Guide for Employers - A guide to pension liabilities, pension strain costs and other costs

This guide aims to give answers to the following questions from employers:

1. What are my pension liabilities as an employer in the GMPF?
2. What factors will influence my liabilities?
3. How will we pay for these liabilities?
4. What are strain costs and when will they occur?
5. How can I obtain an estimate of what a strain cost will be?
6. How will I pay for strain costs?
7. What other costs might I incur?

1. What are my pension liabilities as an employer in the GMPF?

Each employer is responsible for the pension costs incurred in relation to its current and former employees. As an employer within the GMPF, you are responsible for funding the pension promises you have given. There may be cases where former employees have transferred their previous pension benefits accrued to their new employer and if this is the case then the new employer will then become responsible for these liabilities.

Your liabilities are the statutory pension benefits that are either being built up by active members, are in relation to deferred members or are in payment for your current and former employees of the Fund.

When an employee joins the LGPS they begin to build up an entitlement to pension benefits. These benefits (liabilities) are funded by the employee (by way of their employee contributions), the employer (by way of their employer contributions) and by any investment returns achieved by the Fund. The employee pays a contribution rate dependant on the level of their pensionable pay, with the employer paying a varying rate dependant on the amount needed to ensure the benefits are funded.

Employers' contributions are covered in Regulation 67 of Part 2 of the LGPS Regulations 2013. In accordance with regulation 62, every three years the Fund's actuary carries out a valuation and sets the employer contribution rates for the next three years. In setting the rates, the actuary must have regard to a Fund's Funding Strategy Statement (FSS). The GMPF's FSS sets out the assumptions and methodologies that have been determined by the Fund's Management Panel after having taken the appropriate advice and carried out the necessary consultation and a copy of this can be found on our website.

2. What factors will influence my liabilities?

It is important to understand what factors can influence your liabilities, in order to allow you to manage some of the issues involved and to help you to mitigate risk where possible.

Some of these factors can be within your control and you will have a direct influence over them. Others cannot generally be directly influenced by an employer but do require an awareness.

Factors within an employers control

- *Salary growth*

As part of the Fund's valuation, the actuary will make an assumption about future salary increases. If an employer grants salary increases that are greater than the assumption used by the actuary then it will have a direct effect on that employer's individual pension liabilities. In some cases, GMPF can request that an additional payment is made to the Fund to cover the increase in liabilities caused by the higher than assumed pay awards. Therefore, GMPF would suggest to all employers that they consider carefully the salary increases they award, in terms of both the number and the level of such awards.

- *Membership movements*

The actuary will also make assumptions based on the estimated number of future active contributors to the Fund that an employer will have. If there is a significant or unexpected decline in the number of active contributors then this is likely to have an impact on liabilities. Therefore, GMPF would recommend employers consider this aspect if they are thinking about transferring large numbers of employees to another employer or pension provider, or if they are thinking of conducting redundancy or similar exercises.

- *Transfers in and out*

Upon joining the LGPS, members usually have twelve months within which to elect to transfer previous LGPS benefits to count alongside the benefits they will build up in their new employment. The LGPS regulations impose a twelve-month window in which to elect but also allow the employer discretion to extend this time limit. In exercising this discretion, employers should be aware that transfers could carry a significant pension liability. GMPF would suggest employers consider this when making their decisions and speak to the GMPF about the potential liability to be incurred before drawing up or amending their policy statement and before agreeing to a late request to transfer.

Where bulk transfers of employees occur, either into or out of the Fund, significant liabilities can be incurred dependant on the terms of the transfer agreed. Therefore, GMPF would suggest that an employer get in touch at the earliest opportunity to discuss how they can best limit any increase to liabilities resulting from a bulk transfer.

Factors outside an employers control

- *Investment returns*

The employee and employer contributions received by the Fund are invested. The Fund's actuary makes an assumption during the valuation process the rate of investment returns. If investments outperform the assumption, then liabilities will decrease. However if investments underperform then liabilities will increase. An employer has no direct influence on this factor. However, an employer may be able to have an indirect influence by contributing to any consultations or debates on what the Fund's investment strategy should be and to any discussions regarding individual investment strategies.

- *Longevity / Mortality*

The actuary will also make assumptions on expected longevity and mortality rates of pension fund members. The actuary will use the latest information and assumptions to do this and will make an allowance for future improvements in longevity.

- *Pensions Increase*

The rate of pensions increase (currently based on CPI) will also have an impact on liabilities. As with the factors above, the actuary will make an assumption about what the future rate of pensions increase will be and so if the rate of CPI is greater than assumed then liabilities will increase.

- *Regulation changes*

In estimating future liabilities, we can only do this using the benefits structure under the current or known future changes to the LGPS regulations. If regulations change then this can have a direct and unexpected effect on pension liabilities. Although employers cannot generally have a direct influence on this, they can have an indirect influence by responding to Government consultations on regulation changes.

3. How will we pay for these liabilities?

An employer pays for these liabilities generally through their employer contribution rate. In some cases, employers may be asked and agree to pay their contribution rate plus a cash lump sum amount. More information on this can be found in our Funding Strategy Statement (FSS).

In some cases, costs relating to transfers may need to be paid as cash lump sums. See sections 4 to 6.

4. What are strain costs and when will they occur?

Pension strain costs (often also called capital costs) occur when there is a clear shortfall in the assumed level of funding needed to provide a particular pension benefit.

Often, strain costs occur when a member draws their benefits a lot earlier than expected.

The normal retirement age for all members of the LGPS is now linked to State Pension Age. Members aged 55 and over can elect to retire without their employer's consent, with actuarial reductions where applicable.

A member may request to retire early and ask you as an employer to waive actuarial reductions or allow other protections to apply in their circumstances. If a member is allowed to retire early, and particularly if the grounds for retirement are redundancy or efficiency, then there is likely to be a strain cost. This is because it is assumed that as the benefits are being paid earlier then they will be paid out for longer, and also because employee and employer contributions will not have been paid in for as long as was anticipated.

In the same way, pension strain costs generally always occur for ill health retirements. Benefits are generally paid earlier than expected and without reduction for early payment, and those benefits may be enhanced. Deaths can also lead to strains on the Fund, particularly when people die young in service and leave dependants who are entitled to pension benefits. And if an employer chooses to award additional pension to a members pension then there will be a strain cost for doing so.

The other type of strain cost that can often occur is transfer strain, where someone transfers previous pension benefits into the Fund on joining. These generally occur when a member's pay in their current employment is significantly higher than the pay used to calculate their previous pension benefits. Therefore, the transfer payment received often fails to match the liabilities taken on.

5. How can I obtain an estimate of what a strain cost will be?

Other than for transfer strains, the Pensions Office computer database (Altair) calculates the capital costs as part of the benefit calculation process. If you are an employer with access to Altair then you will be able to calculate an estimate of the cost yourself. If not, you should complete an estimate request form on the employers' website stating in the comments box that you wish to receive details of the capital cost.

If you require details of a transfer strain cost then you should contact a member of the Transfers team.

6. How will I pay for strain costs?

How strain costs have to be paid varies from employer to employer. If an employer is part of a pool, then some costs are pooled, some may be charged to a separate budget established as part of the employer contribution rate, and other costs may be invoiced for payment to be made up front to the Fund.

Please refer to your own Fund admission documentation plus the 'Schedule of Employer Costs and Charges' for more information about this.

7. What other costs might I incur?

You may incur other administration related costs, such as charges for actuarial work conducted on your behalf (e.g. Financial reporting standard (FRS) costs) and for additional administration work or re-work.

If you were to terminate your membership of the GMPF for whatever reason then you may be liable for termination costs. Termination costs are calculated on a more prudent basis than the ongoing valuation basis and therefore termination costs tend to be significant. To find out more about this please refer to our 'Guide to Termination'.