Fair Deal Consultation

March 2019

MHCLG has published its long awaited consultation on draft Regulations introducing New Fair Deal into the LGPS in England and Wales, replacing the Best Value Direction 2007 and Welsh Authorities Staff Transfer Direction 2012. The consultation also makes provision for an automatic transfer of assets and liabilities to a successor body when an LGPS employer is taken over or is part of a merger. This Spotlight sets out Aon's views on the consultation, considering the administering authority, scheme employer and contractor perspective and is intended to help stakeholders in formulating their own response.

Fair Deal - Introduction

Fair Deal sets out how pension issues should be addressed when staff are compulsorily transferred from the public sector to contractors providing public services. The current protections are that employees who are contracted out should be given continued access to the LGPS or be offered access to a broadly comparable scheme.

In July 2012 Government announced a new Fair Deal policy which requires continued access to public service schemes and removed the broadly comparable option. Whilst new Fair Deal applies to academies, it does not apply to LGPS employers subject to the Best Value Direction nor the Welsh equivalent. Following a previous consultation on LGPS changes in May 2016 and publication of Government's response in April 2018, a further consultation has been published setting out how the Government proposes to translate new Fair Deal into the LGPS in England and Wales.

The consultation also proposes an automatic transfer of LGPS assets and liabilities to a successor body where an exiting LGPS employer is taken over or is part of a merger.

The consultation closes on 4 April 2019.

This Spotlight sets out Aon's views on the questions posed in the consultation. It is intended to assist administering authorities and other stakeholders in formulating their response to the consultation.

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

The definition of a protected transferee as an active member who is compulsorily transferred appears sensible from a lay perspective. However, draft Regulation 3B(7) extends the protections to include employees recruited by the service provider to work on the outsourced contract, where the service provider and Fair Deal employer jointly agree. Draft regulation 3B(8), however, provides that such agreement may be terminated by either party at any time.

We do not believe that an option to extend the protections should be included in the regulations (particularly one which appears to be applied at an individual level rather than as a matter of policy for all employees working on a contract) for the following reasons:

- It adds an additional layer of complexity to the procurement process, and possibly misunderstanding/confusion regarding its application (because it is discretionary).
- It makes monitoring who is a protected transferee more complex (see below).
- It potentially creates conflict with the guidance "Fair Deal for staff pensions: staff transfer from central government" for academies and other central government bodies that participate in the LGPS and are covered by both these Regulations and the Fair Deal guidance.
- Scheme employers letting contracts may not wish to use this flexibility because:

(i) they do not want to guarantee LGPS liabilities relating to members they have never employed (assuming they would be guaranteeing these liabilities either as the deemed employer or via Regulation 64(3)(a)).

(ii) if service providers price bids on a defined benefit basis for future new recruits to the contract as well as for current Fair Deal employees, this will drive up the cost of the service.

- Private sector service providers may strongly resist extending entry to the LGPS due to:

  (i) Interference with harmonisation of benefit programmes. If a different value pension is awarded to new recruits depending on what contract they are employed to work on, this could lead to changes to other aspects of their pay and reward.

  (ii) General movement away from defined benefit pensions in the private sector. New recruits typically do not receive a defined benefit pension, so there is no expectation that this should be provided. If a service provider decides to offer new recruits access to the LGPS but the contract is subsequently re-let to another service provider that does not wish to offer access to the LGPS for new recruits, this runs the risk of workforce disengagement and/or union involvement both with the current provider and any subsequent provider. In that situation it might actually have been preferable for the original service provider not to have allowed new recruits access to the LGPS.

If the definition of Protected Transferee is implemented, there are a number of issues that will need to be addressed (whether in any Scheme Advisory Board guidance or otherwise):

- Who will be responsible for maintaining a list of protected transferees and how will this be monitored?

  The employers may want or expect this to be an administering authority responsibility, but we do not believe this will be practical as the administering authority may not have been involved in contractual discussions (and with the deemed employer route may not be aware that an outsourcing has occurred!).

  3B(2) of the draft Regulations provides that *"the employer of a protected transferee must ensure that the protected transferee has access to membership of the Scheme…"*. 3B(15) confirms that the service provider is the employer in this context, which suggests that the list of protected transferees should be the responsibility of the service provider. However, we would recommend that the Fair Deal employer is also involved in maintaining this list.

- What is meant by "wholly or mainly employed" in draft Regulation 3B(5)?

  Guidance should clarify what "wholly or mainly employed" on a contract means, particularly for the more complex scenarios, e.g. a service provider may be running several services for different outsourcing bodies in different LGPS funds under a Framework Agreement. An employee may be 100% engaged on one contract at contract commencement but later work across three contracts and split their time equally. If those contracts are aligned to three different outsourcing bodies in different LGPS funds the employee risks losing his/her right to LGPS membership.

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

It appears reasonable for Admission Bodies not to be subject to Fair Deal in relation to any employee who has not been subject to Fair Deal previously.

The exclusion of HE/FE institutions is not unexpected given previous announcements. However, the inclusion of some Part 2 employers (including wholly owned companies) goes beyond the current requirements. We think the Scheme Advisory Board (SAB) and other stakeholders should ensure this is well publicised so the new requirements are adhered to.

The draft regulations (3B(13)) set out that Fair Deal employers must have regard to the advice issued by the Scheme Advisory Board. However, Fair Deal extends further than the defined 'Fair

Deal employer', as Admission Bodies (and employers who have used the deemed employer route) who have protected employees could, in theory, sub-contract some (or all) of the service to another service provider. Thus we believe it is important that these employers should also be required to have regard to the Scheme Advisory Board advice in relation to those protected transferees.

Question 3: Do you agree with these transitional measures?

We largely agree with the proposals, but care will be needed to address the issue of current service providers sub-contracting part (or all) of the service to another service provider, which does not appear to be addressed in the regulations.

We also believe that consideration should be given to permitting, under exceptional circumstances, a service provider to offer pension provision through a broadly comparable scheme. Examples of exceptional circumstances that we have seen with central government contacts and the NHSPS in particular are:

- Where re-entry to the NHSPS is not permitted for Fair Deal employees who have started drawing part or all of their deferred pension in that scheme.
- Where the NHSPS does not offer broadly comparable service credits for bulk transfers with RPI linkage. Whilst the NHSPS will convert those RPI linked benefits to CPI, they will not uplift the member's service credit to reflect the change.

These examples may not apply to the LGPS but demonstrate the value that some flexibility can provide in responding to issues that came to light after the introduction of New Fair Deal and which, in the NHSPS, remain unresolved. We understand that HMT may not wish to deviate from its policy to end use of broadly comparable arrangements but believe that MHCLG should take the opportunity to learn from experience elsewhere and leave open the possibility for flexibility should future experience require it.

Question 4: Do you agree with the calculation of inward transfer values?

Current application of Fair Deal where bulk transfers take place between service providers under local government contracts

Currently, service contracts and GAD Passports set out broad terms for an onward bulk transfer. These terms are contractually binding for the service provider but not the trustees of their scheme. As broadly comparable schemes predominantly provide final salary benefits these terms require payment of a past service reserve, which allows for future salary escalation, based on the transferring schemes' funding basis ("technical provisions" basis).

There may be instances where terms are not set out in service contracts or service providers are unaware of the requirements for an onward bulk transfer in which case payment of a cash equivalent could be made to the receiving scheme.

In all cases, the expectation is that the receiving scheme grants broadly day-for-day service credits so that the member is not disadvantaged by commercial agreements on the transfer amount paid from one scheme to another.

To the extent that the contractually required bulk transfer amount is insufficient to grant the day-for-day service credits in the receiving scheme, the Awarding Authority would be expected to pick up the initial funding shortfall.

Consultation proposals regarding inward bulk transfers to the LGPS

We do not agree with the proposals as necessarily being fair to members, scheme employers and local taxpayers as stated in paragraph 26 of the consultation document.

The principal reason we do not believe they are fair to members is that members cannot transfer final salary benefits in a broadly comparable scheme in return for similar benefits in the LGPS.

In relation to employers, in our experience LGPS transfers to broadly comparable schemes have on occasion been based on transfer values significantly higher than cash equivalent transfer values following negotiation with the service provider (having regard to the funding regime in the private sector). As part of this negotiation the service provider has undertaken to provide a transfer value back to the LGPS on similar terms at the end of the contract. However, because of the lack of bulk transfer value provision in regulations it has been necessary to convert these enhanced transfer values into LGPS benefits using individual cash equivalent terms. This has resulted in significantly enhanced benefits for the members transferring back to the LGPS to the detriment of the relevant employer (and hence local taxpayers) by the 'round trip' of transfers from and to the LGPS.

We would instead suggest the following regulatory changes, which would address the concerns we have raised above:

- The introduction of an inward bulk transfer regulation

  Aon's Public Sector Team has long requested that there should be a bulk transfer value regulation for inward transfers from other Schemes (akin to the outward bulk transfer value regulation (Regulation 98)) as its absence has caused significant difficulties, including in relation to transfers from other public-sector schemes.

- An amendment to Regulation 9 of the LGPS Transitional Regulations 2014 to extend the references to public service schemes to include broadly comparable schemes where members have previously transferred LGPS membership and/or accrued additional membership by virtue of having been employed in the provision of services for a Fair Deal employer.

Our suggestion is to facilitate a bulk transfer that would enable final salary (either pre-2008 or pre-2014) scheme benefits to be granted in the LGPS where members have final salary benefits in the broadly comparable scheme. Other differences in benefit structure, including Normal Retirement Age etc, could be dealt with via adjustments to the service credits or employer undertakings etc as is often the case for transfers between the LGPS and other public service schemes.

We also think there should be proposals to require the Fair Deal employer to initiate a bulk transfer back to the LGPS at the end of the contract. In the unfunded public sector schemes, the Authority initiates the bulk transfer process, contacting the Government Actuary's Department who contacts the service provider. This supports the principles around Fair Deal that members should be no worse off as a result of the outsourcing. Under paragraph 26 of the consultation document, there seems to be no obligation on the Fair Deal employer to initiate this process and this, together with the lack of bulk transfer-in terms, is likely to lead to difficulties in ensuring members are protected.

The advantage of the individual transfer route is that it avoids the administration and advisory costs associated with bulk transfers and gets around the lack of contractual provisions relating to a transfer back to the LGPS. However, our suggested approach could also avoid these issues if there were also a set transfer value basis, as is currently adopted by GAD for the unfunded schemes. If there were a shortfall between the transfer value on the central basis and the amount required by the LGPS fund to provide broadly day-for-day service credits, this would then need to be funded by the relevant LGPS employer. There is less likelihood of a shortfall arising in the broadly comparable scheme due to differences in funding assumptions adopted between public and private sector schemes, but any shortfall would be a matter for the trustees of the broadly comparable scheme and not the administering authority of the receiving fund.

Question 5: Deemed Employer Status proposals

We appreciate that the Deemed Employer approach would help reduce the number of (smaller) admission bodies across the LGPS but from an administering authority perspective we are not convinced it will reduce operational and administrative work/costs overall.

Encouraging pooling of the admission body with the Fair Deal employer could be a better solution to implementing risk sharing / pass through agreements between the Fair Deal Employer and the service provider. Whilst pooling would lead to cross subsidies and hence sharing of demographic risks between employers and their members, the potential advantage for service providers is that they benefit from the same funding mechanisms used for the Deemed Employer, for instance the longer deficit recovery periods and any smoothing applied to employer contributions.

Some of the difficulties we perceive may arise with the Deemed Employer route are set out below. We are sure others will emerge over time and with experience.

- **Additional work related to payroll system**

  The service provider is likely to have a separate payroll system and is unlikely to want to use the Fair Deal employer's system. This negates many of the apparent advantages of the Deemed Employer route. For example, where administering authorities have monthly direct data feeds into the administration system from payroll, the Deemed Employer route would mean the same additional work for the Administering Authority linking up their system to the new payroll system as would be the case if the service provider were an admission body.

- **Provision of data**

  It is not clear if administering authorities would have the power to enforce provision of data from the service provider if the Deemed Employer route is used as there is no contractual agreement between the administering authority and the service provider (i.e. no admission agreement). For example, Regulation 69 only requires scheme employers to pay contributions within the regulatory timescales, so we assume there would be no obligation on the service provider if the Deemed Employer route were taken.

  Paragraph 40 of the consultation document and draft Regulation 3B(14) provide that the service provider must provide information to the Fair Deal employer to enable it to meet its obligations to the Fund. As a minimum this should be extended to refer to the administering authority being able to meet its obligations but it is not clear to us that service providers providing details of employees leaving or retiring, and of changes in pay or hours, to the Fair Deal employer for onwards transmission to the administering authority (assuming that is the proposal) will be an efficient or effective process from an administration perspective. Is the expectation that the administering authority would need to rely on the contract between the Fair Deal Employer and the service provider in relation to data provision and should it be able to veto the Deemed Employer approach if the contract between the Fair Deal employer and the service provider is not sufficient in this regard?

- **Employee contributions**

  Paragraph 40 of the consultation sets out that there is an expectation that the service provider will deduct contributions and pay these to the fund (although there is nothing in the draft regulations to this effect and no Admission Agreement to require this). This clearly indicates that there is a need for Administering Authority and service provider to provide information to each other, which does not reduce the administration with the Deemed Employer route. Where the service provider is not a scheme employer, additional regulations may be required to replace provisions currently in the Admission Agreement since this may be more effective in securing compliance than Scheme Advisory Board guidance. It is also not clear how tPR would view a breach of the legislation (e.g. non or late remission of employee contributions) by a body which is not technically an employer in the fund.

- **Additional burden on Fair Deal Employer**

  The Deemed Employer route could add substantial additional burden on the Fair Deal Employer, who will be responsible for paying employer contributions on behalf of the service provider, checking employee data and ensuring adequate data is being provided to the administering authority.

  We presume that under the Deemed Employer approach the service provider would not be responsible for any ongoing pension costs (other than those set out set out in draft regulation 3B(14)(b)) unless there is a provision in the contract between the Fair Deal Employer and the service provider regarding the reimbursement of pension costs. There is a danger here that Fair Deal employers adopt the Deemed Employer route without adequate protection being included in the contract and as a result will be responsible for paying employer pension contributions with this not being reflected in the pricing of the contract.

- **Identification of service providers using Deemed Employer route**

  Administering authorities and their actuaries will want to identify those working for a service provider even if the Deemed Employer route is being used to assist with administration (e.g. the administering authority may decide it is easier to deal with the service provider who has payroll records to hand rather than dealing with the Fair Deal Employer who will simply pass on the message to the service provider) and implementation of any risk sharing agreements. This negates part of the apparent reduction in administration and could even increase the administrative burden if the administering authority is then required to administer multiple different risk sharing approaches for different contracts or different Fair Deal employers.

- **Decision-making powers**

  It is not obvious how the role of the service provider as the de facto employer would interact with the Fair Deal employer potentially being responsible for any discretions. As such there would need to be clarity over which party has decision-making powers, recognising that there may be areas where a joint approach is required (for instance, authorisation of requests for flexible retirement or ill-health retirement). Our expectation is that the party that exercises the discretion would be responsible for any additional costs, unless otherwise agreed between the two parties.

- **Non-compliant service providers**

  As the Deemed Employer, the Fair Deal employer would be responsible for all pension liabilities and contributions if the service provider is non-compliant with its obligations (e.g. through insolvency or failure to provide timely information to the Deemed Employer). While there should be remedies via the outsourcing contract, there would be a time delay to recovery, and recovery may be less than 100% of the monies owed. There is no bond requirement (or other suitable guarantee) under this approach compared to the admission body route and our assumption is that any "loss" (in terms of pensions costs) would fall on the Fair Deal Employer. Whilst we are supportive of what we believe is an intention that Fair Deal employers, rather than the Fund, pick up any costs, in our experience letting authorities are still often far less well-informed than service providers and under these proposed new arrangements it will be even more important for Fair Deal employers to understand the pensions implications of the contractual agreement.

- **Academies**

  We are very concerned with draft Regulation 3B(4), which provides that an academy can only use the deemed employer route if it has followed guidance from the Secretary of State. The Regulation does not make it clear that this is Department for Education guidance (rather than MHCLG) but we assume that is the intention from paragraph 39 of the consultation document. Our concerns are that it is not clear who is responsible for ensuring the guidance has been followed and, if it has not been followed, what the default position is to protect scheme members—presumably establishment of an admission agreement? In order to protect administering authorities from the administrative burden of dealing with academy outsourcings, we believe that it would be better if there were not an option for academies to enter into admission agreements and for there to be a statutory list of protections within the LGPS regulations, which would apply to service providers where the Deemed Employer is an academy.

- **Codification / Guidance**

  Our view is that whilst high-level, permissive Regulations supported by statutory guidance can be a useful way of keeping the legislative provisions up-to-date and responsive to changing circumstances or practice, the proposed draft regulations are too light on detail and may lead to unintended consequences that defeat the stated aim of reducing the administration burden. We expect that codifying and capturing the issues for all parties (the service provider, the Deemed Employer and the fund) in guidance and regulations will be a big challenge. In the same way as the Regulations currently include a list of items to be included within an admission agreement, it may be useful for there to be a similar list (of the key issues) in relation to the contractual arrangements for Deemed Employers, perhaps supplemented by guidance issued by the Scheme Advisory Board.

Question 6: What should advice from the scheme advisory board contain to ensure that deemed employer status works effectively?

We have raised a number of issues above and believe there are a number of barriers to the effective working of Deemed Employer status. In addition to the issues above, we believe that the guidance should also address:

- What the standard risk sharing approaches are (in accordance with our comments later, where this is the route to be taken).
- Protection to be considered for the Fair Deal Employer, such as increased pension liability related to excessive salary increases prior to retirement where there is a final salary link, or reimbursement of redundancy costs (assuming these are charged to the Deemed Employer in the first instance).
- Alternatives to the Deemed Employer route that could perhaps achieve a better solution to risk sharing, such as a contribution pooling arrangement with the Fair Deal employer.
- Further details of the respective responsibilities of the parties, i.e. service provider, Fair Deal employer and administering authority, as these are not well set out in the draft Regulations.
- Areas that should be set out in the contract including those that would otherwise be included in an Admission Agreement, such as whether the contract can be terminated for non-compliance with pensions responsibilities or any penalties.
- Advice on whether administering authorities must administer whatever risk sharing arrangements are in place between Fair Deal employers and service providers, or whether they can elect to administer only certain “standard” approaches, to be set out in the Funding Strategy Statement or other fund document. Our strong preference as Administering Authority advisers would be the latter, although as advisers to scheme employers and service providers we also sympathise with their likely preference for flexibility to agree whatever provisions are appropriate for the circumstances of the contract. Where standard approaches are favoured, due diligence would be required in order to better understand what approaches are most commonly adopted between contracting parties, and Fair Deal employers would need to ensure that service providers are made aware of the standard approaches as early as possible in the procurement.

We believe a policy decision is needed on whether MHCLG/SAB would prefer consistency of approach across administering authorities or whether how administering authorities choose to approach Deemed Employers should be set locally (within the provisions of the Regulations) and set out in the Funding Strategy Statement. This should then influence the content of the guidance.

Consideration should be given to consulting on any proposals made by the Scheme Advisory Board, to ensure that what is being proposed can be implemented by all parties.

Finally, we suggest that guidance covers more than just the Deemed Employer route as we believe it is important that both sides consider risk sharing issues as part of the procurement exercise. We have long advocated training on, and guidance for, letting authorities on pension outsourcing matters but with staff turnover and lack of interest of pension matters (outside those that are in pensions departments) this has remained a struggle. In our experience this exposes letting authorities (and ultimately taxpayers) to unquantifiable risks / costs.

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

Deduction of Member Contributions

The consultation sets out that under the Deemed Employer route the service provider will retain an administrative role, e.g. deducting employee pension contributions and providing information to the fund. There is, however, nothing in the draft regulations, and no admission agreement, to require a service provider to provide this information to the fund. The regulations simply refer to providing information to the Fair Deal employer to enable it to meet its Scheme employer functions. This is therefore a cost and responsibility that appears to fall on the Fair Deal employer when in fact it should fall on the service provider. Overriding pensions legislation may well put the onus on the service provider as the actual employer to deduct and pay over pension contributions, but we think it would be preferable for this to be made clear, e.g. in Scheme Advisory Board guidance.

Risk

We would typically expect to see any increase in liability due to action of the service provider, such as the award of excess salary increases (with the term 'excess' being defined), to be retained by the service provider.

We do not believe that service providers would generally expect to take financial responsibility for additional liabilities arising from court judgments or other imposed benefit improvements like GMP equalisation or the cost cap effects (unless there is a very long-term contract (20 years plus) where the service provider may have the ability to absorb more pension risk). The key reasons for this are:

- Such events are likely to be unforeseeable and/or unquantifiable at the point of pricing for the service contract. If passed back to the service provider this could inadvertently and negatively impact the service being outsourced unless the service provider has the ability to increase its contract price.
- The service provider has no decision-making powers over the benefits/contributions, funding or investment strategy of the Scheme. As such, any additional liabilities arising as a result of decisions taken by Government should not financially impact a service provider who is participating in the LGPS at the time and who has agreed its pricing with the Fair Deal employer.

Where the Deemed Employer route is taken the service provider is likely to benefit from a smoothing of contribution changes, which is typically applied to councils and the other employers most likely to be Fair Deal employers. It would seem reasonable for those contribution changes to be passed on to service providers and it may be extremely difficult to separate out all the different elements of contribution rate changes (noting that unlike in the private sector it does not follow that increases in costs due to regulatory or other legal changes are immediately passed on in full to employers).

The amount paid by the Deemed Employer for the cost of pension accrual does not need to be the same as that paid by the service provider to the Deemed Employer for that accrual. We would expect that the service provider's contributions will be governed by the service contract and can include any risk sharing as agreed between the parties. It would, however, be useful to have standard risk sharing agreements as options for those who do not wish to negotiate bespoke agreements.

Other Costs

Where the service provider requests work from the Fair Deal employer or administering authority's advisers, and the cost of this work is not included in the employer contribution rate, we would expect the service provider to take responsibility for those costs.

Question 8: Is retention of admitted body status and inclusion of risk sharing within admission agreements the right approach?

We agree that it would be appropriate to retain the option of admitted body status for the reasons stated in paragraph 42 of the consultation document. In addition, as set out above, it may be administratively easier in some circumstances to agree a risk sharing arrangement in conjunction with an admission agreement (and potentially a pooling of contribution rate) rather than the potentially complex relationship required between the Fair Deal employer, the service provider and the Fund in order to facilitate the Deemed Employer approach.

We assume the intention is for the Fair Deal employer to make the final decision regarding the approach to be used, ideally prior to the issuance of procurement documents. If the Fair Deal employer decides to consult with the service provider regarding the approach to be used, then we believe the Fair Deal employer should be required to provide information to prospective service providers at the start of the procurement, as it will have a bearing on how the bidders price the service. We also believe that it should be a requirement of the Fair Deal employer to notify the administering authority of the approach to be adopted and to provide details of the Deemed Employer if that is the approach adopted.

From a fund perspective, if the risk sharing mechanism is included in admission agreements as standard practice, then it will need to be taken into account by the Fund actuary in actuarial valuations. This potentially causes additional complexity in the valuation process (particularly if admission agreements are poorly worded, which we have seen in the past) with resultant additional cost. Some funds have many large employers all outsourcing services and we have been encouraging administering authorities to take a firm line with letting authorities to avoid incurring the additional costs and administration associated with a wide range of risk sharing and other approaches which are contractual agreements between the employers. If it is decided that standard practice is to include the risk sharing mechanism within the admission agreement then it will be necessary for the administering authority to consult with the Fund Actuary to ensure the risk sharing can be accommodated in the valuation process. In this instance, we would suggest that administering authorities should be able to pass on any extra costs associated with administering such arrangements or to limit the options they are prepared to administer through their Funding Strategy Statement or associated employer policy document.

In addition, it is not clear how risk sharing agreements fit with some of the pooling or grouping arrangements that are already in place, which could again lead to further work and costs for administering authorities.

Question 9: What further steps can be taken to encourage early consideration of pension issues?

We agree that pension considerations are still often an after-thought in the outsourcing process; or where addressed as part of the procurement process, the requirements are not always fully appreciated by one or both parties.

Government could consider:

- internal education/upskilling campaigns for Fair Deal employers. It should be a requirement that any department that outsources work should have a base level of understanding of pension matters (noting that in our experience procurement exercises can often be led by the department responsible for the service, which means little or no pensions experience builds up within the authority);
- including an additional question on the pre-qualification questionnaire, which requires bidders to confirm whether they have engaged a pension specialist (this could be internal or external support). This would encourage bid teams to engage with their pension/HR department at the very early stages of a procurement;
- making it a requirement for Fair Deal employers to obtain a Pensions Information Pack, for dissemination to bidders, from their Fund Actuary. Government could also consider introducing a power for administering authorities to levy fines where pensions issues have not been adequately addressed, perhaps via an uplift to the additional cost incurred (to avoid any complaints that unjustified penalties are being imposed). This is quite a draconian suggestion but in our experience administering authorities have often offered to provide training or other support to letting authorities but with low or little take up and a continual

expectation that they will sort out any issues relating to pensions.

Additional comments

Consideration should be given to rolling out a standardised LGPS risk sharing agreement (with optional paragraphs to suit different circumstances) where either the Admission Body or Deemed Employer route is taken. This would help:

- minimise the time spent, and the cost associated with, discussing risk sharing with different bidders at the procurement stage;
- reduce the risk of a service provider failing mid-contract due to higher than expected pension costs;
- reduce the risk of service providers submitting higher priced bids due to not having sufficient detail about the pension costs and risks;
- bring pension considerations to the forefront, which should in turn support the issues highlighted above in Question 9.

Transferring pension assets and liabilities

Question 11: Is this the right approach?

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

On the face of it, this appears to be a reasonable approach and clarifies what is sometimes a difficult decision for administering authorities regarding the legality of merging assets and liabilities or imposing an exit payment. It also addresses concerns about mergers being used to evade payment for the liabilities of the former employer, which some administering authorities have encountered in the past.

However, unfortunately we believe the proposals are too simplistic and that there are a number of issues to be addressed, which require other changes to the regulations:

- The administering authority should have the power to amend the contribution rate to allow for the merger or take-over. This would avoid the "successor" body being chosen as the employer with the lower contributions and ensure that any monetary deficit contributions can be re-certified for the combined entity (rather than the deficit contributions being limited to those certified for the receiving employer). This could be achieved either by inclusion of additional wording in draft Regulation 64(12) or by amending Regulation 64(6)(b) (it is extremely unclear at present that the latter Regulation can be used in these circumstances because of the reference to Regulation 62(8)). We have raised this issue with the Scheme Advisory Board in relation to interim valuations.
- In draft Regulation 64(12) the Regulations should make it clear that all assets and liabilities are transferred (including those relating to former employees) as is implicit in draft Regulation 64(11).
- Where the successor body is in a different fund to the exiting employer, draft Regulation 64(12) should clarify how this interacts with paragraph 3 of Part 2 Schedule 3 where the Secretary of State must be asked for permission to transfer with all parties agreeing. We presume this Regulation is intended to bypass this arrangement? Similar comments apply in relation to Regulation 103.
- Is it intended that all active members will automatically transfer their accrued LGPS benefits to the new fund and will not be allowed the option to retain their deferred benefits in the exiting employer's fund?
- Clarity should be provided about what will happen to pensions already in payment in relation to the original employer – would these automatically be transferred to the new fund?
- We are concerned that a merger of employers in different funds could mean a deficit transferring to a weak employer as a result of a merger. This increases the risk to the fund and hence other employers participating in that fund, and under the current draft regulations the Administering Authority would not be able to refuse such a transfer. We wonder whether, in exceptional circumstances,

the Administering Authority could refuse to accept such a transfer value.

- Regulation 64(12) should be amended to clarify which Administering Authority will be the 'host' where two employers in separate funds merge to form a new organisation operating equally across both sites (e.g. a college merger creating a new college organisation across two sites). The regulation should also clarify that it does not apply to an academy joining a MAT that operates across multiple funds (we assume that it is intended for academies to remain in their geographical fund).
- If all the assets and liabilities are to transfer then it is not clear what additional guidance is required, but we suspect it may be useful to set out streamlined requirements rather than relying solely on Regulation 103. In particular, we believe that all the assets relating to the exiting employer should be transferred even where there are fewer than ten members (which is a requirement in Regulation 103), as any shortfall (surplus) after the transfer will otherwise fall to be met by other employers in the fund. This could be set out in this guidance.
- We do not believe that it will always be in the best interests of the employers to transfer assets and liabilities to another fund. In some cases a "clean break" may be preferable and avoids the cost and time associated with bulk transfers between funds, which can be expensive relative to the benefits if there is only a small number of members. We believe some flexibility for all parties to agree that the exiting employer pays the exit payment in the exiting fund rather than the assets and liabilities transferring would be helpful. The reason for the cost is partly that it requires agreement of the approach / calculation of the amount to transfer by two actuaries (under Regulation 103 or under guidance by the Secretary of State). Clearly if it is all assets and liabilities then there should be little negotiation involved but it will still require:

  i. agreement of the roll-forward approach (but perhaps this could be set out in the Secretary of State guidance?);

  ii. the collection and checking of cashflow data and the undertaking of the roll-forward calculation;

     - transfer of records—in particular transfer of payroll records and ensuring pensioners get paid correctly;
     - checking of administration records transferred to ensure there is no missing information.

- Complications may occur in relation to Compensatory Added Years (CAYs) and AVCs so this should also be considered.
- We have had experience of Multi-Academy Trusts closing and there being a number of successor bodies, and some liabilities not being transferred to any of those successor bodies. In such circumstances it is appropriate for an exit valuation to be carried out. In addition, it is not at all clear how the new draft Regulations would be implemented in cases where there is not a straightforward transfer from one employer to another. Even if all the schools within a MAT are treated as a single employer, that does not solve this issue since in the cases we have experienced, the schools from a failed MAT transferred into a number of other, different MATs. We would much prefer a specific change in the Regulations to cover academies and MATs that acknowledges that multiple employers may be involved, enables the Administering Authority to amend the contributions of all the affected MATs and also retains the requirement to carry out an exit valuation to ensure that appropriate funds are received where there are some liabilities that become orphan, i.e. do not transfer to another employer/successor body.

The draft regulations do not define what is meant by a merger or take-over and it is not clear who is responsible for deciding whether Regulations 64(11) to (13) apply. In order to avoid disagreements between the parties we would have preferred to see further explanation within the Regulations rather than something so fundamental as to whether or not the provisions apply being left to guidance.

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

The main areas will be to set out:

- How the initial value of assets is calculated, e.g. at the previous formal valuation, or based on the most recent unitisation figure.
- How that value is then adjusted from the previous formal valuation (or other date where appropriate), including allowance for expenses etc.
- Who has to agree to the approach—one of the issues with Regulation 103 is that it is the actuaries to the two funds who have to determine the transfer payment when in practice it is important for the employers to have a role.
- Whether there should be a time limit for the payment (to avoid what can be quite material delays in transfers), including a requirement for the parties to agree the data as well as the transfer amount.
- How any advisory costs are dealt with—Regulation 103 states they should be shared between the funds but it may be preferable for these to be deducted from the transfer payment so that the employers concerned meet the cost rather than other employers in the paying fund.

We would also note that in our experience Directions under paragraph 3 of Part 2 Schedule 3 have not been explicit enough to avoid potential disagreements on the approach to take.

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