

Essex Pension Fund

Essex County Council
Invest Essex

Pensions information as at 1 April 2017

Barnett Waddingham LLP

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Introduction

Purpose and scope of the report

We have been asked by Essex County Council, the Administering Authority for the Essex Pension Fund (the Fund), to advise the Administering Authority on the pensions information required in respect of eligible employees transferring their employment from Essex County Council (the Letting Authority) to a new employer.

Although this report is addressed to the Administering Authority, it will usually be commissioned by the new employer. The report may be shared with the Letting Authority, new employer or their advisers, provided that it is done so in whole. In particular, the Administering Authority may allow the new employer to use the results of this report for the purposes of the risk assessment that they are required to carry out if they become an admission body in the Fund.

The pension arrangements for the eligible employees transferring their employment from the Letting Authority to the new employer are covered by the Transfer of Employment (Pension Protection) Regulations 2005. The Fund participates within the Local Government Pension Scheme (the LGPS), a defined benefit statutory scheme administered in accordance with the Local Government Pension Scheme Regulations 2013 (the Regulations).

The purpose of this report is to set out the pensions related issues to be considered by the new employer assuming it participates in the LGPS as an admission body in the Fund, or provides a broadly comparable pension scheme.

This report provides:

- recommended contribution rates to be paid by the new employer to the Fund;
- an assessment of the risks associated with the early termination of the admission agreement as required by Part 3 of Schedule 2 of the Regulations; and
- details of the recommended level of the bond to be put in place.

In addition, for the broadly comparable route this report provides an estimate of the bulk transfer value to be paid from the Fund to a broadly comparable scheme. Details of the broadly comparable route are detailed in Appendix 3.

This advice complies with all Generic Technical Actuarial Standards and the Pensions TAS issued by the Financial Reporting Council. We have taken account of current LGPS Regulations and any known changes to the LGPS regulations as at the date of this report.

Results

The following table sets out the key information regarding the arrangement with the new employer assuming it participates as an admission body in the Fund.

Key information	
Date of admission	1 April 2017
Letting Authority	Essex County Council
Fully/partially funded	Fully funded
Open/closed agreement	Not known
Expected duration of contract	Not known

The transfer date is 1 April 2017 and we have carried out our calculations as at 31 October 2016.

Admission body route

In this section we consider the contribution requirement and risk assessment should the new employer become an admission body within the Fund under Part 3 of Schedule 2 of the Regulations.

The funding of these liabilities at the outset will be defined within the admission agreement. For the purposes of this report we have assumed that the liabilities are transferred on a fully funded basis at the start of the contract.

As the new employer is assumed to start fully funded, it will be credited with assets equivalent to the value of the pension liabilities assumed.

The admission agreement will be in respect of the eligible employees and can either be open to new staff employed on the contract (an open agreement), or closed so that only the original transferring membership joins the new employer's section of the Fund (a closed agreement).

We have set out this information in the table below:

Ongoing funding position	
Assets	£469k
Liabilities	£469k
Deficit	-
Funding level	100%
Open contribution rate (p.a.)	20.4%
Closed contribution rate (p.a)	25.4%

The open contribution rate requires the average age of the membership to remain stable. If the average age of the active members increases then the open contribution rate will not be sufficient and higher levels of contribution will be required in future.

With a closed agreement the contribution rate as a percentage of payroll would be expected to increase as the membership gets older so the calculated rate allows for this and is based on the average cost of benefits over the whole contract for this group of members. As the number of members is less than ten we would recommend applying the closed rate as the likelihood of maintaining a stable average age is small.

These rates are based on the member data and assumptions set out in Appendix 1; if there are any material changes to the membership from the initial data supplied then our calculations will have to be updated.

The level of the bond is calculated to provide protection against costs arising in some or all of the following areas on the cessation of the new employer within the Fund:

- **Underfunding.** Although the new employer is fully funded at the outset and the contribution rate is calculated to try to maintain this funding position, it is almost certain that the funding position will not be exactly 100% at any point in time in the future. The assumptions adopted are unlikely to be exactly borne out in practice, and the membership profile will change over time. The bond level allows for a funding level deficiency of 5% on the cessation date.
- **Strain costs.** These arise as a result of immediate pension benefits becoming payable to relevant staff who could be made redundant, staff taking flexible retirement, the employer waiving the early retirement reduction for early payment of a member's benefits or as a result of efficiency of service.
- **Unpaid contributions or expenses.** These may include unpaid normal employer contributions, unpaid additional employer contributions in respect of early retirements, and expenses associated with the premature termination of the admission agreement.

The following table sets out the projected level of the bond taking into account the risks detailed above.

Year	Potential risks			Total
	Underfunding	Strain costs	Unpaid contributions or expenses	
1	£24k	£44k	£19k	£87k
2	£29k	£33k	£20k	£82k
3	£35k	£19k	£21k	£75k
Max in first 3 years				£87k

The expected duration of the contract is not known. As shown in the table, the bond level in the first year is the maximum level in the first three years. It may be advisable to set the bond at £87k until the subsequent review to provide a margin against adverse experience.

The required bond amount is calculated at the outset of the contract and should be reviewed regularly (preferably annually, but at least once every three years if the contract extends that far). This should ensure that the level of the bond remains appropriate as the membership of the new employer evolves. It is the responsibility of the new employer to arrange for provision of the bond: the admission agreement may not come into force without the suitable arrangements being in place. Any arrangements should be agreed with all parties involved in the admission agreement.

Whether or not the admission body enters into an indemnity or bond, where possible, the admission body must also provide an alternative guarantee in a form satisfactory to the Administering Authority.

More detail on the admission body route is set out in Appendix 2 to this report.

Broadly comparable route

If all members transfer, we estimate that the bulk transfer value will be in the region of £469k as at 1 April 2017 i.e. the same as would be credited to the employer if it was an admission body within the Fund. The actual amount paid will also depend on the timing of the final settlement of the transfer and will usually be adjusted between 1 April 2017 and the final payment date.

Final comments

For the purposes of our calculations it is assumed that the liabilities are transferred on a fully funded basis at the start of the contract. If the contract is actually let under different terms then the bond level and contribution rate calculations should be updated.

Please note that these figures are based on the ongoing funding basis. On an accounting basis, the value placed on the liabilities is generally expected to be higher and as such we would expect there to be a deficit at the start of the contract on an accounting basis.

These results are based on the member data and assumptions set out in Appendix 1; if there are any material changes to the membership from the initial data supplied then our calculations will have to be updated.

Contribution rates will be calculated again at each triennial valuation and should be regularly reviewed with a view to achieving a fully funded position at the end of the contract. The contribution rate may be reviewed more regularly as the contract end date draws near.

Any deviation from the fully funded position will be corrected at each triennial valuation. If any deficit is revealed then the new employer will be required to pay additional deficit contributions over the remaining term of the contract.

We would be pleased to answer any questions arising from this report.



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Appendix 1 Data and assumptions

We have been provided with membership data by the Administering Authority which is summarised in the table below and our calculations are based on this information.

Active members	Number	Actual pensionable salary	Pre 2014 pension	Post 2014 pension	Average age
Male	4	£177,993	£9,681	£9,878	50.5
Female	4	£126,157	£5,310	£5,890	46.1
Total	8	£304,150	£14,991	£15,768	48.3

For the purposes of this report it is appropriate to use the method and assumptions consistent with the actuarial valuation as at 31 March 2016, updated where necessary to reflect market conditions.

A summary of the financial assumptions used for our calculations and brief details of the mortality assumptions adopted are set out in the table below:

Calculation assumptions		% p.a.
Discount rate		4.7%
Rate of pay increases		3.9%*
Rate of pension increases (CPI)		2.4%
Commutation	It is assumed that members will exchange 50% of their commutable pension for cash at retirement.	
Retirement age	Members retire at a single age, based on the average age at which they can take each tranche of their pension.	
Post-retirement mortality	The post retirement mortality tables adopted for all calculations are the S2PA series with a multiplier of 105% for males and 100% for females, making allowance for CMI 2015 projected improvements and a long-term improvement rate of 1.5% p.a.	
*Salaries are assumed to increase in line with CPI over the period to 31 March 2020.		

Full details of the demographic and other assumptions adopted as well as details of the derivation of the financial assumptions used can be found in the relevant actuarial valuation report or on request if the report is unavailable.

Appendix 2 **Admission body**

In this section we consider the contribution requirement and risk assessment should the new employer become an admission body within the Fund under Part 3 of Schedule 2 of the Regulations.

Admission to the Fund will be effected through an admission agreement. This is a legal document which will establish the conditions of admission and needs to be agreed by:

- the Administering Authority;
- the Letting Authority (if different); and
- the new employer.

The new employer must comply with the various administrative requirements and make any payments as required under the Regulations. Examples include:

- member and employer contributions;
- payments to be made upon exercising employer discretions under the Regulations; and
- payments required upon termination of the contract.

Funding at the start of the contract

At the start of the contract we have assumed that the pensionable service of the eligible employees will transfer to the new employer who will become responsible for the liabilities in respect of that service, and will be allocated assets in respect of them.

The allocation of assets is notional and for the sole purpose of determining the new employer's contribution rate; there is no actual transfer of assets to the new employer.

The funding of these liabilities at the outset will be defined within the admission agreement. For the purposes of this report we have assumed that the liabilities are transferred on a fully funded basis at the start of the contract. This means that the value of the liabilities will be calculated on the underlying ongoing funding basis, and the new employer will be notionally credited with assets of equal value.

The ongoing basis of calculation of the value of the liabilities and assets to be allocated to the new employer is decided by us as the Fund Actuary.

Any deviation from the fully funded position will be corrected at each triennial valuation. If any deficit is revealed then the new employer will be required to pay additional deficit contributions.

Ongoing contribution rate

The ongoing contribution rate represents the annual cost of benefits accruing and, as the liabilities are assumed to be transferred fully funded, makes no allowance for the transfer of any share of the deficit within the Fund.

Contribution rates will be calculated again at each triennial valuation and should be regularly reviewed with a view to achieving a fully funded position at the end of the contract. The contribution rate may be reviewed more regularly as the contract end date draws near.

The employer will need to pay any expenses charged to them by the Fund as part of the Fund's Pensions Administration Strategy Statement and there is also an allowance in the contribution rate towards the Fund's overall running costs which is consistent with the approach taken at the last actuarial valuation.

In addition, employees continue to contribute at the rates set out in the Regulations.

Funding at the end of the contract

On termination of the admission agreement a cessation valuation will be completed by the Fund Actuary detailing the value of the liabilities and assets of the new employer within the Fund.

The basis of the calculation of this valuation will be determined by the Fund Actuary in conjunction with the Fund unless an alternative arrangement is specified within the admission agreement. The method and assumptions adopted will reflect the prevailing economic circumstances at the time.

If the liabilities are transferred fully funded at the start of the contract, then these should be returned on a fully funded basis at the end of the contract.

If the cessation valuation reveals a deficit then the new employer should expect to make payments to the Fund; where the cessation valuation results in a surplus the new employer will have nothing further to pay. The new employer will not receive any monies from the Fund.

Further considerations

On becoming an admission body in the Fund, the new employer will take on the following responsibilities.

Future benefit changes

Changes in the Regulations may alter the benefits provided by the Fund. Any changes to the benefits that occur during the contract term may affect the cost of the benefits being provided in respect of all past service, not just the service being accrued with the new employer.

Employer discretions

The Regulations contain the flexibility for participating employers to exercise discretion in certain areas. The Regulations require that each participating employer must formulate, publish and maintain a written policy on the exercise of discretions.

Additional contributions in respect of early retirements

The new employer will be required to make additional contributions to the Fund to cover any additional costs arising as a result of members taking early retirement due to, for example, redundancy or efficiency, ill-health or flexible retirement.

The amount of any additional contributions required will be calculated by the Fund Actuary, or by the Administering Authority using tables supplied by the Fund Actuary.

Calculations in advance of the transfer date

It should be noted that the advice within this report is based on market conditions as at the date of calculation. If the transfer actually takes place after this date and the results are not updated, changes in data and market conditions will not be allowed for and may mean that the contractor receives more or less assets than it would do if it was recalculated at the transfer date.

Indemnity or bond

In accordance with Part 3 of Schedule 2 of the Regulations, the new employer is required to carry out an assessment of the level of risk to the Fund should their participation within the Fund cease due to, for example, insolvency, winding up or liquidation. This assessment will be to the satisfaction of the Administering Authority and Letting Authority (Scheme employer), having sought actuarial advice. If the new employer ceases to participate in the Fund for any reason then a cessation valuation will be completed by the Fund Actuary.

Whether or not the admission body enters into an indemnity or bond, where possible, the admission body must also provide an alternative guarantee in a form satisfactory to the Administering Authority from:

- (a) a person who funds the admission body in whole or in part;
- (b) a person who owns, or controls the exercise of the functions of the admission body, for example a parent company; or
- (c) the Secretary of State in the case of an admission body which is established by or under any enactment, and where that enactment enables the Secretary of State to make financial provision for that admission body.

The level of the bond set out in the results is therefore the minimum we would recommend as Fund Actuary to the Administering Authority.

The level of the bond is calculated to provide protection against costs arising in some or all of the following areas on the cessation of the new employer within the Fund:

- **Underfunding.** Although the new employer is fully funded at the outset and the contribution rate is calculated to try to maintain this funding position, it is almost certain that the funding position will not be exactly 100% at any point in time in the future. The assumptions adopted are unlikely to be exactly borne out in practice, and the membership profile will change over time. The bond level allows for a funding level deficiency of 5% on the cessation date.
- **Strain costs.** These arise as a result of immediate pension benefits becoming payable to relevant staff who could be made redundant, staff taking flexible retirement, the employer waiving the early retirement reduction for early payment of a member's benefits or as a result of efficiency of service.
- **Unpaid contributions or expenses.** These may include unpaid normal employer contributions, unpaid additional employer contributions in respect of early retirements, and expenses associated with the premature termination of the admission agreement.

The required bond amount is calculated at the outset of the contract and will be reviewed regularly (preferably annually, but at least once every three years). It is the responsibility of the new employer to arrange for provision of the bond: the admission agreement may not come into force without the suitable arrangements being in place. Any arrangements should be agreed with all parties involved in the admission agreement.

The new employer will be required to maintain a bond until such time as all the liabilities identified in the cessation valuation have been paid; the level of bond requirement in the final year of the contract will take this into account.

Appendix 3 **The broadly comparable route**

As an alternative to participation as an admission body in the Fund, the Letting Authority may consider proposals for provision of another broadly comparable pension arrangement.

The general principle is that the proposed arrangement must be considered broadly comparable in value and nature for each employee involved in the transfer.

Broad comparability will be assessed by the Fund Actuary. The Government Actuary's Department provides passports to schemes which have been evaluated as broadly comparable; if the passport is up to date it is unlikely that the Fund Actuary would find the proposal not to be broadly comparable.

It is most unlikely that a proposal based primarily on provision of money purchase (sometimes called defined contribution) benefits would be deemed to be broadly comparable.

Bulk transfer payment at contract start

If a new employer wants to propose a broadly comparable arrangement, the Letting Authority will require eligible employees to be offered the opportunity to transfer their benefits earned in the Fund to the new pension scheme. Bidders are therefore required to confirm in their bids that the trustees of any broadly comparable scheme offered will accept transfers in.

Where eligible employees elect to transfer their benefits it is required that they are offered benefits in the broadly comparable scheme of equivalent value to the benefits transferred from the Fund. The new employer will also be required to agree with the Fund Actuary the level of service credits to be granted.

Where eligible employees do decide to transfer their pension benefits the Fund will make a transfer payment (calculated by the Fund Actuary) to the broadly comparable scheme.

Broad details of the assumptions used to determine any bulk transfer payment are set out in Appendix 1.

Bidders are advised that the terms set out by the Fund Actuary are not negotiable and bids should be prepared on that basis. Bids should indicate if a contract price adjustment is needed in order to accept these terms, and any adjustment (which will be tested for reasonableness by the Fund Actuary) must be accompanied by an explanation of why it is needed.

The bidder should therefore discuss any potential bulk transfer with the trustees and actuary of the broadly comparable scheme.

Communication and employee decision

The new employer is responsible for communicating the details of the broadly comparable pension scheme to the eligible employees and offering membership of that arrangement on transfer of employment.

The Administering Authority is responsible for communicating the options available to eligible employees in respect of their benefits accrued in the Fund.

Communication of the service credits that will be awarded in the broadly comparable scheme will be the responsibility of the new employer. Clearly there are advantages if this communication accompanies the communication of options in order that the eligible employees can make an informed decision.

The eligible employees should be given a period of not more than three months to decide whether or not to accept the transfer of their Fund benefits to the broadly comparable scheme.

Bulk transfer payment at the contract end date

The new employer must ensure that at the end of the contract all members of the new employer's scheme in service at that time are offered the option to transfer their benefit entitlements in the new employer's broadly comparable scheme to a successor provider's scheme or back to the Fund.

The transfer must be on terms which enable the provision of service credits (in either of those schemes) of equal value to the benefits held in the broadly comparable scheme. The set of actuarial assumptions used should be no less favourable than those used to calculate the initial bulk transfer. The Letting Authority will require a firm commitment to this effect at the outset of the contract.

For the avoidance of doubt 'no less favourable' terms will be such that the transfer payment would be at least as great as if evaluated using:

- financial assumptions which are derived from market indicators (interest rates etc) in the same manner as the initial bulk transfer;
- longevity assumptions consistent with those adopted for the initial bulk transfer (and allowing for any implied future improvements); and
- other demographic assumptions consistent with the initial bulk transfer basis.

The new employer must agree to pay the successor new employer's scheme or the Fund, as appropriate, any shortfall between the transfer amount as specified in its original contract exit terms, and the transfer amount actually paid from the new employer's broadly comparable scheme. The new employer is therefore advised to discuss this requirement with the trustees and the actuary of its broadly comparable scheme at the bidding stage and also as the contract end date draws near, particularly if the broadly comparable scheme is in deficit.

Other issues

The new employer must keep adequate records of the data of employees, including identification of employees who transferred across their employment and identification of those who also transferred across their pensions.

The new employer must provide data and negotiate the terms for the onward transfer in a timely manner so that it can be taken into account during the bidding process for the subsequent transfer.

The eligible employees should be given a period of no longer than three months to decide whether or not to accept the transfer of their pension from the new employer's scheme back to the Fund, or to another broadly comparable scheme offered by the successor new employer.