



Ministry of Housing,
Communities &
Local Government

Local Government Pension Scheme (England and Wales)

Partial Government Response: review of
employer contributions and flexibility on
exit payments



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Contents

1	Introduction	4
2	Review of employer contributions	5
3	Flexibility on exit payments	7
	Spreading exit payments	8
	Deferred Debt Agreements (DDAs)	10

1 Introduction

1.1 Between 8 May and 31 July 2019 the Secretary of State for Housing, Communities and Local Government [consulted](#) on proposals to amend the Local Government Pension Scheme (LGPS) in England and Wales, comprising:

- Changes to the local valuation cycle from the current 3-year (triennial) to a 4-year (quadrennial) cycle;
- Measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle, including proposals for review of employer contributions;
- Proposals for greater flexibility on exit payments;
- Proposals for further changes to the rules on provision of exit credits;
- Proposals for changes to the category of employers required to offer local government pension scheme membership.

1.2 We are grateful to the 279 individuals and organisations that took the trouble to respond.

1.3 Since the consultation, administering authorities and employers in the scheme have faced new potential risks as a result of the global pandemic. The employers and administering authorities have made representations seeking early implementation of these proposals in order to assist management and mitigation of these risks.

1.4 The Government is therefore publishing a response on these proposals and will make regulations at the earliest opportunity. It is the intention to develop guidance on the use of the new powers working with the Scheme Advisory Board and CIPFA.

1.5 The Government response on the [reform of exit credits](#) was published on 27 February 2020 and the Government amended the 2013 regulations accordingly¹ so that administering authorities may determine, at their absolute discretion, the exit credit payment due, having regard to any relevant considerations. A further response will be issued on the remaining proposals in the consultation in due course.

¹ <http://www.legislation.gov.uk/uksi/2020/179/contents/made>

2 Review of employer contributions

Background

2.1 Administering authorities currently review employer covenant strength from time to time and take steps to manage and reduce covenant risks, for example seeking additional security or reviewing contributions for employers likely to exit. At fund valuations administering authorities may take account of covenant strength, for example in setting secondary contributions to target a specific funding level. However, the circumstances of employers may change between valuations, for example due to a change in covenant strength or workforce composition, or local government reorganisation.

2.2 The consultation sought views on proposals to give administering authorities the following powers:

- To amend employer contributions during the inter-valuation period following a covenant review, perhaps in relation to some categories of employer only
- To amend an employer's contributions at the request of the employer

2.3 It was also proposed that the costs of a review would be met by the fund if it was undertaken by the fund, and by the employer if it was undertaken at the request of the employer. Administering authorities would be required to set out their policy on review of employer contributions in their Funding Strategy Statement (FSS) including on categories of employers eligible for reviews.

Summary of responses

Question 7 - Do you agree with the proposed changes to allow a more flexible review of employer contributions between valuations?

Response	Number of responses
Fully support	97
Support with reservations	26
Cannot support	10

Question 8 – Do you agree that Scheme Advisory Board (SAB) guidance would be helpful and appropriate to provide some consistency of treatment for scheme employers between funds in using these new tools?

Response	Number of responses
Fully support	105
Support with reservations	12
Cannot support	6

Question 9 – Are there other or additional areas on which guidance would be needed? Who do you think is best placed to offer that guidance?

2.4 The responses to the consultation strongly supported the proposal for review of employer contributions. Some respondents had reservations based on the availability, transparency and reliability of relevant information on which a review could be based, and the potential costs of a more active approach to monitoring covenant strength.

2.5 Respondents also highlighted concerns over the circumstances in which a review of contributions may take place, for example following changes in market value of assets.

Administering authorities and employers took opposing positions on the desirability of funds taking security as part of a deal for lower secondary contributions.

2.6 Views differed on the review process, with administering authorities seeking discretion and flexibility while employers sought clear communication between the parties as well as consistency and safeguards. Some respondents highlighted concerns that the proposal to require administering authorities to specify the categories of employers eligible for reviews would be too rigid and considered that reviews should be available for all employers.

2.7 On guidance, most respondents supported the principle of guidance to ensure consistency. Administering authorities expressed a preference for guidance to be principle based and not overly prescriptive. Employers were more concerned with consistency between funds and wished to see more in regulations or statutory guidance.

Government response

2.8 The large majority of respondents supported the proposals with appropriate safeguards to ensure consistency and transparency. Since the consultation, representations from funds and employers have strongly argued that the flexibility to review contributions would be helpful to administering authorities and employers in responding to the impacts of COVID-19 and other pressures.

2.9 In view of responses to the consultation and subsequent representations, the Government has concluded that the power to review contributions should be available in respect of all employers. This would enable administering authorities to respond to the full range of circumstances which may change between valuations, including potential impacts of COVID-19 and some other circumstances for example when local government reorganisation leads to a change in liabilities.

2.10 The Government will therefore amend regulations to grant administering authorities and employers the following new flexibilities:

- Administering authorities may review the contributions of an employer where there has been a significant change to the liabilities of an employer
- Administering authorities may review the contributions of an employer where there has been a significant change in the employer's covenant
- An employer may request a review of contributions from the administering authority.

Administering authorities will be required to consult with the employer when undertaking a review of the employer's contributions.

2.11 In order to provide consistency and transparency in the use of the new power, administering authorities will be required to state their policy on the review of employer contributions in their FSS and obtain advice from their actuary.

2.12 Administering authorities will be expected to consider the impact on other employers in the fund of any change in contributions payable by an employer or employers. Market volatility or changes in asset values would not be a proper basis for a change in contributions outside a full valuation. The new power may be used only where there has been significant change in liabilities or significant change in covenant.

2.13 The Government consulted on what would be the most helpful and appropriate guidance for the review of employer contributions and will consider the responses and work with the SAB and CIPFA when developing the guidance.

3 Flexibility on exit payments

Introduction

3.1 The current rules on exit payments may be onerous for some employers and may mean that exiting employers continue accruing liabilities which they cannot afford in order to defer an exit payment. There could also be a risk that some employers could become insolvent as a result of inability to meet an exit payment when they come to leave, with potential implications for employment, delivery of local services and future support for the scheme.

3.2 The Government therefore proposed the introduction of additional flexibilities on exit payments, giving administering authorities the following options in managing exiting employers:

- Option 1 - As currently, calculate and recover an exit payment for employers ready and able to leave and make a clean break. These employers may begin making exit payments prior to leaving (Regulation 64(4) of the 2013 LGPS Regulations).
- Option 2 - Agree a repayment schedule for an exit payment with employers who wish to leave the scheme but need to be able to spread the payment
- Option 3 - Agree a Deferred Debt Agreement (DDA) with an employer to enable them to continue paying deficit contributions without any active members where the administering authority is confident that the employer would fully meet its obligations

3.3 In question 14 of the consultation, the Government sought the view of whether option 2 and 3 should be available to administering authorities as an alternative to current rules on exit payment and 120 of the responses were in favour, one supporting with reservations and five against.

3.4 The Government also consulted on whether statutory or SAB guidance was needed, and which type of guidance would be appropriate for which aspects of these proposals (question 15 in the consultation document). The Government will consider the responses further and work with the SAB and CIPFA when developing the guidance.

3.5 The views of respondents and the Government response on option 2 are set out below at paragraphs 3.8 to 3.16 and on option 3 at paragraphs 3.19 to 3.26.

Spreading exit payments

Background

3.6 The Government proposed to grant administering authorities the flexibility to make an agreement with an exiting employer to spread exit payments. The period over which to spread the exit payment would be set by the administering authority but having regard to the interests of the fund and other existing employers.

3.7 The term “buy-out” was used in the consultation document as short-hand for a low-risk or gilts basis, which administering authorities may adopt for exit payments, but to avoid confusion the term “termination basis” is used in this response to refer to the basis adopted by the administering authorities for determining the liabilities for exit payments (which may be a low risk, gilts, on-going or other basis).

Summary of responses

Question 10 – Do you agree that funds should have the flexibility to spread repayments made on a full buy-out basis and do you consider that further protections are required?

Response	Number of responses
Fully support	103
Support with reservations	27
Cannot support	4

3.8 The responses highlighted that some flexibility for exit payments already exists, as employers can spread exit payments in the period before an expected exit, while an employer still has active members in the LGPS. However, the consensus was that a power to agree that an exit payment may be paid over a longer period would be helpful.

3.9 Some responses pointed to potential negative impacts if a large number of employers exit a fund in this way, including affecting the maturity of a fund or increasing risks of not receiving exit payments in full. Some administering authorities also considered that agreements to spread exit payments with employers should be reviewable if the employer’s covenant improves or deteriorates.

3.10 The employers supported the proposal but sought guarantees on consistency and predictability in agreements on the spreading of exit payments. Some respondents also sought transparency in the use of agreements.

3.11 The consultation sought views on a maximum period over which payments could be spread, but there was no consensus. Most administering authorities wished to have discretion to set maximum periods. There was also a range of views on what guidance if any Government should provide on the termination basis.

Government response

3.12 The large majority of respondents were in support of the proposals with appropriate safeguards to ensure consistency and transparency. Since the consultation, representations from funds and employers have strongly argued that the flexibility to spread exit payments would be helpful to administering authorities and employers in responding to COVID-19 pressures.

3.13 Some administering authorities may already achieve similar objectives through side-agreements. However, the Government also recognises the importance of ensuring administering authorities adopt a consistent approach and have regard to the interests of the fund and employers as a whole.

3.14 Administering authorities are best placed to take account of the diverse range of employers in the LGPS and to use judgement and local knowledge in balancing competing interests.

3.15 The Government will therefore amend regulations to provide administering authorities with a power to spread exit payments from an exiting employer over a period where the employer no longer has active members in the scheme. In order to ensure consistency and transparency administering authorities which wish to make use of the new power will be required to set out within their FSS their policy on spreading exit payments and to obtain advice from their actuary.

3.16 Administering authorities will be expected to determine whether to spread an exit payment, over what period and the proportion of the exit payment to be paid each year, taking account of the interests of all employers and the funds as a whole.

Deferred Debt Agreements (DDAs)

Background

3.17 The Government also proposed to grant administering authorities the power to allow an exiting employer to defer the exit payment where they have no active members, in return for an on-going commitment to meet their existing responsibilities as employers in the scheme. This is similar to the approach adopted by private sector multi-employer pension schemes which use deferred debt arrangements.

3.18 The exiting employer would enter into a deferred debt agreement (DDA), becoming a deferred employer, and undertaking to pay secondary contributions as set by valuations and meeting its obligations on administration.

Summary of responses

Question 11 – Do you agree with the introduction of deferred employer status into LGPS?

Response	Number of responses
Fully support	121
Support with reservations	7
Cannot support	6

Question 12 – Do you agree with the approach to deferred employer debt arrangements set out above? Are there ways in which it could be improved for the LGPS?

Response	Number of responses
Fully support	101
Support with reservations	24
Cannot support	5

Question 13 – Do you agree with the above approach to what matters are most appropriate for regulation, which for statutory guidance and which for fund discretion?

Response	Number of responses
Fully support	114
Support with reservations	8
Cannot support	2

3.19 There was strong support for the approach proposed, with most responses focussing on the detail of implementation, including the following suggestions:

- relevant events triggering a review or termination of a DDA could include a change to the sponsor covenant, changes in the asset values, and a desire to de-risk the fund overall.
- either party to a DDA should have the right to terminate the agreement on notice, which would trigger an exit payment.
- DDAs should be reviewed regularly, taking account of costs incurred in doing so and the availability of data and intelligence
- deferred employers should have their own investment strategy, separate to that of the fund as a whole.

3.20 Some responses were concerned that employers and administering authorities could take on too much risk through entering into DDAs and sought clarity on when DDAs should

be considered instead of the existing approach of seeking to get employers as close to fully funded as possible by the time the last active member leaves.

3.21 Responses also highlighted that under the current arrangements some administering authorities and employers have side agreements or work arounds in place to achieve similar ends.

3.22 It was generally accepted that there is a need for consistency, with many responses calling for statutory guidance. However, some responses felt that, in order to manage risk appropriately, there would need to be wide flexibility and rejected detailed guidance. Respondents felt that the guidance should be accessible and intelligible to all parties, especially employers, so that there was transparency and predictability in decisions reached. There was a consensus that guidance should come from a single source with the involvement of stakeholders in preparation, and a range of topics were suggested including how to monitor and assess covenant and content of DDAs.

Government response

3.23 The large majority of respondents were in support of the proposals with appropriate safeguards to ensure consistency and transparency. Since the consultation, representations from funds and employers have strongly argued that the flexibility to enter into DDAs would be helpful to administering authorities and employers in responding to COVID-19 pressures.

3.24 The Government will therefore introduce deferred employer status and DDAs in the LGPS. The exiting employer's responsibilities under a DDA will be the same as for employers of active members but excluding the requirement to pay primary contributions.

3.25 In order to ensure consistency and transparency administering authorities which wish to make use of the new power will be required to set out within their FSS their policy on DDAs and to obtain advice from their actuary.

3.26 The Government expects administering authorities to consider all the evidence available and use judgement and local knowledge before allowing an exiting employer to enter a DDA, and to monitor DDAs carefully including regular actuarial valuations to ensure they are on track to meet its funding target and put in place recovery plans where shortfalls are identified. Generally, this will not include a separate investment strategy for deferred employers as it is more effective in the long term for funds to maintain a single investment strategy which is suitable for the range of employers across the fund.