Report for: Pensions Committee and Board 19 November 2019

Title: Fund Ill Health Early Retirement Liability Approach

Report authorised by: Jon Warlow, Director of Finance (S151 Officer)

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Ward(s) affected: N/A

Report for Key/ Non Key Decision: Non Key decision

1. Describe the issue under consideration

1.1. The purpose of the paper is to determine the Fund's approach to Ill Health Early Retirements – specifically the way that the often large liabilities arising from these are apportioned to employers who participate in the fund. Currently the fund employs a different approach for Haringey Council and all other employers in the Fund, with the Council taking a self insured approach, and all other employers being covered by an external insurance policy.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. The Committee and Board note the contents of this report, and any other verbal updates provided by officers, the fund actuary and the fund's Independent Advisor in the meeting.

3.2. The Committee and Board agree to adopt a 'self insured' approach to ill health retirement liabilities from 1 April 2020, with a proportion of all employers contributions being pooled to fund ill health early retirement costs when they materialise.

Alternatively

3.3. The Committee and Board agree to continue with the approach of purchasing external ill health liability insurance for all employers other than Haringey Council at an anticipated cost of £1.171m over the three financial years 2020/21 – 2022/23, which will be funded by employer contributions for those employers covered by the insurance.

4. Reason for Decision

4.1. When individuals retire early on ill health grounds, a ‘strain’ becomes payable to the fund, to take account of the fact that a pension is paid before the individual’s normal retirement date, and at the level their pension would have been expected to reach had they continued to work until their normal retirement date. These ‘strain’ costs vary significantly from individual to individual, but often total hundreds of thousands of pounds, and in some cases, exceed one million pounds.

4.2. For small employers with few employees, if such ‘strain’ costs became payable, this could cause these employers to go into administration or liquidation. This unpaid deficit which had materialised through ill health early retirement ‘strain’ would then normally be shared out among all other employers in the fund.

4.3. Before 2016, all employers in the fund bore this risk individually, with early retirement strains being calculated at each valuation, and added to each employers deficit, to be recovered in subsequent years. Some employers had previously complained about this approach and had purchased their own insurance policies to safeguard against this risk. In 2016 the fund agreed to put in place partial ill health liability insurance for all of the employers in the fund, except Haringey Council. Since 1 January 2017 the fund has purchased this insurance. With the 2019 Valuation soon to be finalised, and with new employer contribution rates to become payable for the 3 years from 1 April 2020, it makes sense to now review this policy in line with the timescales of the new valuation.

5. Other options considered

5.1. There are several approaches that the Fund could adopt for dealing with the risks posed by early retirements through ill health:

- The Fund could take no action, and to allow each employer to bear the risks associated with early ill health retirements. This is not recommended due to the risks to individual employers’ solvency previously highlighted.
- The Fund could continue to purchase external insurance.
- Alternatively, the Fund could adopt a pooled risk or self-insurance approach where a proportion of all employers’ contributions are pooled and this pool of contributions is used to fund all ill health retirement strains when they occur.

5.2. Any of the above approaches could be adopted on a whole fund approach, with all employers having the same treatment, on a partial fund approach, where some employers are grouped and receive different treatment, or on an employers choice approach, where employers are allowed to choose their approach.

5.3. Allowing individual employers to choose their own approach would be administratively complex, and could potentially expose other employers in the fund to risk, this is therefore not proposed.

5.4. The fund has currently implemented a partial fund approach where all employers except the Council fund external insurance. The Council is self-insured against ill health early retirement costs.

6. Background information

6.1. Ill health early retirements could be considered to be statistically random in their value and distribution. For a large employer such as Haringey Council, ill health retirements between valuations do not lead to wild fluctuations in employer contributions. However, for smaller employers such as an Academy school or a cleaning or catering provider with few staff members, they are not of sufficient scale to be able to absorb the effects of ill health retirements when they do occur, so if external insurance or a pooled risk approach is not implemented, this can lead to significant increases in contributions, which can be unaffordable for the employers.

6.2. The numbers and values of ill health early retirement strains for the three financial years 2016/17 – 2018/19 are summarised below.

Ill Health Early Retirement Strains	Number	Value	Average Value
Haringey Council – self insured approach	11	£ 2,350,191	£ 213,654
All other Employers – covered by external insurance policy	8	£ 1,105,785	£ 138,223

6.3. The current approach using external insurance costs around £337k per annum, and is charged based on a % of payroll for all the employers covered by the insurance. This is charged to all employers' asset shares except the council, so that only those employers who benefit from the insurance fund the costs of this.

6.4. As a whole, the fund would be able to manage the risks of ill health early retirement costs without the need for involving an external insurer, by pooling all employers and adopting a self insured approach across the whole fund unilaterally. The risk of this approach, as opposed to purchasing external insurance, is that if there were to be a spike in ill health retirements across the fund, this would impact on all employers equally via an increase in employer contributions at the next valuation.

6.5. The Fund has already acknowledged a willingness to bear this risk for larger employers by previously adopting a self insured approach for the Council. This could now be extended to all other employers.

6.6. While purchasing an external insurance policy will likely be more expensive over the longer term for the fund as it allows for the insurer's profit margin, the benefit to this approach is that it allows ill health insurance costs to be planned for more accurately, as a fixed amount is paid each year (subject to annual recalculation of premiums). Purchasing an external insurance policy should allow for less volatility in employer contributions between valuations, however it should be noted that adopting a pooled or self insured approach for the whole fund would not be expected to result in significant changes to employer contribution rates between valuations.

6.7. There are clearly pros and cons of both approaches, however officers are minded to recommend changing the approach to a self-insured approach for all employers uniformly, and cease utilising an external insurance policy.

6.8. An approach must be determined by the Committee and Board in this meeting, as the approach will be detailed in the Fund's Funding Strategy Statement which will be consulted on with employers in December, prior to the valuation being signed off and new employer contribution rates beginning for the three years from 1 April 2020 – 31 March 2023. The estimated costs of ill health liability insurance (including an allowance for inflationary indexation) total £1.171m over these three years (an average of £390k per annum). These costs will be charged to the asset shares of all employers except Haringey Council proportionally. The current provider of the fund's existing insurance policy, Legal and General, is the only provider to offer this specific insurance to LGPS Funds, so there are no alternative providers who can be considered.

7. Contribution to Strategic Outcomes

7.1. Not applicable

8. Statutory Officers comments (Chief Finance Officer (including procurement), Assistant Director of Corporate Governance, Equalities)

<u>Finance and Procurement</u>

8.1. Finance comments are contained throughout the content of this report. In the past, the Fund has taken the approach of allowing employers to pay for the cost of ill health retirement by adjusting employer contribution rates at each triennial valuation. This carries a risk that due to ill health retirement and a subsequent adjustment of contribution rates, smaller employers in the Fund may find the resulting annual monetary contribution prohibitive and therefore unable to carry on as a going concern.

8.2. The continued use of an insurance product that allows the Fund to eradicate this risk for all employers except the Council is an option that merits consideration, however, the alternative approach highlighted, to adopt a self insured approach is potentially advantageous and worthy of serious consideration.

Legal Services Comments

8.3. The Assistant Director of Corporate Governance has been consulted on the content of this report.

8.4. Regulation 35 of the 2013 Regulations provides that if an active member who has qualifying service for a period of two years and whose employment is terminated by a Scheme employer on the grounds of ill-health or infirmity of mind or body before that member reaches normal pension age, is entitled to, and must take, early payment of a retirement pension if that member satisfies certain conditions contained in the regulation.

8.5. The recommendation set out in this report is in effect a review of the funding strategy statement. The Fund must keep the funding strategy statement under review and, after consultation with such persons as it considers appropriate, make such revisions as are appropriate following a material change in its policy set out in the statement, and if revisions are made.

8.6. In reviewing the funding strategy statement the Fund must have regards to the guidance set out in the document published in 2016 by CIPFA, the Chartered Institute of Public Finance and Accountancy and called “CIPFA Pensions Panel Guidance on Preparing and Maintaining a Funding Strategy Statement and the statement of investment principles published by the administering authority under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016).

Equalities

8.7. None applicable.

9. Use of Appendices

None

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.