Report for: Pensions Committee 20th September 2016

Item number: 9

Title: Ill Health Liability Insurance Report

Report authorised by: Tracie Evans, Chief Operating Officer (COO)

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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. This paper provides information on the potential impact of Ill Health Early Retirement (IHER) on Haringey Pension Fund and how this liability could be mitigated by taking out Ill Health Liability Insurance (IHLI).

1.2. The report also considers three possible options to adopt as to the level of ill health insurance that should be adopted by the Fund; Whole Fund, Partial Fund or Employer Choice.

1.3. The paper proposes how the cost of purchasing ill health liability insurance should be funded by considering three approaches: No Allowance; Partial Allowance; or Full Allowance.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. That the Committee note the content (including the appendix) of this report around ill health early retirement (IHER) cost risks and the possibility that some employers could find it difficult to remain a going concern if their employee(s) were forced to take early retirement due to ill health if IHLI is not in place.

3.2. That the Committee agree that the Fund should adopt a whole of fund approach to funding the cost of IHER insurance.

3.3. That the Committee agree that the cost of purchasing IHLI is met by the Fund on a Full Allowance basis.

4. Reason for Decision

4.1. At present the Fund self insures itself against ill-health retirement. When an employee is retired on grounds of ill-health, the strain to the Fund will be apportioned to the relevant employer. At the next triennial valuation, the strain cost arising from early retirements will be calculated and added to relevant employer's future contribution rates.

4.2. For the larger employers, like the Council, this is not necessarily a significant risk. However, for smaller employers in the Fund, such as academies and contractors providing lunches in schools, it could be the difference between going out of business and remaining a going concern.

4.3. While there has not been a case of an employer in the Fund going out of business due to inability to mitigate the cost of ill health retirement, an employer has complained about the potential cost of having to do so. Furthermore, Age UK recently went into liquidation as a result of its inability to fulfil its financial responsibility to the Fund in respect of payments relating to outstanding liability/deficit. Although, it is possible that some of the cost may have been accrued through ill health retirement of staff in the past.

4.4. Taking out IHER insurance would mitigate the risk of potential financial difficulties that may arise from an employer having to meet the cost of one or more of its employees having to retire due to ill health.

5. Other options considered

5.1. The Fund could continue as it currently does where it charges any strain costs arising from ill-health retirement to the relevant employer and increase the employers' contribution at the next valuation to recover the cost of the ill-health retirement to the Fund.

6. Background information

6.1. When a member of the pension scheme is retired on grounds of ill-health, the Fund incurs additional costs and the liability for this cost is added to the relevant employers' deficit/liability to the Fund.

6.2. At present the Fund's approach is that employers effectively self-insure against ill health early retirement (IHER) costs via an element of their contribution rate. For example, in the London Borough of Haringey

Council Pool, employers pay around 3.0% of pensionable payroll per annum towards IHERs but this amount varies from employer to employer depending on membership profile.

6.3. When a member of an employer retires due to ill health the strain cost is added to the employer's deficit at the next valuation and subsequently recovered via increased contributions.

6.4. This arrangement works for larger employers (e.g. the Council) but not for smaller employers (e.g. Academies, school lunch providers/ cleaners). There is a risk that some employers in the Fund may be unable to meet the strain cost arising from an ill-health early retirement. In the worst case the increased deficit and contributions could put an employer out of business.

6.5. There are currently 22 funds that have taken out a form of ill health liability insurance to protect the employers and it is being considered by another 16 funds. This equates to approximately 40% of Funds that are either considering or already have ill health liability insurance in place.

6.6. An illustration of the potential strain cost of an employee, which will result in an immediate increase in the relevant employers' deficit/liability to the Fund, is shown below.

Member Age	Salary	Tier 1 Strain Cost
46	£32,000	£375,000
31	£26,000	£350,000
48	£67,000	£575,000
43	£110,000	£1,600,000

6.7. There had previously not being a tailored product for LGPS that would allow insurance against IHER risk. However, Legal and General are now able to offer ill health liability insurance to LGPS schemes at cost of £0.88p, £0.95p and £1.28p per £100 of payroll for Whole Fund, Partial Fund and Employers choice respectively.

6.8. Using approximate payroll cost of £115m for all employers in the Fund, the total cost to the whole fund of taking out IHLI is estimated at £1.1m. The IHER could be funded using the assumed ill health element of employers' contributions. This currently stands at 3% of payroll (£3.45m), but the actuary has estimated that this could fall to 2% (£2.3m) for the next valuation.

6.9. Employer contribution rates would normally be adjusted up where IHER costs have been incurred between triennial valuations. Otherwise, the ongoing ill health percentage within the overall contribution rate will be maintained.

6.10. The Fund should consider implementation of one of the following approaches:

- **Whole Fund -** This is an approach to managing the ill health risk as part of funding strategy whereby the Administering Authority maintains an ill health liability insurance policy on behalf of all of the employers;

- **Partial Fund** - the Administering Authority maintains an ill health liability insurance policy on behalf of all of the employers except for the Council;

- **Employer's Choice** - Individual employers given the option to take out their own insurance policy with Legal and General. This will result in multiple policies across the Fund.

6.11. In terms of how the insurance premium is funded, the Fund could take the following three approaches:

- **Full Allowance** – Fully allow for the premium in the contribution rate (i.e. the full amount would be deducted from the employers contribution rate);

- **Partial Allowance** – partially allow for the premium in the contribution rate;

- **No Allowance** – premium will be charged on top of the contribution rate, so that no allowance is given for premium to be deducted for contribution rate.

6.12. The attached appendix to this report sets out, in more detail, the insurance options against IHER cost.

7. Contribution to Strategic Outcomes

7.1. None.

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

Finance and Procurement

8.1. 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 availability of an insurance product that allows the Fund to eradicate this risk for all employers is an attractive option that merits serious consideration.

8.3. The report proposes that the Fund purchase ill health liability insurance at whole fund level and that the cost of premiums is funded from contributions/existing fund assets. This option is deemed the best approach to ensure that the risk to the Fund from ill health early retirement is fully mitigated.

Assistant Director of Corporate Governance

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

8.5. In reviewing the funding strategy statement the Fund must have regards to the guidance set out in the document published in March 2004 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 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (members should note that this Regulation is due to be replaced by Regulation 7 in the proposed new Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016)..

Equalities

8.6. There are no equalities issues arising from this report.

9. Use of Appendices

9.1. Appendix 1 – Ill Health Retirement Cost: Risk Mitigation Using Insurance

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.