Consultation Response

The Scottish Public Pensions Agency (SPPA) ran a consultation in May 2024 proposing to amend the Scottish LGPS regulations, so that payment of an exit credit when an employer ceases to participate in a fund becomes a discretion of the fund for payments after 29 June 2024. Prior to this consultation, funds had to pay an exit credit if there was a surplus on the cessation basis when an employer exits. Spence & Partners has submitted a response to the consultation, set out below.

SPENCE

Consultation Response

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We are very supportive of the changes made to the regulations in 2018 that require exit credits to be paid to employers if there is a surplus on a cessation basis when they exit from a fund. It addressed the fundamental asymmetric risk position that existed prior to this where employers had to fund deficits, but could not access a surplus.

This change has made LGPS participation attractive for employers, and should help the LGPS thrive. It means employers can be more relaxed about ongoing contribution levels if they have the comfort that in the event they over-paid, they can re-coup that over-payment on eventual exit. This helps ensure ongoing valuations and contributions are not challenged by employers, keeping down LGPS running costs.

Removing this certain ability to access a surplus on exit would be damaging for the LGPS. Employers would no longer have the confidence that they will access over-payments on exit, meaning they will likely challenge ongoing contribution levels far more, particularly if they consider the required contributions to be too high.

Whilst a repayment would still be possible, it would be at the Fund's discretion. As worded, the Fund appears to be able to take almost anything it wants into account when deciding to exercise the discretion, e.g. clause (2F)(d)'s reference to "any other relevant factors." This gives no confidence to employers that this discretion will be exercised. Instead, it gives the impression that the Fund could very easily decide not to exercise the discretion.

The policy implication here of making it harder to access LGPS surpluses seems inconsistent with the recent DWP consultation seeking to make it easier for employers to access DB surpluses in occupational DB schemes. The DWP consultation aims to encourage schemes to run-on and invest in productive finance, and recognises that the existing asymmetric risk position in occupational DB schemes has led to the closure of many of these schemes and employers seeking to get them off balance sheet. This SPPA consultation seems to risk introducing exactly the same position in LGPS that led employers to close down and seek to exit occupational DB schemes.

There are circumstances where it seems inappropriate for funds to have to pay an exit credit. For example, if an employer has a pass-through arrangement or guarantee or subsumption agreement with the Council, which means it is not exposed to downside funding risk whilst participating in the fund, then it seems inconsistent that it should receive an exit credit on cessation that emerges because of upside experience.

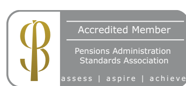
Funds do already have other levers at their disposal for reducing the size of exit credits, which some funds are already deploying. For example, the cessation valuation basis can be made more prudent, which then reduces the size of the exit credit. Arguably this means funds already have the ability to reduce or remove exit credits without the change proposed in this consultation.

If a discretion is to be introduced, our view is that there needs to be more prescription on what funds need to take into account when exercising (or not exercising) the discretion. For example, the regulations could specify that exit credits will be paid for employers that were fully on-risk whilst participating, and that the discretion only applies to employers that were not fully on-risk.

The transitional protection as worded applies to payments made before 29 June 2024. It would seem more appropriate for it to apply to exits before 29 June 2024, rather than payments, otherwise funds could make exits fall into the scope of the new regulations by simply stalling on paying the exit credit. More broadly, the 29 June 2024 is a very short timeframe for introducing the new regulations. We struggle to see how a meaningful consultation can take place in a three week consultation period, with an implementation date of only one month after this. Furthermore, many funds have only just revisited Funding Strategy Statements off the back of the 31 March 2023 valuations, and may want more time before needing to revisit them again for these new regulations.

We do not understand the explanatory note at the end of the draft regulations, which states that no impact on the private or voluntary sectors is foreseen, and therefore no impact assessment has been carried out. If funds chose to apply the discretion and not pay exit credits, then this has a very significant impact on the finances of employers participating in the funds. In our view an impact assessment should be carried out to address this.

on behalf of Spence & Partners, May 2024.



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