Client Briefing Note

Client: Kent County Council Pension Fund **Date** 18 August 2011

Subject: Bond Levels

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1 Introduction

1.1 When a Scheme employer outsources a service that is to be provided by a transferee admission body, the LGPS Regulations state that the letting authority should "*carry out an assessment, taking account of actuarial advice, of the level of risk arising on the premature termination of the provision of the service by reason of insolvency, winding up or liquidation of her transferee admission body*".

1.2 The Regulations also state that the assessment should be "*carried out to the satisfaction of the administering authority*".

2 Potential Risks

2.1 When transferee admission bodies were first allowed to join the LGPS the consensus view was that the key risk was early retirement strain costs associated with any redundancies over age 50 (now age 55). However this view has developed with experience and we now suggest including other risks.

2.2 When an employer is in difficulty it is not unusual for them to default on payment of employer contributions. Further if the transferee admission body does fail and the admission agreement comes to an end, then there will be costs associated with the termination of the admission agreement – an actuarial valuation is required and some legal costs and additional work for the Fund may are also likely.

2.3 These costs would normally fall to the transferee admission body but assuming they are insolvent then they would have to be met elsewhere. Thus to protect the Fund (or more likely the letting authority) from incurring these costs, we recommend that letting authorities consider including some allowance in the bond value for these costs.

2.4 Finally we have considered making some allowance for any funding deficit at the date the admission agreement comes to an end.

2.5 With transferee admission bodies, the concept is that they start off fully funded and pay contributions to remain fully funded throughout the contract period. In practice this is difficult to achieve without keeping a constant eye on funding levels and there is a material chance that the funding position at the date the admission agreement will reveal a deficit. Assuming the transferee admission body is insolvent then the deficit will ultimately fall to the letting authority.

2.6 We do have some experience of transferee admission bodies going under with deficits, and where there was the mistaken belief that the bond was intended to cover the deficit. We therefore we suggest including some allowance for a possible deficit in the calculations. There is of course no guarantee that it will be sufficient but at least some provision is being made.

3 Conclusions

3.1 Ultimately the risks the bond are intended to cover, and the resulting level of bond, is a decision for the letting authority – the bigger the bond the less risk for the letting authority of having to pick up any early retirement costs, termination costs and deficit should the transferee admission body fail.

3.2 However the bigger the bond the greater the cost of securing the bond and in some cases whether the transferee admission body is able to secure the level of bond may also be a factor.

3.3 Our role is to assess the potential risks and quantify the potential costs should they materialise. We are always happy to discuss with authorities, the various issues in setting the bond level.