BARNETT WADDINGHAM
beyond the expected

Royal County of Berkshire Pension Fund
The College Funding Pool

Introduction

This report is provided to Royal Borough of Windsor and Maidenhead as Administering Authority for the Royal County of Berkshire Pension Fund (the "Fund").

This report may be shared with the employers in the College Pool (the "Employers") as participating employers within the Fund but it does not constitute advice to them. The Fund is part of the Local Government Pension Scheme (LGPS).

This advice complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 300: Pensions (TAS 300) as issued by the Financial Reporting Council (FRC).

Background

Historically the 5 colleges in the Berkshire Fund have been "pooled" for the purposes of determining employers' contribution rates. The main purpose of pooling is to help keep employer contribution rates stable. Pooling of employers' pensions risks and costs can result in some cross subsidy between employers but provided the employers in the pool are relatively homogenous in terms of membership profile and experience, the amount of cross subsidy should be minimal. The major risks affecting employers' contributions – investment and inflation risk are the same for all employers in the Fund so pooling only extends the risk sharing to other less significant risks.

At the 2016 valuation of the Fund there were a number of issues identified for the College Pool.

- All further education establishments in England and Wales were subject to the "area review" by Government - a review of the number of colleges and similar institutions across the country.
- The new "insolvency regime" for such bodies.
- The group was no longer homogeneous. In particular University of West London ("UWL") are now headquartered in Ealing and all new members of staff eligible for the LGPS are joining the London Borough of Ealing Fund rather than the Berkshire Fund. Accordingly the University of West London in the Berkshire Fund was now a "closed employer" and at some point would become an "exiting employer" once there were no longer any active members.
- Strode's College, an employer in the Surrey County Council Fund, was to merge with East Berkshire College in July 2017, and a direction order would be sought from the Secretary of State to move the Strode assets and liabilities from the Surrey Fund to the Berkshire Fund. The Direction Order has now been obtained and the transfer is in progress.

The purpose of the 2016 valuation was to set levels of employer contributions for all employers in the Fund for the period 1 April 2017 until 31 March 2020. Given some of the uncertainty for the colleges therefore it was

agreed to only certify contribution rates for the period 1 April 2017 until 31 March 2018 and then carry out some further work after the valuation to determine the rates to be certified from 1 April 2018.

We have had a number of meetings with officers of the Fund and invited representatives of the Colleges to these meetings. All colleges apart from University of West London have attended these meetings.

Whilst a number of issues were identified at these meetings, the key issue identified was the fact that University of West London was now closed and so no longer qualified to remain in the College Pool. Remaining in the pool with a quickly diminishing number of active members would have key consequences:

- Allocating the pool deficit across the 4 colleges and then funding as a percentage of payroll would mean that UWL would pay much less than its fair share of the pool deficit which would ultimately be met by the other colleges.
- Whilst assets and liabilities are pooled for the purposes of determining employer contribution rates, we do track individual employer assets and liabilities – not least for accounting purposes. UWL is by far the largest employer in the pool in terms of share of total liabilities and deficit. As part of the pool therefore the contributions to be paid by UWL under the pooling arrangement is not really funding their individual deficit due to the relatively small deficit contributions they are effectively paying.
- As a closed employer, UWL will reach a point when they no longer have any active members. They will then become an "exiting employer" under Regulation 64 and trigger a "cessation valuation", requiring them to pay off their individual deficit in full. The assessment of their deficit on cessation will produce a much larger deficit than the ongoing deficit revealed by the 2016 valuation.
- Regulation 64(4) also states that where an employer is likely to become an exiting employer then the administering authority may obtain a revised rates and adjustments certificate certifying levels of contribution to target a fully funded position by the expected exit date.
- It was noted that the Funding Strategy Statement would need to be amended to reflect UWL leaving the pool.

The purpose of this paper is to look at the implications of University of West London leaving the pool.

BARNETT WADDINGHAM
beyond the expected

2016 Valuation data and results

The following table sets out a summary of the valuation data and results for the College Pool as at the 2016 valuation. The assumptions underlying the results are included in our valuation report and also replicated in the appendix for ease of reference.

Employer membership statistics	Number of members							
	Actives	Deferreds	Pensioners	Pensionable Pay £(000)	Pooled assets £(000)	Pooled liabilities £(000)	Deficit £(000)	Funding Level
Newbury College	122	260	79	1,506	4,409	6,211	1,802	71%
Berkshire College of Agriculture	139	264	67	2,489	5,943	8,371	2,428	71%
East Berkshire College	133	338	165	2,607	13,818	19,465	5,647	71%
Bracknell & Wokingham College	186	213	128	2,442	8,577	12,081	3,504	71%
University of West London	26	399	343	985	28,168	39,680	11,512	71%
Total	606	1,474	782	10,029	60,915	85,808	24,893	71%

Assuming UWL were to remain in the College Pool and allowing for contributions to be stepped up to the required level until 31 March 2020 the required level of contributions would be as follows:

		Period to 31 July 2017		Period to 31 July 2018		Period to 31 July 2019		Period to 31 July 2020	
	Future Service Cost	Total Rate	Projected total conts	Total Rate	Projected total conts	Total Rate	Projected total conts	Total Rate	Projected total conts
Employer name	% pay	% pay	£	% pay	£	% pay	£	% pay	£
Newbury College	15.8%	22.6%	£340,000	22.6%	£340,000	29.7%	£447,000	36.8%	£554,000
Bracknell & Wokingham College	17.3%	24.2%	£592,000	24.2%	£592,000	31.3%	£764,000	38.3%	£936,000
East Berkshire College	15.0%	22.3%	£582,000	22.3%	£582,000	29.1%	£760,000	36.0%	£938,000
Berkshire College of Agriculture	13.9%	22.3%	£555,000	22.3%	£555,000	28.6%	£712,000	34.9%	£870,000
University of West London	15.8%	23.5%	£232,000	23.5%	£232,000	30.2%	£297,000	36.8%	£363,000
			£2,301,000		£2,301,000		£2,980,000		£3,661,000

The following table shows the projected deficit for UWL and the other colleges as at 31 March 2020 assuming UWL were to remain in the pool.

Employer name	31/03/2016 £(000)	31/03/2017 £(000)	31/03/2018 £(000)	31/03/2019 £(000)	31/03/2020 £(000)
University of West London	£11,512	£12,068	£12,654	£13,204	£13,718
Other colleges	£13,381	£13,429	£13,479	£12,900	£11,659

As we see the UWL deficit continues to grow as the effective deficit contributions are not sufficient to meet the interest on the deficit, never mind fund any of the capital element of the deficit, whereas the deficit for the other colleges declines as expected.

The following table shows the required level of contributions after removing University of West London from the pool.

Employer name	Future Service Cost % pay	Period to 31 July 2017 Total Rate % pay	Period to 31 July 2017 Projected total conts £	Period to 31 July 2018 Total Rate % pay	Period to 31 July 2018 Projected total conts £	Period to 31 July 2019 Total Rate % pay	Period to 31 July 2019 Projected total conts £	Period to 31 July 2020 Total Rate % pay	Period to 31 July 2020 Projected total conts £
Newbury College	15.8%	22.6%	**£340,000**	22.6%	**£340,000**	24.7%	**£373,000**	26.9%	**£405,000**
Bracknell & Wokingham College	17.3%	24.2%	**£592,000**	24.2%	**£592,000**	26.3%	**£643,000**	28.4%	**£695,000**
East Berkshire College	15.0%	22.3%	**£582,000**	22.3%	**£582,000**	24.2%	**£631,000**	26.1%	**£680,000**
Berkshire College of Agriculture	13.9%	22.3%	**£555,000**	22.3%	**£555,000**	23.7%	**£589,000**	25.1%	**£624,000**
University of West London	15.8%	23.5%	**£232,000**	23.5%	**£232,000**	75.5%	**£744,000**	127.6%	**£1,257,000**
			£2,301,000		**£2,301,000**		**£2,980,000**		**£3,661,000**

As expected, the other colleges see an overall contribution reduction from 1 August 2018 and a significant increase for UWL. In practice we would certify the required contributions for UWL as the future service rate plus cash sums for the deficit element as their payroll will continue to decline. The cash sums for the 2 final periods would be of the order of £600k and £1.1m.

Impact of Strode's College joining the Fund

On a basis consistent with the 2016 valuation basis for the Berkshire Colleges, Strode's College had assets and liabilities of around £5m as at that date and so once included in the pool will marginally improve the financial position of the pool.

As this transfer will take some time to finalise we would suggest that the impact of Strode's College joining the pool is assessed at the 2019 actuarial valuation.

Funding issues for UWL

Extracting UWL from the College Pool will result in a significant increase in employer contributions in terms of a percentage of the payroll of the remaining members. This is entirely due to the number of active members reducing significantly since as all new staff join the Ealing Fund. Had this not taken place the required levels of contribution as a percentage of payroll would have been comparable with the other colleges in the pool.

Kevin Taylor and Graeme Muir met with UWL on 5th March to discuss their issues and options. Whilst the increase in contributions is likely to be an issue for them in the short term, they also have to face the implications of being a closed employer and ultimately an exiting employer.

When they no longer have any active members and become an exiting employer which will trigger a "cessation valuation" which will certify the deficit payment they will be required to make. The ongoing deficit at the 2016 valuation was £11.5m although had they ceased on that date without a guarantor to stand behind the remaining liabilities then the "full cessation deficit" would have been over 3 times that amount.

Across England and Wales we are seeing a number of colleges merging. Where the colleges are in the same LGPS Fund then it is relatively straightforward – the assets and liabilities of both colleges are merged within the Fund. Where they are not then it is less straightforward. Assets and liabilities in one Fund have to be transferred to the other Fund – a bulk transfer. The LGPS Regulations only permit the assets and liabilities of active members to be transferred. However if only the active members are transferred then this leaves the transferring employer as an exiting employer in the transferring Fund, triggering a cessation valuation.

However there is a mechanism that can be used to avoid this. It is possible to ask the Secretary of State for a direction order to allow all the assets and liabilities, not just those in respect of active members, to be transferred. Normally the receiving Fund is the Fund that covers the geographical area in which the new merged body has its

registered office but we do not believe that this is mandatory. It may be possible to use the other Fund as the receiving Fund.

In the case of UWL therefore, whilst they are not yet an exiting employer they will become one at some point and it could be relatively soon. The LGPS Regulations also require an administering authority to set the funding strategy for employers who will become an exiting employer and to essentially set the funding target as a fully funded cessation position. So rather than wait until the exit date and require the full cessation debt to be paid, levels of employer contributions are set to fund the cessation debt over the period to the expected exit date.

If we were to set the level of contributions for UWL to target a fully funded cessation positon in 10 years' time the deficit contributions would be in excess of £3m per annum.

The solution to avoid these significant costs for UWL is to seek a direction order from the Secretary of State to transfer the assets and liabilities in the Berkshire Fund to the Ealing Fund. This not only requires the permission of the Secretary of State but also the agreement of both Funds.

The Ealing Fund is much better funded than the Berkshire Fund and so transferring all the UWL assets and liabilities in the Berkshire Fund will increase the overall deficit in the Ealing Fund and reduce their funding level. The Ealing Fund therefore may not agree to the transfer as if UWL was to subsequently fail then it would be the other employers in the Ealing Fund who would have to fund the UWL deficit (which would be bigger than it would have been if the transfer had not taken place). There may be ways to mitigate this risk by asking UWL to fund their deficit more quickly or put up some security such as property.

Alternatively the Berkshire Fund could be used as the receiving Fund for all UWL assets and liabilities. On the Berkshire funding basis for colleges, we estimate that the liabilities that the Berkshire Fund would receive would be fully covered by the assets received. So if the transfer was from Ealing to Berkshire then the overall deficit in the Berkshire Fund would not increase and in fact there would be a slight increase in funding level.

In terms of the relative size of assets and liabilities in both Funds then the assets and liabilities on an accounting basis as at 31 July 2017 were as follows:

	Berkshire	**Ealing**	**Total**
Assets	£24.7m	£75.0m	£99.7m
Liabilities	£51.7m	£105.9m	£157.6m
Accounting deficit	£27.0m	£30.9m	£57.9m

As we see the Ealing liabilities on the accounting basis are around twice the Berkshire liabilities but the Ealing assets are three times the Berkshire assets.

BARNETT WADDINGHAM
beyond the expected

Funding Strategy Statement

The Funding Strategy Statement sets out a number of policies on how the liabilities are funded. The section on pooling currently says:

Pooling of Individual Scheme employers

3.27 The policy of the Fund is that each individual Scheme employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly contribution rates are generally set for individual employers to reflect their own particular circumstances.

3.28 However, certain groups of individual Scheme employers may be pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

3.29 Currently, other than Scheme employers that are already legally connected, there are the following pools:

Colleges
Academies
Community Admission Bodies
Housing Associations

3.30 The main purpose of pooling is to produce more stable Scheme employer contribution levels in the longer term whilst recognising that ultimately there will be some level of cross subsidy of pension cost amongst pooled Scheme employers.

We would suggest that the reference to "Colleges" is replaced with "Colleges excluding University of West London", or possibly "Colleges open to new staff".

Summary and Conclusions

The conclusions are

- Due to the closed nature of UWL, they can no longer participate in the College Pool and need to be assessed on a standalone basis.
- On leaving the pool, even if we adopt the same funding strategy for them in terms of assumptions and deficit recovery period, the required level of contributions will increase significantly.
- UWL will become an exiting employer under Regulation 64 at some point, at which time an exit valuation will be required. Unless UWL can find a guarantor within the Fund or obtain a direction order to move to the Ealing Fund, the assessment of their funding position at that time will be on a full cessation basis. If we were to set levels of contributions now to target the required amount of assets to meet these liabilities in 10 years' time then the required level of contributions would be of the order of £5m to £10m per annum.
- Accordingly we would suggest an early meeting with UWL to discuss these issues.
- In the meantime extracting UWL from the College Pool will require a minor modification to the Funding Strategy Statement.

Barnett Waddingham LLP
19 February 2018

BARNETT WADDINGHAM
beyond the expected

Appendix 1 - Assumptions

The following table sets out a summary of the financial assumptions adopted at the 2016 valuation.

		31 March 2016	31 March 2013
Discount rate	Unitaries	5.7% p.a.	6.1% p.a.
	Non-unitaries	5.5% p.a.	6.1% p.a.
Pay increases	Long-term	3.9% p.a.	4.5% p.a.
	Short-term	CPI for period from 31 March 2016 to 31 March 2020	1% for period from 31 March 2013 to 31 March 2016
Retail Price Inflation (RPI)		3.3% p.a.	3.5% p.a.
Consumer Price Inflation (CPI)		2.4% p.a.	2.7% p.a.
Pension increases		2.4% p.a.	2.7% p.a.
Post-retirement mortality (member) - base table		95% of the S2PA tables	S1PA tables with a multiplier of 100% for males and 90% for females
Allowance for improvements in life expectancy		2015 CMI Model with a long-term rate of improvement of 1.5% p.a.	2012 CMI Model with a long-term rate of improvement of 1.5% p.a.