Funding Strategy Statement

Summary of Consultation Responses

August 2019

NORTHERN IRELAND LOCAL GOVERNMENT OFFICERS' SUPERANNUATION COMMITTEE

Northern Ireland Local Government Officers' Superannuation Committee

Summary of Consultation Responses

1 Background

1.1 NILGOSC is the administering body for the Local Government Pension Scheme (LGPS) in Northern Ireland. NILGOSC was set up by the Government in April 1950 to operate a pension scheme for local councils and other similar bodies in Northern Ireland. The pension scheme is known as the Local Government Pension Scheme (Northern Ireland) and is a defined benefit scheme. The pension scheme is funded by contributions paid by both employees and the scheme employers.

1.2 NILGOSC's role is to administer the LGPS Regulations, both in terms of pension scheme administration, including the calculation and payment of benefits, and the management of the investment fund. The Regulations are made by the Department for Communities and, while NILGOSC will respond actively to any consultation process, it does not have any power to change the regulations or determine their content.

1.3 Under the Local Government Pension Scheme Regulations (Northern Ireland) 2014, NILGOSC is required to prepare, maintain and publish a Funding Strategy Statement (FSS) which sets out the framework for the funding of all pension liabilities. The regulations also require that the FSS and any subsequent changes to it must be agreed following consultation with relevant stakeholders.

1.4 The current Funding Strategy Statement was published in September 2016 and is currently due for review as part of the 2019 triennial valuation process. NILGOSC has taken advice from the Scheme Actuary, Aon Hewitt, on its funding strategy and has identified a number of proposed changes. The key change is in respect of the tracking of employers' notional assets and only impacts those employers within the Main Employer group for contribution rate setting purposes.

1.5 The key changes proposed are summarised as follows:

End to Notional Asset Tracking with effect from 1 April 2019 (Main Group Only)

1.5.1 Since 2004, assets held within the Fund have been notionally allocated to employers in the Main group and "tracked" individually between triennial actuarial valuations, based on the contributions paid by the employer, overall fund returns and estimated benefits paid in respect of each employer's membership. This notional allocation is used for annual employer accounting under FRS102/IAS19, as well as in inter-valuation actuarial calculations on exit from the Fund or the Main Group. The notional allocation is however not used when setting employer contribution rates as Main Group employers all pay a common contribution rate based on the average for the Group as a whole. This has resulted in a divergence of individual employer tracked assets relative to the overall Fund position and is inconsistent with the principles of grouping and common contribution rates. This position is not considered sustainable over the longer term.

1.5.2 To correct this anomaly, it is proposed that the notional tracking of assets ends on 1 April 2019 and going forward employers will be allocated a share consistent with the funding level of the Main Group as a whole. For example, if the Main Group as a whole is 102% funded i.e. a 2% surplus then each employer in the group will be allocated a share of assets relative to their individual liabilities to ensure they have a funding level of 102%.

1.5.3 The proposed change has no impact on how employer contributions are set however it will result in a rebalancing exercise at each valuation to realign individual asset shares with that of the Main Group. That step-up or step-down in notional asset allocation will be reflected in the balance sheet position of individual employer's and the Actuary will provide additional narrative for the accounts to explain the movement.

Pooling of Death-in-Service and Ill-Health

1.5.4 This is an extension of the current approach to "pooling" death-in-service lump sum costs across all employers and is intended to help protect smaller employers from the significant additional funding costs and resulting deficits that can result from these events. It means that at each valuation the Actuary will calculate how ill-health retirement experience compares to the assumptions made and the cost (or saving) from this experience will be shared across all employers in proportion to their pensionable pay. This sharing of risk covers all employers in the Fund (i.e. both those in the Main Employer Group and those outside of this Group) and will be effective from 1 April 2019.

General Amendments

1.5.5 Wording has been updated to better clarify the approach to setting contribution rates in a surplus situation and to reflect changes made to the Statement of Investment Principles since the last Funding Strategy Statement review.

1.5.6 A number of minor narrative amendments have been proposed to simplify or provide clarity around the more technical aspects of the FSS.

2 Consultation Process

2.1 An 8 week consultation process was launched on 3 June 2019 seeking views from relevant stakeholders. Scheme employers, the Trade Unions and other interested parties were directly invited to take part in the consultation.

2.2 The closing date for the consultation was 31 July 2019.

3 Summary of consultation responses

3.1 A total of 7 responses were received by the closing date of 31 July and two late submissions received on 12 August and 14 August respectively. A list of respondents is attached at Appendix A.

3.2 A summary of the comments received in respect of the consultation questions, together with NILGOSC's response, is attached at Appendix B. One respondent confirmed their support for the proposed changes in their entirety. The response from NILGA endorsed the response from Fermanagh & Omagh District Council opposing the end to notional employer asset tracking and rebalancing and noted that the cost implications of pensions remain a huge challenge for the local government sector.

3.3 With the exception of a minor wording change in section 7.2.4, no changes are proposed to the draft Funding Strategy Statement agreed by the Committee on 28 May 2019. The Funding Strategy Statement is attached at Appendix C.

3.4 Some responses to the consultation reinforce the technical nature of actuarial valuations and the range of complex assumptions and calculations undertaken by the Scheme Actuary. The prescriptive nature of professional accounting standards as to how liabilities must be calculated for accounting purposes creates further complexity, as liabilities calculated under IAS19/FRS102 will generally be higher (more prudent) than those calculated during the Scheme valuation, which is used to determine the funding level and to set contribution rates.

3.5 While the changes proposed to notional asset tracking and rebalancing will have no impact on the level of contributions payable by those employers within the Main Group, responses to the consultation suggest that this is not widely understood by employers. NILGOSC will seek to further explain the changes to its Funding Strategy Statement at the Employer Actuarial Valuation events to be held on 9th and 10th October 2019.

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Appendix A

Respondents

Belfast Visitor and Convention Bureau

Controlled Schools' Support Council (CSSC)

Fermanagh & Omagh District Council

Libraries NI

Mid & East Antrim Borough Council

Mid Ulster District Council

NILGA

Translink

University of Ulster

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Appendix B

1. Do you agree with the proposal to end to the tracking of employers' notional assets within the Main group with effect from 1 April 2019?

Four respondents agreed with the proposal to end notional asset tracking with effect from 1 April 2019. One respondent stated that, while they did not disagree in principle with the proposal, they had insufficient information on the impact on their own position to fully support it.

One respondent did not agree with the proposal as they did not consider the rationale behind it to be clear and believed that it would advantage some employers and disadvantage others. The respondent considered that full transparency be provided on the relative funding positions of each employer as part of the consultation process.

One respondent noted that it was not applicable as they sit outside of the Main Group.

NILGOSC RESPONSE

NILGOSC acknowledges the technical complexity of actuarial valuations and accounting standards such as IAS19/FR102. The proposal to end the tracking of individual employers' notional assets is based on professional actuarial advice and is necessary to correct the current anomaly whereby individual employer funding positions are continuing to diverge from that of the overall Fund, despite all grouped employers paying the same contribution rate.

NILGOSC continues to believe that over the longer term employers benefit from its grouped approach to setting contribution rates. Grouping allows for the pooling of risks and helps reduce volatility in individual employer contribution rates, as the common contribution rate is set based on the experiences of the Group as a whole. This 'smoothing' effect is particularly beneficial for smaller employers. The alternative approach would be to move to individual employer rates, which would lead to significantly more volatile contribution rates and would eradicate all the benefits of a multi-employer Fund.

NILGOSC accepts that the proposed change will impact employers differently with respect to their IAS19/FRS102 accounting figures. As set out in the consultation document, those employers whose individually tracked assets relative to their liabilities are currently less than the average in the Main employer group will see an improvement or "step–up" to their notional asset allocation at the 2019 valuation, and vice versa for those employers whose individually tracked assets relative to their liabilities are currently higher than the group average. NILGOSC does not consider it to be appropriate to provide the relative funding positions of individual employers as this is inconsistent with the overriding principles of Grouping and common contribution rate setting.

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2. Do you agree with the re-balancing of the overall fund assets where assets are required for individual employer calculations?

Three respondents agreed with the proposal acknowledging that re-balancing was consistent with the grouping principle.

One respondent noted that it was not applicable as they sit outside of the Main Group.

Two respondents commented that they were concerned that the re-balancing could have an adverse impact on their balance sheet with one of the responses highlighting that they were more concerned with the financial cost of maintaining the fund than accounting entries.

One respondent did not agree with the proposal noting that existing deficit recovery payments were onerous and challenging but were justified on very specific terms relative to each organisation. They further noted that pooling may be justified in a surplus situation but that the proposal was not satisfactory in the event of a deficit.

NILGOSC RESPONSE

NILGOSC notes the comments on the impact of rebalancing on accounting figures and will work with the Scheme Actuary to ensure that adequate supporting narrative is provided to employers along with IAS19/FRS102 disclosures to help explain any movement.

NILGOSC acknowledges the comments around cost pressures however would note that the tracking of employers' notional assets or the proposal to re-balance within the Main Group will have no impact on the level of capital/deficit recovery contributions payable. Instead, the deficit is assessed at a Group level with all employers sharing funding risks equally. Deficit recovery/capital contributions are payable as a fixed monetary amount rather than a percentage of payroll to help protect the Fund, and ultimately employers, against the risk of slowing and/or declining employer payrolls.

3. Do you agree with extending death-in-service pooling to death-in–service spouse pensions and ill-health risks across all employers in the Fund?

Six out of the seven respondents agreed with the proposal to extend death-in-service pooling to death-in–service spouse pensions and ill-health risks across all employers in the Fund, with respondents acknowledging that this was consistent with the principles of pooling and likely to reduce the risk to smaller employers. One of the responses in support of the proposal noted that it would be useful to understand the mechanics of removing an employer from the pooling arrangement.

One respondent disagreed with the proposal as they considered that pooling of risks should not be extended to those employers outside of the Main Group.

NILGOSC RESPONSE

NILGOSC already pools death-in-service lump sum costs across all employers and this proposal is designed to extend the pooling to death-in–service spouse pensions and ill-health risks, effectively a form of self-insurance for the Fund. The proposal is primarily to help protect smaller employers from the significant additional funding costs and resulting deficits that can result from these events.

Should an employer's individual experience be significantly worse than the Fund average, NILGOSC will consider whether a strain cost should be levied on the employer. Consideration may also be given as to whether the employer displays particular characteristics so out of line with the Main Group that its ongoing participation in the Group may be called into question.

4. Are there any further changes you would wish to see to the Funding Strategy Statement?

Three respondents identified changes they would like to see in the Funding Strategy Statement:

- One respondent requested a reference be added to section 5.2 to reflect the CIPFA guidance requirement for the administering authority 'to enable the local pension board to review the valuation process as set out in their terms of reference'. They further suggested that the Statement of Investment Principles be added as an appendix to the FSS.
- One respondent suggested that the wording in 7.2.4 be updated from 'may' to 'will' in the sentence; *'In order to ensure that other employers in the Main Group do not have to pay for the decisions of individual employers within the Main Group, key elements of experience may be monitored…'.*
- One respondent requested that affordability for employers and employees be added to the four aims of the fund set out in section 4.2.

NILGOSC RESPONSE

In contrast to the rest of the UK, NILGOSC undertakes the dual role of administering authority and pension board and therefore the particular CIPFA guidance reference is not applicable to the LGPS NI.

Consideration has been given to attaching the Statement of Investment Principles however; as this is a 'live' document and subject to change within the funding strategy cycle; a cross reference is believed to be more appropriate. NILGOSC will circulate the latest version of its Statement of Investment Principles with any future Funding Strategy Statement consultations to assist stakeholders in forming their response.

The wording in 7.2.4 has been updated as suggested.

NILGOSC acknowledges the comments around affordability and notes that under the stability aim at 4.2.1 it aims to keep employer contributions as nearly constant as possible and at reasonable cost to stakeholders. The four aims are in line with the CIPFA guidance and reflect the need for balance between affordability of contributions and longer term cost efficiency and solvency of the Fund.

5. Are there any other comments you wish to make on the Funding Strategy Statement?

Three respondents provided additional comments on the Funding Strategy Statement:

- Once respondent commented that they were pleased to note that NILGOSC's draft FSS was closely aligned to the CIFPA Guidance 'Preparing and Maintaining a Funding Strategy Statement on the LGPS 2016 edition'.
- One respondent stated it would preferable if there was greater correlation between FRS102/IAS19 accounting figures and actuarial reports on Scheme funding. The same respondent expressed their opinion that any surplus should be used to offset employer contributions and not retained on the basis of future uncertainties as these can be incorporated into the following actuarial review.
- One respondent noted that they were a new employer since the 2013 valuation and sought clarification in respect of annual deficit recovery contributions, together with the impact of the proposed rebalancing exercise on such an employer. The respondent also sought clarification on 7.6.3 and specifically the mechanics as to how NILGOSC will determine whether a potential reduction in contributions would lead to an unacceptable risk of contributions needing to increase again in the future. The response requested further clarification on the circumstances in which employer contribution rates may be reduced.

NILGOSC RESPONSE

NILGOSC acknowledges the technical nature of actuarial valuations and the range of complex assumptions and calculations undertaken by the Scheme Actuary. NILGOSC also acknowledges that the method used to calculate liabilities for Funding purposes is very different to that required under professional accounting standards. The measurement basis for accounting purposes is prescribed by the relevant accounting standard which state that liabilities must be measured using the current yield on high quality corporate bonds – usually AA rated bonds – regardless of how the Scheme actually invests. This means the liabilities calculated under IAS19/FRS102 will generally be higher (more prudent) than those calculated during the Scheme valuation, which is used to determine the funding level and to set contribution rates.

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NILGOSC is required to consider the professional advice of the Scheme Actuary when considering how any surplus may be applied. In accordance with its aim of ensuring employer contributions remain as stable as possible, NILGOSC's funding strategy sets out that at each valuation it will determine whether any increase in contributions will be payable immediately or will be spread over future years. This approach will also be applied to any surplus and NILGOSC will determine, in conjunction with advice from the Scheme Actuary, whether it is prudent to reduce contributions immediately or if it is more appropriate to allow the surplus to be run off over a suitable period. This ensures consistency in approach between the management of any deficit and surplus and helps reduce the potential for significant volatility in contribution rates across valuation cycles. One example of such a situation would be where there is a reasonable likelihood that future changes to the Scheme or its demographics will result in an increase in liabilities, and therefore future contribution rates. In such circumstances it would be deemed prudent to hold back some of the current surplus to offset the increase.

New employers joining the Scheme between valuations will pay the current future funding rate but do not have to make any existing deficit recovery payments. At the next triennial valuation, any new employers will become a 'full' member of the Main Group and will be allocated a share consistent with the funding level of the Main Group as a whole.