Scottish LGPS SAB
Guidance to Funds on using Deferred Debt Agreements in cessation

Amendments to the LGPS (Scotland) 2018 introduced in June 2022 gave Funds the flexibility to defer the debt (the "exit payment") that employers owed when their last employee left the LGPS. Previously this had to be paid immediately, but Funds can now stagger this over a period of time, with certain conditions. The SAB examined whether a degree of consistency in the application of this flexibility would be helpful, and a consultation with funds indicated it would be. A working group was established to develop guidance, using the document issued by the English and Welsh SAB as a starting point. The working group has now reviewed this document, found the guidance relevant and helpful, and adjusted it to be accurate for the Scottish LGPS.

The English and Welsh guidance also had three schedules. One was a detailed cross reference to other employer discretions, which was felt to be unnecessary. One was a glossary of terms, which was felt to be helpful. The final schedule was a model contract clause which Funds could use with employers if they wished to make use of the deferred debt arrangements. The working group explored adapting this model agreement to be compliant with Scots Law, and obtained a quote of £2,500 to adapt and modernise it in light of experience of its use in England and Wales.

The SAB is invited to:

1. Approve the circulate of the guidance to Funds.
2. Consider whether it wishes to include a model agreement, and if so to agree the expenditure for this.

Guide to Employer Flexibilities

Background and scope

1. This guide has been produced by the Scheme Advisory Board (SAB) in accordance with its functions under Regulation 2 of the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 to assist Administering Authorities (Section 1) and employers (Section 2) in the implementation of the following regulations:

- Regulation 61A: Revision of rates and adjustments certificate: *'*Scheme employer contributions'
- Regulation 61B: Revision of actuarial certificates: *'*Exit payments'
- Regulation 61(4A): Special circumstances where revised actuarial valuations and certificates must be obtained; 'Deferred Debt Agreements'

Throughout this document, the use of these regulations is referred to as "the flexibilities" and unless otherwise stated 'regulations' or 'Regulation' refers to the Local Government Pension Scheme (LGPS) (Scotland) regulations 2018 (as amended).

2. These additional regulations build on the previous regulatory framework where exit payments were required for all exiting employers regardless of their situation or the potential risks to the fund.

3. Nothing within this guide overrides, supersedes or varies in any way regulation, statutory guidance or the policies of Administering Authorities on these matters as set out in their Funding Strategy Statement (FSS). The contents reflect the SAB's understanding of the relevant requirements under the regulations, and its views on how the flexibilities could or should be utilised.

4. This guide has been drafted with the assistance of representatives from LGPS Administering Authorities (Section 1) and scheme employers (Section 2) and the Board would like to thank those who provided input to each section.

5. The SAB actively encourages Administering Authorities to make use of these flexibilities, where appropriate, taking into account the interests of the employer concerned and other employers within the fund.

6. In making use of these flexibilities, Administering Authorities must have proper regard to the regulatory requirements for solvency and cost-efficiency and ensure that they are compliant with the Regulations. They should also have regard to the legal principle that no decision should be so unreasonable that no responsible person acting responsibly could have made it in:

- the proportionality of approach to and demands on employers; and

- how the risks to other employers within the fund are considered.

7. This guide makes reference to instances in which the Administering Authority may wish to take advice from their actuary. Where actuarial involvement is not strictly required under the Regulations, this will be at the discretion of the Authority taking into account their FSS, normal procedures and policies.

8. It is the intention that over time this guide will be supplemented by case studies and examples from Administering Authorities of these flexibilities working in practice. These case studies and examples will be added to the SAB website as they are submitted. The first instance in each section of entries in the Glossary are in **bold type**

Section 1 – A Guide for Administering Authorities

Overview

1. This guide is presented in a question and answer format. It provides information, examples and options in relation to the use of the flexibilities. It also includes consideration of:

   - matters for Administering Authorities to consider when setting policies
   - the data and information which may be necessary
   - the roles and responsibilities of all parties during the implementation of the flexibilities.

2. Effective communication and engagement with scheme employers will be vital to ensuring outcomes which enhance the ability of those employers to meet their duties under the Scheme. Although policies may vary across Administering Authorities, the SAB encourages effective communication and engagement practices with scheme employers to ensure their early participation in, and understanding of, any process undertaken.

3. Consideration of the type of events which may require a review of employer contributions is important and is covered in more depth at question 2 below. It is equally important to be clear about which type of events are not in scope of the policy as those which are. Employers will require this clarity in order to understand why a review might take place as well as when an application for a review may, or may not, be appropriate.

4. When considering whether a contribution review would be appropriate/should be requested, all parties should be mindful that:

   - As a principle the appropriate starting point would be the approach from the **Funding Strategy Statement (FSS)** in force at the time, using **assumptions** as at the date of the **actuarial valuation** to which that FSS relates.

- The provision should not be used with the sole objective of only increasing or only reducing employer contributions, but to set appropriate employer contributions regardless of the outcome.
- Changes in assumptions/asset values since the last actuarial valuation should not, in general, be allowed for unless specifically justified.
- Other aspects of the funding plan may be reviewed on a case by case basis but should be justified and remain within the provisions of the existing FSS.

Question 2 below gives more details about when a review might be appropriate.

5. Understanding and assessing **employer covenant** is an important element of the flexibilities. Administering Authorities should consider whether existing frameworks and policies to monitor covenant are transparent and sufficient to meet their needs, in particular does the framework, which may consist of a number of policies and documents beyond the FSS :

- Effectively identify events which might constitute a change of significant magnitude in the employer's ability to meet its obligations
- Ensure such an event is considered in the context of the employer's existing and potential obligations to the Fund
- Identify changes to covenant both positive and negative
- Differentiate sufficiently between different types of employer and different types of participation
- Include a **'notifiable events'** process
- Provide for a proportionate process recognising the balance between resource requirement/complexity and the employer's obligations to the Fund?

Question 4 below gives further details on employer covenant.
Question 8 below provides more detail on notifiable events

6. When considering whether a more flexible approach to employer exits, either by spreading payments or entering into a **Deferred Debt Agreement (DDA)**, as appropriate, Administering Authorities may wish to take into account the following:

- The general starting point, in accordance with the Scheme Regulations, is that the employer is liable for an immediate debt payment on exit and any variation away from this should be considered in the light of this benchmark. In this regard Administering Authorities may wish to clearly set out the circumstances where such variation may or may not be considered.
- Whilst having regard to the above, Administering Authorities should nevertheless be mindful of the broader objectives and finances of the employer with regard to the available options
- It is important to recognise that a more flexible debt arrangement, while needing to be in the best interests of the Fund, may in some cases be

appropriate even where the employer covenant is weak as it may allow an employer to avoid accruing further liabilities.

- Regular but proportional review of the conditional elements of any arrangement, together with full engagement in covenant reviews, will be important to ensure that it remains appropriate and in the best interests of all parties.

Question 12 below gives more details about the two approaches.

The Review Process

Q1. What is the difference between a Fund valuation and a review under the Regulations?

1. At the Fund valuation the **Administering Authority** reassesses employer funding plans and contribution rates to take into account changes in membership, economic and demographic conditions and individual employer circumstances. Changes in economic and demographic conditions may also necessitate a change in the fund's funding assumptions.

2. A review under the Regulations will be as a result of either a significant change in membership data or an employer's circumstances. A review can be prompted by the Administering Authority's own monitoring processes or as a result of an application from an employer, but should not be carried out as a result of changes in wider economic or demographic conditions. In all cases the justification for a review should be that the change that has occurred is likely to have a material impact (up or down) on the employer contributions required in order to achieve or maintain full funding.

3. Where it seems likely that an employer may exit before the next Fund valuation then Administering Authorities can use their existing powers under Regulation 61(6) to carry out a valuation and allow for market conditions.

Q2. What events or circumstances could prompt a review?

1. A review may be prompted by two main events:

   a. Employers can request a review, or
   b. An Administering Authority can require a review.

2. One approach could be to set out a list of "trigger events" that could lead to the consideration of the need for a review of employer contribution rates between valuations. Such events may be included in the employer responsibilities, for example via the **Pensions Administration Strategy**, service agreement and/or **admission agreement**.

3. In order to ensure the triggers for review are robust, it is suggested that a series of notifiable events are recorded to ensure an employer informs Administering Authorities of circumstances driving significant change which

may or may not be identified by the Administering Authority. The notification of such events could be included in the Pensions Administration Strategy, service agreements and/or admission agreements. Examples of notifiable events might include:

i. Material change in LGPS membership, where the definition of material is both transparent and appropriate to each fund
ii. Material change in total employer payroll and LGPS pensionable pay
iii. Change in employer legal status or constitution (to include matters which might change qualification as a Scheme employer under the LGPS Regulations)
iv. A decision which will restrict the employer's active membership in the Fund in future
v. Any restructuring or other event which could materially affect the employer's membership.
vi. Confirmation of wrongful trading
vii. Conviction of senior personnel
viii. Decision to cease business
ix. Breach of banking covenant

4. Whichever the case, a review should be triggered if the Administering Authority believes that there is a reasonable likelihood that there has been either:

   a. a change in liabilities arising or likely to arise, or
   b. a change in the employer's ability to meet their obligations.

5. These criteria are considered in more detail in later questions.

Q3. What may be constituted as a change in liabilities arising or likely to arise?

1. A change in liabilities is defined where the benefits in the Fund for which an employer is responsible have materially changed, or are likely to change, all other things being equal, compared to those included in the most recent Fund valuation. A change in liabilities due to the assumptions used to project future benefit cashflows, or the level of discounting applied to those cashflows, should not constitute a change under the regulations.

2. Examples of such changes, which although not exhaustive give an idea of where this flexibility may be appropriate, would include:

i. A significant outsourcing or transfer of staff to another employer (not necessarily within the Fund)
ii. Restructuring of a scheme employer, or a change in how its rate is assessed
iii. Significant changes to the membership of an employer, for example due to redundancies, significant salary awards, ill health retirements, age retirements, large number of withdrawals or the loss of a significant contract or income stream

iv. Establishment of a wholly owned company by a scheduled body which does not participate in the LGPS.

3. Note that there may be occurrences of the above examples which do not trigger a review of employer contribution rates. This would be on the basis that:

i. the change is not deemed to have a significant or material impact on the liabilities and hence the contributions likely to be required to meet the funding objective
ii. by taking no action, there is only a negligible increase or decrease in risk to the Fund and other employers in the Fund; or
iii. the new **Rates and Adjustments Certificate** as part of a Fund valuation exercise as required under Regulation 60 will imminently come into force, and any changes will be included within that Certificate.

In these instances, the Administering Authority may wish to seek their Actuary's opinion.

4. In some instances, a change in the liabilities will also result in a change in an employer's ability to meet these obligations.

5. Ultimately, the final decision rests with the Administering Authority after, if necessary, taking advice from their Actuary.

Q4. What may be constituted as a significant change in an employer's ability to meet their obligations?

1. Ultimately, this decision rests with the Administering Authority after, if necessary, taking advice from their Actuary or a covenant specialist. Examples of such changes would include:

i. Provision of, or removal of, security, bond, guarantee or some other form of indemnity by an employer against their obligations in the Fund.
ii. Material change in an employer's immediate financial strength (evidence should be available to justify such a view).
iii. Material change in an employer's longer-term financial outlook (evidence should be available to justify such a view).
iv. Where an employer exhibits behaviour that raises concerns over their ability to contribute to the Fund. For example, a persistent failure to pay contributions (at all, or on time), or to reasonably engage with the Administering Authority over a significant period of time.

2. Note that there may be occurrences of the above examples which do not trigger a review of employer contribution rates. This would be on the basis that:

i. the cost of the review outweighs the benefit to the employer, the Fund and other employers in the Fund;

ii. no action was deemed to have a negligible increase or decrease in risk to the Fund and other employers in the Fund; or
iii. the new Rates and Adjustments Certificate as part of a Fund valuation exercise (as required by Regulation 60) will imminently come into force, and any changes will be included within that Certificate.

3. In these instances, the Fund may wish to seek their Actuary's opinion.

Q5. In what circumstances could a request from an employer be treated as a valid reason to exercise these powers?

The Administering Authority may specify that the employer's request must align with one of the two criteria set out in the Regulations which trigger an Administering Authority review; namely a significant change in the liabilities arising or likely to arise or a significant change in the ability of the employer to meet its obligations in the Fund.

1. The employer's request should be evidence-based. The employer should be willing and able to provide sufficient evidence to the Administering Authority to support their request. A review would then be carried out if the Administering Authority considers that there is a reasonable likelihood that the review would result in a material change in the employer's contribution rates.

The Employer should understand and accept that there will be costs associated with the review which, in accordance with the Regulations, they will have to meet.

Q6. When carrying out a review, can the Administering Authority:
(a) use updated membership data?

1. In some cases, the starting point could be the membership data provided for the most recent triennial Fund valuation, for example, if the review was happening during or shortly after the valuation. In most cases, given that the review will only be happening due to material changes in membership, the employer and Fund should work together to prepare a fully updated data set for the actuary to use in their calculations. There may be instances where updated membership data is not required, for example if it is deemed proportionate to use the previous triennial Fund valuation data without adjustment.

2. Where the cause for the review is a change in an employer's ability to meet their obligations, updated membership data may not need to be used unless there have been significant membership movements since the previous Fund valuation that could significantly affect the outcome of the review.

3. The Administering Authority should discuss with their Actuary whether updated membership data is required for each review.

(b) factor in changes to market and/or demographic conditions since the last Fund valuation?

1. As a default, changes in economic and/or demographic conditions since the last Fund valuation should not be taken account of when carrying out a review. Exceptions to this are:

   i. the Administering Authority believes it is in the best interests of the Fund (i.e. all employers) to do so;
   ii. as a result of transfers of liabilities and notional assets between employers in the Fund, market related calculations are required and to ignore the change in market conditions is impractical.
   iii. Change in employer covenant.

2. Where it seems likely that an employer may exit before the next Fund valuation then the Administering Authority can use their existing powers under Regulation 61(6) to carry out a valuation and allow for updated market conditions.

(c) alter the structure or derivation of any financial and/or demographic assumptions?

1. No, the financial and demographic assumptions used should be consistent in their structure and derivation with the principles in the FSS and those used at the last Fund valuation.

2. If, as part of a review, any change to the structure or derivation of assumptions is considered then the Administering Authority should discuss the changes with the Fund's Actuary and may consult with relevant employers.

(d) change the employer's funding target?

1. Yes, such a change may be appropriate. The new funding target should be consistent with the Fund's existing funding strategy. For example, where an employer's circumstances change such that they move from funding on an ongoing basis to a cessation basis.

(e) change the employer's funding time horizon?

1. Yes, such a change may be appropriate. The new time horizon should be consistent with the Fund's existing funding strategy, in particular how employer recovery periods are determined.

(f) change the level of prudence/risk in the employer's funding plan?

1. Yes, such a change may be appropriate. The revised level of prudence/risk should be in line with the Fund's existing funding strategy, however, care will need to be taken with regard to any potential impact on other employers in existing pools or groups of employers.

(g) make revisions to the contribution rates without the Actuary's input and agreement?

1. No, any change to an employer's contribution rate will require a change to the Rates and Adjustment Certificate which is prepared by the Actuary.

Therefore, any change must be agreed by the Fund's Actuary prior to it being communicated to the employer.

Q7. How can expectations on cost and timing be managed?

1. Ultimately the cost and timescales for reviews will be dependent upon a number of factors, to include the complexity involved and the level of engagement with the employer. For instance, a contribution review and any associated covenant review might vary in depth of analysis depending on:

   i. the nature of the circumstances prompting review,
   ii. the type of employer,
   iii. the level of information provided and available to the Fund,
   iv. the information and advisory support the Administering Authority requires to make an informed decision.

2. In managing the expectations of employers, whether the review is prompted by the Administering Authority itself, or requested by the employer, an Administering Authority may give consideration to a range of cost and timescales by way of a guide, but in practice would be expected to acknowledge and to confirm that these variables will ultimately be dependent on the level of work involved. An Administering Authority may wish to develop a routine/regular form of annual review for employers who request an update on metrics, which could inform whether a more detailed review would be warranted.

3. In terms of responsibility for costs arising, where the review is requested by an employer the expectation would be that those costs are passed onto the employer, subject to local specification and recharging arrangements.

4. With regards to timing, but to be determined by the Administering Authority (unless there is a material change in risk), it may be considered reasonable to preclude a review during a window immediately after or prior to a triennial Fund valuation. Insofar as the Administering Authority is to complete a review, it will need to collate information, undertake the review, take advice and follow its own process to develop and propose an outcome for discussion with the employer. For instance, within 12 months following the statutory valuation date, during the period when updated membership data and more in depth assessment of the Fund and individual employer liabilities is under review, the Administering Authority may wish the triennial Fund valuation process to take precedence over any individual employer reviews (although there may be cases where, at the discretion of the Administering Authority review may be warranted ahead of a revised Rates and Adjustment Certificate coming into effect).

5. It may also be reasonable for the Administering Authority to set out within its own policy a maximum number of requests per employer within a set period (except in exceptional circumstances, to be determined by the Administering Authority). For example, potentially one review per year.

Q8. What additional information is required from an employer?

1. The information required from an employer is likely to depend on whether the review is prompted as a result of a reasonable likelihood of a significant change in liabilities, a significant change in covenant or because the review has been requested by the employer for another reason.

2. Information that may be required to enable a review should be appropriate to the situation and status of the employer and could, for example, include:

i. Membership data to evidence potential for significant change in liabilities (where not already known to the Administering Authority).
ii. Most recent employer annual report and accounts, latest management accounts, financial forecasts (3 year) and details of outstanding facilities, position of other creditors (to include encumbered assets and potentially asset valuations) etc. to evidence significant change in covenant.
iii. Any other relevant information required by the Administering Authority to inform their assessment of employer liabilities and/or covenant.

Q9. How should employers be involved in the review process

1. The involvement of an employer and at which stage, will depend on whether it is a review prompted by the Administering Authority or the employer itself. Regardless of the origin of the review there will need to be a greater degree of individual employer dialogue than would be, for example, the case in a triennial Fund valuation in order to ensure that all parties are fully engaged, led by the Administering Authority in their role conducting the review.

2. In the case of the former, the triggers which prompt the review are likely to be driven by the Administering Authority's own monitoring/flow of information, with the exception of notifiable events outlined in Question 2 above. Once the Administering Authority has considered the evidence and formed the basis for review, it is anticipated that the employer will be informed from that point onwards as part of an extended dialogue, particularly where information is required, and to confirm the basis for review.

3. When the employer requests a review, it will naturally become involved earlier in the process, with the employer expected to outline the rationale and case for the review through a suitable exchange of information.

4. In each case, whether triggered by the Administering Authority or via an employer request, it would be reasonable to assume there would be dialogue between the parties, to include, but not limited to, an outline of information requirements, an estimation and update of advisory and other necessary costs, an estimated timeline, together with confirmation of the final outcome.

Q10.How should the review decision be communicated?

1. Administering Authorities should communicate and document the consideration of reviews, together with the outcome to the employer in writing, noting the policy (or policies) and process followed and any material determining factors. As well as following a proper and transparent process it will be particularly important that the reasons behind the decision are set out and explained clearly.

2. Details of the employer request process should be determined by each Administering Authority in accordance with its own policies and decision-making processes, including associated delegations.

Q11. How should any appeals process operate?

1. Any appeals process is left for the Administering Authority to determine in accordance with their own policies including any existing employer appeals process, but in its simplest form it would require an employer to evidence one of the following:

   i. A deviation from the published policy or process by the Administering Authority

And/or

   ii. Any further information (or interpretation of information provided) which could influence the outcome, noting new evidence to be considered at the discretion of the Administering Authority).

2. In setting out an appeal process the Administering Authority should have regard to the following principles:

   i. The process and any amendments to it should be subject to consultation with employers
   ii. The appellant should be granted a reasonable period of time both to make any appeal following a decision and in order to prepare the basis of their appeal
   iii. The process should reflect the responsibilities of the Administering Authority in respect of the triennial Fund valuation or other regulatory obligations which may supersede prior to the completion of any appeal
   iv. The process, including the timescales and requirements for evidence should be accessible, clearly signposted and transparent
   v. Any review of a decision should be considered independently from those directly involved in the original decision

3. Any process determined by the Administering Authority under this section does not supersede or replace the ability for a person to make a complaint under Regulation 69 (applications to resolve disagreements).

Debt Spreading Arrangement and Deferred Debt Agreement

Q12. What is the difference between the two and when might you want to use them?

1. Employers with a **Debt Spreading Arrangement (DSA)** are exiting the Fund. These arrangements may be appropriate for an employer which has no active members, no intention of returning to active employer status in the future and wishes to crystallise any debt to the Fund. Employers have an obligation to make good on the payments due under the DSA, which when completed will finalise their exit.

2. Employers with a Deferred Debt Agreement (DDA) have not exited the Fund. These arrangements may be an appropriate alternative to a DSA for an employer which although they have no active members may return to active employer status at some point. Alternatively, these can be used for employers who do wish to exit but do not wish to crystallise any debts to the Fund. They continue to share in the fortunes and risks of the Fund for the duration of the DDA. The exact details of the DDA can be varied depending on the employer/Fund circumstances, but for example the employer might:

i. Continue to benefit from positive investment returns, which would act to reduce their debt
ii. Continue to be exposed to the risk of poor investment returns or increasing liabilities, which would act to increase their debt.
iii. Continue to be exposed to the risk of a failure of other employers, with the associated increase in liabilities.
iv. Continue to exercise some degree of control over their liabilities, for example by being involved in ill-health
v. Continue a relationship with a guarantor

Q13. What are the different scenarios when either arrangement might be used?
The fundamental difference between the two arrangements means that different approaches might be appropriate depending on the circumstances of the employer. Some example scenarios are illustrated below:

(a) When the employer has a very strong covenant or can offer significant security and wishes to minimise costs

1. In this case, given the very strong covenant/security position, the fund may be willing to defer the debt payment for an appropriately significant period of time using a DDA. Under this approach, the employer's liabilities could be assessed on an ongoing basis. Subject to the Administering Authority's FSS the ongoing **funding position** would be calculated at each valuation – the employer would make good any deficit in a manner consistent with the FSS.

2. Should the employer have cash reserves available the Administering Authority may wish to consider, and discuss with the employer, whether

some form of up-front payment would be appropriate to ensure that the DDA commences from a strong funding position.

3. Over time and subject to a combination of factors, including investment returns and cashflows, the funding position will vary. It may be, possible that a significant surplus could build up relative to the funding target. Alternatively, the employer's deferred status with no active contributions (employer **primary contributions** and employee contributions) flowing into the fund could prevent any surplus from arising. It should be noted that an employer's cessation basis may use actuarial assumptions that are more prudent than those used for the ongoing funding basis. Therefore, a surplus on an ongoing basis may not be sufficient to meet exit debt on an employer's cessation basis.

4. Should a surplus arise to the extent that the assets are sufficient to cover the cessation liabilities the DDA is required under regulation 61(4E)(e) to cease and the employer become an exiting employer, without any requirement for an exit payment. Where a surplus exists on a cessation basis, an exit credit will be payable as determined by the Administering Authority. The employer will then have paid only the contributions required to cover the ongoing liabilities – the rest will have been achieved through investment returns and positive membership returns.

(b) When initial affordability is low, but with the prospect of increased affordability in future

1. In this case, a DDA could enable the employer's funding basis to be set in line with the fund appropriate cessation basis. At each actuarial Fund valuation the remaining cessation deficit would be assessed, and **secondary rate contributions** put in place to address the deficit. The level of the secondary contributions may also take into account changes in the employer's affordability. If affordability/covenant improves between valuations, the Rates and Adjustments certificate could be reviewed (under Regulation 61A) to increase contributions.

(c) When the employer is very weak and must rely on future investment returns to fully or partially fund the cessation debt.

1. In some cases, the employer may be very weak, but not facing imminent insolvency. In these cases, although a DSA might be more appropriate, the fund might decide that it is better to agree to put in place a DDA over an appropriately long period and a sufficiently long recovery plan to manage that employer's situation as far as practical, and within the allowances set out in the Fund's FSS, effectively relying on investment returns to make up most of the cessation deficit. This is clearly far from ideal, but the Fund may need to consider as a last resort that it is better to receive some level of contributions from the employer rather than crystallising a cessation debt and forcing immediate insolvency.

2. In this and potentially other circumstances where a DDA is being considered the possibility of the employer covenant being supported by obtaining some form of guarantor or security could be considered as not all employers will be able to obtain a guarantee.

3. If a guarantor already exists (including, where applicable, the related employer referred to in Regulation 61 (5) of the 2018 Regulations) it will be important to involve them in the process. However, care will need to be taken to ensure confidentiality of sensitive information is maintained and that any potential conflicts of interest are effectively managed.

(d) When the employer expects to continue to employ members in the LGPS, but temporarily has no active members.

1. For example, this might happen with a small employer where the very few active members opt out of the fund but will be re-enrolled under auto-enrolment. In this case, a DDA might be preferred, as it would allow the employer to continue to be associated with the fund. Subject to the circumstances of the employer, such an approach may be more appropriate than using the existing suspension notice permitted under Regulation 61(3).

(e) When the cessation debt can be afforded over a relatively short period, but not immediately.

1. In this case, a DSA might be preferred, as it would allow the employer to remove obligations to the Fund as quickly as is affordable, which would remove the administrative burden of liaising with the Fund. Conversely, where the debt can only be afforded over a longer period, a DDA might be preferable, as it allows the position to be updated over time in the light of changing funding positions. Employers who may be party to either a DSA or a DDA should be encouraged to discuss any potential impact on their accounting treatment with their auditors.

Section 2 - Employer guidance on new LGPS flexibilities

Overview

1. These amending regulations have been laid because the powers they grant had been requested by employers and Administering Authorities for some time. They received strong support from scheme stakeholders through the consultation process.

2. Employers are reminded that while it is not mandatory for Administering Authorities to exercise these new powers, those that do are required to set out how the flexibilities will apply in their **Funding Strategy Statement (FSS)**, in line with (**non-statutory**) SAB guidance. This will ensure consistency of treatment between employers and allow for transparency in the process. Administering Authorities are expected to consult on material changes to the FSS with affected parties, including their employers.

3. It is intended that these new flexibilities provide a formal basis for discussion between employers and their Fund on these issues so employers should feel able to approach their Fund should they wish to investigate how they may apply in their case. In particular, where an employer is considering exiting the LGPS or will be exiting as a result of another trigger event, it is strongly encouraged that the employer engage with the **Administering Authority** in advance of leaving the fund to understand the options that may be open to them on exit.

4. Administering Authorities are under no obligation to use these new flexibilities although the SAB are encouraging their use. If an employer's Fund has chosen not to use the flexibilities, they should be asked to clearly state their reasons for not doing so.

5. Although it is hoped that decisions under these regulations can be reached by the Administering Authority to the satisfaction of the employer, that may not always be the case. Those Funds which do use these flexibilities will be expected to have in place a transparent process for dealing with appeals against their decisions. This is set out further in question 11 of the guide for Administering Authorities.

Review of Contributions

1. This power has been granted to Administering Authorities and employers to recognise that employer circumstances can and do change in between triennial Fund valuations by respectively initiating or seeking a review of contributions.

Q1. What is a review?

1. Administering Authorities now have the power to consider whether the contribution rate agreed for an individual employer as part of the most recent triennial Fund valuation remains appropriate, in advance of the next Fund valuation. In most cases a review would mean a reassessment of the employer's covenant with a view to potentially changing the employer contribution rate. The employer in question will have to be consulted as part of the review.

Q2. When might it take place?

1. There are three scenarios where a material change may have taken place that could indicate a review of the employer contribution rate could be necessary:

   a. Administering Authorities may review the contributions of an employer where there has been a significant change to the liabilities of that employer, for example, if there has been a bulk transfer in, or out. This should not be interpreted as allowing a review to be undertaken if the **funding level** associated with a particular employer changes, for

example, due to a change in asset values, as this would be managed through the triennial Fund valuation process.

b. Administering Authorities may review the contributions of an employer where there has been a significant change in the strength of the employer's covenant, for example, through business restructuring or merger.
c. An employer may request a review of contributions from the Administering Authority, for example, if the employer believes their circumstances have changed significantly such as through a material change in their LGPS employee numbers. Employers may also wish to ask for a review of their contribution rate alongside the provision of additional security to the fund; or if there are other reasons for believing the covenant strength has improved, for example, the employer has been taken over by a stronger parent organisation.

2. Your Administering Authority may set out a list of "trigger events" that could lead to the consideration of the need for a review of employer contribution rates between valuations. Such events may be included in the employer responsibilities, for example via the **Pensions Administration Strategy,** service agreement and/or **admission agreement**. Employers should familiarise themselves with this list to ensure that they take them into account when considering actions which may cause them to trigger a review, and to enable them to engage with their Administering Authority in advance.

3. Your Administering Authority may set some limits around when a review can take place, for example they may not be willing to undertake a review that is requested in the 12 months following a Fund valuation date.

Q3. Can I ask for a review?

1. The employer can request a review of their contribution rate in accordance with the policy contained in the Fund's FSS. The Administering Authority would not be expected to consider undertaking a review unless the employer can demonstrate that there has been a significant change to its circumstances, for example:

i. The securing of a security, bond, guarantee or some other form of indemnity by an employer against their obligations in the Fund.
ii. Material change in an employer's immediate financial strength (evidence should be available to justify such a view).
iii. Material change in an employer's longer-term financial outlook (evidence should be available to justify such a view).

2. The policy under which an employer may request a review will be set out in the Administering Authority's FSS together with the matters to be considered when determining whether such a request shall be accepted.

Q4. What could this mean for employers?

1. The review may conclude that no change is necessary or that the employer contribution rate (**primary or secondary**) may need to increase or decrease.

2. Should an employer request a review they would be required under the regulations to meet the reasonable costs incurred for both the employer and the Fund. The Fund should set out, in principle, the information it will require together with the anticipated costs of undertaking such an exercise including the process for obtaining reasonable but necessary actuarial, covenant advisory, legal and other advice, and the method of payment, before the project starts. If the costs were later expected to be significantly in excess of this, a process can be put in place between the employer and Fund to monitor and manage this.

3. In addition, employers should note that the Fund will be required to consider the impact on the other employers in the Fund when undertaking a contribution review in order to manage how risk is shared across the Fund. For example, this could be mitigated by a request for security from the employer.

Q5. What would I need to evidence if I do ask for a review?

1. Employers will need to be able to set out their reasons for requesting a review. This would include explaining the change in circumstances, together with evidence to back up the materiality of any change in covenant strength including financial and non-financial impacts. For example, details of any potential or planned change in business structure, ownership or credit rating, information from financial forecasts, changes in LGPS membership numbers or covenant strength or details of security that could be provided to the Fund.

2. Employers may consider whether requesting that the Administering Authority sign a confidentiality agreement would be appropriate in order to be able to share all information and evidence as may be set out in the FSS or requested by the Administering Authority.

Debt Spreading Arrangement

Q6. What is a Debt Spreading Arrangement?

1. Once an employer triggers an exit payment it would be calculated on the agreed basis (as reported in the FSS or termination policy). Although the default position remains that an exit payment is immediately payable in full, this exit payment could potentially be divided into instalments and spread over time. This could better enable the employer to afford to leave the scheme and manage the impact on the business' cashflow.

2. The structure of the **Debt Spreading Arrangement (DSA)** would be at the discretion of the Administering Authority, regarding which they may wish to

take the advice of the Fund's actuary. The process by which this is decided should be set out in the FSS.

3. The Administering Authority would decide whether to spread an exit payment, over what period the exit payment is to be paid and when it is to be paid. However, it is expected that this will follow a discussion between the Administering Authority and employer.to determine a payment structure that is both achievable and protects all other employers in the Fund. The regulations allow a significant degree of flexibility in relation to setting up the arrangement to meet the needs of different situations, but the ultimate decision as to whether a DSA should be put in place rests with the Administering Authority.

4. While in most cases the spreading arrangement would remain fixed for the agreed duration, the Administering Authority may feel it is appropriate to allow the terms of an agreement to be altered at a future date if, say, the employer wanted to pay the balance, or there was a significant change in the **employer covenant**.

5. The Fund will be required to consider the potential impact on the other employers in the Fund to ensure that competing interests are balanced. It is possible that security will be required as this could reduce the risk to other employers. The FSS would be expected to include how security may be required, what this would cover and how this would be managed over time.

Q7. Why would it happen?

1. These flexibilities have been introduced to provide an option to those employers that face the challenge of no longer being able to afford to continue to build up future liabilities, but who also cannot afford to pay the exit payment as a single payment. Spreading the payment may enable them to exit in an orderly manner to the benefit of all the employers and the Fund. Any process by which an employer may request to investigate spreading their exit payment will be set out in the FSS with an expectation of the likely timescale for reaching agreement.

2. The current option of making a full payment on exit would remain.

Q8. What needs to be considered?

1. A key question is the ability of the employer to afford the full payment at the point of exit. If the employer is able to make a single payment in full this will usually be the preferred option for the Administering Authority as this provides greater certainty for future funding, may minimise any interest the Administering Authority may charge for spreading payments and minimises the risk to other employers. Therefore, any employer wishing to use this option will have to set out clear and evidenced reasons for needing to spread the payment. In the case of weaker employers, spreading their exit payment can be a method of reducing risk to the remaining employers in the Fund.

2. A further consideration for the Fund is the ongoing covenant strength of the exiting employer. The Administering Authority will need to be comfortable that the strength of covenant s such that it can be relied on over the payment period. This will influence the length of the spreading period. There are no minimum or maximum spreading periods set out in the regulations. Employers will need to demonstrate that they are sustainable over the agreed term or are able to provide the Fund with additional security. The Administering Authority will need to set out in the FSS how security will be managed over the period of the arrangement as the size of the debt reduces.

3. The Fund will be required to take account of the interests of all employers and the Fund as a whole when considering a request to spread an exit payment. The requirements for information necessary to inform the decision, together with any requirements for security should be set out in the FSS or Pensions Administration Strategy.

4. Employers who may be subject to a DSA are encouraged to discuss any potential impact on their accounting treatment with their auditors.

Q9. What information or security might be required?

1. Allowing the exit payments to be spread over an extended period may increase the risk faced by remaining employers. To manage the additional risks the Administering Authority will need to have sufficient information to be able to make a judgement on the covenant strength of the relevant employer. Employers may already be familiar with the type of information required as many Funds make detailed assessments of employer covenant as part of the triennial Fund valuation process.

2. This could include information on business structure and ownership, credit rating, the report and accounts, information from financial forecasts, sources of income, access to government support, numbers of LGPS eligible staff, details of security that could be provided to the Fund, and other pensions obligations.

3. It is to be expected that the Administering Authority will monitor the covenant strength over the spreading period and may consider amending or terminating the agreement.

4. The Fund will need to ensure that any security required is sufficient and could be called on should the employer covenant weaken.

Q10. Will there be costs?

1. It is anticipated that spreading will be an employer driven request therefore all reasonable costs will be expected to be met by the employer. Funds should share an overview of the anticipated costs of the exercise with employers, including the process for obtaining necessary actuarial,

covenant advisory, legal and other advice, and set out how payment should be made, before the project starts. Actual costs may significantly deviate from those anticipated at the start of the project and Administering Authorities will be expected to keep employers up to date with any changes during the process.

Deferred Debt Agreement (DDA)

1. **Deferred Debt Agreements** will allow employers to continue to participate in a fund when they no longer have any active members. These arrangements are well established in the private sector for multi-employer schemes. Although some Administering Authorities have interpreted the LGPS regulations as already allowing analogous arrangements the additional regulations provides a clear regulatory framework, clarity and encourages the consistent treatment of employers within and between LGPS Funds, and expects Funds to set out clear reasons for divergence.

2. A table of discretions is included at Schedule B. This shows how each of the discretions under the scheme apply to exiting employers. Employers will need to update their policies once their status changes.

Q11. What is a DDA?

1. Administering Authorities now have the power to allow an employer to defer the exit payment where they no longer have any active members, in return for an on-going commitment to meet their existing responsibilities as employers in the LGPS. Essentially, this allows the employer to continue to carry the funding risk for their **past service liabilities** and to pay secondary contributions to fund any deficit, calculated on the appropriate basis as set out in the FSS. The employer will continue to be responsible for funding their liabilities for as long as the DDA is in force.

Q12. How is it different to a debt spreading payment?

1. An exit payment is calculated at the date of exit using a basis consistent with the Fund's FSS to assess the cost of funding the employer's past service liabilities. This amount may be spread over an agreed period, but is fixed. Once the spreading arrangement is in place the payments are known and predictable. In this case the employer will be classed as an exiting employer.

2. A DDA is entirely at the discretion of the Administering Authority and as it will require more regular monitoring than a DSA it would remain subject to the ongoing agreement of the Administering Authority. It is anticipated that each DDA would at least be reviewed as part of the triennial Fund valuation process. Therefore, the contributions payable may change at each future valuation and although the DDA will start with a specified period this may require variation over time. In this case the employer will have ongoing responsibilities as a deferred employer in the LGPS.

3. Employers who may be subject to either a DSA or a DDA are encouraged to discuss any potential impact on their accounting treatment with their auditors.

Q13. What needs to be considered?

1. In order for an Administering Authority to agree to set up a DDA, the employer will need to be able to demonstrate that it has sufficient strength of covenant so that the Fund and the other employers are not exposed to undue risk. In particular, the Administering Authority will need to be assured that the covenant is not expected to weaken over time. Therefore, the employer will need to demonstrate their duration of covenant, as they would with any recovery plan, and to engage in future discussions on covenant as part of the triennial Fund valuation. In some cases, the Administering Authority may request additional security and/o r an up-front cash injection in order to be comfortable to set up a DDA. The policy and process by which an employer can request to be considered for a DDA, and the nature of the evidence (including covenant assessment) which the Administering Authority would take into account when determining whether or not to grant a DDA, will be set out in the FSS and Pensions Administration Strategy.

Q14. How will it work once agreed?

1. The arrangement would need to be reviewed regularly as part of the triennial Fund valuation process and referenced in the valuation report. Funds will need to have a process in place for regular engagement and monitoring of the employer's funding level between Fund valuations, monitoring of the employer's covenant. A process will also be required to allow the amendment or termination of the arrangement, triggering an exit valuation, should there be a significant deterioration in covenant or change in funding level. This process may in time be set out in the FSS, or more likely the DDA itself. It is possible that a DDA could lead into a spreading arrangement to allow a managed exit from the Fund should the employer become an exiting employer.

2. An employer could also request that the DDA be terminated, if at a future point the employer wished to entirely exit the scheme. At this point, if there was a past service deficit, the required exit payment would be calculated (and possibly a spreading arrangement considered).

Q15. Will there be costs?

1. As a DDA request would be expected to be driven by an employer, all reasonable costs of the employer and the Fund would be expected to be met by the relevant employer. Where possible, the Administering Authority should outline the potential costs of such an exercise including the process for obtaining necessary actuarial, covenant advisory, legal and other advice, and how payment would be made, before the project is started. Should the actual costs significantly exceed the predicted cost the fund should engage

with the employer to inform them of this, and assess how this will be managed.

Schedule A Glossary of Terms

Actuarial certificates

A statement of the contributions payable by the employer (see also rates and adjustments certificate). The effective date is 12 months after the completion of the valuation.

Actuarial valuation

An investigation by an actuary, appointed by an Administering Authority into the costs of the scheme and the ability of the fund managed by that authority to meet its liabilities. This assesses the funding level and recommended employer contribution rates based on estimating the cost of pensions both in payment and those yet to be paid and comparing this to the value of the assets held in the Fund. Valuations take place every three years (triennial).

Administering Authority

A body with a statutory duty to manage and administer the LGPS and maintain a pension fund (the Fund). Usually, but not restricted to being, a local authority.

Admission agreement

A written agreement which provides for a body to participate in the LGPS as a scheme employer

Assumptions

Forecasts of future experience which impact the costs of the scheme. For example, pay growth, longevity of pensioners, inflation and investment returns

Debt spreading arrangement

The ability to spread an exit payment over a period of time

Deferred debt agreement

An agreement for an employer to continue to participate in the LGPS without any contributing scheme members

Employer covenant

The extent of the employer's legal obligation and financial ability to support its pension scheme now and in the future.

Funding level/position

The funding position is the value of assets compares with the liabilities. It can be expressed as a ratio of the assets and liabilities (known as the funding level) or as the difference between the assets and liabilities (referred to as a surplus or deficit).

Funding strategy statement (FSS)

Published under regulation by each Administering Authority it Sets out, how employers' pension liabilities are to be met going forwards. Benefits payable under the Local Government Pension Scheme (LGPS) are guaranteed by statute and thereby the pension promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

Fund valuation

See actuarial valuation

Fund valuation date

The effective date of the triennial fund valuation.

Non-statutory guidance

Guidance which although it confers no statutory obligation on the parties named, they should nevertheless have regard to its contents

Notifiable events

Events which the employer should make the Administering Authority aware of

Past service liabilities

The cost of pensions already built up or in payment

Pensions Administration Strategy

A statement of the duties and responsibilities of scheme employers and Administering Authorities to ensure the effective management of the scheme

Primary and secondary employer contributions

Primary employer contributions meet the future costs of the scheme and Secondary employer contributions meet the costs already built up (adjusted to reflect the experience of each scheme employer). Contributions will therefore vary across scheme employers within a Fund.

Rates and adjustments certificate

A statement of the contributions payable by each scheme employer (see actuarial certificates)

Statutory guidance

Guidance produced under powers contained in legislation and which must be complied with