Private & Confidential
LGF Reform and Pensions Team
Ministry of Housing, Communities and Local Government
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Dear Sirs

Response to Consultation

Hymans Robertson LLP is pleased to provide its response to the MHCLG consultation on amendments to the LGPS regulations introducing Fair Deal protections in to the scheme.

About Hymans Robertson LLP

Hymans Robertson has grown up with the LGPS. The firm was founded to provide advice to the LGPS in 1921, just as the first funds were being created. Whilst our business has developed over the decades, working with the public sector remains at the heart of what we do.

We have a specialist public sector actuarial team, which employs over 60 people exclusively advising on the LGPS. Alongside our actuaries there is a team of 15 investment consultants providing investment advice and a team of benefit/governance consultants providing benefit and governance advice to our LGPS clients.

Protected transferees

Question 1 – Do you agree with this *[protected transferee]* definition?

We are happy with the broad definition of protected transferee, as drafted, and are happy that:

- the concerns regarding FE and HE colleges as well as (community) admission bodies expressed as part of the earlier consultation have been taken on board by MHCLG;
- the concerns originally raised regarding transferred staff covered by either the Best Value Staff Transfers (Pensions) Direction 2007 (the 2007 Direction) or the Welsh Authorities Staff Transfers (Pensions) Direction 2012 (the 2012 Direction) have largely been addressed, enabling those historic transferees to continue receiving appropriate pension protection on any subsequent retender; and
- protected transferee status will remain in force on any sub-contract, as currently applies under the 2007 and 2012 Directions.

We do, however, have some concerns which we believe require further consideration in order that the proposals can work effectively in practice, which we set out below:

- **Broadly comparable scheme alternative** – We believe the removal of the broadly comparable option on any retender goes too far in those cases where an incumbent provider already provides this as their preferred means of ensuring pension protection under either the 2007 or 2012 Directions. Insisting that any successful incumbent has to offer ongoing protection via the LGPS could have wider implications for such employers in the ongoing funding of any broadly comparable scheme in which they participate. At the extreme this requirement could risk a service provider becoming liable for a debt under s.75 of the Pensions Act 2004 or the broadly comparable schemes being forced into the Pension Protection Fund as a consequence of members being compulsorily moved into the LGPS on any successful retender with the option to transfer in accrued rights, with current deferred and pensioner members of that scheme losing out as a result. While we appreciate the desire to provide ongoing protection to current employees covered by the 2007 and 2012 Directions this should not be achieved at the expense of those deferred and pensioner members remaining in any broadly comparable schemes.
- We believe consideration should be given to enabling incumbents to continue to offer access to their established broadly comparable scheme if they so wish, so long as it does not have any impact on the overall procurement and evaluation processes.
- **Machinery of Government** - The suggestion in the consultation is that, where there are machinery of Government type changes, the staff affected would automatically move to the new public sector scheme, while retaining "protected transferee" status. The expectation that staff would automatically transfer to the new public sector pension scheme appears to us to go beyond the expectation of paragraph 1.8 of the new Fair Deal – which suggests that the transferred staff would remain in their original scheme.
- If it is the case that staff would be automatically transferred to the new public service scheme we would expect any ongoing "protections" to be consistent with those available to similarly transferred staff in other areas of the public sector.
- Administratively we do have concerns over how any such protected transferee status would be tracked by the Fair Deal employer, particularly where any arrangement could be in place for many years. The Fair Deal employer may also feel it unfair that they have any responsibility for monitoring protected transferee status where the decision to alter the method of delivering the service resulted from Central Government.

Fair Deal employers

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

We are happy with the broad definition of Fair Deal employer and, as stated in our response to question 1, that the concerns regarding FE and HE colleges as well as (community) admission bodies expressed as part of the earlier consultation have been taken on board by MHCLG.

We agree with the inclusion of Police and Crime Commissioners, Police Constables and ALMOs in the Fair Deal employer definition, believing it important that protection is extended to cover all relevant areas of the public sector.

We appreciate the extension of these provisions to enable FE/HE colleges and admission bodies to apply them, should they wish to, but in reality we do not expect this to be taken up that often, if at all.

Transitional arrangements

Question 3 – Do you agree with these transitional measures?

As previously stated we are pleased to see that protected transferee status is to be extended to cover those individuals currently protected under the 2007 or 2012 Directions.

We do have some concerns, however, regarding the potential unintended consequences of compulsorily requiring any incumbent to offer access to the LGPS as part of any successful retender, where previously they had a broadly comparable alternative. Such an approach could:

- lead to remaining active transferees being required to leave a broadly comparable scheme that is actually better than the LGPS;
- result in those transferees losing a final salary link to their pension rights accrued in any broadly comparable scheme, either if retained as a deferred benefit or on transfer into the LGPS as a CARE benefit;
- adversely impact the trustees' funding plan for the broadly comparable scheme;
- risk a service provider becoming liable for a debt under s.75 of the Pensions Act if the last active member leaves the broadly comparable scheme.

While we appreciate the desire to provide ongoing protection to current employees covered by the 2007 and 2012 Directions it is our view that this should not be achieved at the expense of those deferred and pensioner members remaining in any broadly comparable schemes.

Although we are not employment lawyers we also wonder if the removal of the broadly comparable option, where it is currently used, might have any unintended issues relating to the transferees' contracts of employment with the incumbent that may need to be considered.

While we appreciate the wider policy objective of not allowing new broadly comparable arrangements being agreed when outsourcing new services, we do believe consideration should be given to enable incumbents to retain the broadly comparable option in future re-tenders, where to do so does not impact costs or tender evaluations.

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

We appreciate that in the normal course of events a service provider can lose contracts on retender and that in such circumstances staff would become deferred members in the broadly comparable scheme they are in. As a result they would be free to elect to transfer those accrued rights in to another scheme, including the LGPS, and purchase equivalent rights in that scheme. Our concerns centre on the compulsory nature of the removal of a broadly comparable scheme and the lack of any specific protection for those accrued rights where they are being transferred in to the LGPS.

The approach, as set out in the consultation (i.e. the compulsory movement from a broadly comparable scheme to the LGPS), does raise some concerns which we believe merit further investigation:

- Draft regulation 3B(12) and paragraph 26 of the consultation document suggests that any cash equivalents into the LGPS would be converted using non-Club transfer factors (which are generally more penal than Club factors to members who transfer in benefits). In addition, we assume that the trustees of the broadly comparable scheme would be able to reduce the value of any such transfer amount, in the event that the scheme is underfunded. These factors increase the risk that protected transferees make poor decisions, in the belief that transferring accrued rights in to the LGPS will provide greater protection;
- The risk may also be introduced whereby the funds available to those transferring out later on are less than those available to those able to transfer soon after any changes are introduced. This might be the case if the broadly comparable scheme were to start to run out of money;

- We are assuming any CETV would purchase CARE benefits back in the LGPS and so would not replicate final salary benefits. This raises questions about the changing nature of the benefit, in seeking to provide protected transferee status to anyone currently covered by the 2007 or 2012 Directions. By compulsorily removing them from a broadly comparable pension scheme and enabling them to transfer accrued rights in to the CARE element of the LGPS members would, through no fault of their own, break any final salary link they may already enjoy in their broadly comparable scheme.

In seeking to introduce protections for these individuals, therefore, the proposal could result in them being placed in a worse position overall than they are now. To avoid this situation, affected transferees could be offered access to final salary benefits in the LGPS.

The 'deemed employer' approach

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

We support the suggested move to introduce "deemed employer" status within the LGPS and would like to see this option developed further. We believe, if it is appropriately adopted, along with suitable guidance including separate Department for Education guidance for academies, it will provide a useful alternative to the admitted body route.

We are not convinced, however, that it will necessarily provide the expected panacea for administrators, Fair Deal employers or service providers by removing the administration headaches currently experienced in setting up and managing admission agreements. It is quite possible that if taken forward, 'deemed employer' status may simply introduce a different set of issues for all parties to resolve. That said, we do not believe any of these should derail the introduction of this option within the scheme.

Certainly, from the scheme members' perspective, we see much to commend this option as a means of ensuring the required pension protection is available to them from day-one on becoming protected transferees. We do actually wonder if this consultation provides an opportunity for a more radical approach to be taken to the issue of pension protection for transferred staff and for 'deemed employer' to be the scheme wide default in all such cases. The alternative of admitted body status could then be adopted where agreed between a Fair Deal employer and its service provider.

Introducing a scheme wide default would ensure the policy intention of providing ongoing pension protection for transferred staff would be met, regardless of the level of engagement from Fair Deal employers or their service providers in the process. If there was a desire to opt for the alternative admission body route then all parties would be free to pursue this if they wished.

As previously mentioned, while we are supportive of the "deemed employer" approach we do believe there are some significant administrative issues that need to be acknowledged, although we do not believe any should prevent its introduction. We have set out our concerns below:

- **Timely decision making** - The consultation document suggests the introduction of "deemed employer" status, and the requirement for Fair Deal employers and bidders to make a formal decision on whether to use either the admission agreement or deemed employer route, will ensure pension issues are considered in a timely manner. We are not convinced that this requirement alone will deliver on this expectation. In our experience delays in setting up admission agreements can be attributable to either:
  - scheme employers routinely overlooking pension protection matters when outsourcing, with Fund administrators only becoming aware of an outsourcing after the event; or
  - scheme employers and contractors misunderstanding the current bond/guarantor requirements, leading to delays in funding admission agreements (or in extreme cases failing to put them in place during the contract term).

Should the current proposals be adopted as drafted, Fair Deal employers and their contractors would still be required to choose between the options of admission body or deemed employer status. We have seen over the

years that attempting to use admission body status has not always proved easy, especially where smaller service providers are concerned. Fund administrators are then left to pick up the pieces where commercial contracts have ended, with the aim of ensuring transferred staff have not been disadvantaged. In the meantime, the affected staff have not been well served by either the scheme or their previous and current employers.

- **Fair Deal employer responsibilities** – the responsibilities are covered by the proposed 3B(13) and (14). Even where deeming takes place, there is still an onus on Fair Deal employers to deal with service providers and ensure they deliver on their responsibilities to the Fund. Our concern would be that the Fair Deal employers are not adequately resourced or educated to be able to police their contractors/service providers and ensure that they meet their regulatory requirements.
- **SAB Guidance** - Similarly regulatory requirements and supporting guidance alone will not immediately result in "deemed employers" and service providers being able to cope any better with complex matters such as assumed pensionable pay, ill health retirement, the exercise of discretions, etc. all of which will still need to be dealt with by them. Furthermore, there is a significant risk that a service provider is actually further removed from the scheme and administrators when there is a "deemed employer" in place (c.f. being an admitted body), given that they do not have a formal agreement in place with the Fund and its administrators.
- **Administration** - We still suspect that administering authorities will need to hold separate employer details for each service provider that has a "deemed employer", in order to track them within the Fund. As a result, this approach would not see any reduction to the increasing number of employers needing to be set up and monitored in any of the Funds. The administrative burden will, therefore, continue, notwithstanding any scheme advisory board guidance that is put in place.
- **Security** - Given the expectation that a service provider that has a "deemed employer" would still be responsible for meeting all additional costs set out in regulation 68 a requirement may still exist for a redundancy only bond to be put in place, thereby retaining one of the current obstacles in successfully navigating the admitted body route.

Notwithstanding our concerns above and our earlier comments regarding the compulsory removal of the broadly comparable scheme option where an incumbent currently provides this, we still do see merit in taking the "deemed employer" approach forward.

In our view, while there are still a number of practical issues to resolve in relation to the deemed employer option, we believe consideration be given to setting this as the default option within the LGPS Regulations. Fair Deal employers and their service providers would then be free to opt for the alternative admission body route where it was believed to be a better route. As stated above, our view is that an exception be made for incumbents who are using the broadly comparable option – they should be allowed to retain this approach.

The advantages of introducing a scheme wide default would be to smooth the procurement process as well as ensuring all protected transferees are provided with an appropriate level of pension protection via the scheme.

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

An initial concern about any scheme advisory board guidance relates to its status once published. In order to have greatest effect we believe it should be statutory and as a result issued by the Secretary of State and not the scheme advisory board.

We believe that any guidance should focus only on those specific elements of the unique relationship between the Fair Deal employer, the service provider with a "deemed employer" and the administering authority. Where there are provisions within the regulations that would already cater for any element of these relationships (e.g. the poor performance of employers) the guidance should do no more than signpost the reader to those parts.

In terms of the contents of any guidance (statutory or otherwise) we believe it should include:

- Those pension related issues that would be expected to be included, as a minimum, within any commercial agreements;
- Basis for the setting of the "deemed employer" contribution rate for the service provider;
  - Potential to set out a default position where a Fair Deal employer fails to set this out in any commercial agreement with a service provider;
  - The discretion for the employer contribution rate to vary based on the commercial position of any arrangements;
  - The basis of any guidance - e.g. will the guidance set the assumptions for any transfer of accrued rights from the broadly comparable scheme in stone, or simply spell out the process that fund actuaries should follow but with discretion to agree appropriate assumptions with each other?
- Process for exercising of employer discretions;
- Financial reporting;
- Practical day-to-day activities (roles and responsibilities);
  - Paying over of employer and employee contributions;
  - Service provider and deemed (Fair Deal) employer responsibilities as regards assumed pensionable pay;
  - Leavers, etc.;
  - Ill health retirement provisions and processes;
  - Year-end
- Obligations at the contract end.

Responsibilities for employers

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

We do not believe it appropriate to set out in legislation any additional costs that should be met by a service provider where there is a "deemed employer" in place, other than those set out in regulation 68. It would be useful to clarify whether the intention is that the service provider MUST meet the additional costs under both 68(1), (2) and (3), or if such costs should be met in accordance with an administering authority's wider discretions policy in relation to the recovery of such amounts.

Existing arrangements

Question 8 – Is this the right approach?

Please see our earlier comments regarding the "deemed employer" approach. In our view this is an opportunity to simplify the pension protection options via the LGPS.

Where the admission agreement route is to be used we would agree with the proposal to enable risk sharing to be included within the agreements, if desired.

Timely consideration of pensions issues

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 functions are outsourced?

As previously stated we believe that providing Fair Deal employers and service providers with a choice of two options in the LGPS could be confusing and as a result could risk both disengaging with the process.

The key requirement of these proposals is to ensure appropriate pension protection for the transferring staff, which should be the key focus of any solution.

We believe that having "deemed employer" as the default option should ensure, regardless of any Fair Deal employer engagement, that transferring staff are assured of the pension protection they are entitled to.

The Regulations currently cover issues of poor employer performance and administering authorities should be encouraged to utilise this more in these cases.

That said it would be useful if any guidance covered specific requirements that:

- Any procurement exercise could not proceed unless the s.151 officer (or equivalent) signs off that consideration has been given to all necessary pension related matters;
- Evidence of any analysis (e.g. checklist of issues that have to be covered off) is provided as part of any s.151 officer (or equivalent) sign off.
- Failure to provide either of the above could result in additional pension administration costs being met by the Fair Deal employer and/or the ability for administering authorities to levy fines.

Public sector equality duty

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?

Other than those already highlighted within our response we can think of no other significant equalities impacts or particular groups who may be disadvantaged as a result of these proposals.

Transferring pension assets and liabilities

Question 11 – Is this the right approach?

In principle we agree with the approach as proposed.

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

There appear to be three distinct elements set out in the proposed amendments to regulation 64.

- 64(11) – we agree that this proposal is appropriately drafted
- 64(12) – in general we appreciate the intention here, but wonder if the successor body may benefit from choosing which Fund should be the appropriate Fund for any merged entity rather than having this imposed via the scheme. More widely we are concerned that the proposal effectively forces a fund to accept an employer where doing so may damage the health of the receiving or letting fund. Currently the administering authority can object to accepting this transfer, or at least use powers to extract additional guarantees or cash amounts to protect the rest of the Fund. It may be unhappy about accepting a body that is poorly funded with no leverage to protect existing members. It is important, therefore, that any requirement here is strengthened to enable the receiving fund to not unnecessarily protect its own interests and those of its other participating employers.

- 64(13) – we are unsure on this point, as it would very much depend on the basis of any guidance. For example, is the intention that the guidance sets the assumptions for any transfer in stone (which we would not support, given the different terms of transfer, etc. each Fund might have), or simply spell out the process that fund actuaries should follow but with discretion to agree appropriate assumptions with each other (which we would be happy to support)?

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

We believe that any guidance should:

- Make it clear that the merged (or taken over) employer's assets and liabilities should be transferred in full from the ceding fund i.e. cover accrued benefits for active, deferred and pensioner members. For the avoidance of doubt, this would include any assets and liabilities relating to other (potentially historic) fund employers where the merged (or taken over) employer has responsibility for them.
- Fix the amount transferred to the share of the employer's assets in the ceding fund at the merger/take-over date, adjusted by fund returns (or index returns for any periods where fund returns are unavailable) between that date and the final payment date
- Allow the respective funds to agree on payment in cash, in specie or a combination of both.
- Allow the receiving fund the discretion to revise the successor body's contribution rate to allow for the transfer (e.g. to reflect any transferred-in deficit), including the ability to request a lump sum if the existing body's funding level is diluted by the transfer
- Allow the receiving fund to assess the covenant of the successor body and request additional security if the merger/take-over has led to a deterioration in the body's ability to meet its LGPS obligations.
- Include the ability for the ceding fund to continue to administer contributions and benefits of the merged (or taken over) body for a limited period after the merger date, with any cash flows reflected in the final transfer payment.

Yours faithfully

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This response is addressed to MHCLG and is provided solely for the purpose of the MHCLG consultation on amendments to the LGPS regulations introducing Fair Deal protections in to the scheme. It has not been prepared for use for any other purpose and should not be so used. We accept no liability for use out with the purpose.