Title of Report	Small Employers Admissions Policy
For Consideration By	Pensions Committee
Meeting Date	28 November 2023
Classification	Public (With Exempt Appendices)
Ward(s) Affected	All
Group Director	Jackie Moylan - Interim Group Director of Finance

1. Introduction

1.1. This report introduces the Small Employers Admission Policy for review by the Committee. The purpose of the Policy is to set out the administering authority's approach to admitting small admission bodies (20 or fewer employees) into the fund on a pass-through basis, where those admission bodies' participation in the Fund is guaranteed by another scheme employer (e.g. local authority outsourcings).

1.2. The policy outlines the admission process for these small employers and sets out how contribution rates are to be calculated and how risks are shared under the proposed pass through arrangements.

2. Recommendations

2.1. The Pensions Committee is recommended to:

- **Approve the draft Small Employers Admissions Policy for consultation with employers.**

3. Related Decisions

3.1. Pensions Committee 30 March 2023 - Actuarial Valuation 2022 - Final Valuation Report & Funding Strategy Statement

4. Comments of the Interim Group Director of Finance

4.1. This paper introduces the Small Employers Admission Policy for review by the Committee. This new policy is intended to simplify the Fund's processes for managing small employers to make administering the LGPS easier and cheaper for employers and to reduce the administrative burden on the Fund.

4.2. The key financial impact from the policy is possible changes to future contribution rates for small employers. A key tenet of the policy is that the default contribution rate for small employers should be the Council's contribution rate (currently 27%). This could be higher or lower than the potential calculated contribution rates for these employers.

4.3. Given the small size of the employers to which this policy will apply, the overall financial impact on the Fund is likely to be negligible. It should be noted that the key drivers behind the introduction of the policy are non-financial, and relate to service quality. It is possible that savings could be delivered through a reduction in actuarial fees associated with these employers.

5. Comments of the Acting Director of Legal, Democratic and Electoral Services

5.1. The Pensions Committee's Terms of References sets out its responsibility for management of the Pension Fund. One of the responsibilities of the Committee is to make arrangements for the triennial actuarial valuation, monitor liabilities and to undertake any asset/liability and other relevant studies as required.

5.2. Given these responsibilities, it is appropriate for the Pensions Committee to consider the Fund's approach to the admission of small employers to the Fund, as this potentially impacts on the Fund's liabilities.

5.3. There are no immediate legal implications arising from this report.

6. Background to the report

6.1. This report introduces the Small Employers Admission Policy for review by the Committee. The purpose of the Policy is to set out the administering authority's approach to admitting small admission bodies (20 or fewer employees) into the fund on a pass-through basis, where those admission bodies' participation in the Fund is guaranteed by another scheme employer (e.g. local authority outsourcings). The policy covers admission bodies only and will therefore not affect academy conversions.

6.2. Employees outsourced from local authorities, police and fire authorities or from independent schools (generally academies, regulated by the Department for Education (DfE) must be offered pension benefits that are the same, better than, or broadly comparable to, the Local Government Pension Scheme (as per the Best Value Authorities Staff Transfer (Pensions) Direction 2007). This has traditionally been achieved by employees remaining in the LGPS and the new employer becoming an admitted body to the Fund and making the requisite employer contributions.

6.3. Pass-through is an arrangement whereby the letting authority (the local authority or the independent school) retains the main risks of fluctuations in the employer contribution rate during the life of the contract, and the risk that the employer's assets may be insufficient to meet the employees' pension benefits at the end of the contract.

6.4. Default pass through would apply to small admission bodies (20 or fewer employees) in the absence of an alternative preferred approach from the letting authority. The letting authority in these circumstances would be either the Council (including maintained and voluntary aided schools) or an academy.

6.5. This report includes 2 exempt appendices. Appendix 1 presents a draft Small Employers Admission Policy, which the Committee is asked to approve for consultation with employers. The post-consultation version will be brought to the March 2024 Pensions Committee for final review and approval.

6.6. Appendix 2 is a report from Hymans Robertson, the Fund Actuary, which presents the proposed design of the pass through arrangement in more detail, as well as summarising the risks and benefits. The document was prepared by the Actuary following discussion with Fund officers around the specific design of the proposed arrangement.

7. **Benefits and Drawback**

7.1. The Fund recognises that a large number of the Council's maintained and voluntary aided schools, as well as academies, have chosen to outsource catering and cleaning contracts in recent years. The contracts for the services are often relatively short (e.g. 3 years) and generally cover small numbers of staff.

7.2. Under the current approach, key pension risks transfer from the letting authority to the employer for the duration of their participation in the Fund. This creates an administration and governance burden on the Fund itself, the letting authorities and the contractors involved, particularly where the contract length is short. Introducing a default pass through arrangement will help reduce this burden and could also offer other benefits, such as making it easier for employers to understand their pension responsibilities and allowing the Fund to offer a more efficient service.

7.3. Advantages to the Fund of introducing pass through are a reduction in the governance burden but also the avoidance of exit credits in respect of these employers. This will help to mitigate against the risk of an employer joining the fund for a short period and enjoying significant investment growth in that period, potentially requiring a substantial exit credit.

7.4. The traditional approach also poses a number of difficulties for the Council or academy as letting authority and the admission bodies themselves. One such difficulty is uncertainty over costs for new employers during volatile market conditions e.g. large increases to regular contributions, big cessation debts etc.

7.5. The time required to calculate a new contribution rate for each new admission body also means that schools (or other parts of the Council as the letting authority) are required to tender for contracts without full information on the pension contributions payable by the new contractor. On occasion this has led to significant difficulties with the tender process and raises the risk that neither the letting authority nor the contractor have a full understanding of their responsibilities with regards to provision of the LGPS.

7.6. The current transfer of risks to the contractor also means that the Council and the schools may not be getting best value for money out of their current outsourcing arrangements, as the contractor may price to offset some of the risks associated with pension provision, such as exit payments and contribution rate volatility.

7.7. Use of a pass through approach should make it much easier for the Council and the schools to properly understand their responsibilities for pension provision when outsourcing, and allow the Fund to offer a much more efficient service in terms of providing contribution information. It also offers a degree of risk reduction for small contractors, giving greater certainty over contributions and removing the risk of an exit payment being required.

7.8. There are some risks associated with the implementation of pass through. The majority of risks (except those relating directly to the actions of the contractor, such as pension augmentation) will remain with the letting authority, and the assets and liabilities associated with transferring staff will remain on their balance sheet.

7.9. There is also the potential for the fixed contribution rate payable to be incorrect in hindsight, although use of the Council's contribution rate should help to mitigate this risk. However, any mispricing cannot then be 'corrected' via an exit credit or payment.

7.10. Whether using the standard approach or pass-through, the letting authority still retains long term responsibility for pension risks as all the members' accrued benefits transfer back to the letting authority at the end of the contract. The letting authority also remains the ultimate guarantor for all pension obligations throughout the contract in the event of the employer becoming insolvent. This is unchanged whether adopting the standard approach or using pass-through.

7.11. Appendix 2 to this report presents a summary of the benefits and risks of pass-through to the Fund, letting authorities, and contractors. This can be found on Page 7.

8. **Arrangement design**

8.1. There are many ways in which a pass-through arrangement can be designed; arrangements are specific to each pension fund and sometimes to each individual employer. The preference of Fund officers is to introduce a single default arrangement to apply to all new outsourcings where 20 or fewer employees are involved. This will help realise the full benefits of the pass-through and mitigate against new risks.

8.2. Key design factors in a pass through arrangement include the following:

- Application - should the arrangement be optional, apply as the default or be mandatory?
- Size of contractor - what size of contractor should the arrangement apply to?
- Types of risks - which risks will remain with the authority and which will pass across to the contractor?
- Contribution rates - how should these be set and on what frequency should they be reviewed?
- Bond / indemnity requirements - can these requirements be waived?
- Documentation - how should the terms be documented in the policy document?
- Asset allocation - how will these be allocated between the letting authority and the contractor?
- Legacy admission bodies - how will these be treated?

8.3. In considering the design of the proposed arrangement with the Actuary, it is Fund officers' preference that the arrangement should be as straightforward as possible, to maximise the governance and cost benefits of the arrangement. This can best be achieved by permitting the majority of risks (except for risks relating directly to the actions of the contractor, such as pension augmentation) to remain with the letting authority.

8.4. In line with this principle of simplicity, the suggested rate payable by contractors is the Council's contribution rate (currently 27%). This removes the need for an individual actuarial exercise to be carried out for each outsourcing, and permits regular review at each triennial valuation. It also helps reduce the risk that contributions will be significantly over or underpaid.

8.5. As set out in Section 6, it is recommended that the arrangement apply by default to new admission bodies with 20 or fewer employees. A default arrangement is preferred as it helps ensure that the benefits of the arrangement are realised but without the legal and procurement difficulties associated with attempting to mandate the arrangement.

8.6. In terms of the size of contractor, 20 or fewer employees has been proposed as such an arrangement would cover the majority of small admission bodies resulting from school outsourcings, whilst ensuring that a custom approach is still applied for larger admission bodies.

8.7. Further information on the proposed design of the arrangement can be found in Appendix 2 to this report.

9. Next Steps

9.1. Appendix 1 to this report presents a draft Small Employers Admission Policy, which the Committee is asked to approve for consultation with employers. Officers will then invite responses from employers during October 2023. The post-consultation version will be brought to the March 2024 Pensions Committee for final review and approval.

Appendices

Appendix 1 **(EXEMPT)** - Draft Small Employers Admission Policy
Appendix 2 - **(EXEMPT)** Pass-through for new admitted bodies - Discussion document

By Virtue of Paragraph(s) 3 Part 1 of schedule 12A of the Local Government Act 1972 this report and/or appendix is exempt because it contains Information relating to the financial or business affairs of any particular person (including the authority holding the information) and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Background documents

None

Report Author	Name Rachel Cowburn Title Head of Pensions Email rachel.cowburn@hackney.gov.uk Tel 020 8356 2630
Comments for the Interim Group Director of Finance prepared by	Name: Deirdre Worrell Title: Director, FInancial Management Email: deirdre.worrell@hackney.gov.uk Tel: 020 8356 7350
Comments for the Acting Director of Legal, Democratic and Electoral Services prepared by	Name: Georgia Lazari Title: Team Leader (Places) Email : georgia.lazari@hackney.gov.uk Tel: 0208 356 1369