

Tyne and Wear Pension Fund

Assessment of Employer Risk

Agreed by Pensions Committee on 7 March 2024

Introduction

1. This document sets out the approach to be taken by Tyne and Wear Pension Fund (“the **Fund**”) in respect of the assessment of employer risk at the time of admission and also throughout the time of an employer’s participation in the Fund.
2. This policy should be read in conjunction with the Fund’s information documents, ‘A Guide for Scheme Employers and Prospective Employers’ and ‘Pass-through Admissions - A Guide for Scheme Employers and Prospective Employers’, along with the Fund’s Admission Policy, Funding Strategy Statement and the Policy on Actuarial Fees.
3. The approach to employers exiting the Fund is set out in the Policy on Employers Exiting the Fund contained in Appendix E of the Funding Strategy Statement.
4. At all times, the Fund will act in accordance with the Local Government Pension Scheme Regulations 2013 (“the **Regulations**”). Extracts from the Regulations are appended to this policy; however, it must be noted that the Regulations are amended from time-to-time, and it is an employer’s own responsibility to ensure it is checking the correct legislation.
5. Copies of policies referred to in this document can be found at www.twpf.info or can be requested from the appropriate client relationship manager.

Admission Status

6. The Regulations provide for three main admission routes into the LGPS, specifically:
 - (a) Scheduled Bodies (this includes local authorities, police or fire authorities, universities, colleges, academy trusts);
 - (b) Designation Bodies (such as subsidiaries of certain Scheduled Bodies); and
 - (c) Admission Bodies (this typically tends to be contractors or bodies of a charitable nature).
7. The Fund will assess the risk of each employer individually, but the general approach, depending on the admission status, is set out below.

Scheduled Bodies and Designation Bodies

8. In accordance with the Regulations, Scheduled Bodies and Designation Bodies are automatically admitted to the Scheme. Albeit, Designation Bodies are required to designate those staff with LGPS eligibility who are to become members of the Scheme.
9. The Regulations do not place any legal obligation on a Scheduled Body or Designation Body to provide either bond cover or to secure a guarantee in respect of that employer's participation in the Fund. Notwithstanding this, the Fund undertakes a risk assessment of all employers at the time of admission, irrespective of the nature of the admission, and the Fund may require a bond or a guarantee in respect of any Scheduled Body or Designation Body where the Fund considers this appropriate.
10. The Fund's assessment of risk will link in with the funding strategy taken in respect of employers and further detail on this can be found in the Funding Strategy Statement.

Admission Bodies

11. The Regulations impose a legal requirement on an admission body coming into the Fund to undertake an assessment of risk to the satisfaction of the Fund. This assessment of risk must take account of actuarial advice and assess the level of risk arising on the premature termination of the admission due to the insolvency, winding up or liquidation of the admission body.
12. Where the admission is under paragraph 1(d)(i) of Schedule 2, Part 3, the assessment of risk must also be to the satisfaction of the related Scheme employer (which is typically the letting employer) as the related employer provides the Fund with what is commonly referred to as 'the statutory guarantee' (see below). Where a pass-through arrangement is agreed, the letting employer will provide a guarantee and subsumption commitment. This means that the letting employer will assume responsibility for all of the assets and liabilities of the admission body at the end of the contract, and for the future funding of those assets and liabilities.
13. The assessment of risk referred to above (and in paragraph 6 of Schedule 2, Part 3 of the Regulations) will be based on actuarial advice. Whilst there is no requirement for this advice to be provided by the Fund Actuary, the legal requirement for the assessment to be to the satisfaction of the Fund means it is unlikely that the Fund will accept actuarial assessments from other actuarial service providers.

14. From the date of commencement of an admission body in the Fund, the admission body will be required to arrange appropriate bond cover or a suitable guarantee, or a guarantee and subsumption commitment from the letting employer where a pass-through arrangement is agreed, to protect the Fund and, where appropriate, the related Scheme employer. This will be documented in a legal agreement with the Fund and either the bond provider or the guarantor.
15. In accordance with the Regulations, the Fund's starting expectation is that, where a traditional admission agreement is agreed, the admission body (excluding an admission body under paragraph 1(a) of Schedule 2, Part 3 of the Regulations) will secure bond cover at the minimum level identified in the bond report prepared by the Fund Actuary. For admission bodies where a pass-through agreement is in place, a bond is not normally required unless this is a requirement as set out by the administering authority and letting employer.
16. The bond provider must satisfy the requirements of paragraph 7 of Schedule 2, Part 3 of the Regulations. Specifically, the bond provider must be at least one of:
 - (a) a person who has permission under Part 4 of the Financial Services and Markets Act 2000 to accept deposits or to effect and carry out contracts of general insurance;
 - (b) a firm in an EEA state of the kind mentioned in paragraph (5)(b) and (d) of Schedule 3 to that Act, which has permission under paragraph 15 of that Schedule (as a result of qualifying for authorisation under paragraph 12 of that Schedule) to accept deposits or to effect and carry out contracts of general insurance; or
 - (c) a person who does not require permission under that Act to accept deposits, by way of business, in the United Kingdom.
17. Where bond cover is required, this must be maintained at an appropriate level for the duration of the admission and until such time as all exit liabilities have been fully satisfied.
18. In certain cases, the Fund may agree for an admission body not to secure bond cover. Instead, the admission body will be required to secure a guarantee.
19. The Fund will, as far as possible, require a guarantee instead of bond cover in respect of an admission body under paragraph 1(a) of Schedule 2, Part 3 of the Regulations.
20. In accordance with paragraph 8 of Schedule 2, Part 3 of the Regulations, the guarantor must be one of:
 - (a) a person who funds the admission body in whole or in part;

(b) in the case of an admission body falling within the description in paragraph 1(d) of Schedule 2, Part 3 of the Regulations, the related Scheme employer referred to in that paragraph;

(c) a person who—

(i) owns, or

(ii) controls the exercise of the functions of the admission body, or

(d) the Secretary of State in the case of an admission body—

(i) which is established by or under any enactment, and

(ii) where that enactment enables the Secretary of State to make financial provision for that admission body.

21. The guarantee to be provided must be unrestricted in terms of financial value and must remain in place until such time as all exit liabilities have been met in respect of the admission body. The Fund will provide written notification of release of the guarantee once all exit liabilities have been met.

22. In order to accept a guarantee, the Fund must be satisfied as to the covenant strength of the guarantor.

Statutory Guarantee

23. Where an admission body is admitted to the Fund under paragraph 1(d) of Schedule 2, Part 3 of the Regulations, 'the related employer' is responsible for any unmet liability of the admission body upon termination in accordance with regulation 64(3) of the Regulations.

24. The statutory guarantee is a guarantee of last resort and will only be called upon if the admission body leaving the Fund is unable to meet the exit liability and there is no, or inadequate, bond cover or guarantee from another body.

25. Given the liability imposed on the related employer under regulation 64(3), it is important that the related employer, where appropriate, ensures that the admission body has appropriate bond cover at all times.

26. In admissions where the parties have agreed to a pass-through arrangement, the financial risk (as well as the assets and liabilities) remains with the letting employer.

Assessment of level of Bond Cover

27. In assessing the recommended level of bond cover, the Fund Actuary shall calculate the primary exposure and secondary exposure for which cover is required.

28. Primary exposure is the calculated cost of providing early payment of the accrued pension benefits for all those members of an employer who are aged 55 or over at the date of calculation.
29. Secondary exposure provides for all other areas of potential liability that may arise on the financial failure of an employer. This is typically broken down into the following four areas:
- (a) Existing shortfall / surplus – Where an employer has a funding deficit, an allowance will be made for this. If there is a surplus, then the ‘allowance for adverse experience’ may be reduced by the amount of the surplus;
 - (b) Administration costs – an allowance is made for projected administration costs which may be incurred by the Fund if the employer were to financially default;
 - (c) Contributions due but unpaid – an allowance is made to cover the risk that, at the point of employer failure, there are unpaid contributions owed to the Fund.
 - (d) Allowance for adverse experience – the funding level of an employer can vary significantly due to adverse experience, such as poor investment returns on assets and / or falls in asset values not being matched by falls in liability values. To mitigate this risk, the Fund Actuary will assume that the funding level for an employer could fluctuate 10% from its anticipated level and an allowance is made for this.
30. In most cases, the Fund Actuary will assess the level of bond cover needed by using the ongoing Orphan Body Funding Target. This is irrespective of the funding target which the employer is to participate in the Fund on. The Fund does; however, reserve its right to require the bond assessment to be undertaken on another funding target (including the Low Risk Funding Target) where this is considered appropriate.

Maintaining Bond Cover throughout the admission term and beyond

31. Where bond cover is in place in respect of an employer (irrespective of the admission route), this must be maintained at an appropriate level throughout the admission term and until such time as all exit liabilities have been met in full.
32. Whilst an actuarial assessment is undertaken prior to admission to assess the level of bond cover needed, the level of cover initially assessed is unlikely to remain appropriate for the duration of admission. In fact, the calculated risk exposure can change significantly over relatively short periods. For this reason, the Fund reserves its right to review the financial value of bond cover required. Where appropriate, an employer may be required to increase the level of bond cover. In some cases, the admission agreement may set out requirements for the review of the level of bond cover in place and must be met.

33. For admissions under paragraph 1(d) of Schedule 2, Part 3 of the Regulations, the Fund will consult with the related Scheme employer on the level of bond cover for the admission body. However, the Fund will view it as the responsibility of the related Scheme employer to ensure an appropriate level of bond cover is in place for the admission body throughout the admission term and until such time as all exit liabilities have been met. This is because the bond cover in such admissions is in place to protect the related Scheme employer given the presence of the statutory guarantee in regulation 64(3) of the Regulations (see above).

Exemptions in respect of the level of Bond Cover

34. The assessment of the level of bond cover undertaken by the Fund Actuary makes no allowance or consideration of the financial strength of an employer. Rather, this is expected to be reflected in the cost of the premium the employer is required to pay in obtaining the bond cover.

35. Whilst no allowance is made for the financial strength of an employer in the assessment of bond cover, the Fund does acknowledge that an employer of strong covenant is unlikely to financially default in the short term. Therefore, if an employer can satisfy the Fund of its covenant strength then the Fund may be willing to waive the requirement for bond cover to include an allowance for adverse experience. This exemption is at the sole discretion of the Fund.

36. In respect of the Fund being satisfied of the covenant strength of an employer, this will need to be determined by a covenant assessment undertaken by the specialist team at the Fund's actuarial service provider. It will be necessary for the covenant assessment to be undertaken every 12 months to ensure the covenant strength of the employer remains sufficiently strong. Should the covenant strength of an employer fall below the required level, then eligibility for this exemption shall be lost and the employer will be required to ensure full bond cover at the level assessed by the Fund Actuary.

37. In order for an employer to be eligible for an exemption in respect of the level of bond cover, the employer must be of an 'open' admission status (i.e. future employees will have access to the Fund) and the employer must also be able demonstrate a long term commitment to the Fund.

38. A first application for this exemption from an employer will require the approval of Pensions Committee. Decisions in respect of the continuation of an exemption (i.e. after the initial 12-month period) may be approved by officers.

39. Any employer applying for this exemption will be required to meet all costs incurred during the process, including the fees of the covenant assessment(s) and any other fees incurred by the Fund.

Appendix – extracts of relevant legislation

Schedule 2, Part 3 of the LGPS Regulations 2013

1. The following bodies are admission bodies with whom an administering authority may make an admission agreement-

- (a) a body which provides a public service in the United Kingdom which operates otherwise than for the purposes of gain and has sufficient links with a Scheme employer for the body and the Scheme employer to be regarded as having a community of interest (whether because the operations of the body are dependent on the operations of the Scheme employer or otherwise);
- (b) a body, to the funds of which a Scheme employer contributes;
- (c) a body representative of-
 - (i) any Scheme employers, or
 - (ii) local authorities or officers of local authorities;
- (d) a body that is providing or will provide a service or assets in connection with the exercise of a function of a Scheme employer as a result of-
 - (i) the transfer of the service or assets by means of a contract or other arrangement,
 - (ii) a direction made under section 15 of the Local Government Act 1999 (Secretary of State's powers),
 - (iii) directions made under section 497A of the Education Act 1996;
- (e) a body which provides a public service in the United Kingdom and is approved in writing by the Secretary of State for the purpose of admission to the Scheme.

2. An approval under paragraph 1(e) may be subject to such conditions as the Secretary of State thinks fit and the Secretary of State may withdraw an approval at any time if such conditions are not met.

3. The Scheme employer, if it is not also the administering authority, must be a party to the admission agreement with a body falling within the description in paragraph 1(d).

4. In the case of an admission body falling within the description in paragraph 1(b), where at the date of the admission agreement the contributions paid to the body by one or more Scheme employers equal in total 50% or less of the total amount it receives

from all sources, the Scheme employer paying contributions (or, if more than one pays contributions, all of them) must guarantee the liability of the body to pay all amounts due from it under these Regulations.

5. If the admission body is exercising the functions of the Scheme employer in connection with more than one contract or other arrangement under paragraph 1(d)(i), the administering authority and the admission body shall enter into a separate admission agreement in respect of each contract or arrangement.

6. An admission agreement must require the admission body to carry out, to the satisfaction of the administering authority, and to the satisfaction of the Scheme employer in the case of a body falling within paragraph 1(d)(i), an assessment, taking account of actuarial advice, of the level of risk arising on premature termination of the provision of service or assets by reason of insolvency, winding up, or liquidation of the admission body.

7. Notwithstanding paragraph 6, and subject to paragraph 8, the admission agreement must further provide that where the level of risk identified by the assessment is such as to require it, the admission body shall enter into an indemnity or bond in a form approved by the administering authority with-

- (a) a person who has permission under Part 4 of the Financial Services and Markets Act 2000 to accept deposits or to effect and carry out contracts of general insurance;
- (b) a firm in an EEA state of the kind mentioned in paragraph 5(b) and (d) of Schedule 3 to that Act, which has permission under paragraph 15 of that Schedule (as a result of qualifying for authorisation under paragraph 12 of that Schedule) to accept deposits or to effect and carry out contracts of general insurance; or
- (c) a person who does not require permission under that Act to accept deposits, by way of business, in the United Kingdom.

8. Where, for any reason, it is not desirable for an admission body to enter into an indemnity or bond, the admission agreement must provide that the admission body secures a guarantee in a form satisfactory to the administering authority from-

- (a) a person who funds the admission body in whole or in part;
- (b) in the case of an admission body falling within the description in paragraph 1(d), the Scheme employer referred to in that paragraph;
- (c) a person who-

- (i) owns, or
 - (ii) controls the exercise of the functions of, the admission body; or
- (d) the Secretary of State in the case of an admission body-
- (i) which is established by or under any enactment, and
 - (ii) where that enactment enables the Secretary of State to make financial provision for that admission body, or
 - (iii) which is a provider of probation services under section 3 of the Offender Management Act 2007 (power to make arrangements for the provision of probation services) or a person with whom such a provider has made arrangements under subsection (3)(c) of that section.

9. An admission agreement must include-

- (a) provision for it to terminate if the admission body ceases to be such a body;
- (b) a requirement that the admission body notify the administering authority of any matter which may affect its participation in the Scheme;
- (c) a requirement that the admission body notify the administering authority of any actual or proposed change in its status, including a take-over, reconstruction or amalgamation, insolvency, winding up, receivership or liquidation and a material change to the body's business or constitution;
- (d) a right for the administering authority to terminate the agreement in the event of-
 - (i) the insolvency, winding up or liquidation of the admission body,
 - (ii) a material breach by the admission body of any of its obligations under the admission agreement or these Regulations which has not been remedied within a reasonable time,
 - (iii) a failure by the admission body to pay any sums due to the fund within a reasonable period after receipt of a notice from the administering authority requiring it to do so.

10. An admission agreement must include a requirement that the admission body will not do anything to prejudice the status of the Scheme as a registered scheme.

12. Where an admission body is such a body by virtue of paragraph 1(d), an admission agreement must include-

- (a) a requirement that only employees of the body who are employed in connection with the provision of the service or assets referred to in that sub-paragraph may be members of the Scheme;
- (b) details of the contract, other arrangement or direction by which the body met the requirements of that sub-paragraph;
- (c) a provision whereby the Scheme employer referred to in that sub-paragraph may set off against any payments due to the body, an amount equal to any overdue employer and employee contributions and other payments (including interest) due from the body under these Regulations;
- (d) a provision requiring the admission body to keep under assessment, to the satisfaction of the bodies mentioned in paragraph 6, the level of risk arising as a result of the matters mentioned in that paragraph;
- (e) a provision requiring copies of notifications due to the administering authority under paragraph 9(b) or (c) to be given to the Scheme employer referred to in that subparagraph; and
- (f) a provision requiring the Scheme employer referred to in that sub-paragraph to make a copy of the admission agreement available for public inspection at its offices.

13. Where an admission body of the description in paragraph 1(d) undertakes to meet the requirements of these Regulations, the appropriate administering authority must admit to the Scheme the eligible employees of that body.

14. An admission agreement may take effect on a date before the date on which it is executed.