Funding Strategy Statement

Summary of Consultation Responses

August 2016

NORTHERN IRELAND LOCAL GOVERNMENT OFFICERS'
SUPERANNUATION COMMITTEE

Northern Ireland Local Government Officers' Superannuation Committee

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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 (previously the Department for the Environment) 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 March 2015 and is currently due for review as part of the 2016 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.

1.5 The key changes proposed are as follows:

a. Employer Covenant Assessment - NILGOSC undertakes an assessment of employer covenants on a triennial basis as part of its risk management and funding strategy and regularly monitors covenants between triennial assessments. The FSS has been amended to reflect the impact of NILGOSC's assessment of employer covenant strength on the triennial valuation in relation to the grouping of employers and the setting of contribution rates. The FSS has also been amended to highlight the responsibility of each employing authority to provide the information requested by NILGOSC as part of its employer covenant assessment exercises.

b. Trajectory Period and Recovery Period - NILGOSC applied a Trajectory Period (the period between the valuation and the date on which solvency is targeted to be achieved) of 20 years in the 2013 valuation. This assumption is reviewed at each triennial valuation and therefore the wording in the FSS requires to be amended so that it remains valid if NILGOSC takes a decision to change the Trajectory Period. In addition, some minor amendments have been made in respect of the definition of the Recovery Period.

c. Employer Contribution Rates - The FSS has been amended to reflect NILGOSC's proposed change to the funding strategy in respect of employer contribution rates. Following the 2016 valuation, employer contribution rates will be expressed as a percentage of pensionable pay and a fixed monetary sum. The percentage will be the actual future funding rate as calculated by the actuary and it will not be adjusted for any deficiency identified at a triennial valuation. NILGOSC will limit the change in the future funding rate to plus or minus 1% of pay for long term secure employers. Where a triennial valuation reveals that the pension fund is in deficiency, defined streams of capital contributions will be payable by employers, rather than a percentage of payroll. The purpose of this is to protect the Fund, and ultimately employers, against the risk of slowing and/or declining employer payrolls. At each triennial valuation NILGOSC will assess whether the capital contributions are re-spread and rebalanced across the payrolls of the employers within the main group, or are retained and the new surplus or deficit incorporated into new streams. The capital contributions applicable for each year will be payable on a monthly basis by employers as opposed to an up-front lump sum payment at the start of the year.

d. Bulk Transfer Policy - NILGOSC has formalised its Bulk Transfer Policy which has been added as an appendix to the FSS. The new Policy is not significantly different from the current Funding Strategy Statement but rather it provides greater clarity around how NILGOSC will manage bulk transfers.

2 Consultation Process

2.1 An 8 week consultation process was launched on 3 May 2016 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 30 June 2016.

2.3 It should be noted that CIPFA is currently revising its Guidance on Preparing and Maintaining a Funding Strategy Statement but has not yet published the final document. The Regulations require NILGOSC to have regard for the CIPFA guidance and therefore some changes may be required following the publication of the document. It is not however anticipated that this will impact on NILGOSC's overall funding strategy.

3 Summary of consultation responses

3.1 A total of 9 responses were received and a list of respondents is attached at Appendix A. One respondent noted the consultation document but did not provide any further comment. In addition, the Department for Communities acknowledged the consultation but declined to respond on the basis that the consultation was targeted primarily at those employers who contribute to the LGPS(NI).

3.2 A summary of the comments received and NILGOSC's response is attached at Appendix B.

Northern Ireland Local Government Officers' Superannuation Committee

Summary of Consultation Responses

Appendix A

Respondents

Antrim & Newtownabbey Borough Council

Arc21

CCEA

Education Authority

Fermanagh & Omagh District Council

Lisburn & Castlereagh City Council

Methodist College

Mid Ulster District Council

NI Fire & Rescue Service

Northern Ireland Local Government Officers' Superannuation Committee

Summary of Consultation Responses

Appendix B

1. Do you agree with the principle of applying NILGOSC's assessment of employer covenant strength in the triennial valuation, specifically in relation to the determination of the eligibility of each employer to remain in the main group and the setting of employer contribution rates?

All respondents agreed with the principle that the assessment of employer covenant strength should be taken into account during the triennial valuation, specifically in relation to eligibility to remain in the main employer group.

One respondent requested that NILGOSC feeds back the results of its assessment to each employer, together with performance statistics on the quality and timeliness of returns.

NILGOSC RESPONSE

NILGOSC will feed back the outcome of its assessment to scheme employers following completion of the exercise. This will include a high level summary of the overall outcome of the review.

2. Do you agree with the concept of capital contribution streams, outlined in section 7.6.1, as an alternative to the current % of payroll, as a means of protecting the Fund and other employers against the risk of declining payrolls?

Six out of eight respondents agreed in principle with the concept of capital contribution streams as being beneficial to the Fund. All six provided an additional comment setting out suggestions and/or concerns, One respondent disagreed with the concept on the basis the current method was fair and easier for employers to administer. The remaining respondent did not comment on the concept in principle but highlighted a number of concerns.

The comments made in responses to this question are as follows:

- A common theme amongst respondents was the need for early notification of amounts payable in order that the necessary financial planning and budgetary arrangements can be made by employers. One respondent requested advance notice of at least 6 months should be provided to employers in respect of the capital contribution streams payable.
- Four respondents stated that the new approach would increase complexity and increase the challenges around financial planning.
- Two respondents agreed with the concept provided amounts payable will be kept as constant as possible.
- One respondent highlighted the need for employers to have clarity around future pension rates and suggested NILGOSC should further consider the impact on employers.
- One respondent suggested a flexible approach be adopted for repayment periods

depending on employer needs.

- One respondent noted it was unclear how any future surplus would be treated in capital contribution schemes and suggested a cap of a 1% rate change.
- One respondent noted that the new approach may increase uncertainly for employers ahead of each triennial valuation.

In summary, the majority of respondents agreed with the concept of capital contribution streams provided early notification was given and realistic and/or affordable recovery arrangements agreed.

NILGOSC RESPONSE

NILGOSC acknowledges the comments made by respondents and recognises the impact that a move to capital contribution streams may have on payroll administration and financial planning. NILGOSC would like to reassure all scheme employers that the change is being made as a means of reducing risk and protecting the Fund.

At each triennial valuation, the Scheme Actuary uses a number of assumptions to value the liabilities of the fund. Liabilities are split between those that relate to the past (the past service cost), and those that relate to the future (the future service cost). The future service rate meets the cost of providing benefits going forward, whilst the past service element deals with any difference between the past service cost and the assets within the Fund. The latter will create either a surplus or deficit position. Historically the majority of employers will have paid a single contribution rate, expressed as a % of payroll, to cover both the future service rate and a past service or deficit recovery rate. While this approach undoubtedly offers simplicity to employers, there are a number of risks to fund solvency in adopting this approach.

In calculating the deficit recovery portion of the contribution rate payable, the Actuary makes a number of assumptions around future salary growth and the stability of employer payrolls and effectively divides the deficit up based on payroll size and expresses this as a %. Any deviations from the assumptions, positive or negative will therefore have an impact on the funding position. The key risk to the Fund is through declining or stagnant payrolls, as this will mean that insufficient contributions are paid to keep the Fund on track to full solvency. At present any shortfall is picked up at the next valuation and re-spread in such a way that the deficit is reducing little between valuations, particularly when the interest that accrues on the deficit is taken into account. In addition, the grouping of employers for contribution rate setting means that, unless any trend in flat or declining payrolls is across the board, the cross-subsidy between employers will increase and the principle of equity is called into question.

Given the contraction in the public sector in Northern Ireland in recent years, this is no longer an appropriate risk to achieving solvency for the Fund to bear. Accordingly, NILGOSC is proposing to introduce the payment of past service deficit obligations by fixed monetary sum rather than as a % of payroll. This is a common approach adopted by other UK LGPS funds in recent years.

The introduction of capital contribution streams means that following the 2016 valuation, the Scheme Actuary will calculate the past service deficit in the usual way but instead of converting to a % based on current payroll levels, he will convert the shortfall into fixed *monetary sums for each of the following 3 years. This will provide employers with full transparency and clarity over the amounts payable in respect of the deficit for each of the next 3 years and should therefore help with financial planning. By ensuring that the Fund recovers the full amount of deficit contributions due from employers over the next valuation cycle, it is less likely that future contribution rates will have to increase further to help return the Fund to 100% solvency in the future. It is perhaps worth noting that for an employer whose payroll does not decline but instead grows in line with assumptions, the amount payable under the capital contribution stream will be the same as that payable if the past service rate is expressed as a % of payroll.*

NILGOSC notes the respondents' preference for the 'smoothing' of contribution rates. The +/- 1%pa cap will continue to apply to the future funding rate under the updated Funding Strategy Statement. NILGOSC will be cognisant of the impact of the changes on employer costs however it would not be appropriate to apply a cap to the fixed monetary sums due.

NILGOSC recognises the importance of ongoing communication with scheme employers and will endeavor to share the results of the 2016 and future valuations with employers at the earliest opportunity. The 2016 employer valuation outcome seminars are planned for the first week in October 2016 and this will kick start a process of direct engagement with individual employers.

3. Do you agree with the treatment of bulk transfers as set out in the Bulk Transfer Policy in Appendix 1?

All respondents indicated their agreement with the treatment of bulk transfers.

One respondent highlighted that the immediate settlement of any shortfall arising as a result of internal bulk transfers might be unaffordable to an employer and suggested an amendment to allow for the funding of a shortfall over a mutually agreed recovery period.

NILGOSC RESPONSE

NILGOSC would note that the requirement for transferring employers to make good any funding shortfall attributable to those employees transferring to a new employer is merely a codification of existing policy.

NILGOSC notes the suggested amendment but remains committed to the principle that each employer is responsible for the funding of all pension benefits relating to its own members. NILGOSC's primary duty remains to protect the interests of the Fund, and therefore scheme employers as a whole, and believes the approach set out in the Funding Strategy Statement is a fair and transparent approach.

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

One respondent suggested that consideration be given to the treatment of any future surpluses to protect against any subsequent downtowns.

NILGOSC RESPONSE

Noted

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

The following general comments were noted in response to this question;

- The proposed amendments were welcomed as they appear to strengthen the pension fund as a whole.
- It would be helpful if employers had sight of detailed workings on the approach to setting employer contribution rates using both the main group and the individual tracked asset share approach.
- Consideration should be given to the contribution rates payable by employees in line with the new FSS so that employers are not significantly affected by the proposed changes.
- Reiteration of earlier comments on the impact of budget pressures and the requirement for adequate advance notice to be given to employers of capital contributions payable.

NILGOSC RESPONSE

Noted.

NILGOSC considers the grouping approach to setting employer contribution rates at triennial valuations to continue to be in the best interests of the Fund as a whole at the current time. The FSS notes that the key benefit to employers from adopting the grouping approach is the ability to reduce volatility in the contribution rate payable. The consequence of a smoothed rate is that it may be higher or lower than the rate which would otherwise be payable if the grouping did not exist. NILGOSC does not intend to undermine the principle of grouping by undertaking detailed calculations for individual employers on alternative contribution rate setting bases.