if scheme employer ceases and any deficit on exit cannot be recovered from them, a bond or guarantor.</b>
<b>Recommendations</b>	<b>That the Committee notes the contents of this report and the approach to dealing with orphan liabilities in the Cambridgeshire Pension Fund. That the Committee also notes progress reports as and when required.</b>
<b>Enquiries to:</b>	Mark Whitby, Deputy Head of Pensions Tel – 01604 368502 E-mail – <a href="mailto:Mwhitby@northamptonshire.gov.uk">Mwhitby@northamptonshire.gov.uk</a>

**1. Background**

- 1.1 At the Pension Committee meeting held on 25 June 2015, the Employer Admissions and Cessations Report discussed the long standing cessations of two scheme employers from the “Small Admitted Bodies” pool. These employers were Mepal Outdoor Centre and Red 2 Green.
- 1.2 Mepal Outdoor Centre has shown, through disclosure of their financial accounts that they are unable to afford to pay any of their outstanding deficit. Red 2 Green expressed that they are unable to pay their entire deficit, as calculated on the more prudent cessation basis, but requested negotiations over paying a mutually agreeable amount.
- 1.3 Both employers were “old style” admission bodies for which there was no guarantor of last resort to assume responsibility for any deficit that couldn’t be paid upon cessation. For this category of scheme employer the LGPS Regulations require any unpaid deficit at exit should be spread across all other employers in the Fund.
- 1.4 In the report presented to the Pensions Committee on the 25 June, officers recommended that the cessation payment for Mepal Outdoor Centre should not be pursued because there are no tangible assets for the Fund to make a claim against. It was also recommended that the Fund should be prepared to negotiate with Red 2 Green over a mutually agreeable cessation payment.

- 1.5 Officers advised that there are other “old style” admission bodies remaining in the Fund who would be in a similar situation if they ceased. These employers form part of the “Small Admitted Bodies” pool. Officers felt that the risks associated with this group of employers to the Fund were of an immaterial size in the context of the value of the whole Fund.
- 1.6 Officers provided assurance to the Committee that arrangements were in place for dealing with “old style” admission bodies who cannot afford to pay their deficit on exit.. This arrangement is through a “No Actives” pool and is described further in section 4 of this report.
- 1.7 The Committee expressed strong concerns with the recommendations made by officers as detailed in section 1.2 of this report as to the wider implications of the deficit to the Fund associated with employers in the “Small Admitted Bodies” pool and the potential financial impact on the Fund. The Committee requested that officers provide a report setting out the gilt based cessation value of each “old style” admission body and the scale of risk to the Fund should they cease as scheme employers. This report sets out the scale of the risk to the Fund and a plan for mitigating the risk.

## 2. Types of Scheme Employer

- 2.1 Employers in the Fund can be classified under a number of types of scheme employer, as set out in the Local Government Pension Scheme Regulations 2013. For the purposes of this report the potential risk to the Fund falls under the following employer types:

Employer Type	Risk Exposure
Transferee Admission Bodies	<p>The Fund is protected by either:</p> <p><b>a)</b> a ceding employer, on whom the pension liabilities fall if the admission body cannot pay off their deficit; or</p> <p><b>b)</b> a bond or guarantor</p>
Community Admission Bodies	
Admission Bodies as classified under the 2014 LGPS Regulations	
“Old style” Admission Bodies	<p>If either type of body cannot pay off their deficit on exit, the liabilities must be spread across all other employers in the Fund</p>
Parish Councils	

- 2.2 As can be seen in the table above, the risk exposure to the Fund relates primarily to “old style” admission bodies and possibly Parish Councils. This is because there is

no other body to take on their pension liabilities following their exit from the Fund. The liabilities are therefore spread across all other employers in the Fund.

### **3. Scope of this Report**

- 3.1 A staged approach to considering the risks to the Fund has been taken. In light of the risks highlighted above, this report focuses on those employers in the “Small Admitted Bodies” pool as these present the highest risk to the Fund. This is due to the fact that they generally have a very small membership size, making them more likely to exit the Fund and as they do not have tax raising powers and generally little or no tangible assets, they are more likely to have problems paying their cessation deficit.
- 3.2 As some employers have already ceased with no entity standing behind their residual liabilities, including scheme employers exiting from the “Small Admitted Bodies” pool, this report also includes an assessment of the current position of those employers in the “No actives” pool. The assessment illustrates the current arrangement for dealing with “old style” admission bodies unable to pay their deficit at exit and the current funding position of this pool.

### **4. No Actives Pool**

- 4.1 The “No Actives Pool” comprises employers that currently have no active members and have ceased making contributions to the Fund. There is no other body responsible for taking on the pension liabilities of these ceased employers and so the liabilities fall on the whole Fund.
- 4.2 The “No Actives” pool is assessed at each valuation by the Actuary to determine if the level of assets held in the pool is adequate to pay the liabilities. At the point where the Actuary considers that the pool is reaching a point where the assets held will not be adequate to meet the liabilities they will seek, with approval from officers and the Pension Committee, to spread the liabilities across all other employers in the Fund. This approach to dealing with employers who have no more active members has been applied through multiple valuation cycles.
- 4.3 As at 31 March 2013 the Actuary approximated that the “No Actives” pool had assets of £34.2m and corresponding liabilities of £39.4m leaving an estimated deficit of £5.2m. This has been assessed on a prudent basis and therefore represents, broadly speaking, a worst case scenario. The current financial climate has also had an effect on these figures as gilt yields are currently at a historical low. Just a small increase in the gilt yield of 0.5% p.a. would dramatically reduce the deficit by between 40% and 75% to around £3.1m and £1.2m respectively.

## **5. Small Admission Bodies Pool**

- 5.1 The “Small Admission Bodies” pool comprises small employers which have no other scheme employer acting as a guarantor and for which it was thought would benefit from pooling. The reason for pooling these employers is to smooth the effect of experience on the individual employer’s contribution rate as the contribution rate paid by employers in the pool is based on the experience of the entire pool not the individual employer. The individual funding position of each employer is still individually tracked.
- 5.2 One of the disadvantages of the pool is that none of the employers will be paying the correct individual contribution rate; some will be paying more and some less. This only becomes an issue when one of the employers ceases participation in the Fund. As these are small employers with relatively few active members there is a risk that they are more likely to cease than other employers.
- 5.3 There are now only nine employers in this pool. If these employers were to cease participation in the Fund and be unable to pay off their deficit on exit the liabilities would fall onto all other employers within the Fund.
- 5.4 The pool was created because regulatory constraints and common practice at that time did not provide the flexibility to pre-fund a cessation by aiming for a target funding level above 100%.
- 5.5 The Actuary has provided estimates of what the cessation deficits would be for each employer, in the “Small Admission Bodies” pool, to assess the risk exposure to the Fund if these bodies were all to cease. The current aggregated deficit of these nine employers is £7,375,000 as at 27 August 2015. This is comprised of liabilities valued at £13,939,000 on a cessation basis and assets of £6,564,000. It should be noted that this represent 0.35% of the overall deficit of the Fund.
- 5.6 It should be noted that these figures are deliberately calculated on a much more conservative basis than the ongoing figures used at the valuation. Had the cessation deficit been calculated on an ongoing basis, the combined deficit for these employers would be reduced to £2,819,000.
- 5.7 Should the full cessation deficit of £7,375,000 be paid in its entirety by the outgoing scheme employer, this notional slice of the Fund would have a funding position of more than 100% on an ongoing basis. This means that an employer failing to pay a cessation deficit in full does not necessarily mean an additional liability will fall on the Fund. However, it does mean that the cushion required against adverse future experience is not provided to the extent it would otherwise have been.
- 5.8 In addition to the full cessation deficit already being considerably more prudent, the ongoing calculation basis itself has an element of prudence built into it. Therefore, if

at least the ongoing deficit value is collected from an exiting employer a level of cushion would already be built into the value.

- 5.9 Furthermore, the current risk exposure is artificially inflated as gilt yields are currently at a historical low. If gilt yields rise, and all other things remain equal, deficits would fall. If gilt yields were to fall further, liabilities would increase and as shown previously, the deficits are highly sensitive to changes in gilt yields.

## **6. Further Steps**

- 6.1 The next step will be to look at each individual employer in the “Small Admission Bodies” pool and carry out a more detailed analysis of their funding position, employer covenant, financial position and the quality of admission agreements in place. Officers will then take an appropriate approach for each employer which may result in removing them from their respective pool.
- 6.2 Officers would like to reiterate, that it is the nature of these types of employers to be able to afford to pay monthly pension contributions on an ongoing basis but not be able to pay their full deficit on exit. As seen with the example of Mepal Outdoor Centre this is because these types of employer usually have little or no tangible assets to use in paying their funding deficit.
- 6.3 Officers will also look at the “Designating Bodies” pool to assess the current funding level and risk to the Fund.

## 7. Relevant Pension Fund Objectives

Perspective	Outcome
<b>Funding and Investment</b>	<ul style="list-style-type: none"> <li>To ensure that the Fund is able to meet its liabilities for pensions and other benefits with the minimum, stable level of employer contributions.</li> <li>To ensure that sufficient resources are available to meet all liabilities as they fall due.</li> <li>Administer the Funds in a cost effective and efficient manner utilising technology.</li> <li>Ensure benefits are paid to, and income collected from, the right people at the right time in the right amount.</li> <li>Understand the issues affecting scheme employers and the LGPS in the local and national context and adapt strategy and practice in response to this.</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>To have robust governance arrangements in place, to facilitate informed decision making, supported by appropriate advice, policies and strategies.</li> </ul>

## 8. Finance & Resources Implications

8.1 Actuarial costs in obtaining this report.

## 9. Risk Implications

a) Risk(s) associated considering this report

There are no risks associated with considering the contents of this report.

b) Risk(s) associated with not considering this report

Risk	Risk Rating
This is a report for the Committee to note. The risk of not considering this report is that the Committee will not understand the current risk exposure to the Fund or the appropriateness of the current approach for dealing with this risk.	Green

## 10. Communication Implications

10.1 Not applicable.

## 11. Legal Implications

11.1 Not applicable.

## 12. Consultation with Key Advisers

12.1 The accompanying **appendix** was produced by Hymans Robertson, the Fund Actuary.

## 13. Alternative Options Considered

13.1 Not applicable.

## 14. Background Papers

14.1 Not applicable.

## 15. Appendices

15.1 Appendix 1 “No Actives” pool at 2013 valuation

15.2 Appendix 2 “Small Admitted Bodies” pool

<b>Checklist of Key Approvals</b>	
Is this decision included in the Business Plan?	No
Will further decisions be required? If so, please outline the timetable here	No
Is this report proposing an amendment to the budget and/or policy framework?	No
Has this report been cleared by Chief Finance Officer/Section 151 Officer?	Chris Malyon – 5/10/2015
Has this report been cleared by Deputy Head of Pensions?	Mark Whitby – 24/09/2015
Has the Chairman of the Pension Fund Committee been consulted?	Councillor Hickford – 29/9/2015
Has this report been cleared by Legal Services?	Copy sent to Quentin Baker 09/10/2015

## Appendix 1

### Cambridgeshire Pension Fund "No Actives" pool at 2013 valuation

Employer	000's		
	Assets	Ongoing Liabilities	Deficit
Peterborough Development Corporation	20,128	20,915	787
Anglia Higher Education College	300	387	87
Bowthorpe Hall	279	413	134
Centre 33	11	35	24
Connexions	3,732	5,966	2,234
Cambridge & County Folk Museum	103	156	53
Cambridge Institute of Education	76	70	-6
Cambridge ITEC	326	325	-1
Cambridge College of Agriculture & Horticulture	459	649	190
The Cresset	784	1,365	581
Commissions East	323	393	70
Cambs Career Guidance	-23	40	63
Eastern Arts Board	1,341	2,070	729
Farmland Museum	64	59	-5
Huntingdonshire Citizens Advice Bureaux	255	290	35
King's School Peterborough	89	134	45
Mepal Outdoor Centre	256	456	200
Methodist Homes for the Aged	3,863	2,948	-915
Nene Valley Research Committee	90	83	-7
Westgate Project	33	31	-2
Screen East Ltd	214	291	77
St Martin's Day Care Centre	104	162	58
St Neots Museum Ltd	12	52	40
Cambridge Federation of Tenants	167	470	303
Turning The Red Lights Green	81	112	31
Cambridgeshire & Peterborough MHT	5	38	33
Homerton School of Health Studies	793	1,134	341
Cambridge Sports Lake Trust	291	235	-56
Edwards & Blake Ltd	35	32	-3
Aaron Services Ltd	53	47	-6
<b>Total for pool at 2013 valuation</b>	<b>34,244</b>	<b>39,359</b>	<b>5,115</b>

Notes:

- 1) The above figures are as at the previous valuation date of 31 March 2013 and have been calculated on an ongoing basis.
  - 2) The asset figures shown exclude any additional sums received after 31 March 2013 in respect of outstanding cessation deficit payments.
  - 3) Figures in brackets represent a surplus.
  - 4) Isle College funding is guaranteed by the College of West Anglia.
  - 5) Contributions of £632,000 p.a. will be received from Ministry of Justice for 8 years from April 2013 in respect of Cambridgeshire Magistrates.
- August 2015

## Appendix 2

### Employers Funding Positions (27 Aug 2015)

Employer	Assets	Ongoing Basis (£000)		Cessation Basis (£000)	
		Liabilities	Deficit	Liabilities	Deficit
ADEC	373	470	97	769	396
Drinksense	353	469	116	638	285
Cambridges hire MENCAP	1,051	1,660	609	2,298	1,247
Conservator s of the River Cam	853	1,032	179	1,604	751
Kelsey Kerridge Sports Hall Trust	2,299	3,364	1,065	4,888	2,589
Collections Trust	707	1,009	302	1,658	951
St. Columba Group Therapy	276	375	99	497	221
Wisbech and Fenland Museum	92	174	82	264	172
Wisbech Grammar School	560	830	270	1,323	763
<b>Total</b>	<b>6,564</b>	<b>9,383</b>	<b>2,819</b>	<b>13,939</b>	<b>7,375</b>

