HYMANS ROBERTSON

Formal response to DCLG Consultation on Pooling Arrangements for Academies within the Local Government Pension Scheme

November 2013

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PUBLIC SECTOR

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1 Executive Summary

1) The government remains concerned about the "stability" of employer contribution rates for Academies in the LGPS. The cause of this concern is that in some cases Academies have found that they are paying higher contribution rates than they were as LEA schools.

2) Administering authorities have local policies for initial asset allocation for all new employers, including Academies on formation and for setting employer contribution rates. These policies take account of a number of factors including financial strength, membership profile and fairness and consistency of treatment between different employer groups in the Fund.

3) The funding approach for Academies in the LGPS has been a problematic issue for administering authorities due to the gradually evolving guidance and government policy (in relation to guarantees for example).

4) However, thanks to the recent Department for Education (DfE) guarantee that came into force on 18 July 2013, and further guidance from the Department for Communities and Local Government (DCLG), we believe that LGPS administering authorities are generally moving towards a more settled position and using contribution setting policies which should meet DfE and DCLG objectives without the need for regulation.

5) We do not believe that imposing pooling is the only way to meet the DCLG and DfE objective of "stability" of employer contributions and comparability with LEA schools.

6) In fact, pooling Academies with local authorities, or with each other in Academy or "school" only pools, whether voluntarily or through regulation, could cause problems in future for Academies and other employers in LGPS Funds. Potential drawbacks include, for example, unfair cross-subsidies between employers.

7) Any pooling arrangement should be a local decision after consultation on the pros and cons of such arrangements. Where pooling is used, additional safeguards might be desirable to mitigate against some of the potential problems (e.g. a requirement for individual Academies to pay additional contributions in the event of excessive salary awards).

8) One example of an alternative approach that can meet the DCLG objective of "stability" in an equitable way is as follows:

   - to set standalone rates for individual Academies;
   - to use assumptions and valuation methods consistent with those for LEA schools in the same fund (e.g. the same deficit repair period and the same approach to long term stabilisation of contributions).

   The outcome of this type of approach will be employer contribution rates that should, at the current time, be broadly similar to those for LEA schools and can be stabilised in the longer term in a similar way to those for LEA schools so long as the guarantee stands. It is possible that in future there could be some divergence between the local authority contribution rates and rates for individual Academies, but only to the extent justified by their different actions and experience (e.g. higher or lower pay awards). In cases where the local authority contribution rates rise significantly as a percentage of pay because of falling payrolls, the alternative approach described could have significant benefits for Academies since their contribution rates will not be tied to those of the local authority.

9) We already see evidence of administering authorities taking positive steps to make suitable funding arrangements for Academies in the LGPS with the aim of broadly meeting DfE and DCLG objectives. These are progressing without the need for further regulation. The approaches used do not always involve pooling; most maintain the point of principle that an Academy, like any other employer in the LGPS, should ultimately “pay its own way”. Arguably this principle is entirely in line with the principle underlying the formation of Academies in the first place.

10) In summary, our conclusions are:

- pooling is not the only way of achieving DCLG’s objective of “stability” in Academy contribution rates – in fact it has a number of potential drawbacks;
- pooling arrangements for Academies should not be imposed on LGPS Funds;
- local flexibility in setting employer contributions is preferable to centralised prescription and regulation.

2 General comments

2.1 Hymans Robertson is currently the actuarial advisor to 37 LGPS Funds in England, and is involved in advising administering authorities on funding arrangements for approximately 45% of all Academies.

2.2 The Government continues to be concerned that there has been insufficient progress to ensure the long term stability of Academy contribution rates with too many Academies paying contribution rates significantly higher than those payable by Local Education Authority (LEA) schools in the same Fund. However, there are various reasons for this divergence between Academy contribution rates and LEA school rates, including;

- The lower strength of covenant for Academies compared to local authorities and LEA schools, leading to higher contribution rates all other things being equal (for instance, due to shorter deficit recovery periods);
- The need to treat Academies in a consistent manner with other employers in the Fund, who in turn are paying contribution rates typically higher than those of the local authority;
- The initial asset allocation, market conditions and local authority's funding position at the time the Academy was established;
- The Academy's own membership profile as compared to that of the local authority.

2.3 The DfE guarantee that came into force on 18 July 2013, together with further guidance from DCLG, have resulted in most Funds reconsidering their policy in respect of contribution rate setting for Academies. This has coincided with the review of funding strategies as part of the 2013 actuarial valuations. At the time of writing, all LGPS Funds in England are currently reconsidering the funding strategy for Academies in the light of recent developments.

2.4 Each LGPS Fund must establish a suitable funding strategy for all employers, which is reviewed at the time of each triennial actuarial valuation. The funding strategy appropriate for Academies must therefore be consistent with that adopted for other employers in the Fund, as well as being appropriate to the Fund's broader circumstances.

2.5 Other than the requirements to stabilise employer contributions insofar as that is possible and to make adjustments appropriate to individual employers, the LGPS Regulations are not prescriptive about methods and assumptions used to set contribution rates for any type of employer. Instead, each Fund will determine an appropriate funding strategy based on a number of factors including perceived risks or strengths of covenant of each type of employer.

2.6 It is fair to say that the evolving situation since 2010 has led administering authorities to materially reconsider their view of Academies. In many cases we are seeing this being reflected in the revised funding strategy statements for the 2013 valuation. In particular, the improved perception of strength of covenant for Academies due to the DfE guarantee is allowing administering authorities to consider funding strategies that will result in long term stabilisation of contributions similar to that currently enjoyed by local authorities and LEA schools due to their strong covenant.

2.7 As a result, we believe that Academy contribution rates after the 2013 valuation will generally be closer to those of local authorities and LEA schools than might otherwise have been the case. This is happening due to proper consideration of the risks and strength of covenant, and has not required any change in Regulations.

2.8 We therefore do not believe that new Regulations are required in order to achieve the DCLG objective of “stability” of Academy contribution rates (which we take to mean contribution rates similar to those of local authorities and LEA schools). The absence of enforced pooling is not the problem. Administering authorities are already implementing funding strategies that are appropriate to local circumstances, consistent with policies in respect of other employer groups and meet the objectives both of DCLG and of the Funds themselves. Rather than regulation or prescription of approach, some appropriate additional guidance on principles and objectives (e.g. the aim of “stability” of Academy contributions) could be introduced if necessary.

3 Question 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?"

3.1 We do not agree that the best way of achieving the stated objective is by pooling Academies with their ceding local authority. The reason for this is that pooling a) involves potentially unfair cross-subsidies; and b) may not achieve the objective of "stability" for employers (e.g. if the Council contribution rate increases because of falling payroll).

3.2 However, this is not to say that status quo is the best way the LGPS can achieve the required contribution stability for Academies. We believe that Funds now have sufficient assurance on the covenant of Academies in the form of the DfE guarantee to enable them to introduce policies that meet the DCLG objectives in ways that avoid the potential drawbacks of enforced pooling or prescriptive legislation.

3.3 Options available to Funds in setting a funding policy for Academies (with varying impacts on the main parties) include the following:

Option	Academies	Councils	Administering authority
A1 Pooling with Council	Same contribution rate as Council and LEA schools Could gain or lose from cross-subsidies	Council could gain or lose from cross-subsidies	So long as total contributions sufficient and parties involved accept potential cross-subsidies then administering authority could agree to pooling. Potential practical problems if try to apply retrospectively to existing academies.
A2 Academies only pool	Contribution rate could be similar to Council and LEA schools pool although not necessarily identical (similar method, assumptions, long term stabilisation). Could win or lose from cross-subsidies.	Transfer of share of deficit from Council pool to Academies only pool at same time as transfer of payroll from LEA school to Academy. After initial asset transfer, Council contribution rates not affected by Academies in the pool and no cross-subsidies.	So long as total contributions sufficient and Academies involved accept potential cross-subsidies then administering authority could agree to pooling. Can set long term "stabilised" contributions similar to Council pool. Potential practical problems if try to apply retrospectively to existing Academies.

Option	Academies	Councils	Administering authority
B Individual contribution rates for Academies (using similar assumptions to Councils/LEA schools or different)	Contribution rate could be similar to or different from Council rate depending on method and assumptions. Retain responsibility for own long term funding.	Transfer of share of deficit from Council pool to individual Academy at same time as transfer of payroll from LEA school to Academy.	Avoids cross-subsidies. Can reflect DfE guarantee & DCLG guidance in approach to setting individual Academy contribution rates.

3.4 It is possible to track individual Academy asset shares in any pool based on their own actions and experience but no effect in practice if pooling arrangement continues. There are of course other variations on the broad types of arrangement above and the considerations are similar. For example, a pool for LEA schools and Academies would potentially cause cross-subsidies between these employers.

3.5 Option B (individual Academy contribution rates) could in theory, include the status quo which for some Funds has until now meant using different assumptions for setting contribution rates for Academies (e.g. shorter deficit recovery periods for Academies compared to the Council). However, in practice, we would anticipate that the same principles applicable to setting the Council contribution rate could be applied to setting each Academy's contribution rate. Option B would still give rise to a variety of rates for different Academies, reflecting their different membership profiles, different experience and different market conditions at the time each converted; however, this would still be consistent with the way in which the Council contribution rate is set.

3.6 **It is important to appreciate that pooling is by no means the only way in which the DCLG objective of "stability" of Academy contribution rates can be met.** In fact, pooling has various disadvantages attaching to it as shown below:

Option	A1 Pool with Council	A2 Academies' only pool	B Set Academy's own individual contribution rates
1 – Council costs rise	Academy's contribution rises too, regardless of own position	Academies' pool rate needn't change	No impact on Academies
2 – Academy costs rise	Absorbed by pool, cross-subsidised	Absorbed by Academies in pool	Impact on Academy's own position only
3 – Academy outsources	Absorbed by pool, cross-subsidised	Absorbed by Academies in pool	Impact on Academy's own position only
4 – Academy awards pay rise	Absorbed by pool, cross-subsidised	Absorbed by pool	Impact on Academy's own position only

Option	A1 Pool with Council	A2 Academies' only pool	B Set Academy's own individual contribution rates
5 – Council pays deficit via monetary contributions	May be difficult to set appropriate Academy rates	No impact on Academies in pool	No impact on Academies' contribution rates
6 – More than one ceding LEA / Council in same Fund	Separate pools for each ceding LEA/Council in Fund	May or may not require separate pools for each LEA/Council	Academy's initial contribution rate could be set by reference to LEA/Council
7 – Other employers / staff join Council pool or transfer out	Academy's contributions affected too	Academy's contributions unaffected (provided not linked to Council pool rate)	No impact on Academies
8 – Removal of DfE guarantee	Would need to break-up the pool and revert to another approach	May review contribution policy for Academies only pool (e.g. shorter deficit recovery period)	Change approach to contribution rates (e.g. reduce deficit recovery period due to weakened covenant), but no change in principle versus other employers

3.7 **Pooling Academies (particularly with the Council) has three major inherent potential problems:**

a) It involves potentially unfair cross-subsidies between employers. Examples would include higher than average pay awards made by an individual Academy which would effectively be funded by other employers in the same pool.

b) An Academy's contribution rate would be subject to the vagaries of the Council contribution rate, so that Academy rates may rise substantially if and when substantial headcount reductions and/or restructuring at the Council causes its own rate to rise. Clearly Academies would prefer to avoid such a situation. There are also differences in maturity between Councils and Academies; there may be benefits for Academies in not being pooled with Councils due to the greater maturity of Councils. c) Some Academies are currently paying contribution rates below that of the Council. Whilst these may be a minority, they are a sizeable one. Therefore, any move to pooling would immediately increase these Academies' LGPS costs as a direct result of prescribed regulations.

3.8 **It is not necessary to establish pools, in order to achieve the stated objective.** We believe the LGPS Funds are already well-placed, and in most cases have already taken various steps, to achieve greater stability of Academy contribution rates by comparison to the Council. Examples of approaches adopted by Funds to achieve this objective include:

1) Setting a common contribution rate for all Academies which is similar (or identical) to the Council rate, usually following appropriate risk management analysis to justify this approach (although this common rate could be too much for some academies and too little for others); or

2) Using a similar method and assumptions to those underlying the Council contribution rate calculation, to arrive at a different contribution rate for each Academy which will normally be fairly similar to the local authority rate. In the few cases where this is not the case, there are usually very good reasons, for instance a very different membership profile of the Academy.

3.9 The principle underlying the establishment of Academies is that they are independent of their former Council. Pooling arrangements involving cross-subsidies between Academies and local authorities is not consistent with this principle. Instead, the objectives can be similarly met but in a manner which is consistent with the Funds' treatment of their other employers. We believe that the existing local flexibility is sufficient to achieve the stated objective already, without the need for specific regulation.

3.10 **What a non-pooled solution might look like:**

- Standalone employer contribution rates (Option B above) to avoid pooling cross-subsidies;
- Set initial contribution rates (and short-term increases) as per the Council;
- Set future contribution rates using the similar approach and methodology used for setting contributions for the Council thus ensuring similar contributions to LEA schools (all else being equal);
- Investigate any outliers to minimise the risk of underfunding in those cases.

3.11 Finally, we acknowledge that in some cases an Academy may have a contribution rate which is still relatively high compared to their former Council. We do not believe that prescription in approach or regulation is necessary to deal with such cases. Instead, some additional guidance on principles and objectives could be introduced if needed. Any such guidance should recognise that there may be some cases where contribution rates will - now or in future - differ from those of LEA schools with justification due to differences in membership and experience (e.g. different practice in relation to pay awards).

4 Question 2

"What bodies should be included in the pool – Academies and Local Authority maintained schools, or only Academies? Please say what other arrangements would achieve this aim."

4.1 Our proposed approach in reply to Question 1 (no enforced pooling) would avoid the need to consider this issue.

4.2 If pooling was to be introduced, then our recommendation would be that this is among Academies only. This is to ensure a risk management approach consistent with the Funds' treatment of other employers. LGPS Funds generally apply similar assumptions and method to setting contributions for a group of broadly homogenous employers. This would also avoid the situation where Academy contribution rates increase because of falling payroll for the Council they are pooled with. Furthermore we would suggest that in the unlikely event of the withdrawal of the DfE guarantee, any shortfall on the failure of an individual Academy should be paid for by other Academies in the same pool.

5 Question 3

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

5.1 Our proposed approach in reply to Question 1 (no enforced pooling) would avoid the need to consider this issue.

5.2 If pooling was to be introduced then we believe it would be most appropriate for the Administering Authority (not the organisations themselves) to determine the membership of the various pools in its Fund. In general, we would expect the choice of pooled membership to be permanent, to avoid anti-selection (e.g. individual employers opting in or out depending on whether their contribution rates would be higher in or out of the pool), or else to permit only one opportunity to opt-out of the pool (or at least very restricted opportunities). If pooling arrangements are optional rather than prescribed under regulation, we would expect administering authorities to consult Academies before pooling is introduced. Any such consultation should set out the pros and cons of any proposed pooling arrangements.

6 Question 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?"

6.1 Our proposed approach in our reply to Question 1 above (no enforced pooling) would avoid the need to consider this issue.

6.2 We are not entirely clear on the meaning of the second part of this question. However, in principle, we would prefer to avoid centrally prescribed assumptions or approaches. This is for reasons of consistency with other employers in the Fund (including the LEA schools), and to reflect the Fund's own particular circumstances. For instance, different assumptions may be appropriate due to different demographics, different investment strategies, etc. It is more important that consistency is achieved **within** a given Fund, than **across** a number of different Funds.

7 Question 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?"

7.1 We are not entirely clear what the "additional costs" is intended to refer to. There are different interpretations of this but, in any event, they all point to the same principle: if pools were to be established by prescribed regulation, then this will inevitably lead to questions regarding retrospection, which are not readily solved and could result in added delays, uncertainty and cost.

7.2 It should be noted that some Funds have different policies applying to different tranches of Academy conversions due to the evolving view on Academies in the LGPS. Therefore, retrospection would be even more difficult in such Funds.

7.3 An Academy which has paid a higher historic rate than its peers may ask the Fund for a refund of these contributions. It is not clear what the response to such a request would be, since:

1) The Fund might argue that policy decisions were made from time to time for good reasons, based on the information available at that time;
2) An Academy may ask for equality relative to its peers, but such retrospective equalisation will be complicated, time-consuming and costly (refunds of contributions from the Fund are not permitted).

7.4 Academies existing at the time of setting up any new pool may or may not be forcibly entered into the new pool. Enforced retrospection, i.e. bringing the historic Academies into the pool, might achieve the advantage of future consistency with their more recently converted peers; however, there are a number of disadvantages such as the enforced increase to some Academies' contribution rates, the reallocation of asset shares between the Academies and the Council, and the increased costs and timescales.

7.5 In summary, our proposed approach as per our reply to Question 1 above (no enforced pooling) would avoid the need for this issue. However, any degree of retrospection is bound to give rise to added delays, costs and disagreement.

8 Question 6

"If any administering authority has satisfactory arrangements already in place, or is in the process of implementing solutions that satisfy all parties, please could you provide a brief description of them? It is not the intention to disrupt successful local solutions, but rather to encourage the sharing of best practice which might best meet Ministers' aims of similar and stable employer rates when a maintained school converts to academy arrangements."

8.1 In our experience, broadly half of LGPS Funds have already put in place arrangements to ensure that Academy contribution rates are not too dissimilar from those of their former Council. Following review of Funding Strategy Statements as part of the 2013 valuation, we expect more administering authorities to move in this direction. Examples of approaches that achieve this without pooling with the Council include:

1) Same initial contribution rate as the Council

Simply set the Academy's initial contribution rate to be identical to, or similar to, the Council rate (possibly following suitable analysis to ensure this is an appropriate contribution rate for the long term since a potential drawback is that this could be too much or too little for an individual Academy);

2) Standalone rates using similar assumptions and method as used for Council

Apply the same assumptions, principles and method to calculate the Academy contribution rate as would apply to setting the Council rate;

3) Academies' only pool

Establish an Academies' only pool which, with the associated increased strength of covenant and appropriate valuation method and assumptions, results in a contribution rate similar to that of the Council.

8.2 Furthermore, as part of the 2013 actuarial valuation, we are aware of many Funds that are considering adopting one of the above approaches, or another approach which arrives at broadly the same position. Therefore, in our experience, most LGPS Funds are already well along the road to achieving the DCLG's objective of 'stable' Academy contribution rates without the need for prescription or regulation.

Appendix – Reliances and Limitations

1. This is the formal response of Hymans Robertson LLP to the Department for Communities and Local Government Consultation on Pooling Arrangements for Academies within the Local Government Pension Scheme.

2. This response is not intended as advice to any LGPS Fund or other party.

3. Hymans Robertson LLP makes no representation or warranties to any third party as to the appropriateness or completeness of this information.