NORTHUMBERLAND COUNTY COUNCIL PENSION FUND
Pension Fund Panel Meeting 21 June 2019

South Tyneside Council

Pensions Committee

Date: 11th June 2019

Pensions Administration

(for information and discussion)

Report of the Head of Pensions

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- **Purpose of Report**

1. This report briefs the Committee on developments in certain pension administration matters that are LGPS specific and also provides an update on non-LGPS specific matters which are of interest.
2. The Committee is asked to note the report.

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Background

3. This report provides an update to Committee on important pensions administration matters that are of particular relevance at this time. The report is split into 2 main sections, namely:

   - Local Government Pension Scheme specific matters; and

   - Non-Local Government Pension Scheme specific matters which are of interest. Issues in this section of the report are for information only.

LGPS Specific Matters:

MHCLG consultation – LGPS: Fair Deal – Strengthening Pension Protection

4. When a local authority, or other Best Value body, is outsourcing a service which results in the compulsory TUPE transfer of staff, the outsourcing employer is currently required to ensure:

   - continued LGPS membership; or

   - access to a Government Actuary's Department ("GAD") certified broadly comparable scheme.

5. MHCLG recently consulted on a proposal to change the above requirements by introducing Fair Deal in the LGPS. Fair Deal is not new and has applied to other public sector bodies for several years. However, whilst long mooted, this has not previously applied to local authorities or other Best Value bodies.

6. If introduced, Fair Deal will remove the option for staff to be granted access to a GAD certified broadly comparable scheme. Instead, outsourcing 'Fair Deal Employers' (this term will include most Scheduled and Designation Bodies) will be required to provide continued LGPS membership for "Protected Transferees" (a person with LGPS eligibility employed by a Fair Deal Employer).

7. The proposed removal of the GAD certified broadly comparable option is welcomed, as is the protection for transferring staff of a range of Scheduled and Designation Bodies. These safeguards will help to maintain LGPS membership.

8. Whilst the introduction of Fair Deal in the LGPS has long been expected, the current consultation included a number of suggested changes that we had not previously envisaged. This included:

   - the power for admission agreements to contain risk sharing provisions;

- the extension of the 'Deemed Employer' regime as an alternative to admitted body status;

- provisions on automatic asset and liability transfer in the event of takeover / merger.

9. The Fund submitted a response to the consultation on 4 April 2019. A copy of the Fund's response is set out in appendix 1 to this report. Nonetheless, a summary of the Fund's response was as follows (our expressed view is shown *italicised*):

   (i) Removing the option for an outsourcing employer to offer a broadly comparable scheme for transferring staff and to require continued LGPS membership.

   The Fund supported this proposal as it promotes the LGPS.

   (ii) Extending the range of employers to whom Fair Deal will apply in comparison to those covered by Best Value (which is the outgoing regime).

   The Fund supported this proposal on the basis that it promotes the LGPS. The notable exclusions from those to be covered by Fair Deal are colleges, universities and admission bodies. The logic being that such bodies are private sector bodies and, as such, should not be protected in the same way as public sector bodies.

   In relation to the colleges and universities, we have requested MHCLG consider this again on the basis that they are large employers and a possible reduction in numbers (i.e. in the event of large outsourcings) from those employers could adversely impact the scheme.

   (iii) The introduction of 'deemed employer' status for service providers to facilitate risk sharing provisions and to provide an alternative to admitted body status.

   We broadly supported the principle, but we expressed concern that MHCLG is looking to overly simplify a complex area (risk sharing and pass through arrangements can be very complex). Additionally, we expressed concern that the proposals are too light on detail at this time (it is being proposed that the detail is to follow, but we would prefer to consider the matter fully once the detail is known). We asked MHCLG to delay implementing this to allow further consideration.

   (iv) To allow for the automatic admission of a new entity following merger / takeover and for that new entity to become responsible for the assets and liabilities of the outgoing entity.

We supported this proposal as it protects the Fund should an employer exit the Fund following a merger / takeover.

(v) Following the merger / takeover of 2 entities, where the successor entity participates in another LGPS fund, to automatically require the transfer of the assets and liabilities of that successor entity to the other LGPS fund.

We opposed this proposal as it is excessive and unnecessary. We see no reason why the successor entity cannot participate in more than one LGPS fund and the transfer of assets and liabilities is time consuming for officers and results in otherwise unnecessary actuarial fees being incurred.

10. MHCLG is considering the consultation responses at this time and a response from MHCLG will be expected in due course.

MHCLG consultation – LGPS: Changes to the Local Valuation Cycle and the Management of Employer Risk

11. MCCLG launched a new consultation on 8 May 2019. A copy of the consultation has previously been circulated to Committee by email.

12. The consultation is seeking views on the following proposals:

- changing the local fund valuation cycle from the current 3 year period (triennial) to a 4 year period (quadrennial);
- introducing measures to mitigate the risks of moving to a quadrennial valuation cycle. This may include powers for an administering authority to conduct interim valuations and an employer may also be permitted to request an interim valuation;
- introducing flexibility on exit payments;
- amending the exit credit regime, specifically factoring in risk sharing agreements; and
- removing the ‘requirement’ for further education corporations, sixth form college corporations and higher education corporations in England to offer new employees access to the LGPS. Existing active members, and those with current LGPS eligibility, are to be protected.

13. Changes to the valuation cycle had been expected; however, as with the consultation on Fair Deal, this consultation has gone further than we anticipated. In particular, the proposal to amend the status of colleges and universities within the LGPS had not been foreseen in the short term.

14. Officers are in the process of formulating their views on this, but will submit a formal response to the consultation ahead of the deadline on 31 July 2019.

15. As there is no Pensions Committee between this meeting to the deadline date, it is proposed that the formal response will be agreed with the Chair and Vice Chair prior to final submission. Initial views on the proposals will be discussed at the meeting.

Ongoing Consultation – Guaranteed Minimum Pensions

16. In a number of earlier reports the Committee has been advised that in February 2017 the Fund responded to an HM Treasury ("HMT") consultation on options for how the Guaranteed Minimum Pension element of pensions paid to those members who will reach state pension age on or after 6th December 2018 should be indexed. Since then members have been provided with an update at each meeting.

17. In January 2018, HMT published its response to this consultation. This acknowledged that it is a complex area and more time is required to identify a long term solution. As a result, it will now extend the existing interim solution, covering those members of public service schemes reaching state pension age between 6th April 2016 and 5th December 2018 to those that reach state pension age on or before 5th April 2021. Further time will then be taken to identify the longer term solution.

18. The interim solution increases the value of liabilities in the LGPS, though this increase is not generally material and the Fund Actuary does not envisage any need to review employer contributions to the Fund before the 2019 valuation.

19. The original consultation set out three options for indexation:

    - case by case – a comparison of total income received by the pensioner from public and state pensions provision under the old and new system,
    - full indexation - public sector schemes to directly meet the cost, and
    - conversion - to convert the GMP into a scheme benefit on 1:1 basis.

20. In their response to the consultation, HMT confirmed that it will disregard the case by case solution, acknowledged that full indexation is overly burdensome and indicated that it is likely to further investigate the possibility of conversion. The direction of travel therefore appears to be towards a move to conversion, but it is understood that there is a willingness to keep options open.

21. It is expected that further consultation will take place, but to date no further progress has been made. The Committee will be kept up to date on this matter.

SAB Review - Academies

22. The Scheme Advisory Board ("SAB") has commenced a review of the participation of existing academies and commissioned PwC to investigate these issues and prepare a report.

23. The report, which was released on 17th July 2017, made no recommendations but set out three broad types of approach or mechanisms to try and resolve these issues. These are:

    - non-regulatory measures within the LGPS
    - regulatory measures within the scheme, and
    - measures outside of the LGPS, including through primary legislation.

24. The SAB review has been split between a funding working group and an administration working group. Work on the administration working group was put on hold due to competing work pressures; however, this has now been lifted and work on this is to resume.

25. Officers will continue to monitor the position and update Committee accordingly.

SAB Review – Tier 3 Employers

26. In addition to the review noted above, the SAB has also commissioned some work in respect of "Tier 3 employers" in the LGPS.

27. Broadly speaking, Tier 3 employers are those employers which: (i) have no tax raising powers, (ii) are not backed by an employer with tax raising powers; or (iii) are not an academy.

28. It is understood that the SAB is seeking to identify the potential funding, legal and administrative issues and liabilities relating to Tier 3 employers.

29. SAB has established a small working group to review concerns expressed by Tier 3 employers and the ways in which they may be resolved. The working group is tasked with reporting back to the SAB with a set of recommendations for further consideration. At the current time, no changes are expected in advance of the 2019 valuation.

30. The latest MHCLG consultation which covers potentially removing the 'requirement' for further education corporations, sixth form college corporations and higher education corporations in England to offer new

employees access to the LGPS, is understood to have its roots in this review.

31. The Committee will continue to be updated on this matter.

SAB Review – Good Governance in the LGPS

32. In 2014/15 the SAB commissioned a project to look at the issues and challenges of potentially separating the pensions function of LGPS administering authorities from their host authorities.

33. The review centred on the potential conflicts of interest that can arise. The view was expressed that, in principal, the greater the separation between the Pension Fund and the employers, the lesser the risk there is of a conflict arising.

34. Whilst a report was produced by KPMG on this subject no firm decisions were taken on how to progress and the initiative was largely put on hold as the SAB prioritised other areas of work such as pooling and academies.

35. The SAB now believes it is appropriate to restart this initiative and issued a tender for some follow up work, focussing on two options:

    - a greater degree of separation within existing structures. This involves establishing a single unit to look after pensions within the host authority, which would retain the scheme manager responsibility. This approach appears to be close to the one currently adopted at Tyne and Wear Pension Fund with a separate standalone Pensions Service within South Tyneside Council as the Administering Authority.

    - separation via new structures. This envisages delegation of the scheme manager function in its entirety to a new body, which would then be responsible for all decisions in relation to the Fund. The constitution of the new body would need to be contained in a formal agreement. One option noted for the legal structure of such a new body is a combined authority similar to those in place for transport and planning.

36. Hymans Robertson has been appointed by the SAB to carry out the project on the "good governance of the LGPS".

37. This review was initially entitled "Options for the Separation of the Host Authority and Pensions Fund". However, more recently, the review has been rebranded as a review of "Good Governance in the LGPS".

38. The latest development in this review is that Hymans has launched a survey seeking views from a limited range of stakeholders including;

    - The Chair of each funds Pensions Committee

- The Chair of each funds Local Pension Board
- The Section 151 Officer at each administering authority
- The Lead Pensions Fund Officer at each administering authority
- The trades unions
- A selection of other employers who participate in the LGPS

39. In particular, views are sought on the following governance models:

    Option 1 – Improved practice: Introduce guidance or amendments to LGPS Regulations 2013 to enhance the existing arrangements by increasing the independence of the management of the fund and clarifying the standards expected in key areas.

    Option 2 – Greater ring fencing of the LGPS within existing structures: Clearer ring-fencing of pension fund management from the host authority, including budgets, resourcing and pay policies.

    Option 3 – Joint Committee (JC): Responsibility for all LGPS functions delegated to a JC comprising the administering authority and non-administering authorities in the fund. Inter-authority agreement (IAA) makes JC responsible for recommending budget, resourcing and pay policies.

    Option 4 - New local authority body – an alternative single purpose legal entity that would retain local democratic accountability and be subject to Local Government Act provisions.

40. Whilst the above options are stated in the survey, Hymans / SAB acknowledge that a one size fits all approach may not be appropriate. Final recommendations could be variations of the options set out above.

41. As previously noted Option 2, is the most closely aligned to approach adopted at Tyne and Wear Pension Fund.

42. Committee will be updated as this matter progresses.

Cost Management Review

43. A cost control mechanism was introduced in public service pension schemes following the Hutton review. The aim was to provide protection to taxpayers and employees against unexpected changes in pension costs.

44. In the LGPS, the cost cap mechanism is complicated by the fact that there are two control mechanisms in place. Both are complex and work in similar ways but are not identical to each other, and are run by:

- Scheme Advisory Board (SAB) – this is non-statutory and is intended to give an 'early warning' of any changes to costs

- Her Majesty's Treasury (HMT) – this is the statutory cost cap, and 'trumps' the SAB version. Proposed changes from the SAB exercise can however, be taken into account by the HMT process when considering their exercise.

45. Both caps have a 'target cost' (determined using Government Actuary's Department (GAD) assumptions) and the underlying legislation requires action to be taken if the target under the HMT cost cap is breached by 2% of pay e.g. if the target was 19.5% of pay, a breach would occur if the cost fell to less than 17.5% or rose above 21.5%. The action involves changes to the benefit or employee contribution structure to bring the cost back to the target cost.

46. As noted above the SAB calculation is intended as an early warning mechanism and as such takes place in advance of the HMT calculation.

47. The outcome of the SAB calculation was a total Scheme future service cost of 19%, against a target of 19.5%. The reduction in cost is believed to largely be attributable to a lower than assumed increase in life expectancy.

48. Consequently, the SAB considered changes to the benefit package and contribution rates to bring the cost back to the target level. It made a proposal to Government which included:

    - removing Tier 3 ill health benefits with eligible members to receive Tier 2 instead;

    - the introduction of a minimum death in service benefit of £75,000;

    - enhanced early retirement factors for members active on 1 April, applied to all service;

    - some amendments to the employee contribution rates at the lower salary levels and others to address tax anomalies.

49. It was estimated that these changes would add additional costs on average of around 0.9% of pay. The above changes, subject to agreement by Government and following a consultation exercise, were initially expected to be introduced with effect from 1 April 2019.

50. In advance of this agreement, the LGA and SAB recommended that steps be taken to prepare for these amendments. Consequently, the Fund wrote to Scheme employers and recommended that steps be taken to prepare for changes to the Scheme with effect from 1 April 2019.

51. If the proposed changes from the SAB are accepted by Government these changes would then be taken into account by the HMT as part of

their cost cap calculation when determining if the cost floor has been breached. If after accounting for these changes the floor is still breached further action will need to be taken.

52. Despite the direction of travel previously appearing clear, an unexpected complication arose. This followed Central Government deciding to appeal a Court of Appeal decision to the Supreme Court in a case referred to as McCloud.

53. The McCloud case relates to transitional arrangements in the Judges' Pension Scheme that are alleged to amount to age discrimination (a very similar case in the Firefighters' Scheme has been joined with McCloud). Although McCloud does not directly relate to the LGPS, the judgement, if upheld by the Supreme Court, could result in an increase in costs in the LGPS if benefits need to be improved to address age discrimination.

54. Therefore, if this judgement leads to increased costs to the Scheme, this will all need to feed into the cost cap calculation, which means the current calculation which suggests that costs have fallen may actually not be the case.

55. Consequently, Central Government has announced that the Cost Cap Review is now on hold until McCloud has been resolved. This means that the benefits improvements will not be introduced from 1 April 2019, although, subject to McCloud, the amendments may need to be made retrospectively at some point in the future.

56. The current position is causing uncertainty in the LGPS and this is most unwelcome as we approach the 2019 valuation.

57. The LGA prepared a Q&A document on McCloud to try and address some of the uncertainty. At the end of the Q&A, the LGA and the SAB asked administering authorities for their preferred approach between dealing with the matter at local level or for SAB guidance to be issued. The majority of respondents, including the Fund, expressed a preference for there to be central guidance.

58. SAB issued its guidance on 17 May 2019 and the proposed approach is as follows:

    (a) If there is no finalised outcome on cost cap/McCloud (in the form of a formal notification by MHCLG to administering authorities including a commitment by government to detailed benefit changes) by 31st August 2019 then the scheme benefit design used in the valuation should be as set out in current regulations.

    (b) In setting employer contributions for 2020 each administering authority should, with their Actuary, consider how they approach (and reflect in their Funding Strategy Statement) the risk and potential extra costs around this matter in the same way as they

would for other financial, employer and demographic risks. This should be to allow employers to be aware of and make provision for the potential cost even though any additional contributions may not commence until after the outcome is known.

(c) Once the outcome of cost cap/McCloud is known and appropriate benefit changes are made, administering authorities should re-visit employer contributions under such statutory guidance or provision in regulation as may be available at that time. Authorities are referred to the proposals for interim valuations and revisiting employer contributions in the consultation entitled Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk published 8th May 2019.

(d) At present the impact on exit payments and credits is unknown. Therefore authorities should take account of regulatory requirements, FSS provisions and discuss the approach to be taken with their actuaries. It may be for example that for some employers any impact from either McCloud or cost cap would be immaterial and therefore no change to calculations is required. For others it may be that a level of prudency could be in included in calculations to ensure that the fund is not adversely affected by the outcome of this process. Authorities are referred to the proposed changes to exit credits in the consultation entitled Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk published 8th May 2019.

(e) In order to provide some assistance for authorities in assessing the potential impact of McCloud the SAB have commissioned GAD to estimate both an overall scheme McCloud cost and a 'worst case' McCloud scenario on a range of pay assumptions. These figures will be published on the SAB website as soon they become available.

59. Officers are currently in discussion with Aon Hewitt and are considering how, if at all, this should be factored into the 2019 valuation.

60. The position will continue to be monitored.

Non LGPS Specific Matters

Public Sector Exit Payments Cap

61. The Small Business, Enterprise and Employment Act 2015 introduced the concept of a 'public sector exit payments cap'. The legislation provides that exit payments to be paid to a person are not to exceed £95,000. The 2015 Act provided the overarching principles of how the exit cap was to

operate, but the detail was to be prescribed in regulations that were expected to soon follow.

62. This matter was very topical in 2015 and 2016; however, following the referendum on EU membership, the matter was placed in abeyance as 'Brexit' dominated central government's attention.

63. After several years of inactivity on the public sector exit payments cap, HMT launched a new consultation on this matter in April 2019. Included in the consultation are draft regulations called 'The Restriction of Public Sector Exit Payment Regulations 2019' (the "Exit Cap Regulations 2019") which provide most of the detail on how the exit cap regime will operate from an employer's perspective. The consultation poses 8 specific questions all targeted at employers, not administering authorities and the consultation deadline is 3 July 2019

64. Under the Exit Cap Regulations 2019, it is proposed that the exit cap will be phased into the public sector, but local government is covered by phase 1. The exit payment cap is to remain at £95,000 despite the passage of 4 years (i.e. it is not index linked) and the exit payment amount is determined by the accumulation of the following:

    - redundancy payment(s);
    - any payment to offset an actuarial reduction to a pension arising by virtue of early retirement (we refer to this as a 'strain on the fund' cost);
    - any payment made pursuant to an award of compensation under the ACAS arbitration scheme or a settlement or conciliation agreement;
    - any severance payment or ex gratia payment;
    - any payment in the form of shares or share options;
    - any payment on voluntary exit;
    - any payment in lieu of notice due under a contract of employment;
    - any payment made to extinguish any liability under a fixed term contract;
    - any other payment made, whether under a contract of employment or otherwise, in consequence of termination of employment of loss of office.

65. As can be seen from the above, the list of what can contribute towards the exit payment cap is extensive. Of particular interest to the Fund is that 'strain on the fund' costs are included towards the cap. In this context, it should be noted that strain on the funds costs alone can exceed £95,000.

It can also be noted this is not just in respect of higher earners. Strain on the fund costs can also exceed this amount for members with long periods of membership.

66. The consultation document states *"the expectation is that pension schemes will provide members with options to use their own monies to make up any shortfall or to take a partially reduced pension".*

67. The Enterprise Act 2016 contains amendments to the LGPS Regulations 2013 to allow:

    - the partial reduction of a member's pension benefits where otherwise the exit payment cap would be breached; and

    - a scheme member to pay a charge to buy out some or all of that reduction.

68. However, further amendments to the LGPS Regulations and guidance is needed to be able to effectively administer the proposed changes.

69. It is hoped the amendments are made to the LGPS Regulations 2013 before, or at the same time as, the Exit Cap Regulations 2019 are implemented and GAD guidance is received otherwise complications may arise.

70. These complications relate to:

    - the methodology in calculating the partial reduction to a member's benefits, the method and calculation for buying out the reduction and the deadline for a member making an election for buying out a reduction

    - the need to standardise the calculation of the strain on the fund factors to ensure that this is consistently applied across the LGPS and potentially other public sector schemes

71. As stated above, the public sector exit payments cap is considered to be an employer issue, rather than a Fund issue. An all employer email has been circulated bringing the consultation to the attention of employers. The Local Government association has produced guidance notes for employers, these have also been circulated.

72. Although more of an employer matter, officers will continue to monitor the position, particularly in relation to how the exit payment cap may be effectively implemented in the LGPS and the administration challenges this will bring. Further information is awaited from MHCLG.

73. Whilst the consultation poses 8 direct questions to employers, Officers of the Fund intend to respond to the HMT and draw attention to the practical administration matters as set out earlier in the report :

- Current inconsistencies across strain on the fund calculations
- Further regulatory amendments and guidance is required in respect of member buyouts if exceeding the cap
- The need for all required information from all parties to be provided in advance of this change coming into effect
- Time to allow pension systems to be updated

74. It is understood that other LGPS pension funds will respond in this manner. The Committee's views on this approach is requested.

75. A copy of any response will be agreed with the Chair and Vice Chair of the Committee in advance of its submission.

Repayment of public sector exit payments (also referred to as "clawback")

76. As well as the public sector exit payment cap, the Small Business, Enterprise and Employment Act 2015 allows for the introduction of a mechanism for the repayment of some or all of qualifying exit payments to be repaid by high earners (i.e. those earning £80,000 or more) should they return to public sector employment within 12 months.

77. Consultation occurred on this proposal in 2015, but this continues to be held in abeyance. Unlike the public sector exit payments cap, the "clawback" provisions are not being progressed at this time.

Recommendation

78. The Committee is recommended to note the report.

11th June 2019

Appendix 1 – Fund consultation response on Fair Deal in the LGPS

Dear sirs

I am writing to provide the response of Tyne and Wear Pension Fund (**TWPF**) to the policy consultation on 'Local Government Pension Scheme: Fair Deal – Strengthening pension protection'.

Before responding to the specific questions raised, I would comment that TWPF broadly welcomes the proposals, particularly those that are seeking to strengthen certain protections.

I will now respond to each of the questions in turn:

Question 1 – Do you agree with this definition (i.e. protected transferees)?

We agree with the definition of 'protected transferee' as set out in regulation 3B(1).

Whilst we agree with the definition found in regulation 3B(1), we have several comments in respect of other paragraphs of regulation 3B, in particular:

- Regulation 3B(5) – we have had the opportunity to see several sets of representations kindly shared by other parties before submitting our own, within these we have noted several parties suggesting the phrase "*wholly or mainly"* should be defined. It could be argued that these words ought to be given their everyday meaning; however, for the avoidance of any doubt, it may be beneficial to provide a definition for the term. Of those definitions we have seen, we would support that of the LGPS Technical Group and for "*mainly*" to be defined as '*spending not less than 51% of an employee's time of employment on the delivery of the service of contract tasks*'.

  I would also query whether the use of the term "*wholly or mainly"* gives rise to potential issues with some larger service providers. For instance, under the proposed regulations, as drafted, an employee would be protected whilst working wholly or mainly on the service contract. However, a service provider may then determine it worthwhile to spread an employee's time across 3 contracts (those contracts could even relate to outsourcings by Fair Deal employers) meaning the employee would no longer be *"wholly or mainly"* employed on the delivery of the service or function transferred. The result of this would be that the employee(s) in question would lose their protection. Given that significant financial savings can be made by service providers simply by moving staff to cheaper schemes, I would question whether we should be looking to make the provisions more robust.

  Also, as drafted, regulation 3B(5) could result in a situation where a temporary break from a service contract results in the loss of LGPS

eligibility for a member. Should that employee return to working on the outsourced service contract they would not regain LGPS eligibility.

- Regulations 3B(7) and (8) – we note the suggestion of a service provider being able to provide LGPS membership for non-transferred staff who are engaged on a transferred service or function. We would question who would monitor the protected transferee status of such members (and would resist any suggestion of this being for an administering authority). Furthermore, if this option is something that could readily be revoked then I would question the fairness of this on the staff member.

- Regulation 3B(11) – we have noted the LGA's suggestion that regulation 3B(11) is in contradiction of regulation 3B(7). We would agree with this suggestion and also support the insertion of the words '*subject to regulation 3B(7)*' at the start of regulation 3B(11).

Question 2 – Do you agree with this definition of a Fair Deal employer?

It is noted that higher and further education corporations have been excluded from the definition of Fair Deal employer. Whilst we acknowledge the logic behind this, it should be noted that this could have an adverse impact on the LGPS.

Higher education and further education corporations are large employers within the Scheme. They are also facing significant financial pressures which has been well publicised. The increasing cost pressures of the Teachers' Pension Scheme and the University Superannuation Scheme will only exacerbate the position. In this context, it cannot be ruled out that higher and further education corporations will take steps to reduce costs wherever possible, including pensions costs. Given the increasing costs in the TPS and USS it is increasingly likely that the colleges and universities may target staff with LGPS eligibility. Failure to protect those staff within Fair Deal could make those staff vulnerable to losing their LGPS eligibility.

We have already seen some colleges and universities create wholly owned subsidiaries and transfer large groups of staff to those entities. The main drive behind this has been to reduce pensions costs. Whilst it is acknowledged that such entities are likely to be Schedule 2, Part 2 bodies the staff would require designation for LGPS eligibility. Clearly, the universities and colleges are not designating such staff.

Given the harm that could be caused to the Scheme by the exodus of members from higher and further education corporations, we would request you consider including those bodies listed in paragraph 14 of Schedule 2, Part 1 of the 2013 Regulations (as amended) within the definition of Fair Deal employer.

In relation to the definition itself, as set out in regulation 5(2), aside from our suggestion of including paragraph 14 (higher and further education bodies),

we note reference to paragraph '25'. I believe this is an error that ought to be amended to paragraph '24'. Additionally, given reference to being "*employed by a Fair Deal employer"* in regulation 3B(1), I would also suggest consideration needs to be given to those members to whom Schedule 2, Part 4 applies. As drafted, they are arguably excluded from the scope of being protected transferees.

Question 3 – Do you agree with these transitional measures?

We largely agree with the transitional measures. One point to make is that regulation 3B(9)(a) does not include a scenario where the current service provider sub-contracts the service to another service provider. This omission could easily be addressed in regulation 3B(9)(a) by providing for that scenario.

Question 4 – Do you agree with our proposals regarding the calculation of inward transfer values?

We have no submissions to make in respect of this question.

Question 5 – Do you agree with our proposals on deemed employer status?

We understand, and support, the principles underlying the proposals in relation to 'deemed employer' status for service providers. Notwithstanding this, we feel the proposals are too light on detail and are potentially being introduced when there has not been sufficient consideration on this point. We are also concerned that the deemed employer status option may be an oversimplification of what is a complex area.

Our concerns on this are as follows:

(1) The proposals that we are being asked to consider are very low on detail with the intention seemingly for the substantive detail to be contained in not yet drafted SAB guidance. We are therefore being asked to comment on proposals with limited information. It would be better for us to comment when proposals have been "beefed up".

(2) Many outsourcing LGPS employers are naïve in respect of pensions matters. Conversely, a number of service providers are sophisticated and well informed on pension risks. As proposed, the deemed employer status, in our opinion, would leave the position open to abuse for service providers and could leave Fair Deal employers exposed to pensions risks. Such risks could be substantial in financial terms. Whilst appropriate safeguards could be built into the service contract, it is highly questionable that many outsourcing employers would have the depth of knowledge required to secure those safeguards.

(3) It is doubtful deemed employer status for service providers would achieve one of the stated aims of reducing the administrative burden on administering authorities. It is questionable that the service provider

(4) will want to use the payroll provider of the Fair Deal employer meaning the administering authority is going to need to liaise with the service provider.

(5) Are sufficient safeguards in place to ensure appropriate provision of data to administering authorities? Regulation 3B(14) is noted and this would require provision of data to the Fair Deal employer who would then be required to relay this to the administering authority. However, this is unlikely to be an efficient system and could result in delays in administering authorities receiving data. This would not be a good outcome.

(6) Paragraph 40 of the consultation document states: 'as the legal employer, they will be responsible for deducting employee contributions and providing information to the pension fund (for example, for end of year processing)'. There is nothing in the draft regulations in relation to this; rather the regulations envisage such measures being facilitated through the Fair Deal employer. Consideration needs to be given as to how this is likely to operate in practice. If administering authorities are to directly liaise with deemed employers then appropriate safeguards need to be built into the regulations.

(7) The deemed employer status option may result in additional work and costs for administering authorities in the following ways:

(i) assuming a scenario where an outsourcing Fair Deal employer has received appropriate advice and has appropriate protection in the service contract, there is likely to be some cost review mechanism in the contract. Such review being likely to take place at the triennial valuation. This would make the triennial valuation exercise for that Fair Deal employer more complex resulting in additional time commitment being needed for the administering authority and increasing costs (for example, by way of additional actuarial fees);

(ii) an administering authority and its actuary are going to want to identify those working for a deemed employer in order to assist with administration. This negates one of the advantages of the deemed employer option and may make the administrative system more complex (i.e. having a Fair Deal employer with a number of connected deemed employers may be a more messy and complex system than having separate scheme employers).

(8) Decision making process – it is not clear how the role of the deemed employer (being the legal employer) would interact with the Fair Deal employer potentially being responsible for the exercise of discretions. Clarity is needed as to who will have decision making responsibility.

Admission Agreements contain a number of important protections that are not necessarily covered in the regulations. Has sufficient

consideration been given to ensuring appropriate protections are in place for administering authorities and Fair Deal employers by the suggested use of the deemed employer status for service providers?

(9) The use of guidance for academies is noted in regulation 3B(4). Who is to prepare this guidance, is this to come through DfE or MHCLG? We would certainly encourage the involvement of MHCLG if this guidance is to come from DfE. Also, who would be responsible for ensuring compliance with this guidance?

(10) The proposed amendments to the regulations are low on content in respect of deemed employer status for service providers. Has a full review of the regulations been undertaken to ensure there are no potential contradictions / complexities?

Despite the above concerns, we are not wholly opposed to the deemed employer status option for service providers. However, we remain concerned that this is being hurried and may be an oversimplification of what is a complex area (i.e. risk sharing / pass through). We would request that this matter be parked temporarily to allow other areas of the consultation to proceed. The matter could then be looked at again with a view to identifying the risks more fully and allowing appropriate safeguards to be put in place.

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

As stated above, we have concerns about the deemed employer status for service providers at this stage. The draft regulations have taken a very 'light touch' approach meaning the detail is going to need to come from the SAB guidance.

Given the proposed importance of the SAB guidance (i.e. being the document that contains the detail), consideration needs to be given to its status. For instance, is it to be binding guidance, or perhaps statutory guidance (if introduced by SoS rather than SAB). Alternatively, is there simply an intention for it to be a guide to the relevant parties and therefore not binding. We would request it is not the latter status.

Consideration needs to be given as to whether a standardised approach to risk sharing is to be taken or whether the parties are free to negotiate, with the administering authority having some element of discretion in agreeing risk sharing provisions. We prefer the latter of these options and each administering authority could set out its position in its Funding Strategy Statement.

In addition to the above, the SAB guidance should contain information on the following:

- when it is appropriate to consider deemed employer status – the pros and cons of this option and the admitted body status option. What types of case may be suited to each of the options;
- what are the risk sharing options;
- other alternatives, such as being pooled (or grouped) with the outsourcing Fair Deal employer;
- the responsibilities / obligations of the parties;
- clearly identifying all of the risks for outsourcing employers;
- what safeguards should be built into the service contract – for example, provisions relating to pay increases, redundancy costs etc. Comprehensive consideration on this point will be needed; and
- it may be appropriate for the SAB guidance to contain draft clauses for use in the service contract.

Given the potential importance of the SAB guidance, we would request there is a meaningful consultation process prior to its introduction.

Once again, given the complexity of this matter, we would request the introduction of deemed employer status for service providers be delayed to allow further consideration by stakeholders.

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

As stated above, paragraph 40 of the policy consultation document provides that the service provider *"will be responsible for deducting employee contributions and providing information to the pension fund".* However, there is nothing in the draft regulations to require this. In fact, under the draft regulations, responsibility for such matters will vest in the Fair Deal employer. It would be prudent for this to be clarified in either the regulations or guidance.

Another area requiring further consideration is regulation 60 of the LGPS Regulations 2013 and how this will be impacted by the deemed employer status of service providers. Consideration should be given to whether changes are needed to the regulations or whether this would be best resolved through the guidance.

Question 8 – is this the right approach (i.e. the retention of the admission body option and allowing for risk sharing provision in the admission agreement)?
We fully support the retention of the admission body option and believe this is entirely appropriate. Given the reasons set out above, and in the absence of

information in SAB guidance at this time, the admission body route appears preferable.

In relation to admission agreements containing a provision to allow risk sharing provisions, we believe it would be better for such provisions to be contained in the service contract, as far as is possible and reasonable. Nonetheless, the proposed regulation simply makes it permissive for admission agreements to contain risk sharing provisions which is an appropriate step. Each case can then be considered on its own merits and a decision taken as to whether to include risk sharing provisions or not in the admission agreement. It would be appropriate for administering authorities to have a written policy statement on this or, alternatively, some detail could be provided in the FSS.

Question 9 – What further steps can be taken to encourage pensions issues to be given full and timely consideration by Fair Deal employers when services or function are outsourced?

Most, if not all, administering authorities will share a frustration that pensions matters are generally an afterthought during an outsourcing.

One way to help improve this may be for a requirement to be imposed in the regulations for an outsourcing Fair Deal employer to notify the administering authority of the outsourcing at a defined time. This would promote early consideration and discussion with the administering authority on pensions matters. This early engagement would hopefully minimise the risks of problems further down the line.

Notwithstanding the above, any duty without 'teeth' may well be overlooked or ignored. The obvious way to make the requirement more rigorous would be to allow an administering authority to fine an outsourcing employer for failing to deal with pensions matters appropriately. It is fully accepted that the ability to issue such a fine would be a fairly draconian step and we are not necessarily lobbying for this. This is simply being stated as an answer to what may help promote the earlier and more detailed consideration of pension issues in an outsourcing.

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

No.

Question 11 – Is this the right approach (i.e. transferring pension assets and liabilities)?

We see this as 2 separate issues, namely:

(1) A successor entity, following takeover or merger, being automatically admitted to the Scheme and being responsible for the pension liabilities of the outgoing entity; and

(2) The automatic transfer of assets and liabilities from one fund to another fund when the successor entity already participates in another fund.

In respect of (1), we support this. The proposals provide appropriate protection for administering authorities and also assist entities who, for commercial reasons, are looking to takeover or merge with another entity.

We do not however support what is being proposed under (2). We consider this to be both excessive and unnecessary. Our reasons for opposing this are as follows:

- There is little harm in the successor entity remaining within the same fund as the outgoing entity (aside from the administrative burden of dealing with more than one LGPS sub-fund for the successor entity, but many employers are in this position already);

- What is proposed is inconsistent with other provisions in the 2013 Regulations (see Schedule 3, Part 2 which results in other entities, such as MATs, participating in more than one LGPS sub-fund);

- The existing administering authority is likely to be local to the place of work for the staff / members;

- Affected members often find it distressing when their pension benefits are to be transferred to another administering authority. This may particularly be the case where there is no local connection for the members;

- It does not allow for any consideration of the position by the respective administering authorities. Surely it would be prudent for administering authorities to be able to assess the funding position of the successor entity. For instance, what if the employer is in a weak position in 2 funds and, following merger, this results in a large deficit. This is unlikely to be a position that is welcomed by an administering authority;

- The successor entity itself may not welcome such a blanket approach. All cases are different and require individual assessment. A ‘one size fits all’ approach should be avoided;

- It is unclear whether the transfer of assets and liabilities relates to active members only or all classes of membership;

- Bulk transfers are time consuming and involve additional costs (i.e. actuary fees).

If this proposal is to proceed, although we would certainly question the wisdom of (2), then it would be appropriate to allow the reassessment of the

employer contribution rate following merger / takeover. This would need to be secured by amendment regulation.

Finally, on a matter as important as the transfer of assets and liabilities, it would be preferable for provisions to be made through the regulations rather than SoS guidance.

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

We believe proposed regulation 64(11)(b) should be amended to make clear that this is effective from the date of takeover / merger.

Whilst we maintain our opposition to proposed regulation 64(12), if this is to progress, consideration needs to be given to this being compatible with paragraph 3 of Part 2 of Schedule 3 of the 2013 Regulations.

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

As stated above, we oppose the automatic transfer of assets from one fund to another following a takeover or merger. Nevertheless, should this proposal proceed, our view is that guidance should provide details on the methodology for assessing the value of the assets and liabilities. In particular:

- How the initial value of assets is to be calculated. For instance, should this be the position as at the last valuation or use a more recent unitised figure (if available);
- How is the initial value then adjusted from the previous valuation, including allowance for expenses;
- Should there be a time limit for payment;
- How are advisory costs to be met – it would be preferable for costs to fall on the employer rather than the administering authorities.

We hope this is of assistance in considering all of the above proposals.

Kind regards

Paul

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