Briefing

LGPS (Scotland) Regulations 2018

Exit Credits

The new Local Government Pension Scheme (Scotland) Regulations 2018 came into effect on 1 June 2018, in response to a previous consultation which had closed in January 2018. Following the lead of the recent LGPS (Amendment) Regulations 2018 which applies to the English and Welsh LGPS Funds, this new regulation introduces the possibility of an exit credit under Regulation 61.

This briefing note discusses the arising issues that administering authorities should consider with regard to exit credits.

Regulation 61 - What has changed?

Under the previous LGPS (Scotland) Regulations 2014, Regulation 62 set out that an exiting employer in an LGPS Fund would be liable to pay an exit payment.

Under the new Regulations, this now comes under Regulation 61 and has been amended such that an exiting employer may be entitled to receive an exit credit. This is a significant change which provides more flexibility for administering authorities to manage liabilities when scheme employers cease participation in their Fund. Previously, administering authorities have been unable to refund any surplus to an exiting employer, meaning any surplus on exit would be retained in the Fund.

> With the introduction of the new Regulations, from 1 June 2018, employers will be entitled to receive an "exit credit" if a surplus is identified in the cessation valuation.

As this provision has not been backdated, this has created a "cliff edge" for employers ceasing either side of the date, but avoids the many complications that backdating would otherwise have caused.

Unlike its English and Welsh equivalent, there is no specification under the new regulations of the timescales within which the exit credit needs to be paid; under the Amendment Regulations applying to the English and Welsh Funds, any exit credit needs to be paid within three months of the date on which an employer ceases to be a Scheme employer (unless agreed otherwise).

Previously, the exit regulation was considered to be one-sided to the detriment of the employer: if a cessation deficit was certified on exit, the employer would be required to pay it, but if there was a surplus on exit, the employer would not be able to access it.

However, Funds (and letting authorities where contractors were involved) were subject to the covenant risk of the employer (i.e. employers not being able to afford the exit payment), so it could be argued that in some cases, being able to retain any surplus within the Fund (or within the letting authority's section) was acceptable compensation for this risk.

In addition, administering authorities could be accused of overfunding (and potentially challenged) if an exiting employer ended up with a surplus they couldn't access, and thus had paid "too much". The new regulations should in theory help avoid such challenges.

Exit credit

An "exit credit" is defined in the Regulations as "the amount required to be paid to the exiting employer by the administering authority to meet the excess of assets in the fund relating to that employer over the liabilities specified in paragraph (2)(a)." This definition closely mirrors the definition of "exit payment".

> The basis itself upon which to calculate the exit credit is not defined; in other words the actuarial assumptions to use to calculate the funding position upon exit is not prescribed.

For most Funds, the basis required will be set out or discussed in their Funding Strategy Statement and consideration will need to be given to this new aspect.

Ability to certify nil exit payment/credit

One immediate question is whether there are any circumstances in which Funds will be able to withhold any identified surplus. For example, prior to the change in Regulations, many Funds would have been happy to allow any scheme employer willing to act as guarantor to absorb any deficit for an exiting employer, with the actuary certifying a nil exit payment thus avoiding any need for the employer to make payment.

Will this apply to employers in surplus? If all parties agree that the surplus should be retained in the Fund (in practice by the guarantor), then will the Regulations allow this? We would suggest that administering authorities obtain legal advice if they wish to explore this question.

Contractor issues

The change in regulation is likely to prove popular with employers who are in the LGPS by virtue of taking on contracts from scheme employers. Most contractor admission bodies will have received initial assets on a fully-funded basis (i.e. equal to the value of the liabilities on the ongoing funding basis).

> Given recent strong asset returns across the LGPS, many of these employers may be in surplus on this basis and may now expect to receive a refund of surplus on exit.

In practice, there may be debate on the appropriate basis to use if an employer is in surplus and in any event, any identified surplus may have been covered in a side agreement between the letting authority and the contractor with a provision to repay the equivalent of any surplus retained on exit through the side agreement. Care will be needed to make sure the contractor isn't "paid twice".

In other cases, contractors may have loaded their contract prices to allow for the possibility of so called "trapped surplus" at the end of the contract, or have other cost sharing mechanisms in place. These will all need consideration. However, the change in regulation makes participating in the LGPS a bit more transparent for new contracts and perhaps will filter through to savings for letting authorities too.

Funding strategy

As mentioned earlier, administering authorities should consider their funding strategy in light of the changes.

> The ability to pay refunds on exit may influence an administering authority's stance on the pace of funding for certain employers.

For example, for ongoing employers who are in surplus, then the administering authority may be able to take a more casual approach to removing the surplus, and the timeframe for doing so, knowing that a refund can be paid on exit. Nevertheless the provisions of Regulation 61 and the ability to amend contribution rates on the run up to cessation may remain a useful tool.

In addition, for closed employers targeting a minimum-risk deficit on exit there may have previously been some caution regarding charging "too much", and thus potentially overfunding the employer and risking challenge, particularly with volatile gilt yields which mean employers' positions can change drastically in a short space of time.

We will be pleased to discuss changes to your Funding Strategy Statement with you and to suggest some appropriate wording.

Employers who participate in the same Fund more than once

The Regulations do not make clear when an employer participates in the same Fund more than once, whether they are treated as a separate or the same employer and consequentially how the new provision should be applied.

> Given the nature of admission bodies participating in a Fund as a result of contract award and the requirement for separate admission agreements for each contract to be made, it would appear logical that each should be treated separately upon exit.

Indeed, each agreement may have a different underlying Scheme employer. Nevertheless, we anticipate interesting conversations emerging where an employer is in surplus and in deficit in the same Fund and will await the emerging legal advice with interest.

In addition, and relating to the ability or not to issue a nil exit credit discussed above, it will also need to be considered where a contract ends for an individual employer and a new contract (and new admission agreement) is entered into by the same employer, how any surplus revealed could be treated. For example, could this be used to reduce the contributions under the new contract, rather than be paid out as an exit credit.

Actions for administering authorities

We would recommend that administering authorities discuss next steps with their Barnett Waddingham contact, which may include:

- Communicating the change in Regulation to employers, in particular contractors and letting authorities who may need to revise existing side agreements
- An exercise to ensure they are aware of any existing side agreements, particularly for contractors in surplus and/or close to a contract end date
- Considering any changes to their existing funding strategy as discussed above.
- Considering any changes to the Funding Strategy Statement
- Considering with their legal advisors whether there are any circumstances in which an exit surplus could be retained
- Considering the Fund's exit process for employers, given the change in timescale for which payment has to be made
- Discussing any live cases with their Barnett Waddingham contact
- Considering their approach to employers that participate in the Fund under more than one admission agreement

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beyond the expected

Other notable changes

Most of the other changes to the Regulations were for clarification or correction purposes. We note a couple of interesting changes below.

Early retirements

Removal of the previous Regulation 29(13) which specified the requirement for employer consent where a member elects to retire over the age of 55 but prior to their normal pension age. Removal of this regulation therefore enables any member to elect to retire early once they reach the age of 55, however, actuarial reductions will still apply as before unless agreed by the employer to be waived.

Exiting employers – suspension notices

The previous regulations set out that a suspension notice (issued for the purpose of suspending an exit payment) would be possible for a period of up to three years, and subject to the requirement that the administering authority has good reason to believe the employer will have at least one active member before the end of the suspension period.

These two conditions have now been removed from the new Regulation 61.

This gives the administering authority more flexibility in dealing with Scheme employers and managing exit payments, and makes clearer the ability for Scheme employers, subject to agreement with the administering authority, to spread the required exit payment over a future period.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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