HYMANS ROBERTSON

60-second summary

Partial cessations in the LGPS

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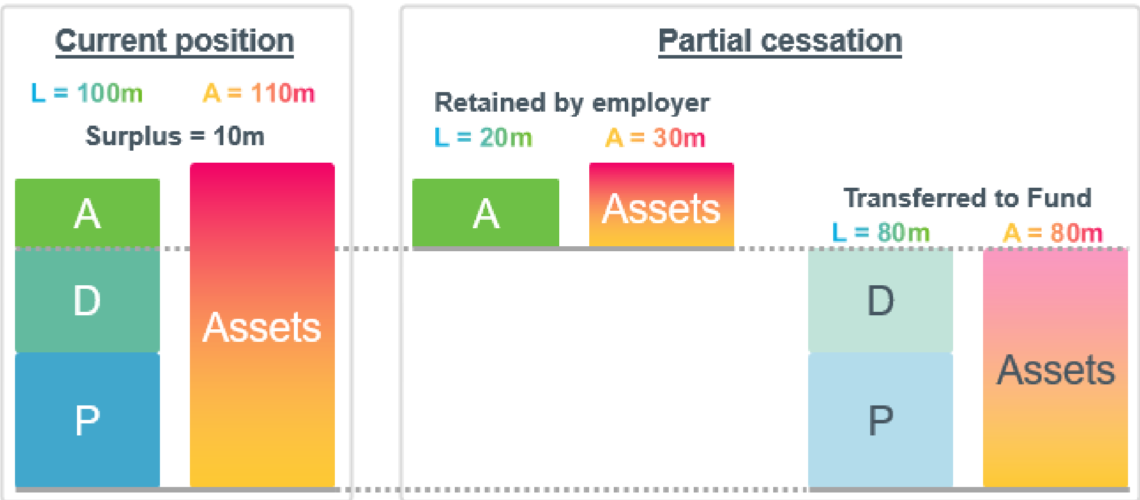
In response to recent improvements in cessation funding levels, ‘partial cessations’ are being suggested to reduce risk for employers. What are partial cessations and what should LGPS funds consider if an employer requests this?

What are partial cessations?

Partial cessations are effectively a risk transfer exercise – moving funding and investment risk from the current employer to the other employers in a fund. Whilst the risk transfer element is like a ‘full’ cessation, a partial cessation is optional (typically at the employer’s request) with the employer that is transferring the risk remaining in the fund as an ongoing sponsor.

The employer requests to cease responsibility for a certain tranche of its liabilities in the Fund whilst remaining responsible for funding the remaining liabilities. The tranches of liabilities typically in scope are all non-active liabilities (as illustrated below) or all past service liabilities accrued to a certain date. This reduces the employer’s exposure to funding risk whilst allowing its active members to continue to accrue fund benefits.



L = Liabilities, A = Assets, **A** = Actives, **D** = Deferreds, **P** = Pensioners

With the recent improvements in low-risk cessation valuation positions, we have seen increased instances of this risk management solution being discussed and requested by employers.

What should funds consider if they receive a partial cessation request?

This is an attractive solution for employers who will leave the fund on the low-risk exit basis; it reduces the level of risk to which they're exposed, and it removes assets and liabilities from their balance sheets. However, the fund should consider all stakeholders and risk when reviewing a partial cessation request (remembering that it's a request which the fund can either accept or decline!):

Funding

- What is the current funding position of the employer? What would be the impact on their contribution rate?
- Does this request raise any concerns about covenant? Or is it an opportunity to mitigate covenant risk?
- Given the optional nature of this solution, and the potential for employers to 'cherry-pick' the date, will the fund request a risk-premium to be paid on the liabilities being transferred (eg require the transferring liabilities to be 110% funded)?

Administration

- How will the split of liabilities be implemented in the fund's administration and cashflow systems?
- Can the partial cessation be carried out retrospectively or will only effective dates in the future be allowed?
- What administration costs (officer time, actuarial & legal fees) will be recharged to the employer?
- Does the fund wish to put in place any additional monitoring of the funding positions?
- Will multiple partial cessations be allowed for an employer, ie as it accrues more liabilities in the future?

Governance

- Will a legal agreement be required to facilitate a partial cessation? Is the fund happy this approach is compliant with the LGPS regulations?
- How will any requests be approved, eg Pensions Committee sign-off? Does the fund's cessation policy need to be updated?
- Where the employer is a contractor, will letting authority approval be required? (particularly when responsibility for the partially ceased funding is transfer to the letting authority)

There's no explicit regulations or guidance to cover partial cessations. On 20 December 2023, the SAB commented in a Statement on surpluses that "*Funds should satisfy themselves that such an approach [for partial cessations] is consistent with the regulations and will need to consider the best way to help an employer manage risk, as well as whether it is consistent with the interests of other employers in the scheme*".

We're expecting further comment on partial cessations in the new FSS guidance (which is expected prior to the 2025 valuation). Funds may therefore wish to wait until guidance is available before forming policy on their approach.

Are there any other options to help employers manage their risk?

Finally, partial cessations are just one way of helping employers manage funding risk in the LGPS. Another option, which some LGPS funds are exploring in advance of the 2025 valuations, is whether different investment strategies for different groups of employers in the fund can achieve better funding outcomes. You can find further information on this topic here.

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