ASSOCIATION OF CONSULTING ACTUARIES

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Dear Sirs

Local Government Pension Scheme: Fair Deal – Strengthening pension protection

I am writing on behalf of the Association of Consulting Actuaries in response to the above-named consultation issued by the Ministry for Housing, Communities and Local Government.

We welcome the Government's proposals to simplify the regime for providing continuity of pension rights when a service or function is outsourced from an LGPS employer. Our main points in our response are:

- The "deemed employer" approach should be clearly differentiated from the admission body approach, by providing that the only cost/risks which can be allocated to the service provider are those which are significantly under their control (redundancy, pay growth, ill-health, discretions). So that if the Fair Deal employer wants the service provider to take on other funding risks, it should do this through the admission body approach.
- Pension issues should be given full and timely consideration by Fair Deal Employers when services or functions are outsourced, and a long term solution could be to make consideration of the pension issues part of the mandatory tendering process and guidance.
- Key to the successful implementation of any change will be ensuring that all stakeholders are clear on the costs and risks which they are taking on, and that there is no ambiguity in the division of responsibilities between the letting employer, the contractor and the LGPS Fund.

We hope our response is helpful in these respects.

Yours faithfully

John Livesey
Chair, Pensions in Public Services Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

The basics of Fair Deal in the LGPS

Question 1: Do you agree with the definition of Protected Transferee?

The draft Local Government Pension Scheme (Amendment) Regulations 2019 which accompany the consultation ("the amending Regulations") define a "protected transferee" as someone who has transferred from a "Fair Deal employer" at the outset. They also clarify that an employee who joins after the contract has started does not acquire protected status when the contract is re-tendered.

We see this as a policy matter for the government to determine and do not have a particular view on this, albeit the proposed definition does not seem to us to be unreasonable. We note that the coverage of the definition is a little wider than a strict application of transfers covered by TUPE, but it does not seem unreasonable overall. Key to the successful implementation of the policy will be clarity around precisely which employees are covered by the definition, and clear communication of this at the outset of any outsourcing or subsequent transfer.

Question 2: Do you agree with the definition of Fair Deal employer?

It seems to us that the definition will cover all LGPS scheme employers other than admission bodies, further education corporations, sixth form college corporations and higher education corporations, although such employers could choose to apply the provisions if they wished. It now specifically includes academy schools and police and crime commissioners.

We see the definition of "Fair Deal employer" as a general policy decision by the Government, and we do not have any particular issues with the proposal. The scope is similar to existing provisions, albeit a little wider.

Question 3: Do you agree with the transitional arrangements?

Overall, this seems to us a sensible proposal, with a minor caveat. Broadly comparable schemes are now relatively rare in practice and we think this will achieve more consistency of approach with other public sector schemes. Equally any historic staff under the existing protections should be brought into the new regime otherwise two regimes would continue to operate for many years to come.

Where a service provider currently has a broadly comparable scheme, that service provider and the Fair Deal employer will need to prepare for a change of approach when the contract is next re-tendered. It is important that authorities review their historic contracts to consider if they are affected and decide on their policy. This should be made compulsory under any new guidance.

However, there may be scenarios where an incumbent service provider is using a broadly comparable scheme and where forcing the staff to leave that scheme could be problematic. Potential issues include scenarios where the staff have a contractual right to membership of the broadly comparable scheme, or where forcing the staff to leave could lead to material financial problems for the service provider (such as triggering a Section 75 Debt). We believe these are likely to be rare occurrences. However, it would be helpful if the opportunity to continue to offer broadly comparable benefits was retained, albeit in limited cases and subject to a suitable business case. This would be broadly consistent with the equivalent requirements under New Fair Deal.

Question 4: Do you agree with our proposals regarding the inward transfer of pension rights?

The employees concerned will be able to take a transfer from their existing scheme and use it to secure career average benefits within the LGPS. We suspect this will be calculated using the normal individual LGPS transfer in terms; the intention here needs to be clarified.

Under the proposals, the relevant LGPS or Fair Deal employer will not be able to refuse such a transfer. This will mean additional (and potentially large) risk and cost is taken on by the Fair Deal employer.

The number of contracts operated on the basis of a broadly comparable scheme is relatively small, and the proposal will apply only to those still in service at the end of the contract, so we suspect it will have only limited effect in practice.

- The proposal will not necessarily provide the employees with full continuity of pension benefits. However, given that the transfer in terms offered by the LGPS are currently relatively generous compared to those normally offered in private sector schemes, on average we suspect members will not lose out if this proposal is implemented and may in fact gain (possibly materially) in relative terms. Nevertheless, we would expect there to be a mixture of gainers and losers.
- Funds receiving a request should be required to issue standard wording to members, explaining that they may be giving up final salary benefits in the broadly comparable scheme, and potentially a higher rate of indexation, to take career average benefits in the LGPS.
- If there are guaranteed bulk transfer terms written into the original contract then these could be very generous and could produce windfall gains for members and increase the exposure for the new employer and ultimately the Fair Deal employer through the pass through arrangement, where before there would not necessarily have been any exposure to additional cost/risks.
- Careful communication will be needed to minimise the risk that staff offered a transfer into the LGPS do not proceed to transfer past service benefits simply because they believe the offer itself must mean the transfer option is beneficial.

Overall we understand the policy intention here but have some concerns over the possibility of windfall gains or losses for members given the individual transfer-in terms on offer in the LGPS and the uncertainty over bulk transfer terms that might be offered by broadly comparable schemes. Some standardisation of the terms offered on transfer back (depending on the original LGPS benefits secured in the broadly comparable scheme) may be preferable, and more equitable, although the likely wide variability in bulk transfer terms on offer from broadly comparable schemes means this may be difficult to achieve in practice. However, given the relatively low number of broadly comparable schemes still in existence, on balance it is something that could be acceptable overall in order to achieve the policy outcome.

Risk sharing

Question 5: Do you agree with our proposals on Deemed Employer status?

This is an area where our LGPS clients and outsourcing clients are likely to have different perspectives, and care will need to be taken to ensure an outcome which fits the requirements of all parties.

From the perspective of the Funds:

- It appears from the wording of draft Regulation 3B(3) that it may be the Fair Deal employer's choice, when initially putting the contract out to tender, whether the Admission Agreement or Deemed Employer approach will be used. This makes it imperative that each Fair Deal Employer has a clear policy on the treatment of each type of employer.
- This is a simplified method of achieving pension protection for the employees, as it avoids the new employer having to consider and sign an admission agreement with the Fund which is a positive from an administrative viewpoint. In our view any significant passing of the pensions risks to the new service provider would be better served by the existing approach using an admission agreement with the Fund. Therefore, the policy of the Fair Deal employer is critical to the successful operation from a Fund perspective.
- Whilst the Deemed Employer route may be simpler in some respects, some of the operational challenges from a Fund perspective will remain the same. We feel that it will be important that the Fair Deal employers have a clear policy on how they intend to operate in terms of service delivery as in some instances the Admission Agreement route will be the better option.

From the perspective of service providers:

- We expect strong support from service providers for the principles behind the proposal of the "Deemed Employer" route.
- Such an approach fits well with the "pass through" approach to outsourcing. We would expect pass through to achieve further benefits, by increasing the plurality of independent providers bidding for local government work, leading to increased quality of services and lower costs for taxpayers.
- The preference from service providers would be for the Deemed Employer approach to become the "default" (i.e. the approach adopted unless the Fair Deal Employer determined otherwise in any particular case). This would most likely increase the number of outsourcings using the Deemed Employer approach, and therefore more likely to adopt a pass through approach to determining the pension costs.
- So long as the Deemed Employer route remains an option rather than the default, bidders for local government contracts will require to obtain specialist advice to understand the pension risks aspect of bids, and how the Deemed Employer and Admission Agreement routes differ. This may deter some potential bidders.
- Paragraph 32 of the consultation documents envisages that the Deemed Employer option would "only be a starting point, and the service contract between the parties would cover the detail of the pensions relationship, including the sharing of risk". In order to minimise the pensions barriers to bidding the tender material should explain in easy to understand language the detail and extent to which the pensions risks are being passed on to the Deemed Employer or retained by the Fair Deal Employer.
- As it is proposed that the admission agreement route will remain an option, we feel the Deemed Employer route offers an opportunity to introduce a new and simpler solution for the requirement to protect pension benefits of affected staff.

- We feel that the Deemed Employer route should require full pass-through of pension costs, with only limited employer-controlled costs being the responsibility of the service provider. By removing any opportunity for flexibility regarding risk transfer, the Deemed Employer route should be much simpler and to put in place, a generally smoother process, and lower advisory costs for all parties.
- There will still be issues around service providers not understanding the residual risks they are exposed to, but if Deemed Employer is made into a standard arrangement, it would be much easier to set out clear, concise and easy to follow guidance for bidders to understand precisely what they are facing if they win contracts.
- Where any parties wanted or were comfortable with there being a greater transfer of risks to the service provider, the existing Admission Agreement approach provides that opportunity.
- There would then be a clear demarcation between Deemed Employer and Admission Agreement approaches.
- It could still be possible to have flexibilities that allow the Fair Deal employer to agree to retain more risks (e.g. cost sharing of redundancy costs) or alternative arrangements for ill-health strain costs (e.g. insurance or pooling) but it should be made clear that under Deemed Employer it is not permissible to transfer additional risks to the service provider.

Question 6: What should advice from the SAB contain to ensure that Deemed Employer status works effectively?

At a high level the Advice should cover that the Fair Deal employer must have a clear policy on the approach it will take.

The Advice should cover what Funds are required to do both on a policy basis and operationally in terms of dealing with both the "Deemed Employer" and the "contractor employer" in the arrangement, given there will be no admission agreement to define all parties' obligations.

As a starting point, the Advice should cover, in simple terms, how the Deemed Employer route works, the circumstances in which it works better versus the Admission Agreement route and vice versa. These are examples of the main features of the Deemed Employer approach that might be explained:

- The service provider will not become responsible for pension costs it cannot control.
- The Deemed Employer arrangement is simple to put in place and no admission agreement is needed
- It will be very convenient for contracts done on a pure "pass-through" or "fixed cost" basis
- It avoids the need to assess exit debt or credit for the Fund at the end of the contract.
- The Admission Agreement approach works better than Deemed Employer where the outsourced employer wishes to take on wider risks, as the admission agreement route provides for a better segregation of the assets and liabilities from the those of the Fair Deal Employer

The guidance could then go on to cover the more detailed operational aspects. In particular, the Advice should set out clearly and carefully set out:

- That the Fair Deal employer will continue to be treated as the employer for LGPS purposes, and that this means it will retain responsibility for the majority of obligations to the LGPS, including contributions and funding risk. The Advice should list exactly what the obligations of the service provider will be, and should echo the amending Regulations in making it clear that the service provider has only these LGPS responsibilities; it is not the employer for any other purpose.

- That the service provider has specified record-keeping and reporting responsibilities to the LGPS, a duty to deduct and pay member contributions and specified additional pension costs within its control.
- That the service provider continues to be liable for specified additional pension costs that are within its control (including those that result from early retirement strains, awards of additional pension, salary increases above a certain level, redundancy and ill health pensions).
- Which party will operate the discretions policy: we suggest that the service provider should operate its own discretions policy but that it will have clear responsibility for any additional pensions cost that arise from operation of the policy.
- The mechanism for passing on member contributions and any other payment in respect of additional pension costs that are within the service provider's control. There will be no direct link between the Fund and the service provider, so the guidance should prescribe how these matters are to be regulated and administered. If the Regulations cannot prescribe these arrangements, the Advice should provide standard contractual terms, to be agreed by the Fair Deal employer and the service provider.
- On which matters the Fund is to deal for administrative purposes with the Fair Deal Employer, and on which matters it is to deal with the service provider. It should set out the administrative responsibilities of each party, that is, the service provider, Fair Deal employer, and the Funds, under the Deemed Employer arrangement; for example, Funds will still need to establish a separate employer code for the service provider, in order to deal with issues such as payroll queries.
- Rules for clear communication between all parties; it should require the service provider, Fair Deal employer and Funds to update their relevant policies
- Whether the service provider is required to account for pension costs (under IAS 19 or otherwise) in the same way as under Admitted Body status: our view from an actuarial stance is that "defined contribution" accounting treatment would normally be appropriate. The advice needs to address this point whilst at the same time recognising that the service provider and its auditors may need to have the final say.
- By minimising the flexibilities around Deemed Employer, it will be easier to produce clear, concise guidance for service providers, many of whom are likely to have limited knowledge or understanding of the LGPS Regulations and their associated obligations.

Question 7: Should the LGPS Regulations 2013 specify other costs and responsibilities for the service provider where Deemed Employer status is used?

We believe the responsibilities of the service provider need to be made absolutely clear and they should be compelled to adopt these as per the service contract or a separate agreement with the Fair Deal Employer. Essentially this needs to replicate the provisions of an admission agreement where relevant and could be embedded in the Regulations but we would prefer the Regulations to refer to specific guidance from the SAB as this would allow easier updates to the process as undoubtedly it would need some adaptation as all parties become accustomed to the new environment. It would then seem sensible for this to be part of the advice from the SAB with template clauses or wording for Fair Deal Employers to include in their bidding documentation.

With regards to costs we would not agree that the Regulations or Guidance should prescribe this for all costs but instead give guidance on Fair Deal Employers adopting their policy. For example where the ill health costs are insured outside the Fund it may be sensible for those costs to be passed across in a different way.

Question 8: Is it right that the Admitted Body route is retained and that risk sharing arrangement can be included in the Admission Agreement?

We agree that the existing arrangements should be retained as they are more appropriate in certain circumstances, for example, where a separate local authority trading company is set up by the local authority.

Although it might be expected that the change should add more flexibility to the drafting of admission agreements, we currently see no barrier to including risk sharing arrangements under the current regulations.

Traditionally our preference has been for admission agreements to be standardised and simply reflect the responsibilities of all parties on participation. Any risk sharing arrangements could be covered in the contractual agreements as they are a matter for the authority and the outsourced employer. On a general basis this would still be our strong preference (as the risk sharing is a matter for the two parties not the Fund). A potential advantage of allowing for risk-sharing explicitly in the admission agreement would be the opportunity to clarify to all parties how the employer should be treated and what arrangements are in place. This is particularly important given the introduction of Exit Credits. However, funds increasingly prefer non-negotiable admission agreements and by keeping the risk sharing solely in the commercial agreement, further delays and costs are minimised.

Question 9: What further steps can be taken to encourage pension issues to be given full and timely consideration by Fair Deal Employers when services or functions are outsourced?

We agree that the Regulations and advice from SAB need to prescribe and encourage timely consideration of the pension issues. However, this is likely to only have limited impact given that the problem often arises because local government departments or officers (who are not pension specialists) are usually unaware of the obligations in the Regulations or Advice and are understandably focused on the service being outsourced. This is principally the reason for the lack of engagement under the current arrangements.

Initially, an effective way would be to educate the various parties on the new requirements and this would likely be best carried out via each Fund; therefore Advice from the SAB on how that should be done would seem sensible. However, this is not always effective unless a continued campaign is sustained.

A long term solution that we think would be effective is to make consideration of the pension issues part of the mandatory tendering process and guidance. This would mean a Fair Deal employer's procurement department (or national framework) would need to include reference to the approaches as a mandatory requirement. We note however that with Central Government (Civil Service and NHS) outsourcings, we still experience scenarios where pensions are left until very late in the process.

In line with our response to Question 7, the tender documentation should include standard clauses to include in contracts and/or bid documents, and refer to the Advice, the LGPS Regulations and the Fair Deal employer's policy on the matter. We do not know how easy this is to achieve but we would recommend it is at least considered by the SAB and MHCLG.

PUBLIC SECTOR EQUALITY DUTY

Question 10: Are you aware of any other equalities impacts or any particular groups with protected characteristics which would be disadvantaged by our Fair Deal proposals?

No

Transferring pension assets and liabilities

Question 11: Is this the right approach?

There has been concern amongst some Funds about the potential for employers to be dissolved without paying off any exit debt (whilst in some cases even transferring the active members to a successor employer). This amendment seeks to change that, by making any successor employer responsible for the original employer's LGPS assets and liabilities, even if the successor employer is in a different LGPS Fund. This seems a positive step to us as it gives clarity and certainty to all parties.

In our view the aim of this policy is sensible, and on the whole it will work well when the intention is for the assets and liabilities to simply consolidate into one Fund. However, we have concerns that as proposed, it does not require the consent of the receiving Fund, as essentially it could increase risk to taxpayers if the employer could not support the combined liabilities in the long term. For example, this might happen where an employer with a weak covenant consolidates a large pension deficit in one Fund. We would therefore prefer it that this continues to require consent subject to that not being unreasonably withheld to provide protection to the receiving Fund.

Question 12: Do the draft regulations effectively achieve our aims?

On the face of it, yes, although we have not reviewed the draft regulations in detail.

Question 13: What should the guidance issued by the Secretary of State state regarding the terms of the asset and liability transfers?

In line with our answer to Question 11, we believe some sort of consent should be required, reflecting the circumstances of the transfer. With regard to the terms of asset and liability transfers, the main issue is usually to determine the assets transferred (as normally the liabilities transferred are determined by the membership records).

We think the guidance should as a minimum include:

- Details of how the date and transfer of administration and payroll records to the successor employer and Fund should be dealt with (in terms of verification and transitional arrangements such as pension payments). If the original and successor employer are in the same Fund some of the requirements will fall away but verification of the data should still be a requirement to avoid dispute at a later date when it is possible that the original employer records do not exist anymore.
- Detail of the acceptable approaches to determining the asset amount, which could be based on a roll forward from the previous valuation or a share of assets if the original employer was part of a group of employers for contribution purposes. This asset value should be agreed and certified as reasonable by the Actuary (or the Actuary to each Fund where a transfer is to another Fund)
- Confirmation that the costs of the transfer should be incurred by the successor employer including any asset transition costs or other fees.

About the Association of Consulting Actuaries (ACA)

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

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