Consultation responses

Pensions Administration Strategy

“The suggestion of bringing in penalties for late or incorrect submission of i-Connect data is unreasonable given that the i-Connect system increases the burden of work on the employer and soes not negate the completion of an LGPS form – It would seem reasonable that if this policy were introduced that the employer could expect penalties paid to them where the fund has failed to update information previously supplied to them.”

Funding Strategy Statement - Change to cessation methodology

Employer 1

“Please could you provide some more information on 4 (the cessation methodology), as the proposed changes do not really make sense. Although I understand the current wording (and how the basis of any cessation credit/debit without a guarantor will be calculated on a minimum risk basis - i..e using gilt yields at time of cessation), the proposed wording is not clear to me what will happen. Although I agree with the principle of trying to make the cessation valuation more stable, it is not clear to me what the "prudence level" is. Although the wording says that it is currently "3.1%", it does not say what this is applied to (e.g. is this some discount rate adjustment, a liability adjustment, a success probability adjustment for the stochastic model etc).”

I think my only initial comment is that although I understand the intention of the prudence level it seems inappropriate that it is only reviewed every three years, as markets move materially in those periods and if my understanding is correct, the fact that now on cessation you would use a discount rate significantly different to the current one obtainable in the market seems unfair. I am sure if interest rates were to drop suddenly suggesting your discount rate was too high, you would (quite rightly) revise the prudence level.”

Follow up comments following information provision

“Thank you for the reply and the report. I have now read this and as I said before, although I agree with the aspiration to reduce the volatility of exit deficits/surpluses, I do not feel it works particularly well and the scheme unsurprisingly continues to disproportionately favour the large employers over the small.

As a comment on the report, on page 4 in the second paragraph it says that the effective annual return of 2.8% was required for 90% certainty, although in the subsequent table the prudence rate is based upon a discount rate of 2.6% (why the difference - are the actuaries adding another 0.2% buffer into the Scheme calculation - or just poor proof reading?).

Fundamentally the issue for small participants within the Scheme, is that we are not able to reduce our asset/liability mismatch in any way. As the Trustees of the ESPS (quite rightly) focus on the viability of the total scheme, all their decisions are naturally biased towards immunising the larger members over the smaller ones. This inequity could easily be solved by offering members some pooled investment options with different levels of risk. This was the large employers could continue to get their required growth asset allocation although would allow the smaller "atypical" members to reduce their investment mismatch (although that does not appear to be an option).

I think the question the Trustees need to ask themselves, is to consider the hypothetical situation where all members within the scheme were to cease today (with no on-going guarantor). In this scenario, would the Trustees use the proposed method as the discount rate, or would they effectively use market rates to ascertain their liability position (the assets are irrelevant). If they would, that is fine, although I imagine they would use market rates (as their focus would now be immunising any asset/liability mismatch in line with their now, much more predictable liabilities), especially if the market rate was higher than the effective actuarial discount rate. If that is the case, then why are they not using that process when smaller levels of members are leaving, as I do not believe it should really make a difference (bar maybe a small profit margin should be included over market rates for remaining employers to reflect the risk transfer)."

Employer 2

"In response to the consultation I have some comments about the proposed calculation of the liabilities on cessation of an employer, without a guarantor being available to take on the liabilities. My concern always has been the significant mismatch between the investment strategy and the movement in the liabilities (on a cessation basis). I understand that it is not acceptable to operate a separate investment strategy for an individual employer.

Hence I support a proposal that seeks to reduce this mismatch and I agree that the proposal below does reduce the volatility of the liabilities and allocated assets (to a lesser extent), although significant volatility will remain.

I do have views about the actual exit payment calculation

I accept that it is entirely reasonable to expect and aim for the assets attributable to the exiting employer supplemented by the exit payment to be sufficient to meet the liabilities of that employer. It feels that this aim would be best met by reducing the asset/liability mismatch. I do not know whether it is possible to have a separate investment strategy for orphan liabilities. If it is, on an actual or hypothecated basis, it could then be appropriate to apply the stochastic analysis to a more appropriate bond based portfolio, which may lead to a lower of a margin for prudence (taking into account the lower expected return). This could have the dual benefit of reducing the exit payment and the likelihood of remaining employers having to support the orphan liabilities."