

This paper was submitted to the Isle of Wight Pension fund committee on 20 November 2015. Minute number 13(e) refers to the discussion and recommendation.

## PAPER C

Purpose: For Decision



# Committee report

Committee	<b>ISLE OF WIGHT PENSION FUND COMMITTEE</b>
Date	<b>20 NOVEMBER 2015</b>
Title	<b>CESSATION PLANNING – HOUSING GROUPS</b>
Report of	<b>TECHNICAL FINANCE MANAGER</b>

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### EXECUTIVE SUMMARY

1. This report presents the outcomes of discussions between the Isle of Wight Pension Fund (“the fund”) and Spectrum Housing Group (“Spectrum”) and Southern Housing Group (“Southern”) – collectively “the housing groups”, concerning future planning for the retirement of the last active member of each employer, and the treatment of the resulting funding deficit on termination.
2. The committee is asked to approve the proposals that an alternative treatment be applied for the cessation of these employers, and that a funding agreement be finalised with the housing groups to secure both their ongoing financial stability and income to the fund.

### BACKGROUND

3. Spectrum (then Medina Housing Association Limited) entered into an admission agreement on 26 July 1990 on its creation following a transfer of housing stock from Medina Borough Council.
4. Southern (then known as South Wight Housing Association) entered into an admission agreement in 1990 on its creation following a transfer of housing stock from South Wight Borough Council.
5. Spectrum and Southern are both community admission bodies. Admission on this basis was granted given the community of interest that each had with the stock transferring councils, now the Isle of Wight Council.
6. Both admission agreements allowed for membership of the fund for the listed employees who transferred to Spectrum and Southern from the council, and

for other employees subject to approval from the fund. The agreements did not contain specific provision for the termination of the agreement, nor was any guarantee sought from the ceding council. A copy of the Medina Housing Association Limited admission agreement, and the side letter acknowledging the amalgamation with Spectrum Housing Group, is available on request from the Technical Finance Manager. The admission agreement for South Wight Housing Association is assumed to be identical to that for Medina Housing Association Limited.

7. The table below sets out the membership numbers of each employer in the fund at January 2015, and the FRS17 accounting deficit shown in each employer's March 2015 FRS17 report. These figures have been provided to give the Committee some context about the size of the each employer relative the Fund.

	<b>Spectrum</b>	<b>Southern</b>
Active members	52	5
Deferred Pensioners	48	8
Pensioners	42	27
Frozen Refunds	1	0
	<u>143</u>	<u>40</u>
 Average age of actives at March 2015	 <u>50</u>	 <u>55</u>
 Assets at 31 March 2015	 <u>£8,000,000</u>	 <u>£4,935,000</u>
Accounting Liabilities at 31 March 2015	<u>£11,751,000</u>	<u>£7,588,000</u>
Accounting Deficit at 31 March 2015	<u>£3,751,000</u>	<u>£2,653,000</u>

### INITIAL REQUEST

8. Whilst neither employer has immediate plans for redundancies or other staffing reductions which would cause the last active members to leave employment, the housing groups are proactively seeking to clarify what would happen once the last active member does cease employment, and the impact of the funding deficit on termination on their accounts. This request was set out in a letter to the fund from the housing groups dated 19 September 2014.
9. In normal circumstances, on the retirement of the last active member from an employer, the Admission agreement for that employer terminates and a cessation valuation will be carried out by the fund's actuaries using cessation assumptions, which will generate a higher funding deficit than the on-going basis used for formal valuations. This cessation deficit will create a liability in the employer's accounts, which will be payable to the fund either immediately, or in agreed instalments.
10. If this principle were applied for the housing groups, the liability would be treated as a debt in their accounts. The housing groups have indicated that this could have a detrimental impact on the assets and resources they have allocated to the Island.

11. It is worth noting that a cessation deficit could be significantly different to an accounting deficit. Different methodologies may be used to derive the financial and demographic assumptions and hence place a different value on the pension liabilities.
12. What Spectrum and Southern wish to agree with the Fund is a mechanism that means that the liability they have to the Fund continues to be treated and paid as a floating liability rather than a crystallised debt as at the date of termination.
13. The fund's most recent [Funding Strategy Statement](#) ("FSS") (May 2014) specifies the approach that the fund will take on the termination of an employer to the fund, but allows for some flexibility on a case by case basis (section 3.1)
14. Specifically, the FSS states "As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members."
15. The proposals contained in the letter dated September 2014 were discussed with the Managing Director and the fund's actuaries. The Managing Director decided that, in principle, the proposals were acceptable, given that similar exercises have been undertaken nationally by other LGPS funds. Indeed the fund has a similar agreement in place with Isle of Wight Society for the Blind, albeit on a much smaller scale.
16. Subsequently, a letter was received from Devonshires solicitors, acting on behalf of the housing groups, setting out their proposals for agreeing the treatment of each employer in the event of the retirement of the last active member of the scheme.

## PROPOSALS

17. It is proposed that a funding agreement be entered into separately with both Spectrum and Southern which operates whilst their respective Admission Agreements are in place and which will also continue to operate when their individual Admission Agreement terminates.
18. It is proposed that the terms of the agreement include the following provisions:
  - The relevant admitted employer (i.e. Southern or Spectrum as appropriate) will close their Admission Agreement to new members

- Whilst the admitted employer has active members, its liability will continue to be assessed on the on-going funding basis applicable to scheduled employers.
  - On the date that the relevant admitted employer ceases to have active members that the admitted employer will exit the Fund (under Regulation 64 Local Government Pension Scheme Regulations 2013 (“the Regulations”) and that the Admission Agreement ends (in strict legal terms).
  - Instead of the debt crystallising and being paid as at the date of exit Southern and Spectrum would like the Fund to agree that the rates and adjustment certificate will highlight that the liability will be that payable under the terms of the Funding Agreement.
  - The relevant employer (i.e. Southern or Spectrum) will continue to be treated as if they had remained in the Fund, i.e. their liability will remain as a floating liability and they will pay in lump sum employer contributions assessed on an on-going funding basis until such time as the Funding Agreement terminates.
  - Conditions (to be agreed) that the employer must comply with in order to protect the fund, and provisions as to when the agreement can be terminated.
19. Following further discussions with the employers concerned and the Managing Director, it was agreed to progress this further and request a draft funding agreement to be drafted by Devonshires solicitors. This has been received and has been reviewed by the Technical Finance Manager, the Managing Director, the Council’s Lawyer – Contracts and Procurement, and the fund’s actuaries, Hymans Robertson LLP.

## STRATEGIC CONTEXT

20. The primary objective of the fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, in accordance with the Local Government Pension Scheme (LGPS) regulations and statutory provisions. The committee aims to operate the fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing.
21. Planning for the future exit of employers from the fund allows decisions to be made which will support the exiting employers in their financial planning, whilst protecting the fund, and the other employers within the fund (of which the Council is the largest), from the risk of insufficient funding in future.

## CONSULTATION

22. The draft funding agreement has been reviewed by the fund's actuaries, Hymans Robertson LLP. They acknowledged that the fund is looking at the "bigger picture" issues – the wider Island context, the potential impact on the council's overall housing strategy and corporate priorities – and recommended that the fund and the council should consider whether additional conditions should be imposed on the housing groups to ensure additional protection for the fund and the Council.
23. They strongly recommended that the Council approve the funding agreement and get confirmation that the Council is willing to underwrite the risk of the Housing Groups' continued exposure in the Fund (to protect the other employers).
24. Another of their recommendations was that the committee formally approve the approach proposed (hence this report).

## FINANCIAL / BUDGET IMPLICATIONS

25. There are no immediate financial implications in agreeing to an alternative approach to the funding of the termination deficit for the housing groups.

## LEGAL IMPLICATIONS

26. The draft agreement has been sent to the council's internal Lawyer – Contracts and Procurement for comment. One of the recommendations, similar to that of the actuaries, is that this matter should be agreed by the committee. Some additional comments were made, which will be taken into account in the final drafting of the agreement, should the committee approve this recommendation.
27. The fund's Funding Strategy Statement dated May 2014 specifies the approach that the fund will take on the termination of an employer to the fund, but allows for some flexibility on a case by case basis.

## EQUALITY AND DIVERSITY

28. The council has a legal duty under the Equality Act 2010 to seek to eliminate discrimination, victimisation and harassment in relation to age, disability, gender re-assignment, pregnancy and maternity, race, religion, sex, sexual orientation and marriage and civil partnership.
29. Initial screening has indicated that there are no specific equality and diversity issues arising from the content of this report.

## OPTIONS

30. Option 1: to formally agree the approach proposed in respect of the cessation planning for the housing groups, delegate the finalisation of the funding agreement to the Technical Finance Manager and the Managing Director, and

request a formal report to be made to the next committee meeting, prior to the agreement being signed.

31. Option 2: to not agree the approach proposed in respect of the cessation planning for the housing groups.

### RISK MANAGEMENT

32. Agreeing an alternative treatment of the deficit on cessation for the employers may increase the risk to the fund of not recovering the funding due to it, and could impact on the council if the employers do not meet their obligations. However, there is opportunity within any funding agreement to mitigate those risks by imposing more stringent conditions on the employers concerned.
33. Not agreeing an alternative treatment may result in financial difficulty for the housing groups, which could theoretically lead to their failure, and hence to a reduction in the provision of social housing on the Island. This would pose a bigger problem for the council in that it would need to provide alternative housing and other support for those residents impacted, and would fail to meet its corporate priorities.

### RECOMMENDATION

34. That the committee approves option 1: to formally agree the approach proposed in respect of the cessation planning for the housing groups, delegate the finalisation of the funding agreement to the Technical Finance Manager and the Managing Director, and request a formal report to be made to the next committee meeting prior to the agreement being signed.

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