Coventry City Council

Public report

Cabinet Member for Strategic Finance and Resources

Cabinet Member for Strategic Finance and Resources 22nd February 2018

Name of Cabinet Member:
Cabinet Member for Strategic Finance and Resources – Councillor J Mutton

Director Approving Submission of the report:
Deputy Chief Executive (Place)

Ward(s) affected: None

Title:
Coventry & Solihull Waste Disposal Company Pension Guarantee

Is this a key decision?
No

Executive Summary:

The Coventry and Solihulll Waste Disposal Company Ltd (CSWDC) is jointly owned by Coventry City Council (CCC) and Solihull Metropolitan Borough Council (SMBC) and currently pays significant dividends to both councils. The company is an employer within the West Midland Pension Fund (WMPF) but has only 2 active employee members within the fund. At the point at which there are no remaining active employees, WMPF will act to ensure that any CSWDC pension deficit can be settled via CSWDC making a minimum risk termination payment. As at the 2016 pension valuation this was estimated to be £3.9m. This settlement payment will restrict the scope for the Company to make dividend payments. The councils' medium term financial plans assume that significant dividends continue to be received in the future.

As continuing members of the West Midlands Pension Fund, both councils are in a position to act jointly with CSWDC in order to avoid the need for a minimum risk payment.

It is proposed that CCC and SMBC provide a guarantee to the WMPF that the pension deficit will be settled. The final form of the agreement may or may not include transfer of the assets and liabilities of the CSWDC to the 2 councils, at the point at which there are no active CSWDC employee members of the fund. With a guarantee, any settlement figure will be much lower than the minimum risk basis, thereby freeing up funds that can be paid as dividends. As at the 2016 valuation the cost of the guarantee to the 2 authorities would have been a total of c£70k pa over 20 years.

Recommendations:

Cabinet Member for Strategic Finance and Resources is recommended to:

1) Approve the provision of a pension guarantee (provided jointly with Solihull Metropolitan Borough Council) to West Midlands Pension Fund, in respect of Coventry and Solihull Waste Disposal Company pension liabilities as set out in Section 2.11 of the report,
2) Approve agreement of the detailed terms of the guarantee and associated arrangements to be delegated to the Director of Finance & Corporate Services on behalf of the Council.

List of Appendices included:
None

Other useful background papers:
None

Has it been or will it be considered by Scrutiny?
No

Has it been or will it be considered by any other Council Committee, Advisory Panel or other body?
No

Will this report go to Council?
No

Coventry & Solihull Waste Disposal Company Pension Guarantee

1. Context (or background)

1.1 The Coventry and Solihulll Waste Disposal Company Ltd (CSWDC) is jointly owned by Coventry City Council (CCC), which has a two thirds ownership and Solihull Metropolitan Borough Council (SMBC), which has a one third ownership and currently pays significant dividends to both councils. The company is an employer within the West Midland Pension Fund (WMPF), and has only 2 active employee members within the fund. At the point at which there are no remaining active employees CSWDC will have to make a termination payment to WMPF relating to any remaining pension deficit risk. This settlement payment will restrict the scope for the company to make dividend payments.

2. Options considered and recommended proposal

2.1 CSWDC is currently making annual pension payments to WMPF of £350k pa over a planned pension repayment period of 6 years. In addition, at the point at which there are no more active employees in the fund the CSWDC will cease to be a scheme employer and would then be required to make a settlement payment to cover the future pension liabilities. This would be set on a minimum risk valuation basis, significantly higher than the total amount that would continue to be payable on an ongoing valuation basis, were the employer to remain as an active member of the scheme. A minimum risk payment in effect "buys out" the risks associated with the ongoing management of the remaining pension liabilities, and is calculated based on by a number of factors, including inflation forecasts and investment returns. Consequently, it will vary over time based on the assumptions about these factors. As at the 2016 pension fund valuation date, the minimum risk valuation was £3.9m, although a more recent estimate of the figure was £3.2m.

2.2 In conjunction with both CCC and SMBC, CSWDC has been exploring ways of managing its transition to the position at which it ceases to be a scheme employer, in a way that minimises the pension cost burden. These entail the two councils, as continuing scheme employers, supporting CSWDC in order to reduce the potential cost impact.

2.3 In recent years CSWDC has paid CCC and SMBC significant sums, including dividends totalling £4m in 2016/17, paid in proportion to the shareholding. The councils' medium term financial plans assume that significant dividends continue to be received in the future.

2.4 The Options are:

2.5 Option 1 – Do nothing

2.6 With only two remaining active employees within the fund there is a significant possibility that CSWDC will be required to make a minimum risk payment (£3.9m at the 2016 valuation date) in the foreseeable future. In the light of this potential cost, and the inherent uncertainty surrounding the level of any required payment, the scope for the company to make dividend payments will be restricted. This will have an impact on each councils' medium term financial position. Consequently, it is proposed that a "do nothing" approach is not adopted.

2.7 Option 2 – CCC and SMBC Provide a Loan to CSWDC

2.8 CCC and SMBC provide a repayable long term loan(s) to CSWDC to allow existing liabilities to be extinguished via a one-off payment by CSWDC to WMPF. This could be followed by a potential transfer of any future pension liability obligations to the councils at the point at which

the last active pension scheme employee leaves CSWDC. This payment would be prior to the point at which any minimum risk payment was required. In such circumstances the loan, and the payment to the fund would reflect the fact that the company was still an active, on-going employer within the fund. This would, to a limited degree, help facilitate the payment of dividends in the intervening period prior to the last scheme employee leaving.

2.9 There are several reasons why this option is not felt to be appropriate. An updated valuation has resulted in the current ongoing deficit being significantly reduced such that the justification for an immediate payment has been removed. In addition, a loan would add a further layer of complexity to the arrangements for both the authorities and the company, and is likely to increase company's tax liability relative to its current position. Notwithstanding, the risk of the minimum risk valuation still exists.

2.10 For the above reasons it is not proposed that this approach is adopted.

2.11 Option 3 – CCC and SMBC provide a Guarantee under Pension Regulations

2.12 Existing pension regulations allow for organisations to provide guarantees to the pension fund in respect of member organisations. A number of such guarantees currently existing, including those given by government in respect of academy schools.

2.13 Both CCC and SMBC, as large continuing members of the WMPF, could provide a guarantee to WMPF in respect of the CSWDC liabilities. The guarantee would avoid the need for a large "minimum risk" payment, and the associated cost to the company.

2.14 Under a guarantee arrangement, once CSWDC has no active employees within the fund, its pension fund assets and liabilities would transfer to the Council and SMBC, to be merged with each council's pension funds. In parallel, at this point CSWDC would make an exit payment to the WMPF reflecting the deficit at that time (on an ongoing valuation rather than minimum risk basis). As continuing large local authority employer members of the fund, the transfer to each council would reduce the risk to the pension fund and thereby remove the need for a minimum risk payment. In addition, as each Council would continue as an active employer member long after the date at which CSWDC ceased to be an active member, the pension fund liabilities would be managed over a much extended period. Based on current estimates the annual cost to the guarantors would be c£70k pa over a period of up to 20 years, of which CCC would incur a cost of c£50k pa (based on an indicative 66% share).

2.15 A potential guarantee should be viewed in the context of the relative sizes of the funds. The city council's share of WMPF asset was £1.2 billion at 31st March 2017, whilst those of CSWDC was £7.7million on 30th June 2017 (the nearest comparable valuation).

2.16 It is proposed that a joint guarantee is provided by the councils as set out above, with the agreement of the details of the guarantee delegated to the Director of Finance and Corporate Services.

2.17 Any guarantee can be shaped in different ways. In particular, in the light of the existence of a joint guarantee, it might be appropriate to align the existing CSWDC pensions payment period to that of the 2 council guarantors i.e. increase it from 6 years to 20 years. This would reduce the cost to the company in the short term, but increase the ongoing costs ultimately borne by the guarantors once the company ceases being an active employer. However, all other things being equal, any increase in pension costs will be offset by dividends available from the Company.

2.18 However, it is possible that the company might cease to be an active employer at a point in which it has made overpayments to the fund (on an ongoing valuation basis). Ordinarily,

these would simply be adjusted via future contributions, but there is no mechanism to do this within existing pension fund structures. Consequently, this would need to be borne in mind when determining the level of annual contributions.

3. Results of consultation undertaken

3.1 No specific consultation has been undertaken.

4. Timetable for implementing this decision

4.1 It is intend to that any arrangements are put in place by the end of March 2018 in time for the start of the 2018/19 financial year.

5. Comments from Director of Finance and Corporate Services

5.1 Financial implications

The financial aspects of the proposal are set out in the main body of the report. The proposals set out a way that the 2 shareholder authorities and the CSWDC can work together in order to most effectively manage the pension fund cost to the company, thereby helping maintain the payment of significant levels of dividends that are built into the existing medium term financial plans. By providing a guarantee, the 3 organisations can limit the amount of pension deficit payments payable and the reality is that the proposed course of action will be financially beneficial to the two councils and to the company.

5.2 Legal implications

The proposed pensions guarantee is in accordance with the Council's legal powers, both as shareholders of CSWDC and as the original employers of the staff. CSWDC is a Limited liability Company and, therefore, the Council as shareholder would only be liable for the debts of the Company to the extent of any unpaid share capital. The terms of the guarantee in this report (once completed) ensures that the necessary arrangements to pay off the pension deficit will be made over an extended period of time at a lower level, even after the last remaining staff have left the scheme.

From a state aid perspective, a guarantee can in some instances constitute unlawful state aid. However, in this particular arrangement, legal services are of the view that the statutory tests for unlawful state aid are not met as this arrangement is not designed to provide a selective advantage to CSWDC but instead represents a commercial decision by the Councils as shareholders (and not as public authority) to protect the financial position of the Company and maximises the dividend payments back to the shareholders.

6. Other implications

Any other specific implications

6.1 How will this contribute to achievement of the Council's Plan?

The proposal will help strengthen the City Council's budgetary position by supporting the payment of dividends from the CSWDC.

6.2 How is risk being managed?

The proposal is designed to avoid the cost of risk associated with the CSWDC no longer being an active member of the WMPF, and the knock on impact that such a cost would have

on dividends earned by the Council. In doing this the councils would take on the assets and liabilities in respect of former CSWDC employer pensioners or provide a financial commitment equivalent to doing this. The risk associated with this would be managed as part of the Council's wider pension fund assets and liabilities.

6.3 What is the impact on the organisation?

The proposal will help strengthen the city council's budgetary position by supporting the payment of dividends from the CSWDC.

6.4 Equalities / EIA

There will be no impact on the pension arrangements of the remaining active CSWDC member of the WMPF or existing pensioners.

6.5 Implications for (or impact on) the environment

The proposal has no impact on the activity of the Coventry & Solihull Waste Disposal Company, simply the way the pension liabilities of the company are managed.

6.6 Implications for partner organisations?

The proposal will include an agreement between Solihull MBC and the Coventry & Solihull Waste Disposal Company and the West Midlands Pension Company. All parties have been involved in these discussions and it is intended that Solihull Council will seek equivalent authorisation to this report.

Report author(s):

Name and job title: Paul Jennings, Finance Manager (Corporate Finance)
Michael Rennie, Lead Accountant (Corporate Finance)
Directorate: Place Directorate
Tel and email contact: 02476833753 paul.jennings@coventry.gov.uk

Enquiries should be directed to the above person.

Contributor/approver name	Title	Directorate or organisation	Date doc sent out	Date response received or approved
Contributors:				
Cllr Mutton	Cabinet Member for Strategic Finance and Resources	-	18/1/2018	18/1/2018
Oluremi Aremu	Major Projects Lead Lawyer	Place (Legal)	2/2/2018	8/2/2018
Suzanne Bennett	Governance Services Co-ordinator	Place	25/1/2018	25/1/2018
Barry Hastie	Director of Finance and Corporate Services	Place	9/2/2018	13/2/18

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