North East Scotland Pension Fund

Policy on Termination Funding for Admission Bodies (“Termination Funding Policy”)

1 Introduction

1.1 This document details the North East Scotland Pension Fund’s (NESPF) policy on admissions into the Fund, the methodology for assessment of a termination payment on the cessation of an admission body’s participation in the NESPF, and considerations for current admission bodies. It supplements the general policy of the Fund as set out in the Funding Strategy Statement (FSS).

1.2 Admission bodies are required to have an “admission agreement” with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.

1.3 A list of all current admission bodies participating in the NESPF is attached as an Appendix to this document. This appendix is kept as a live document and will be updated as new bodies are admitted to the NESPF.

2 Principles

Termination of an admission agreement

2.1 When an admission agreement comes to its end, or is prematurely terminated for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case the employees will retain pension rights within the Fund i.e. either deferred benefits or immediate retirement benefits.

2.2 In addition to any liabilities for current employees the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members.

2.3 In the event that unfunded liabilities arise that cannot be recovered from the admission body, these will normally fall to be met by the Fund as a whole (i.e. all employers) unless there is a guarantor or successor body within the Fund.

2.4 The NESPF’s policy is that a termination assessment will be made based on a least risk funding basis, **unless** the admission body has a guarantor within the Fund or a successor body exists to take over the admission body’s liabilities (including those for former employees). This is to protect the other employers in the Fund as, at termination, the admitted body’s liabilities will become “orphan liabilities” within the Fund, and there will be no recourse to the admission body if a shortfall emerges in the future (after the admission has terminated).

2.5 If, instead, the admission body has a guarantor within the Fund or a successor body exists to take over the admission body's liabilities, the NESPF's policy is that the valuation funding basis will be used for the termination assessment. The guarantor or successor body will then, following any termination payment made, subsume the assets and liabilities of the admission body within the Fund (sometimes known as the "novation" of the admission agreement). This may, if agreed by the successor body, include the novation to the successor of any funding deficit on closure, in place of a termination payment being required of the admission body itself. The effect of this will then be taken into account at the latest at the next valuation based on the methodology applied to set contribution rates for employers based on the Administering Authority's Funding Strategy Statement.

Funding basis

2.6 An admission body may choose to pre-fund for termination i.e. to amend their funding approach to a least risk methodology and assumptions. This will substantially reduce the risk of an uncertain and potentially large debt being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the least risk basis. If an admission body chooses this approach they will be required to maintain their own bespoke individual contribution rate unless agreed otherwise by the Administering Authority.

2.7 For any admission bodies funding on such a least risk strategy a notional investment strategy will be assumed as a match to the liabilities. In particular the admission body's notional asset share of the Fund will be credited with an investment return in line with the least risk funding assumptions adopted rather than the actual (largely equity related) investment return generated by the actual asset portfolio of the Fund. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

Administering Authority options

2.8 In order to protect other Fund employers, when considering applications for admission body status where there is no guarantor within the Fund (i.e. non-Transferee admission bodies), the Administering Authority can determine that:

- The admission body must pre-fund for termination with contribution requirements assessed using the least risk methodology and assumptions; and/or

- The admission body must have a bond or indemnity from an appropriate third party in place. The actuary to the NESPF will be asked to carry out a risk assessment with the level of any bond requirement being determined by the Administering Authority; or

- The admission body's application may be refused.

2.9 Some aspects that the Administering Authority may consider when deciding whether to apply any of the options under 2.8 above, in the absence of a guarantor, are:

- Uncertainty over the security of the organisation's funding sources e.g. the admission body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;

- If the admission body has an expected limited lifespan of participation in the Fund;

- The average age of employees to be admitted and whether the admission is closed to new joiners.

3 Implementation

3.1 With effect from 1 April 2012 the NESPF will apply the above principles to the admission of new bodies into the Fund and to the methodology for assessment of a termination payment on the cessation of any admission body's participation in the NESPF. For the avoidance of doubt this included existing admitted bodies irrespective of the period of participation.

Transferee admission bodies (TABs)

3.2 Transferee admission bodies generally will have a guarantor in the Fund since the Regulations require that, in the event of any unfunded liabilities on the termination of the admission, the contribution rate for the relevant Scheme Employer should be revised. Accordingly, in general, the least risk approach to funding and termination will not apply for TABs.

3.3 On termination of a TAB admission, any unfunded liability that cannot be reclaimed from the outgoing body will be underwritten by the relevant Scheme Employer and will affect that employer's contribution rate in line with the approach to setting contribution rates as set out in the Administering Authority's Funding Strategy Statement.

3.4 Following termination, any orphan liabilities in the Fund will be subsumed by the relevant Scheme Employer.

3.5 The Scheme Employer is required to carry out an assessment of the level of risk on premature termination of the contract. This assessment would normally be based on advice in the form of a "risk assessment report" provided by the actuary to the NESPF. As the Scheme Employer is effectively the ultimate guarantor for these admissions to the NESPF the decision over the level (if any) of any bond or indemnity requirement for the transferee admission body is the responsibility of the Scheme Employer.

3.6 Deficit recovery periods for TABs will be set in line with the Fund's general policy as set out in the FSS

3.7 An exception to the above policy applies if the guarantor is not a participating employer within the NESPF, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the NESPF, the Administering Authority reserves the right to treat the admission body as if it has no guarantor.

Community admission bodies (CABs)

3.8 At present under the regulations, there is no **requirement** to carry out an assessment of the level of risk on termination of the admission agreement for a CAB. The Administering Authority may nevertheless decide to carry out such a risk assessment where appropriate.

3.9 The NESPF's policy is to consider applications on a case-by-case basis, in line with the principles set out above. In general, no CAB will be permitted to join the NESPF without having a guarantor body. If a guarantor (of sufficient standing acceptable to the Fund) is not forthcoming the admission will either not be approved, the admission body will be required to pre-fund for termination with contribution requirements assessed using a least risk or gilts based methodology and assumptions, or the actuary may be asked to carry out a risk assessment with any bond requirement being determined by the Administering Authority. If required, any bond amount will be subject to review on a regular basis.

3.10 On termination of a CAB admission, any unfunded liability that cannot be reclaimed from the outgoing body will be underwritten by the relevant guarantor body.

3.11 Following termination, any orphan liabilities in the Fund will be subsumed by the relevant guarantor body.

3.12 Deficit recovery periods will be determined consistent with the policy set out in the FSS. Alternatively, the Administering Authority may determine an employer specific deficit recovery period will apply.

Notification of Termination

3.13 In many cases, termination of the admission is an event that can be foreseen, for example, because the organisation's operations may be planned to be discontinued. In this case admission bodies are requested to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of the admission. Effectively, this will be achieved by "locking in" to financial conditions for the termination prior to that date, and the hypothecation of a notionally matched investment strategy. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

Termination Assessment Methodology

3.14 The NESPF currently groups all employers (with the exception of new employers admitted on or after 1 April 2008) for contribution rate setting purposes.

3.15 The NESPF policy is that, on termination of admission agreements within a group, the termination assessment is based on a simplified share of deficit approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the body and the group as a whole, and then adjusting to the date of exit. The adjustment to the date of exit will allow for key factors that affect funding position i.e. actual investment returns and changes in market yields since the last actuarial valuation.

3.16 The share of deficit will be assessed based on the ongoing valuation funding basis for employers with a guarantor or a successor body within the Fund, otherwise a least risk funding basis will apply.

3.17 Any unfunded liability that cannot be reclaimed from the outgoing body will be underwritten by the relevant guarantor body. In the absence of a guarantor body any unfunded liability that cannot be reclaimed from the out going body will be underwritten by all employers within the Fund.

3.18 Following the termination of a body, any residual liabilities and assets in respect of that body will be subsumed by any guarantor body, or in the absence of a guarantor, subsumed by the Fund as a whole.

3.19 For those employers who have their own individual contribution rate they will be updated as above taking their own individual starting position at the most recent valuation or admission date if later.

3.20 The approach set out above will be reviewed from time to time and at least after each formal actuarial valuation of the NESPF.

Glossary

Admission bodies: A specific type of employer under the Local Government Pension Scheme (LGPS) (Scotland) who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

Community admission bodies: These are the traditional type of admission bodies – bodies who operate in and/or are connected to local government. They also include admission bodies that are not associated to local government, as follows:

- Bodies which provide a public service in the UK otherwise than for the purposes of gain and which have sufficient links with a Scheme Employer to be regarded as having a community of interest.

- Bodies which provide a public service in the UK otherwise than for the purposes of gain and which are approved by the Scottish Ministers to be admitted to the LGPS. Approval may be subject to such conditions as the Scottish Ministers think fit and they may withdraw approval at any time if such conditions are not met.

- Bodies to which any Scheme Employer provides funding. Where at the date that the admission agreement is made with such a body the total contribution from any one or more Scheme Employers to its contribution income equals 50% or less of the funding contributed by third parties it must be a term of the admission agreement that the Scheme Employer who provides funding (and, if more than one, all of them) guarantees the liability of the admission body to pay all amounts due from it under the LGPS (Scotland) Regulations.

Least risk funding basis: more cautious funding basis than the existing valuation basis. The relevant discount rate used for valuing the present value of liabilities is consistent with that used under the most recent valuation but removing the allowance for asset out-performance. This provides an "insurance" cushion against future adverse experience.

Orphan liabilities: liabilities in the North East Scotland Pension Fund for which there is no sponsoring employer within the Fund. Ultimately orphan liabilities must be underwritten by all other employers in the Fund.

Scheme Employer: the parent authority in the North East Scotland Pension Fund which is letting the contract.

Transferee admission bodies: An employer which participates in the Fund for employees involved with delivery of a specific function or service for a Scheme Employer. An example is where a local authority outsources a specific service (e.g. waste management) to a private sector employer. In these cases the relevant Scheme Employer would be a party to the admission agreement, as well as the admission body itself and the administering authority.

Appendix

Employer Number	Employer Name	Date of Admission	Type of Admission Body	Guarantor	Funding Strategy	Open or closed to new employees	Deficit Recovery period	Current Bond Amount	Date Bond Last Reviewed	Frequency of Bond Review
XXX	ABC Ltd	dd/mm/yyyy	[Transferee Admission Body]/ [Community Admission Body]	[none]/ [XYZ CC]/[etc]	[ongoing valuation funding basis]/[least risk basis] / [other – describe]	[open / closed]	[n years]/ [target date]/ [future working lifetime]	[£]/[none]	[dd/mm/yyyy]/[n/a]	[annually]/[every n years]/[n/a]