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Briefing note

SAB's statement on LGPS surpluses

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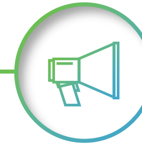
The Scheme Advisory Board (SAB) in England and Wales has issued a statement with advice to funds on how the emergence of LGPS surpluses can be effectively managed and administered.

With many LGPS funds and employers now in surplus, the Scheme Advisory Board has issued a statement about the impact on certain areas, and how the areas can be managed and administered.

The statement covers four key areas—contribution stability, tailored employer investment strategies, 'partial' employer terminations and contribution rate reviews between formal actuarial valuations. These are summarised below along with our own thoughts.



Please speak to your Fund Actuary to identify how this affects your current funding strategies, and any associated policies and processes.

The statement has arisen from work carried out by SAB's 'Surplus working group', involving us and other LGPS stakeholders. It covers four key areas—these are summarised below, along with our thoughts.

Stability of contribution rates

What does the statement say?

It emphasises the importance of stability in employer contribution rates (as required for the primary rate under LGPS regulations). Stability helps employers with financial planning and breeds confidence in the scheme's sustainability. Recognition however is given to the extremely challenging financial position amongst local government and other scheme employers. LGPS regulations allow funds to set negative secondary contribution rates where there is a surplus, which can help deliver contribution stability. Parity of treatment is important i.e. treating like cases alike, with different treatment applied to employers with different covenant values and circumstances. There are also comments at the end of the statement about funds seeking views from employee representative members on the Local Pension Board in rare cases where an overall employer contribution is in line with, or below, average employee contributions (the average is fund specific but is generally around 6.5% of pay).

Our thoughts.

We agree that contribution stability is important, but funds need to also consider employer affordability. The ideal balance is to achieve a long-term affordable rate where the likelihood of having to pay much more, or less, than this rate over time is low. This is ingrained into our valuation approach when helping a fund to consider and set employer rates.

There will of course be employer situations where it is appropriate to set a rate that is lower than the 'long-term rate' eg where an employer is in significant surplus and is exiting a fund in the short to medium term. We assume that the comments about seeking views from LPB members where rates fall to very low levels apply to long term employers only. It is common and reasonable for short term bodies such as contractors with surpluses to have a zero rate.

Tailored employer investment strategies

What does the statement say?

SAB is aware of an increased appetite from some employers, and their advisers, to influence funds' investment and funding strategies. It notes that tailoring of these strategies requires additional resource, governance, support from advisers and consistency with the Regulations, all of which come at a cost. Tailoring might be appropriate for certain employer groups eg employers heading towards exit, and funds should consider their own particular circumstances and be ready to justify any change in approach.

Our thoughts

It's correct that the practical angles and costs need to be considered if this is a strategy area that a fund wants to explore. Assuming the angles are manageable, we do think there is a place for tailored investment strategies to help funds to manage their overall funding risk. This would also allow funds to provide an offering for employers who would like an investment strategy that better suits their own funding objectives. We don't see the regulatory point mentioned as an issue (but we're not lawyers!) - there are multiple funds in the LGPS who already run more than one investment strategy.

'Partial terminations'

What does the statement say?

Some employers have suggesting exiting a fund for their deferred and pensioner members whilst remaining a participating employer for their active members. This locks in current liability values for deferred and pensioners, with no recourse for the employer in question to pay towards those liabilities in the event of adverse future experience. Instead, other employers would have to pick up any extra costs. Funds should ensure that the approach is consistent with regulations and consider the best way to manage employer risk, allowing for the interests of all employers. It also mentions that SAB is currently working with CIPFA to review the existing guidance on preparing funding strategy statements, and that more guidance is needed around risk management, exit credits and employer consultations.

Our thoughts

We agree with the statement about carefully considering the impact for all fund employers. Funds should be mindful of the reason for 'partial termination' being requested and how this interacts with the exit credit regime. The comment about funds ensuring the approach is consistent with regulations implies that legal advice should be sought. We note that it's possible to achieve the objectives behind 'partial terminations' without entering a formal agreement with the employer, by using employer-specific funding and investment strategies. It's not clear when the updated CIPFA guidance will become available. We are working with funds now to refine policy in these areas and suggest that funds continue to progress this rather than waiting for new guidance to emerge (which may be uncomfortably close to the 2025 valuation date).

Contribution rate reviews between formal valuation

What does the statement say?

It notes that LGPS Regulation 64A allows funds to review an employer's rate where there has been a significant change to its liabilities or covenant. SAB's guidance gives examples of this e.g. a large bulk transfer in or out, or a material change in an employer's immediate financial strength (backed up by evidence).

The trigger points for any review should be covered in the funding strategy statement. Generally, local authorities (and other tax-backed employers) are not subject to change in covenant. They have a statutory obligation to pay employer contributions—even if a section 114 notice is issued, they must continue to meet statutory duties, including paying employer contributions. Changes in funding positions due to market movements since the last valuation are not sufficient to trigger a review, and any review of an administering authority's own rate must be carefully managed to avoid a conflict of interest.

Our thoughts

We think the area around local authorities is more nuanced than suggested in the statement. Covenant covers the financial security that an employer offers, and its ability and willingness to pay contributions. At the 2022 valuation, you may have had an employer where rates could have been reduced, but it was instead agreed to keep the rate steady as it was in their budget and long-term rate stability was an important factor. However, the employer's financial position may have worsened since then, which means that now they are willing to sacrifice an element of longer-term stability for a lower short-term rate. This is perfectly valid if both options comply with the fund's current funding strategy and if there is 'headroom' for a reduction based on market conditions and assumptions as at the 2022 valuation. We welcome the clear direction about market movements since the last valuation not being sufficient to trigger a review, although the statement is silent about whether such movements can be allowed for in the actuarial calculations if a review is triggered for a different reason. The SAB guidance at Q6b) provides further commentary on this area. Funds are increasingly being approached to consider contribution rate reviews—this highlights the need to be on the 'front foot' and monitor funding positions, to ensure that funding (and investment) strategies remain appropriate given changes in covenant and market conditions and of course to prepare ahead of the next valuation.

Other areas covered in the statement

And finally, there are some general comments towards the end of the statement about:

1. funds providing specific employer communications explaining why their accounting surplus looks different from their funding surplus,

2. funds considering how they would respond to enquiries from scheme members about the issues covered in this statement.

There is a lot to digest in the statement. Your Fund Actuary can help to identify how this affects your current funding strategies, and the associated policies and processes.

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