Appendix H - Policy on ill health risk management

1 Introduction

The purpose of this policy is to set out the administering authority's approach to managing the risk arising due to ill health retirements.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

1.1 Aims and objectives

The administering authority's aims and objectives related to this policy are as follows:

- To explain the approach taken to manage ill health risk
- To specify circumstances where a review of experience may lead to additional contributions.
- To outline the key risks and benefits to this arrangement.

1.2 Background

Additional liabilities can arise following the retirement of members due to ill health. These additional liabilities can include the unreduced early payment of pension benefits and the award of additional pension. The level of pension benefits paid on ill health depends on the severity of the member's condition.

The LGPS Regulations require the additional liabilities to be funded by way of payments from employers. Payment of large lump sums to meet strains as and when they arise can lead to unexpected payments and put significant strain on employers' budgets. LGPS funds are able to put arrangements in place which mitigate the risk of having to pay a large cash sum due to an ill health retirement strain payment.

To mitigate this risk to smaller employers, and to evidence good governance and risk management, the administering authority has arranged for an external insurance policy to cover ill health early retirement strains for smaller employers in the Fund. Each of these employer's contributions to the Fund includes its share of that year's insurance premium. When an active member retires on ill health early retirement, the claim amount received from the insurer will be credited to the respective employer's asset share in the Fund.

For all other employers that are not covered by the external insurance policy, any funding strain in excess of the allowance made in the funding basis would be met through an increase to ongoing contributions.

1.3 Guidance and regulatory framework

The Local Government Pension Scheme Regulations 2013 (as amended) set out the benefits payable to members and the way in which additional benefits (such as those arising on ill health early retirement) should be funded. These include the following:

- Regulation 35 – permits the early retirement of pension on ill health grounds.
- Regulation 39 – sets out the calculation of the pension payable in the instance of ill health retirement.
- Regulation 68 – sets out the additional contributions payable by the employer to meet the liability strain caused by a member retiring through ill health.

2 Statement of principles

This statement of principles covers the external insurance arrangement in place to manage the risks created by ill health retirements for smaller employers, and the equivalent risks for larger employers not using the ill health insurance arrangement. In general:

- Employers will not be required to pay lump sum amounts to meet ill health retirement strains (in the normal course of events).
- Both Tier 1 and Tier 2 ill health retirement strains will be covered by this arrangement.
- For smaller employers in the Fund that are covered by external insurance:
    - Eligible employers are unable to opt out of this arrangement.
    - Each of these employer's contributions to the Fund includes its share of that year's insurance premium.
- For all other employers in the Fund:
    - Regular contribution rates will include the expected cost of assumed ill health retirements.
    - The Hymans Robertson Employer Asset Tracker (HEAT) system is used to track actual ill health experience.
    - Any funding strain in excess of the allowance made in the funding basis would ordinarily be met through an increase to ongoing contributions at the next triennial valuation. However, the Fund reserves the right to request immediate additional contributions in the event of material ill health strains during the period between valuations.

3 Policy

3.1 Purpose

The purpose of this ill health risk management policy is to protect the Fund against adverse ill health retirement experience of individual employers.

3.2 Eligibility

This policy applies to all employers in the Fund. The 'smaller employers' that are covered by external insurance include all town councils and community admission bodies (with under 75 active members) and exclude scheduled or designated bodies.

3.3 Operation

The policy works as follows:

- Assets shares for each employer are determined each month by Hymans Robertson, using the HEAT system and based on the monthly cashflows and asset information provided by the fund.

  As part of this data provision, the fund determines the strain costs arising due to ill health retirements and this strain is allocated to each active employer in proportion to their asset share at the beginning of that month.

- Contribution rates are set by the Fund Actuary every three years as part of the triennial valuation.

  Primary contribution rates include allowance for the expected cost of assumed ill health retirements (expressed as a percentage of payroll).

This provides ongoing funding for the assumed level of ill health retirement strains.

3.3.1 Smaller employers

- Smaller employers in the Fund are covered by the ill health insurance arrangement.
  - When an active member retires on tier one or tier two ill health early retirement, a claim amount equal to the fund calculated strain cost for the retirement will be received from the insurer (assuming a valid claim) and credited to the respective employer's asset share in the Fund.
  - It is not guaranteed that the insurer will pay the claim, for example if it does not believe that the requirements for a tier one or tier two ill health retirement have been met.

3.3.2 Other employers

- Other employers in the Fund not covered by the ill health insurance arrangement.
  - Where the actual level of ill health retirement strains exceeds the assumed level, this will lead to a shortfall arising at the next triennial valuation for those employers not covered by the ill health insurance arrangement.

    No immediate additional contributions will be required from employers to meet this shortfall, but this could increase the contribution requirement following the next triennial valuation.
  - Similarly, where the actual level of ill health retirement strains is lower than the assumed level, this will lead to a surplus arising at the next triennial valuation.

    No refund will be paid to employers as a result of this, but this surplus could lead to downwards pressures on contributions following the next triennial valuation.

3.4 Review and additional contributions

The administering authority will review the level of ill health experience across all employers at each triennial valuation.

If an employer has an unusually high incidence of ill health retirement over the previous inter-valuation period, the administering authority will engage with the employer to understand the reasons for this. In the event of concerns around the eligibility criteria applied by the employer in granting ill health retirements, this could lead to the need for the employer to pay additional contributions to the Fund.

3.5 Costs

The costs of operating this policy will be met by the Fund as part of its administration expenses.

4 Related Policies

The Fund's approach to setting regular employer contribution rates is set out in the Funding Strategy Statement, specifically "Section 2 – How does the Fund calculate employer contributions?".