THE WEST MIDLANDS PENSION FUND

Pooling arrangements for Academies within the LGPS

Consultation Response – 15 November 2013

Introduction

This document constitutes the West Midlands Pension Fund's (WMPF) formal response to the October 2013 consultation on pooling arrangements for academies, as invited by the Department for Communities and Local Government by 15 November 2013.

The format of this response will aim to cover the WMPF's general observations along with its answers to the questions detailed in Chapter 3 of the DCLG consultation invitation.

The WMPF currently has over 200 academies, which have been integrated into the Fund since September 2002, therefore we feel we are well placed to provide a response to the consultation based on experience and associated policy.

The aim of the consultation appears to be to facilitate the establishment of academies by trying to achieve greater stability of employer contribution rates for them within the LGPS. Clearly part of the background to this is the well-publicised approach by some authorities of adopting pension funding strategies for academies which are more conservative than those for the ceding local authority (in particular the application of shorter deficit recovery periods), and a resultant desire within Government for a greater consistency of contribution rate calculations. In addition we have seen divergence of contribution requirements due to the differing profiles of the transferring Academy staff compared to the ceding Authority, and experience due to ill health and other demographic factors.

General observations

Before turning to the consultation questions themselves, it is worth considering a few general issues both about academies' pension funding within the LGPS and pooling arrangements.

When an Academy is set up there is a Commercial Transfer Agreement which sets out the parameters of the conversion. This covers the transfer of School staff and assets and liabilities (including pension costs) and the funding that will transfer from the LEA budget to the Academy, which comes directly from the Department for Education (DfE) going forward. We understand that there is no fundamental change in the amount of its funding and it is clear to us that the policy position from the DfE is that the Academy is meant to manage its own financial position as a standalone entity. For the WMPF this meant that each Academy was treated as a separate employer for funding and accounting purposes.

The WMPF has endeavoured to adopt a policy whereby academies are treated fairly and equitably upon conversion in terms of the initial allocation of deficit and the period over which it is recovered. In creating such policy, consideration has also been given to the changed status of the academy upon conversion from LEA school, whereby it adopts a different profile from that of the ceding Local Authority (LA) as a whole.

The DfE guarantee, which came into force with effect from 18 July 2013, has strengthened the approach and policy adopted by the Fund, although given the guarantee appears to be of a limited scope, the Fund needs to bear this in mind when considering its risk assessment. We do however appreciate that the contingent liability ceilings have been based upon historic closure rates and that the guarantee is not time bound, although the Parliamentary Minute refers to the right to withdraw the guarantee at any time following a reasonable notice period. The grounds for removal are stated as extending to levels being exceeded or projected costs no longer being affordable.

Pooling in the LGPS

In February 2012 the Fund published a position statement on it's website with regards to academies and pooling arrangements. This was in response to a joint letter from the DfE and CLG on the subject of pooling in December 2011. In summary, the position statement confirmed that the Fund believed its approach to be fair and reasonable, with no intention to change the current arrangements in terms of the introduction of pooling arrangements. The Fund would, however, continue to monitor the situation.

The Fund currently affords academies the same deficit recovery period as the ceding Local Authorities and starts them off with only active members, leaving deferred and pensioner liabilities of the former school with the Local Authority. This gives academies a contribution rate comparable, in most cases, to the rate they had before converting to become an Academy.

At a basic level treating employers as standalone entities for funding purposes gives full ***transparency/attribution*** of pension cost whereas any pooling of employers reduces that transparency – the extent to which depends on the pooling arrangement put in place. Therefore it could be argued that any pooling goes against one of the primary aims of the DfE in terms of the Academy concept. However, as long as all parties understand the implications of pooling then it can have its advantages. For Multi-Academy Trusts with academies in the same Fund, the extension of current arrangements to a pooled arrangement for each Trust is relatively simple and practical extension of the current policy.

The Fund operates under the general principle of each employer being responsible for its own financial experience. Pooling arrangements do have their place and are sometimes used, particularly for groups of smaller employers. The aim is that by amalgamating experience of the employers within the group, more overall stability of contribution rates is achieved. In particular this can be helpful for specific experience factors such as ill health retirements, death in service etc. i.e. demographic factors where the employer has little or no control over the outcome but for smaller employers this can have a material impact on their contribution requirements.

Pooling does, however, suffer from a number of significant drawbacks for Academies depending on how employers are pooled:

- It operates on a system of cross-subsidies, therefore giving rise to 'winners' and 'losers'. A particular example pertinent to Academies is when any employer within a group expands its payroll relative to the other employers it could find itself paying a much greater share of the group's deficit contributions.

- In the case where the Academies are pooled with the entire Council, given the Academies' payroll share would likely have increased due to continual staff cuts in the local authority sector, this could mean that in £ terms the Academy would pay materially higher contributions than if they were standalone bodies. This is exacerbated by the fact that Councils' pension arrangements tend to be much more mature (given the substantial and increasing liabilities for former employees), therefore potentially quite volatile compared with a school/academy which does not initially have any former members' pension liabilities allocated to it. A pooling arrangement which included the entire Council may therefore not be in the financial interests of the Academy, especially in the current environment.

- In addition if choice was given to Academies around pooling or not it could allow them to "play the system" by picking whether they are best off in or out of the pool.

- Most funds are now expressing deficit contributions as a £ amount rather than a % of pay, which does not lend itself to the concept of all employers paying the same contribution rate. Whilst the £ amount can be apportioned between the group's constituents, this can then give rise to disputes about the apportionment process and therefore increased governance/communication to overcome it.

- Any outsourcing of staff from an Academy under the new Fair Deal (e.g. its catering services) will disrupt the grouping arrangement: in particular, the contribution rate for the contractor would normally be calculated on the basis of no initial deficit, thus reducing the pool of employees against which the deficit contributions need to be allocated.

- Equally any outsourcing of staff from a Council would also disturb the grouping arrangement if dealt with on a fully funded basis.

- Pools can be notoriously difficult to unpick if one of the employers wants to exit the pool or the Fund. Allocating the assets between employers is a particular difficulty. One of the key issues is the extent to which the exiting employer can be held responsible for its allocation of the deficit. Clearly the existence of the guarantee from the DfE will be of assistance here.

- On a practical basis, accounting figures under FRS17 will need an asset allocation for each employer, and such an allocation becomes far more difficult within a pooling arrangement. If assets are not rebalanced between employers on a regular basis then the deficit contributions can very quickly become substantially at odds with the deficit which they are purportedly designed to clear for an individual Academy, so rebalancing of assets is an area for disputes to arise.

Questions for Consultation

In conjunction with the general observations and high level comments on pooling arrangements above, the Fund has set out below it's response to the specific questions detailed in Chapter 3 of the DCLG's consultation paper.

The practical considerations of a pool

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

Fundamentally, we believe that each employer should be responsible for its own financial position, and therefore pooling arrangements should not be the norm. The key to operating this arrangement is the fair allocation of deficit at inception and the funding principles applied in light of the DfE guarantee. In our view this is perhaps more important than pooling itself, which after all is a simple "averaging" across the employers in the pool. Being consistent in the allocation/treatment of deficit with the contributions being paid by the LEA schools will give rise to stability at conversion, but not necessarily on an ongoing basis as contribution requirements will, in part, be determined by the experience of the Academies themselves. Certain aspects of this can be stabilised in a pooled arrangement, but not all, and it does not follow that the contribution outcomes will be more stable than a standalone arrangement. This is especially true if pooled with the Council and in fact could mean significant cross subsidy of cost from the Council to the Academy in the current environment.

If pooling was desirable then it needs to reflect the financing arrangements underpinning the concept of the Academies. Therefore we strongly believe pooling with the local authority is not at all appropriate, given that academies have left local authority control and the intention is there is a clear line of sight back to the DfE i.e. a level of transparency of cost is fundamental to the policy requirements of the DfE.

One option to achieve better stability in Academy contributions would be to continue with the stand alone arrangements, but implement a pooling arrangement covering certain costs due to specific demographic factors such as ill health retirement costs, death benefit etc. A number of Funds are already considering or implementing this in relation to smaller employers generally as part of a captive insurance arrangement where the larger employers or a pool of employers (such as all the academies themselves) underwrite these costs in exchange for a fixed premium addition to the contribution rate. This arrangement should be attractive to the academies also given this would, all other things equal, achieve better ongoing stability of costs.

As outlined above, the Fund currently implements standalone contributions with similar assumptions and long term recovery applied to academies as they would for contributions for local authorities and LEA schools. If this approach were applied by all LGPS funds it would ensure similar contributions to LEA schools all other things being equal.

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

For the reasons stated above we do not believe full pooling is necessary if the treatment of Academies at conversion and on an ongoing basis is reasonable. We would however support a pooling arrangement for Multi-Academy Trusts in the same Fund if desired as this could ease the administrative burden on the Funds and the Trust.

If a pool did need to be introduced then we do not believe this should be with the ceding Council for the reasons in 1. above.

The other options are to pool with the LEA schools or a pool comprising academies (including existing academies) only. Whichever is chosen then the Academies themselves need to understand the consequences of being in the pool. These two other options have various advantages and disadvantages (in addition to the ones relating to solely to pooling as noted above).

Pooling with the LEA schools
We do not feel that pooling arrangements should be introduced on this basis. The major disadvantage here is that on a practical level we would find it extremely difficult to split out the LEA schools from the Councils as the records have never needed to do that and also the payroll functions are not set up this way. It would mean a potentially significant cost in system upgrade and creation of historic administration records. Further, it would still require the Funds to track academies separately for accounting purposes and also require careful agreement over the funding rules if an academy was to exit the Fund and there was a call on the DfE guarantee which does not apply to the LEA schools. The governance of such an arrangement would need to be clearly defined in the Fund policy documents and in particular the Funding Strategy Statement. Also, to preserve transparency of cost and budgets for the ceding authorities, Funds are also likely to need a pool for each Council resulting in a number of separate pools for certain Funds. Whilst this adds to the administrative burden it should not be difficult to manage once set up.

Pooling the Academies
This has the advantage that it is relatively simple to explain and administer as it would only include the existing and new academies across the Fund. It would not, however, follow that the ongoing consistency with ceding Authorities LEA schools would be maintained. A possible disadvantage with operating one pool would be that no distinction would be applied to converting schools from different Authorities unless separate academy pools are kept relating to the original ceding authority.

Whilst we do not believe full pooling is warranted, if mandatory pooling were to apply we would favour simply pooling the Academies only. We believe this choice should be left to the Administering Authority concerned in conjunction with the ceding Authority.

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

We feel that the choice should be a policy decision for the Fund concerned. We do not believe there should be a choice for the employer as it is impractical for the Funds to manage. If a pool was implemented it should be permanent to avoid anti-selection and have clearly defined rules of operation, especially around an Academy exit from the pool. We also believe that existing

Academies should be included in any pool to avoid maintaining two distinct groups and therefore potentially different treatment.

Also, in our experience, only a minority of Academies have the financial resource and expertise to understand the consequences of the decision, and we suspect that, if given the choice, the majority would simply opt for the approach which generated the lowest initial employer contribution rate. This would not be in the interests of the existing pool as essentially the cost could trend upwards as the Academies with a "standalone" lower contribution outcome would choose not to join whereas those with a standalone higher contribution outcome would.

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?*

In our view the actuarial assumptions should be agreed at local level having regard to advice provided by the Fund Actuary in the same way as for other employers (including Councils). It would seem illogical and inequitable for an Administering Authority to have responsibility for the funding for other employers and the Fund as a whole, but for the guidance on funding assumptions for Academies to be provided from a central external source. We see no reason that guidance cannot be provided on certain parameters applied for funding for Academies, to ensure fair treatment for the Academies versus LEA schools given the existence of the DfE guarantee e.g. around deficit recovery periods etc. and its parameters like the recovery period, which is key to the maintenance of a stable contribution rate. However, any guidance must be set up so it cannot hinder the ability of the Administering Authority to prudently manage the liabilities of the Fund.

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

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

At a practical level we feel this could be possible as we envisage that any transferred assets and liabilities would simply be allocated in their entirety to the pool and a total "average" contribution would be assessed. Going forward all academies would have the same pooled rate. However, this would inevitably result in 'winners' and 'losers' from the current academies in terms of contribution requirements. In our view we think a one off change in the position is much more preferable to maintaining two distinct treatments under any pooling arrangements. It would also be in line with the DfE policy on the consistency of treatment so the Funds could not be criticised for different treatment for academies depending on when they convert.

Consideration should be given, however, to certain disadvantages of such an approach, for example added costs of re-calculation of contribution rates and FRS17 positions and delays to finalising contributions.

One area that may need some thought is in relation to Free Schools, which may need a different policy treatment due to the distinct nature of the change although we realise that this maybe outside the scope of this consultation.

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 practise which might best meet Ministers' aims of similar and stable employer rates when a maintained school converts to academy arrangements.*

We believe that the approach currently adopted by the WMPF is fair and equitable to the Academies and the ceding Authority LEA schools. It is based on the premise that academies are entities which are wholly responsible for their financial affairs and require transparency of pension cost. The policy adopted is transparently communicated through our FSS and other Fund documents and is reviewed on an ongoing basis as per other employers in the Fund. The treatment has never sought to penalise academies by restricting recovery periods or applying other treatments which result in materially different outcomes except to reflect the membership profile of a particular academy. This has also been the treatment in relation to the majority of other new employers such as admission bodies, and we see no strong reason to change this approach. In terms of any policy decision, we feel that consideration should also be given to the other interested parties here, such as the local authorities and LEA schools, which would be affected by any arrangements put in place.

An area which could be further explored is the introduction of the pooling of certain costs to maintain a level of stability for the academies in line with all other small employers in the Fund via self-insurance (through a captive type pooling arrangement) or external insurance if available at reasonable terms.

Summary

Whilst the Fund appreciates that the DfE wishes for a more consistent funding approach to be taken across all LGPS funds, principally with a view to creating stability of contribution rates for academies, we feel that pooling arrangements, whether compulsory or optional, may not be the best solution for all academies or for other LGPS employers. With the provision of the DfE guarantee, which facilitates funds in adapting suitable approaches and policies, we feel that the ultimate objectives of the DCLG can be achieved without necessarily adopting pooling arrangements. In addition, would the DCLG consider the pooling of all academies nationwide within one pool, in effect a sort of "master Trust"?

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