# Falkirk Council Pension Fund

# Policy on cessations

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1. Introduction

The purpose of this policy is to set out the administering authority’s approach to dealing with circumstances where a scheme employer leaves the fund and becomes an exiting employer (a cessation event).

It should be noted that this policy is not exhaustive. Each cessation will be treated on a case-by-case basis, however certain principles will apply as governed by the regulatory framework and the fund’s discretionary policies (see below).

* 1. Aims and Objectives

The administering authority’s aims and objectives related to this policy are as follows:

* To confirm the approach for the treatment and valuation of liabilities under Regulation 61 (2) for employers leaving the fund.
* To confirm the approach for the treatment and valuation of liabilities for employers who have requested an indicative valuation under Regulation 61 (2A).
* To provide information about how the fund may apply its discretionary powers when managing employer cessations.
* To outline the responsibilities of (and flexibilities for) exiting employers, the administering authority, the actuary and, where relevant, the original ceding scheme employer (usually a letting authority).
  1. Background

As described in the Funding Strategy Statement (FSS), a scheme employer may become an exiting employer when a cessation event is triggered e.g. when the last active member stops participating in the fund. On cessation from the fund, the administering authority will instruct the fund actuary to carry out a valuation of assets and liabilities for the exiting employer to determine whether a deficit or surplus exists under Regulation 61 (2). The fund has full discretion over the repayment terms of any deficit, and the extent to which any surplus results in the payment of an exit credit.

A scheme employer may also propose to become an exiting employer at a future date and request an indicative valuation at a specific date under Regulation 61 (2A). If the employer ceases participation in the Fund within a 90-day period of the indicative cessation date, the results of the indicative cessation valuation must be used to determine whether a deficit or surplus exists. As in the case of a cessation valuation under Regulation 61 (2) the fund has full discretion over the repayment terms of any deficit, however is liable for any surplus through the payment of an exit credit.

* 1. Guidance and regulatory framework

The Local Government Pension Scheme (Scotland) Regulations 2018 contain relevant provisions regarding employers leaving the fund ([Regulation 61](https://scotlgpsregs.org/schemeregs/lgpsregs2018/timeline.php#r61)) and include the following:

* Regulation 61 (2) – this regulation states that, where an employing authority ceases to be a scheme employer, the administering authority is required to obtain an actuarial valuation of the liabilities of current and former employees as at the termination date. Further, it requires the Rates & Adjustments Certificate to be amended to show the revised contributions due from the employer, or the excess of assets in the fund over the liabilities in respect of that employer.
* Regulation 61 (2A) – this regulation states that a person proposing to become an exiting employer may request the appropriate administering authority to obtain:
  + - * 1. An indicative actuarial valuation at a specific date of the liabilities of the fund in respect of benefits in respect of that person’s current and former employees, and
        2. A revised rates and adjustments certificate showing the exit payment that would be due from such an employer, or the excess of assets in the fund relating to that employer over the liabilities specified in paragraph (2A)(a).

and the indicative actuarial valuation must for a period of up to 90 days from the specific date be used in substitution for any valuation at the employer’s exit date carried out under paragraph (2).

* Regulation 61 (2C) states that the administering authority must provide an indicative valuation unless a request has been made within the previous 12 months.
* Under Regulation 61 (2D) an administering authority must determine the amount of an exit credit, which may be zero, and make the payment within six months. The administering authority must notify its intention to make a determination to:
  1. The exiting employer
  2. Any other body that has provided a guarantee to the exiting employer; and
  3. The awarding authority in the event that the exiting employer is an admission body providing a service
* On payment of an exit credit to an exiting employer, no further payments are due from the administering authority (Regulation 61 (2E))
* Regulation 61 (2F) sets out the factors that the administering authority must have regard to when determining the amount of any exit credit which include
  1. The extent to which there is an excess of assets in the fund over liabilities
  2. The proportion of this excess of assets which has arisen because of the value of the employer’s contributions
  3. Any representations to the administering authority made by the exiting employer
  4. Any guidance or statement under Regulation 56 (4) or any other guidance relating to the preparation of a funding strategy statement issued or endorsed by the Scottish Ministers
  5. Any other relevant factors
* Regulation 61 (3) – the administering authority, at its discretion, may issue a suspension notice to suspend payment of an exit amount for up to three years, where it reasonably believes the exiting employer is to have one or more active members contributing to the fund within the period specified in the suspension notice.
* Regulation 61 (4B-4G) – the administering authority may enter into a written deferred debt agreement, allowing the employer to have deferred employer status and to delay crystallisation of debt despite having no active members.
* Regulation 61 (5) – in instances where it is not possible to obtain additional contributions from the employer leaving the fund or from the bond/indemnity or guarantor, the contribution rate(s) for the appropriate scheme employer or remaining fund employers may be amended.
* Regulation 61 (6) – where it is believed a scheme employer may cease at some point in the future, the administering authority may obtain a certificate from the fund actuary revising the contributions for that employer, with a view to ensuring that the assets are expected to be broadly equivalent to the exit payment that will be due.
* Regulation 61 (7) – following the payment of an exit payment to/from the fund, no further payments are due to the fund from the exiting employer.
* Regulation 61B (1) – the administering authority may set out a policy on spreading exit payments.

In addition to the 2018 Regulations summarised above, [Regulation 25A](https://scotlgpsregs.org/schemeregs/tpregs2014/timeline.php#r25A) of the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 (“the Transitional Regulations”) give the fund the ability to levy a cessation debt on employers who have ceased participation in the fund (under the previous regulations) but for whom a cessation valuation was not carried out at the time. This policy document describes how the fund expects to deal with any such cases.

These regulations relate to all employers in the fund.

1. Statement of Principles

This Statement of Principles covers the fund’s approach to exiting employers. Each case will be treated on its own merits but in general:

* it is the fund’s policy that the determination of any surplus or deficit on exit should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the fund have to make contributions in future towards meeting the past service liabilities of current and former employees of employers leaving the fund.
* the fund’s preferred approach is to request the full payment of any exit debt (an exit payment), which is calculated by the actuary on the appropriate basis (as per the FSS and Section 3.1 below). This would extinguish any liability to the fund by the exiting employer.
* the fund’s key objective is to protect the interests of the fund, which is aligned to protecting the interests of the remaining employers who are ultimately responsible for meeting any additional costs arising in respect of the pension obligations of ceased employers. A secondary objective is to consider the circumstances of the exiting employer in determining arrangements for the recovery of any cessation debt.

1. Policies

On considering an exit from the fund, an employer may request the fund to instruct the actuary to carry out an indicative valuation to determine whether there is a surplus or deficit at the proposed date of exit. A period of at least 12 months must have elapsed since any such previous request from the employer.

On exit from the fund and in the event where an indicative valuation has not been carried out, the administering authority will instruct the fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus as defined in the FSS.

Where there is a deficit following a cessation or indicative valuation, payment of this amount in full would normally be sought from the exiting employer. The fund’s normal policy is that this deficit, known as the cessation debt, is paid in full in a single lump sum within 28 days of the employer being notified or within 28 days of exit from the fund in the event that an indicative valuation has been carried out.

However, the fund will consider written requests from employers to spread the payment over an agreed period, in the exceptional circumstance where payment of the debt in a single immediate lump sum could be shown by the employer to be materially detrimental to the employer’s financial situation (see [3.3 Repayment flexibility on exit payments](#_Deferred_spreading_arrangement) below).

In circumstances where there is a surplus, the administering authority will determine, at its sole discretion, the amount of exit credit (if any) to be paid to the exiting employer (see 3.3 [Exit credits](#_Exit_credits) below).

* 1. Approach to cessation valuations

Cessation valuations are carried out on a case-by-case basis at the sole discretion of the fund depending on the exiting employer’s circumstances. However, in general the following broad principles and assumptions may apply, as summarised below:

| **Type of employer** | **Cessation exit basis** | **Responsible parties for unpaid or future deficit emerging** |
| --- | --- | --- |
| Scheduled Bodies | Low risk basis1 | Shared between other fund employers |
| Admission bodies (“TABs” – typically contractors) | Ongoing basis2 | Letting authority (where applicable), otherwise shared between other fund employers |
| Admission bodies (“CABs” – typically any ABs other than contractors) | Low risk basis | Shared between other fund employers (if no guarantor exists) |

1Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (e.g. machinery of Government changes), these cessation principles would apply.

2Where a TAB has taken, in the view of the administering authority, action that has been deliberately designed to bring about a cessation event (e.g. stopping future accrual of LGPS benefits), then the cessation valuation will be carried out on a low-risk basis.

**Risk-based cessation approach**

The fund uses a risk-based approach to set employer funding strategies, including within cessation calculations. In particular, the likelihood of the fund’s assets achieving particular future investment returns is analysed.

Where appropriate, the fund will use this approach to set an upper and lower amount (or “corridor”) in order to consider the amount of assets a ceasing employer must leave behind to pay for its members’ benefits.

Under this approach, an employer is deemed to have a deficit if its assets are below the lower amount and a surplus if its assets are above the higher amount (ie there will be no deficit or surplus if a ceasing employer’s assets fall within the “corridor”).

The upper bound of the corridor is defined as the assets required to meet liabilities, where the liabilities have been calculated using an investment return assumption that is expected to be achieved in 95% of outcomes over the next 20 years (based on the Fund’s investment strategy at the calculation date).

The lower bound of the corridor is defined as the assets required to meet liabilities, where the liabilities have been calculated using an investment return assumption that is expected to be achieved in 85% of outcomes over the next 20 years (based on the Fund’s investment strategy at the calculation date).

The Fund reserves the right to review the definition of the corridor as part of any review of this policy.

* 1. Approach for indicative valuations

If an employer requests an indicative valuation under Regulation 61 (2A) the following principles will apply:

* The fund will adopt a future investment return assumption that has been calculated based on a 95% likelihood of success of being generated by the Fund’s current investment strategy
* An estimate of any additional liability that will be earned by current employees of the employer over 90 days will be included within the calculations, by comparing the cost of accrual against the expected contributions payable.
* Any increases in liability that occur following the indicative valuation that arise in respect of early retirements including redundancy and efficiency, benefit augmentations, ill-health early retirements or salary increases in excess of those assumed within the indicative valuation will be charged to the employer in addition to any cessation debt (or deducted from any cessation surplus)
* The specific date of the indicative valuation must be no earlier, and within 1 month of, the date of the employer’s request.
* The calculation of the liability will make allowance for the next known pension increase order and annual revaluation of CARE benefits.

The risk-based corridor approach does not apply for indicative valuations.

* 1. Repayment flexibility on exit payments

Flexibility on repayment of exit payments will only be considered in the case where a cessation valuation calculation has been carried out following exit from the Fund. Where an indicative valuation has been carried out to determine the exiting surplus or deficit, flexibility offered on repayment of a deficit is at the discretion of the Fund.

All costs of any flexible arrangements (deferred spreading or deferred debt agreements) are met by the employer, such as the cost of advice to the fund, or in the case of a deferred debt arrangement, any ongoing monitoring of the arrangement and correspondence on any ongoing contribution and security requirements.

### Deferred spreading arrangement (DSA)

The fund will consider written requests from exiting employers to spread an exit payment over an agreed period, in the exceptional circumstance where payment of the debt in a single immediate lump sum could be shown by the employer to be materially detrimental to the employer’s financial situation.

In this exceptional case, the fund’s policy is:

* The agreed spread period is no more than three years, but the fund could use its discretion to extend this period in extreme circumstances.
* The fund may consider factors such as the size of the exit payment and the financial covenant of the exiting employer in determining an appropriate spreading period.
* The exiting employer may be asked to provide the administering authority with relevant financial information such as a copy of its latest accounts, sources of funding, budget forecasts, credit rating (if any) etc. to help in this determination.
* Payments due under the DSA may be subject to an interest charge.
* The fund will only consider written requests within three months of the employer exiting the fund. The exiting employer would be required to provide the fund with detailed financial information to support its request.
* The fund would take into account the amount of any security offered and seek actuarial, covenant and legal advice in all cases.
* The fund proposes a legal document, setting out the terms of the exit payment agreement, to be prepared by the fund and signed by all relevant parties prior to the payment agreement commencing.
* The terms of the legal document should include reference to the spreading period, the annual payments due, interest rates applicable, other costs payable and the responsibilities of the exiting employer during the exit spreading period.
* Any breach of the agreed payment plan would require payment of the outstanding cessation amount immediately.
* Where appropriate, cases may be referred to the Pensions Committee for consideration and considered on its individual merit. Decisions may be made by the Chair in consultation with officers if an urgent decision is required between Committee meetings.

### Deferred debt agreement (DDA)

The fund’s preferred policy is for the spreading of payments, as detailed above, to be followed in the exceptional circumstances where an exiting employer is unable to pay the required cessation payment as a lump sum in full. However, in the event that spreading of payments will create a high risk of bankruptcy for the exiting employer, the fund may exercise its discretion to set up a deferred debt agreement as described in [Regulation 61 (4B)](https://scotlgpsregs.org/schemeregs/lgpsregs2018/timeline.php#r61)).

The employer must meet all requirements on Scheme employers and pay the secondary rate of contributions as determined by the fund actuary until the termination of the DDA.

The administering authority may consider a DDA in the following circumstances:

* The employer requests the fund consider a DDA.
* The employer is expected to have a deficit if a cessation valuation was carried out.
* The employer is expected to be a going concern.
* The covenant of the employer is considered sufficient by the administering authority.

The administering authority will normally require:

* A legal document to be prepared, setting out the terms of the DDA and signed by all relevant parties prior to the arrangement commencing.(including details of the time period of the DDA, the annual payments due, the frequency of review and the responsibilities of the employer during the period).
* Relevant financial information for the employer such as a copy of its latest accounts, sources of funding, budget forecasts, credit rating (if any) to support its covenant assessment.
* Security be put in place covering the employer’s deficit on their cessation basis and the fund will seek actuarial, covenant and legal advice in all cases.
* Regular monitoring of the contribution requirements and security requirements

A DDA will normally terminate on the first date on which one of the following events occurs:

* The employer enrols new active fund members.
* The period specified, or as varied, under the DDA elapses.
* The take-over, amalgamation, insolvency, winding up or liquidation of the employer.
* The administering authority serves a notice on the employer that the administering authority is reasonably satisfied that the employer’s ability to meet the contributions payable under the DDA has weakened materially or is likely to weaken materially in the next 12 months.
* The fund actuary assesses that the employer has paid sufficient secondary contributions to cover all (or almost all) of the exit payment due if the employer becomes an exiting employer on the calculation date (i.e. employer is now largely fully funded on their low risk basis).
* The fund actuary assesses that the employer’s value of liabilities has fallen below an agreed *de minimis* level and the employer becomes an exiting employer on the calculation date.
* The employer requests early termination of the agreement and settles the exit payment in full as calculated by the fund actuary on the calculation date (i.e. the employer pays their outstanding cessation debt on their cessation basis).

On the termination of a DDA, the employer will become an exiting employer and a cessation valuation will be completed in line with this policy.

* 1. Exit credits

The administering authority’s entitlement to determine whether exit credits are payable in accordance with these provisions shall apply to all employers ceasing their participation in the Fund after 1 June 2018. .

The results of an indicative valuation carried out under Regulation 61 (2A) will not be used for the purposes of determining an exit credit. The surplus of assets in excess of liabilities will be assessed via a cessation valuation carried out under Regulation 61 (2).

The administering authority may determine the amount of exit credit payable to be zero, however, in making a determination, the Administering Authority will take into account the following factors;

1. the extent to which there is an excess of assets in the fund relating to that employer over the liabilities,
2. the proportion of this excess of assets which has arisen because of the value of the employer’s contributions,
3. any representations to the administering authority made by the exiting employer and, where that employer participated in the scheme by virtue of an admission agreement, any body listed in paragraphs 8(a) to (d)(ii) of Part 2 of schedule 2 of these Regulations,
4. Any guidance or statement specified under Regulation 56(4) or any other guidance relating to the preparation of a funding strategy statement issued or endorsed by the Scottish Ministers,
5. Any other relevant factors

#### Admitted bodies

1. No exit credit will be payable in respect of admission bodies who are contractors (previously referred to as “transferee admission bodies” as per Table 3.1) who joined the fund before 1 June 2018 unless it is subject to a risk sharing arrangement as per paragraph c) below. Prior to this date, the payment of an exit credit was not permitted under the Regulations and this will have been reflected in the commercial terms agreed between the admission body and the letting authority/awarding authority/ceding employer. This will also apply to any 1 June 2018 admission which has been extended or ‘rolled over’ beyond the initial expiry date and on the same terms that applied on joining the fund.
2. No exit credit will be payable to any admission body who participates in the fund via a pass through arrangement.
3. The fund will make an exit credit payment in line with any contractual or risk sharing agreements which specifically covers the ownership of exit credits/cessation surpluses or if the admission body and letting authority have agreed any alternative approach (which is consistent with the Regulations and any other legal obligations). This information, which will include which party is responsible for which funding risk, must be presented to the Fund in a clear and unambiguous document with the agreement of both the admission body and the letting authority/awarding authority/ceding employer and within one month (or such longer time as may be agreed with the administering authority) of the admission body ceasing participation in the Fund.
4. In the absence of this information or if there is any dispute from either party with regards interpretation of contractual or risk sharing agreements as outlined in c), the Fund will withhold payment of the exit credit until such disputes are resolved and the information is provided to the administering authority.
5. Where a guarantor arrangement is in place, but no formal risk-sharing arrangement exists, the Fund will consider how the approach to setting contribution rates payable by the admission body during its participation in the Fund reflects which party is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
6. If the admission agreement ends early, the fund will consider the reason for the early termination, and whether that should have any relevance on the fund’s determination of the value of any exit credit payment. In these cases, the Fund will consider the differential between employers’ contributions paid (including investment returns earned on these monies) and the size of any cessation surplus.
7. If an admitted body leaves on a low-risk cessation basis (because no guarantor is in place, typically previously referred to as “CABs” as per Table 3.1), then any exit credit will normally be paid in full to the employer (including those who joined prior to 1 June 2018).
8. The decision of the Fund is final in interpreting how any arrangement described under c), e), f) and g) applies to the value of an exit credit payment.

#### Scheduled bodies

1. Where a guarantor arrangement is in place, but no formal risk-sharing arrangement exists, the fund will consider how the approach to setting contribution rates payable by the employer during its participation in the fund reflects which party is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
2. Where no formal guarantor or risk-sharing arrangement exists, the fund will consider how the approach to setting contribution rates payable by the employer during its participation in the fund reflects the extent to which it is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
3. The decision of the fund is final in interpreting how any arrangement described under a) and b) applies to the value of an exit credit payment.
4. If a scheduled body becomes an exiting employer due to a reorganisation, merger or take-over, then no exit credit will be paid.
5. If a scheduled body leaves on a low-risk cessation basis (because no guarantor is in place), then any exit credit will normally be paid in full to the employer.

#### General

1. The Fund will advise the exiting employer as well as the letting authority and/or other relevant scheme employers of its decision to make an exit credit determination under Regulation 61 (2D).
2. Subject to any risk sharing or other arrangements and factors discussed above, when determining the cessation funding position the Fund will generally make an assessment based on the value of contributions paid by the employer during their participation, the assets allocated when they joined the Fund and the respective investment returns earned on both.
3. The fund will also factor in if any contributions due or monies owed to the Fund remain unpaid by the employer at the cessation date. If this is the case, the Fund’s default position will be to deduct these from any exit credit payment.
4. The final decision will be made by the Chief Finance Officer of the Administering Authority, in conjunction with advice from the fund’s actuary and/or legal advisors where necessary, in consideration of the points held within this policy.
5. The fund accepts that there may be some situations that are bespoke in nature and do not fall into any of the categories above. In these situations the Fund will discuss its approach to determining an exit credit with all affected parties. The decision of the Fund in these instances is final.
6. Where there is an exit credit payable, the Fund will advise the exiting employer of the amount due to be repaid and seek to make the payment within six months of the exit date or such longer time as the administering authority and the exiting employer may agree. In order to meet the six-month timeframe, the Fund requires prompt notification of an employer’s exit and all data and relevant information as requested. The Fund is unable to make any exit credit payment until it has received all data and information requested.
7. The guidelines above at point e) in the ‘Admitted Bodies’ section, and at points a) and b) in the ‘Scheduled bodies’ section, make reference to the fund ‘considering the approach to setting contribution rates during the employer’s participation’. The different funding approaches, including the parameters used and how these can vary based on employer type, are covered in detail in Table 1 (section 2.1) in the FSS. Considering the approach taken when setting contribution rates of the exiting employer may help the Fund to understand the extent to which the employer is responsible for funding the underlying liabilities on exit. For example, if contribution rates have always been based on ongoing assumptions then this may suggest that these are also appropriate assumptions for exit credit purposes (subject to the other considerations outlined within this policy). Equally, a shorter than usual funding time horizon or lower than usual probability of success parameter may reflect underlying commercial terms about how responsibility for pension risks is split between the employer and its guarantor. For the avoidance of doubt, each exiting employer will be considered in the round alongside the other factors mentioned above.

**Disputes**

In the event of any dispute or disagreement on the amount of any exit credit paid and the process by which that has been considered, the appeals and adjudication provisions contained in Regulations 69-73 of the LGPS (Scot) Regulations 2018 would apply.

1. Practicalities and process
   1. Responsibilities of ceasing employers

An employer which is aware that its participation in the fund is likely to come to an end must:

* advise the fund, in writing, of the likely ending of its participation (either within the terms of the admission agreement in respect of an admission body (typically a 3 month notice period is required) or otherwise as required by the Regulations for all other scheme employers). It should be noted that this includes closed employers where the last employee member is leaving (whether due to retirement, death or otherwise leaving employment).
* provide any relevant information on the reason for leaving the fund and, where appropriate, contact information in the case of a take-over, merger or insolvency.
* provide all other information and data requirements as requested by the administering authority which are relevant, including in particular any changes to the membership which could affect the liabilities (e.g. salary increases and early retirements) and an indication of what will happen to current employee members on cessation (e.g. will they transfer to another fund employer, will they cease to accrue benefits within the fund, etc.).
* meet the cost of all fees and charges incurred by the Fund in the course of cessation including, but not limited to, the cost to obtain the cessation valuation report from the Fund Actuary and the cost of implementing a flexible repayment option (as set out in section 3.3).
  1. Responsibilities of administering authority

The administering authority will:

* gather information as required, including, but not limited to, the following:
  + details of the cessation - the reason the employer is leaving the fund (i.e. end of contract, insolvency, merger, machinery of government changes, etc.) and any supporting documentation that may have an effect on the cessation.
  + complete membership data for the outgoing employer and identify changes since the previous formal valuation.
  + the likely outcome for any remaining employee members (e.g. will they be transferred to a new employer, or will they cease to accrue liabilities in the fund).
* identify the party that will be responsible for the employer’s deficit on cessation (i.e. the employer itself, an insurance company, a receiver, another fund employer, guarantor, etc.).
* commission the fund actuary to carry out a cessation valuation under the appropriate regulation.
* where applicable, discuss with the employer the possibility of paying adjusted contribution rates that target a 100% funding level by the date of cessation through increased contributions in the case of a deficit on the cessation basis or reduced contributions in respect of a surplus.
* where applicable, liaise with the original ceding employer or guarantor and ensure it is aware of its responsibilities, in particular for any residual liabilities or risk associated with the outgoing employer’s membership.
* having taken actuarial advice, notify the employer and other relevant parties in writing of the payment required in respect of any deficit on cessation and pursue payment.
  1. Responsibilities of the actuary

Following commission of a cessation valuation by the administering authority, the fund actuary will:

* calculate the surplus or deficit attributable to the outgoing employer on an appropriate basis, taking into account the principles set out in this policy, including (where appropriate) the corridor amounts.
* provide actuarial advice to the administering authority on how any cessation deficit should be recovered, giving consideration to the circumstances of the employer and any information collected to date in respect to the cessation.
* where appropriate, advise on the implications of the employer leaving on the remaining fund employers, including any residual effects to be considered as part of triennial valuations.