HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Panel:	Pension Fund Panel and Board
Date:	24 July 2020
Title:	Governance: Exit credits
Report From:	Director of Corporate Resources

Contact name: Lois Downer, Deputy Head of Pension Services

Tel: 0370 779 4396 **Email:** lois.downer@hants.gov.uk

Purpose of this Report

1. The purpose of this report is to seek approval from the Panel and Board for the policy on the payment of exit credits, which has been updated following regulation changes.

Recommendation(s)

2. It is recommended that the Panel and Board approve the new policy on exit credits and the consequential changes made to the Funding Strategy Statement, Employer Policy and Administration Strategy.

Executive Summary

3. The LGPS regulations were amended in May 2018 to require the Fund to repay any surplus on exit to the employer leaving the Fund and Hampshire's policy documents were updated for this change. However following responses to a further government consultation the regulations on exit credits have recently been changed again.

4. The new regulations are effective retrospectively to 14 May 2018, and state that before paying an exit credit, administering authorities must have regard to:
    - the extent of any surplus
    - the proportion of a surplus that has arisen because of the value of the employer contributions
    - any representations made by the exiting employer or letting authority

- any other relevant factors.

5. The new regulations mean that each exit will have to be considered on its own merits, but in the interests of transparency, it is recommended that a default approach is set out in the Funding Strategy Statement and Employer Policy.

6. **Background**

7. Exit credits were introduced in May 2018 to allow the payment of surpluses on exit from the Fund; prior to this any surpluses on exit were retained in the Fund. However, concerns were raised by administering authorities about the unforeseen consequences of paying an exit credit, specifically where scheme employers had outsourced services or functions to service providers at a time when the Regulations did not provide for any surplus on exit to be repaid. Some Funds found that a short term contractor was eligible for an exit credit where this would not have been the intention of the contractual side agreement between the letting authority and the contractor, as the letting authority had retained the pension risk via a pass through arrangement.

8. Following a further consultation, the regulations have now been revised such that they set out the factors to which the administering authority must have regard when deciding whether or not to pay an exit credit. This change has been applied retrospectively to when the regulations were first changed, 14 May 2018.

9. In their response to the consultation, the Government stated that a policy on exit credits must protect the interests of employers and members as a whole, and therefore the administering authority must make a consideration that is wider than the perspective of the exiting employer. The response also states that while administering authorities will be required to take into account representations made by the parties, they will not be obliged to enquire into the precise risk sharing arrangements adopted. It will be for those parties to set out why the arrangements made by them make payment of an exit credit more or less appropriate.

Current policy

10. Hampshire’s policy on exit credits prior to the new regulations coming in states that an exit payment will usually be paid to the exiting employer. This policy put the emphasis on employers ensuring that their contractual arrangements cover the treatment of exit credits as well as exit deficits, and guidance was provided to employers at the time to ensure their existing arrangements were reviewed for this change.

11. The main exception in the policy was for the Admitted Body Group employers who had a commitment from a secure scheduled body employer to subsume any liabilities on exit. In those cases, no exit credit would be paid to the exiting employer and the surplus would be retained in the Scheduled Body Group.

Proposed policy

12. The new regulations state that before paying an exit credit, the administering authority must now take into account:
    - the extent of any surplus
    - the proportion of a surplus that has arisen because of the value of the employer contributions
    - any representations made by the exiting employer or letting authority
    - any other relevant factors.

13. After discussions with the Fund Actuary, and consultation with employers (see paragraphs 17 to 19 below) it is proposed that:
    - For exits on a low risk basis (i.e. where there is no continuing employer backing the liabilities) the exit credit will usually be equal to the surplus. For exits where a continuing employer is subsuming the liabilities, the lower of the surplus or the value of employer contributions will usually paid as an exit credit.
    - Actuarial and legal costs of the exit valuation will usually be deducted from the exit credit before payment.
    - The exit credit will usually be paid to the departing employer, leaving letting authorities to recover the value via their side agreements if appropriate.
    - No exit credit will be paid to an employer from the Admitted Body Group as it was a stated condition of the secure scheduled employer who offered to subsume liabilities on exit that no surplus will be paid.
    - Representations from employers seeking to justify a different approach to the default described above will be considered on a case by case basis.
    - The administering authority also will consider any other relevant factors that may result in a different approach to the default approach. These may include, but are not limited to, the extent to which the exiting employer was responsible for the funding risk during their participation in the Fund or any reputational issues arising from the payment of an exit credit.

14. It is proposed that the calculation of value of the employer contributions will be estimated as the contributions paid into the Fund during the employer's participation multiplied by the changes in Fund value over the same period. This uses the monthly change in valuation of the Fund as an approximation

for investment returns but will be sufficient to identify situations where the employer has benefited from a material change in market conditions over the course of their participation.

15. Under this proposed policy, payment will still be made to the exiting employer in most circumstances and therefore employers who let contracts will have to ensure that existing and future contracts allow for the possibility of surpluses on exit. However representations from employers must be considered and therefore letting authorities will need to show clearly why the surplus (or value of employer contributions if lower) should be retained in the Fund rather than an exit credit being paid to a contractor if they believe this to be the right course of action. Similarly, contractors will need to be able to demonstrate why an exit credit should be paid, particularly where the contract was entered into before 14 May 2018 when the regulations did not envisage surpluses being paid out.

16. The proposed policy is set out on pages 4 and 5 of the Funding Strategy Statement which is shown in Appendix 1 of this report. In addition, the Employer Policy in Appendix 2 has also been updated on pages 18 and 19 to reflect the changed approach. Discretion 56 on page 23 has been updated for the change from three months to six months for payment of an exit credit and a new discretion to determine whether an exit credit is payable has been added to page 24 of Appendix C of the Administration Strategy, which is Appendix 3 to this report.

Employer feedback

17. It is a requirement of the regulations that administering authorities detail their policy on exit credits in the Funding Strategy Statement (FSS). The regulations also require that any changes to the FSS are made after consultation with such persons as the administering authority considers appropriate. Employers were therefore asked to comment on the proposed policy on exit credits in a consultation that ran for three weeks from 19 June to 9 July 2020, with a reminder email sent on 3 July.

18. Three employers responded to the email, one to confirm that they had no comments and one who positively endorsed the proposed approach. The other employer provided feedback that it would be unreasonable for employers who were overpaying contributions into the Fund not to receive the full benefit of this if they were to exit on a low risk basis. The focus of the policy as originally considered was on the issue of short term contractors exiting the Fund, having ‘done well’ out of the fluctuations of the market. Although longer term employers exiting had been discussed with the Actuary and agreement in principle reached that if an exit was carried out on a low risk basis an employer ought to have the surplus returned as an exit credit, for simplicity, it had been decided that this would be achieved on a case by case basis under ‘other relevant considerations’.

19. Following the feedback the proposed policy was amended to be more explicit that an employer who has a surplus on a low risk basis would be likely to receive the value of the surplus as an exit credit (rather than it being limited to the lower of this or the value of the contributions).

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	yes/no
People in Hampshire live safe, healthy and independent lives:	yes/no
People in Hampshire enjoy a rich and diverse environment:	yes/no
People in Hampshire enjoy being part of strong, inclusive communities:	yes/no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because the Pension Fund Panel and Board need to approve a consultation response on behalf of the administering authority.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document	Location
None	

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 (‘the Act’) to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionally low.

2. Equalities Impact Assessment:

Equality objectives are not considered to be adversely affected by the information in this report as it affects all scheme members.