NORTHERN IRELAND LOCAL GOVERNMENT OFFICERS' SUPERANNUATION COMMITTEE

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To: Chief Executives
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At: All Employing Authorities

Circular 05/2019
03 June 2019

Dear Colleague

NILGOSC's Funding Strategy Statement

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.

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 on which it is seeking your views.

The key changes are set out in the following paragraphs, with a set of consultation questions included in Annex 1 to this letter. NILGOSC would welcome your views, preferably by way of response to the questions attached in Annex 1, on the proposed changes together with any further suggestions on the FSS by 31 July 2019. The revised FSS is attached in Annex 2 to this letter.

This note distinguishes between employers who are inside or outside the Main group for the purposes of allocating Fund assets and setting contribution rates. Following the covenant exercise conducted late 2018, all those employers assessed by NILGOSC as having a weak covenant and employers who have closed the Scheme or whose participation in the Scheme is believed to be of limited duration will have been advised of their status outside the Main group. All other employers should assume they remain within the Main group.

Proposed Changes for the Main Employer Group

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.

No account has been taken of this notional allocation when setting employer contributions to the Fund, rather all the employers in the Main group share a common contribution rate although the notional asset allocation has been used in any inter-valuation calculations carried out by the Fund Actuary, such as assessments of any deficit payable when an employer exits the Fund, or leaves the Main group. The notional asset allocation is also used for annual employer accounting under FRS102 or IAS19.

The notional, individual asset allocation coupled with a common contribution rate based on the overall fund performance has resulted in a divergence of the individual employer tracked assets relative to their liabilities to the extent that the employer experience differs from the average performance for the overall fund i.e. some in a deficit and others in a surplus position. The Scheme Actuary has indicated that the current position is not consistent with the principles of 'grouping' in a 'pooled fund' and this treatment is not sustainable over the longer term.

To correct this the Funding Strategy Statement proposes an end to the tracking of employers' notional assets within the Main group with effect from 1 April 2019. This means that no notional asset allocation will be made to employers in the group at each triennial valuation. Where calculations require an individual employer funding position, the Fund Actuary will assume a notional asset share such that all employers have the same funding level (i.e. proportion of assets relative to their liabilities) as the Main group as a whole.

This change will require a 're-balancing' of the overall fund assets where assets are required for individual employer calculations. For employers whose individually tracked assets relative to their liabilities are currently less than the average in the Main employer group, the re-balancing will represent an immediate improvement or "step–up" to their notional asset allocation, and vice versa for those employers whose individually tracked assets relative to their liabilities are currently higher than the group average. Employers who report their pension costs under IAS19 or FRS102 will see this step change in their accounting balance sheet position from year ends on or after 31 March 2020.

Employers should expect a change in the accounting balance sheet position in the year following a triennial valuation however the extent of this change could be significant for some employers after the proposed 're-balancing' exercise. Narrative will be provided by the Actuary to employers to explain the movement for post March 2020 annual accounting purposes.

The contributions for employers in the Main group will continue to be based upon the overall average position for the group as a whole at the valuation. There is no proposed change to this approach in the 2019 Funding Strategy Statement.

Employers outside the Main Group

For those employers outside the Main group there are no changes proposed as regards individual asset allocation and setting of individual contribution rates. These will continue to be determined by the Scheme Actuary.

Proposed Changes for All Employers

The other key change to the strategy is the proposed pooling of death-in–service benefits for survivors and ill-health risks across all employers in the Fund. This can be viewed as a form of insurance within the Fund. It means that at each valuation the Actuary will calculate how ill-health retirement experience has compared 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.

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.

Employer experience will be monitored with respect to expected fund average and if an employer has significantly worse experience than expected they may be removed from this pooling arrangement.

Further Proposed Amendments

There are some further amendments to the Funding strategy Statement which fall into three broad categories:

- Amendments to clarify the approach to setting employer contribution rates in a fund surplus scenario
- Amendments required to reflect changes to the Statement of Investment Principles since the last Funding Strategy Statement was published
- Amendments to the narrative to simplify or provide clarity around the more technical aspects of the Funding Strategy Statement

Next Steps

I should be grateful if you would submit your response to this consultative exercise by 31 July 2019 in order that any comments can be considered by the Committee in advance of it agreeing the final version of the document. A copy of the draft Funding Strategy Statement is attached to this letter and can also be accessed through NILGOSC's website www.nilgosc.org.uk.

Responses are welcomed in electronic or hard copy although an electronic version would be appreciated to assist with the collation of responses. Please submit your response to the Finance Manager using the contact details below:

Email: maria.bowers@nilgosc.org.uk

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411 Holywood Road
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I look forward to hearing from you however if you do have any queries, please do not hesitate to contact me 0345 3197 320 or by email maria.bowers@nilgosc.org.uk

Yours sincerely

Maria Bowers
Finance Manager
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Annex 1
Consultation Questions

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?

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

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?

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

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

Thank you for your time in participating in the consultation process for NILGOSC's Funding Strategy Statement. Employing authorities have an important part to play in the formulation and development of NILGOSCs overall funding strategy and your views will be taken into account by the Committee in agreeing the final version of the Funding Strategy Statement.

Annex 1
Consultation Questions

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?

Council appreciates that the tracking of employers' notional assets within the Main group originated as a consequence of the withdrawal of the exemption permitted (to organisations that, despite participating in multi-employer pension schemes with non-segregated assets, have a funding agreement in place to eliminate scheme deficits) under FRS17 to the requirement to disclose pension scheme deficits when FRS 102 became effective.

Council also recalls that the introduction of the requirements of FRS 102 in an effort to ensure that the defined benefit pension scheme liabilities were adequately disclosed in district council accounts was problematic and is of the opinion that it has not contributed to a better understanding of an individual district council's pension scheme liabilities.

Consequently, notwithstanding that the disaggregation of non-segregated assets and the estimation of scheme liabilities are complex matters, Council is content to accept the Actuary's assertion that the current accounting arrangements are neither appropriate nor sustainable.

Council, however, is not qualified to offer a better alternative to the proposed ending of the tracking of employers' notional assets.

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

As stated above, Council is not an expert in accounting for pension scheme liabilities.

Council is not qualified to debate the technical aspects of either Pension Fund accounting or the quantification and disclosure of employer scheme surpluses or deficits.

However, Council does note that it would seem unlikely that the proposed assumption, i.e. that all employers within the Main group will have the same funding level (i.e. proportion of assets relative to their liabilities) as the Main group as a whole, is reasonable.

Council bases this view on the fact that different employers within the Main group are, as a consequent of previous decisions in relation to how accessible early and other forms of retirement were to former employees, e.g. at the time of local government reform, likely to have materially different scheme liabilities.

However, given the Actuary's view that the current accounting arrangements are neither appropriate nor sustainable, and no alternative course of action has been proposed, Council accepts that 're-balancing' of the overall fund assets is necessary for individual employer calculations.

Notwithstanding Council's concurrence with the proposal to 're-balance' the overall fund assets, Council is concerned about the potential impact that such rebalancing may have on the quantification of the secondary contributions (capital costs), which form part of each district council's overall contribution to the Fund.

That said, Council's concern in relation to the potential impact of re-balancing overall fund assets on capital costs is mitigated, albeit to an unquantifiable extent, by its understanding that the Fund's solvency has improved significantly since the original quantification of the capital costs currently payable. As such, Council is hopeful that the capital costs currently payable will reduce significantly, if not completely.

In summary, Council is more concerned with the financial cost of maintaining the Fund than with accounting entries that may be necessary to ensure that its accounts comply with FRS 102 and give a true and fair view.

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?

> Although Council is mindful of the extra costs that agreeing to the extension of pooling to include death-in-service spouse pensions and ill-health risks across all employers in the Fund could bring, it is also cognisant of the fact that employers outside the Main group have already satisfied the Fund's eligibility criteria either on their own merits or as a consequence of benefitting from another employer's guarantee.
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> Council is also mindful of the fact that extension of pooling should reduce the potential for the costs of these matters forcing an employer outside the Main group to become insolvent and therefore reduce the ultimate negative consequences for all remaining employers of the insolvent employer's liabilities becoming orphaned.
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> In the absence of detailed information about the potential estimated costs of the extension of pooling and the associated impact on the primary contributions payable by employers in the Main group, Council concludes that, on balance, it is likely that the extension of pooling will not impact materially on the contributions paid by employers in the Main group.
>
> Accordingly, Council is prepared to agree with extending death-in-service pooling to death-in–service spouse pensions and ill-health risks across all employers in the Fund.

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

> Council suggests that NILGOSC considers whether an additional point be included immediately after paragraph 5.2.11 (potentially numbered 5.2.12) to include "NILGOSC shall review the valuation process as set out in its terms of reference" (assumed) – reference should be made to the last bullet point on page 13 of CIPFA's "Preparing and Maintaining a Funding Strategy Statement in the LGPS 2016 edition"
>
> Council also considers that consideration be given to including NILGOSC's Statement of Investment Principles as an appendix to the Funding Strategy Statement.

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

> Council is pleased to note that the draft Funding Strategy Statement is closely aligned to the guidance published by CIPFA in its "Preparing and Maintaining a Funding Strategy Statement in the LGPS 2016 edition".

Thank you for your time in participating in the consultation process for NILGOSC's Funding Strategy Statement. Employing authorities have an important part to play in the formulation and development of NILGOSCs overall funding strategy and your views will be taken into account by the Committee in agreeing the final version of the Funding Strategy Statement.