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Local Government Pension Scheme – Academies and pooling in the LGPS
Department for Communities and Local Government
Zone 5/F5
Eland House
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Dear Robert

Consultation on the Local Government Pension Scheme – Academies and pooling in the LGPS

Further to the consultation paper issued on 4 October, in which you sought views on potential pooling arrangements for academies, CIPFA is pleased to offer the following observations.

General observations

As you may know, CIPFA, via its Pensions Panel, has over many years supported LGPS practitioners in the efficient and effective administration of the LGPS. With the growth of academies over the last few years, we have received a number of enquiries from practitioners regarding how best to handle these new employers within the LGPS. Over time, funds have each developed their own approaches which best meet local circumstances, including prudently balancing the risks associated with academies as scheme employers with the need to ensure the long term stability of contribution rates for this group of employers. All of this has been achieved without the need for further regulation and it is our view that further regulation is not necessary.

The guarantee which came into effect from 18 July, by which the Department for Education will meet any outstanding scheme liabilities on the closure of an Academy Trust, has assisted funds in forming judgements on the risks associated with academies. However, despite the assurances in the updated FAQ, the limited nature of the guarantee places a restriction on the extent to which it can be relied upon by funds in undertaking their risk assessment.

As outlined above, funds are developing approaches which best meet local circumstances. Were regulation to be brought forward that required funds to pool employers on an unequal risk basis, this should be balanced by placing the above guarantee on an equal statutory footing without the limitations that are currently placed upon it.

As requested, responses to your detailed questions are set out in Annex A.

I hope these comments are a useful contribution to DCLG’s consideration of the issues surrounding academies and pooling. As ever, if you would like to discuss further any of

the points raised, please do not hesitate to contact CIPFA via the Pensions Panel Secretary, Nigel Keogh, at nigel.keogh@cipfa.org.

Yours sincerely

Bob Summers
Chair, CIPFA Pensions Panel

Annex A

The practical considerations of a pool

1. The proposal for this consultation is that stability of a converted Academy's scheme employer contributions will be best achieved by pooling the scheme arrangements of Academies and the ceding local authority. Is this the best way to achieve the stability needed? And, if not, what are the other solutions?

As the consultation points out, pooling arrangements can serve to spread the risk of volatility in contribution rates arising from various factors across a wider range of employers. Shared demographic assumptions for example can help to even out membership profiles that might otherwise cause valuation results (and subsequent contribution rates) to fluctuate significantly in response to relatively minor fluctuations in the profile.

Local authority pension funds have been using these mechanisms over a number of years as a means of protecting certain groups of employers from such volatility. Typical pools may be centred on certain shared characteristics such as membership size, business type etc. It is quite possible therefore that some degree of stability for academies can be achieved by pooling academies, either as a distinct group or with other similar employers.

Whatever the rationale, one feature that underpins most pools is that the employers within them share a similar risk profile.

Pooling academies with local authorities does not fit this model. Not only are academies incomparable with local authorities in terms of size or business model; as the consultation paper makes clear, local authority maintained schools take on a very different risk profile when they convert to academies.

Academies are separate business entities which sit outside of the local government financial framework and as such do not enjoy the "constitutional permanence" of local authority maintained schools which remain under the local authority umbrella. Whilst academies have an open ended rolling funding agreement with the Department for Education, the existence of a 7 year notice period effectively limits the assumptions funds can reasonably make regarding the long-term funding of an academy. This subsequently raises doubts as to its ability to meet its pensions liabilities in the long-term and raises the risk of orphaned pension liabilities falling upon the scheme in the event of the academy losing its funding and/or being wound-up.

These limitations have been recognised by the Department for Education which prompted the department to issue the guarantee that is referred to in paragraph 16 of the consultation paper.

This guarantee gives assurances that in the event of the closure of an academy, outstanding scheme liabilities will not fall upon the fund but will instead be met from the remaining assets of the academy and, where these are insufficient to discharge the liability, from the Department of Education itself.

However this guarantee in itself carries certain limitations which may restrict the reliance that funds can place upon it.

Paragraph 8 of the Parliamentary minute laid by the Department for Education dated 2 July 2013, which sets out the guarantee, states that *"the Department and HM Treasury reserve the right to withdraw the guarantee at any time…Grounds for the Department withdrawing the guarantee include if the levels above are exceeded and projected costs are no longer affordable from within the Department's existing budget or are not approved by HM Treasury. HM Treasury also reserves the option to re-assess the approval of the guarantee at a later date, as appropriate, due to spending considerations or policy developments."*

A provision that allows for the guarantee to be withdrawn with no indication of what further protections may be put in place to protect funds from default on the part of academies raises questions as to how much reliance can be placed upon this guarantee.

The minute goes on to assert that the potential calls upon the guarantee will be limited as the likelihood of an academy closing is low. We understand that this is based upon historic closure rates of local authority maintained schools. This is not a like for like comparison and using such data to predict future patterns in academy closure is likely to be misleading. The risk of closure in local authority maintained schools is primarily through fallings school rolls, whereas the risk of closure of academies extends beyond falling numbers to, for example, wider business failure.

Given that there is little in the way of academy-specific empirical data on which to base such an assumption, it is perhaps a little early in the life-cycle of academies to assume that the closure rate would be so low as to not exceed the financial assumptions that underpin the guarantee. Given the proliferation of academies and the fact many academies have little in the way of assets beyond premises (which in many cases are held under lease and are therefore unable to be used to defray pension liabilities), a default rate of less than 1% would be sufficient to place great strain upon the contingent liability levels referred to in the extract above. This in turn could trigger the withdrawal of the guarantee as set out in the Parliamentary minute.

Regulation 7 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) requires funds to obtain either an indemnity/bond or a satisfactory guarantee when admitting community or transferee admission bodies to their funds. Fund administrators would be unlikely to accept guarantees which are limited by the ability of the guarantor to pay or which could be withdrawn unilaterally by the guarantor. Whilst academies are not classed as admitted bodies, their size, funding characteristics and risk profile closely follow that of transferee admitted bodies. It therefore follows that the requirements placed on academy guarantees should match those placed on other, similarly structured bodies.

The document issued alongside the consultation paper (*Academies and the LGPS FAQ Edition 3 : October 2013*) seeks to address the limitations of this guarantee. Whilst these points are noted, they do not alter the fundamental limitations of the guarantee from the perspective of local authority pension fund proceeding in a prudent manner.

Those limitations, combined with the uncertainty surrounding the long-term funding of academies, still represents risks which are not shared with local authorities or local authority maintained schools.

One potential solution to this is that the guarantee be put on a permanent, statutory footing, with no limitations in terms of duration or amounts which may be sought from the Department of Education in the event of an academy closing with outstanding pensions liabilities.

Were this to be the case, this would reduce the risk of orphaned liabilities falling on other employers within the fund. Fund administrators could proceed into pooling academies together with other similar employers on a similar risk basis, including local authority maintained schools (where practicable – not all local authority maintained schools are identified as discrete employers with within LGPS funds, and to introduce compulsion in this area would add to administrative costs where this is the case). This should provide the desired stability for the reasons outlined previously.

That said, an academy having stable contributions and an academy ultimately meeting its own deficit are not always going to be mutually achievable. For instance, an academy with a much poorer emerging deficit (due to pay awards, lengths of service, historic underpayment of contributions against "actual" costs) is at risk of seeing a widening deficit which is being concealed by the stable contribution rate. At some point that academy's own position will need to be addressed by higher contributions from that academy, regardless of questions of stability. Failing to do so would place other members in the pool at risk of facing higher contributions to compensate.

We would also note, that even with the suggested strengthening of the guarantee, pooling academies with local authorities may still not be appropriate given the differences in size and business type. The contribution rates paid by academies should still reflect the different demographics that academies present and pooling with local authorities (and sharing the same demographic assumptions) would distort the outcome.

Whilst the consultation paper is focussed on pooling as the primary method of achieving stability, in considering the outcome of the consultation, existing practices to stabilise contributions rates should not be overlooked. For example, many LGPS funds operate formal contribution stabilisation mechanisms which may be extended to individual academies. These mechanisms are set up once the funds have tested that the resulting stabilised contribution rates will be likely to secure full funding over the longer term.

2. What bodies should be included in the pool: Academies and local authorities, Academies and local authority maintained schools, or only Academies? Please say what other arrangements would achieve this aim.

As noted above, local authority pension funds have been using pooling mechanisms over a number of years as a means of protecting certain groups of employers from contribution rate volatility. Typical pools may be centred on certain shared characteristics such as membership size, business type etc. It is quite possible

therefore that some degree of stability for academies can be achieved by pooling academies, either as a distinct group or with other similar employers.

There is no evidence to suggest that any one particular pooling model produces better results (in terms of long-term stability of contribution rates) than any other. This is perhaps an area worthy of further investigation. In the absence of evidence to support a single model solution, funds should be free to determine what arrangements best suit local circumstances.

3. If pooling regulations are introduced, should an organisation have a choice about membership of the pool, and should this choice be permanent?

As noted earlier, we do not believe that regulation in this area is necessary. Funds have each developed their own approaches which best meet local circumstances, including prudently balancing the risks associated with academies as scheme employers with the need to ensure the long term stability of contribution rates for this group of employers. All of this has been achieved within the current regulatory structure.

However should DCLG proceed to place pooling on a statutory basis, it should be done in such a way as to minimise unnecessary administrative and financial burdens on both the fund administrator and participating employers. To that end we would suggest the following:

- Participation in the pool should not be compulsory. Academies are independent bodies and will have their own views on the extent they wish to participate in shared arrangements. They should not be viewed as homogenous - they vary in size, business model etc. However potential participating employers should be provided with sufficient information to make an informed decision as to whether participation in the pool best meets their requirements.

- Once participants have opted-into the pool, they may only leave the pooling arrangement with the prior consent of both the fund administrator and other employers in the pool. As the consultation paper rightly points out "*frequent dipping into and out of a pooling arrangement alters the profile of the pool membership and scheme actuaries would not be able to have certainty about who would be in a pool at any one time. This then increases risks and costs, not just for Academies, but across the whole pool".* Such a provision would protect other employers in the pool from suffering unnecessary volatility in the contribution rate generated by a shifting membership composition. It would also reduce the financial and administrative burden associated with constant recalibration of the pool.

We also agree with the stipulations restrictions set in Paragraph 13(c) to (e) of the consultation paper, namely:

c) The fund actuary determines the assets and liabilities as if the pool was a single employer and assets and liabilities are apportioned between the different employers so that each had a proportionate share.

d) Each employer's contribution rate would be set so that, overall, the cost of benefits and any deficit would be recovered over the same period for all employers in the pool.

e) Employers within the pool could retain freedom to use their discretions to manage their workforce but, to ensure costs did not unfairly fall on other employers in the pool, the administering authority could make an extra charge on that employer if;

• the employer increases pay rates for scheme members above the assumed level;

• they have used their discretion to increase the total service of a member or award additional pension (Administration Regulation 402);

• if members becomes entitled to benefits on the grounds of ill health, redundancy, efficiency or flexible retirement (Administration Regulation 413);

• a contribution towards the administration of the pension fund is due under Administration Regulation 424;

• if the administering authority has incurred additional costs resulting from the level of performance of the employer (Administration Regulation 435);

• if due to late payment interest is due under Administration Regulation 446.

These measures would ensure that the pool operates as intended in stabilising the contribution rates for all employers in the pool, and each employer is responsible for meeting costs that arise as a direct consequence of their own workforce management decisions.

4. Should actuarial assumptions used for all employers in the pool be agreed at local level with expert advice from the fund actuary? Or should expert guidance be developed for use by each fund?

There are distinct advantages to allowing local funds and their actuaries to determine the actuarial assumptions to be used in pooling arrangements. This is particularly true of demographic assumptions where in many cases LGPS administrators are using fund-specific mortality patterns developed by their actuary to better inform assumptions. Such patterns vary widely across the country and can have a significant impact on valuation results and subsequent contribution setting.

Fund investment strategies and their associated asset mixes also vary quite widely. This will impact on the assumptions that are made regarding the expected rate of return on assets.

Centralised guidance would by its very nature be too remote to reflect these local nuances.

Effect of introducing a pooling regulation when many maintained schools have already converted to an Academy

5. What provisions might be needed to avoid any additional costs where transfers of assets and liabilities have already been made as a result of academy conversions?

It is not clear what “additional costs” are being referred to here.

The most common method of allocating assets and liabilities when a local authority maintained school converts to academy status is for the local authority to retain the liabilities for deferred and pensioner members. Academies take on the liabilities for the active members that transfer to the academy. The local authority retains sufficient assets to match the liabilities for the pensioner and deferred members, with the remaining assets allocated against the academies liabilities.

To revisit this methodology and reallocate assets and liabilities on some other basis would certainly incur significant costs in terms of actuarial input and fund administrative resources.

As noted previously, we do not believe that regulation in the area of pooling is necessary. However should DCLG pursue this line, then the regulations should be framed in such a way as to focus on the on-going management of academy contribution rates rather the mechanics of establishing assets and liabilities upon conversion.