Pension Fund Committee

5 March 2012

Academy Schools – Risks from Participation in the Pension Fund

Report of Don McLure, Corporate Director, Resources

Purpose of the Report

1 The purpose of the report is

- to provide Members with an explanation of the risks involved for Academy Schools, and for other employers in the participation of Academy Schools within the Fund

- to advise members of the Government's recent proposed method for dealing with Academy School participation in the Local Government Pension Scheme and to ask for approval to consider adopting this method.

Background

2 The Pension Fund Committee considered a report in December 2011 outlining how Academy Schools were participating in the Fund. Members asked for a further report setting out the risks involved in Academy Schools participating in the Fund.

3 Since the last meeting Communities and Local Government and the Department for Education issued a joint letter setting out their guidance that Pension Funds should consider allowing Academy Schools to be pooled with their original local authority for the purposes of setting employer contribution rates in the Local Government Pension Scheme (see Appendix A). The letter promises further supporting guidance will be issued shortly on the pooling proposal.

4 This report considers the risks involved in the Fund's current approach for Academy Schools participating in the Fund compared with the risks involved in the suggested 'pooling' approach.

Current approach: Summary of treatment of Academy Trusts within the Durham County Council Pension Fund

5 The Council, working with the actuary, has considered a range of possible options for dealing with Academy Trusts within the Pension Fund and has decided on the following approach:

- From the date of conversion a new academy is established as a separate employer in the Pension Fund with (notional) separate assets and liabilities.
- The (notional) asset transfer to a new academy is determined after initially ensuring the original Council's non-active liabilities are 'fully funded' as at the last valuation date (31 March 2010) and applying an adjustment to take account of changes to the overall funding level of the Pension Fund since the last valuation.
- The transfer of pension liabilities to the new academy is based solely on the pension liabilities of the transferring employees.
- The assumptions used in setting the new academy's employer contribution rate are the same as those used for other Scheduled Body employers in the Fund.
- The deficit recovery period used for the new academy is nineteen years.
- The method set out above will be subject to review at the next valuation (due as at 31 March 2013, with any contribution changes applying from 1 April 2014).

Advantages and risks associated with the current approach

6 Under the current approach, the Academy School has its own separately calculated ongoing employer contribution rate based on the profile of the employees that transfer to the school, and a deficit contribution rate based on the size of the deficit transferred to the academy when it is established.

7 An advantage of this approach for the Academy School is that its employer contribution rate will not be affected in future by the actions of its former local authority (as would be the case with a 'pooled' approach). Similarly, an advantage for the original Council of this approach is that going forwards the Academy School is responsible for its own pension liabilities. Any employer action that affects pension costs (such as increasing employees' pay above actuary assumptions) will be the responsibility of the Academy School.

8 There are some risks involved in the current approach for both parties: For the Academy School the following risks are relevant:

- There is significant uncertainty about future employer pension costs. Actuarial work is required (with a typical cost of around £2,000) before the costs can be determined.
- Market conditions at the time the academy is established can have a significant impact on employer pension costs.
- With a small overall pensionable payroll the Academy School will have a much more volatile employer contribution rate than a larger employer. So, for example a small number of ill-health retirements at an Academy School could have a significant impact on the employer contribution rate.

For the original Council the following risk is relevant:

- The actuary allows a reduction in the deficit contributions for the original Council equal to the level of deficit contributions paid by the Academy School. When an Academy School is set up as a separate employer this reduction in deficit contributions may be lower than the original Council anticipates, meaning the original Council's deficit contributions increase as a proportion of its overall pensionable payroll. This can have a real impact on the original Council's financial position.

Suggested revised approach: Summary of proposed 'pooling' approach to Academy Trusts within the Durham County Council Pension Fund

9 The Government has recommended that all Academy Schools (existing and future) be given the option to have their LGPS pension liabilities 'pooled' with their former Council so giving them a shared employer contribution rate. There is little detail of how this would operate but from discussions with the Fund actuary it is anticipated that the following approach would apply:

- Following conversion the Academy School would continue to pay the same ongoing employer contribution rate as their former Council.
- The deficit contribution amount would be determined by comparing the payroll size of the Academy School with the size of their former Council's payroll and allocating an appropriate proportion of the deficit contributions to the Academy School.
- Work would be required to understand how a pooling arrangement would be reflected within the pension figures within the accounts of both the Academy School and the original Council.

- After subsequent valuations the same approach would be adopted, the Academy School would have the same ongoing employer contribution rate as its former Council and would be responsible for a proportion of the deficit contributions based on the relative size of their payroll compared to other employers in the pool.

Advantages and risks associated with the suggested ‘pooling’ approach

10 The main advantages of the suggested pooling approach are simplicity and initial certainty of contribution costs. An Academy School would have the advantage of knowing its employer contribution rate would be broadly similar to the rate it paid as a maintained school and the rate it was asked to pay would not depend on market conditions at the time of conversion.

11 Going forwards, the Academy School’s employer contribution rate in a pooled arrangement would be less volatile as the impact of experience (such as salary changes and ill-health retirement) would be shared across all the employers in the pool.

12 For the original Council the advantage of the pooled approach would be that the reduction in its deficit contributions (which would equal the deficit contributions paid by the Academy School) would probably be higher than under the existing approach.

13 From the perspective of the Administering Authority, a pooled approach would have the advantage of protecting all of the employers in the Fund who are not in the pool from the impact of an insolvency / failure of an Academy School. Under the current approach, as a separate Scheme employer if an Academy School were to fail any unmet pension liabilities would fall on all the other employers in the Fund, whereas under a ‘pooled’ approach they would fall on the other employers in the pool.

14 There are a number of risks associated with adopting a pooled approach compared with the current method. For the original Council and for the Academy School there is a cross-subsidy risk. So, for example, if one of the employers in the pool increased its pension liabilities significantly by perhaps increasing salaries above assumptions, all the employers in the pool would have to fund this. Similarly, if one of the participants significantly reduced its pensionable payroll, perhaps through a large outsourcing exercise, the other employers in the pool would pick up a bigger share of any deficit payments (which are apportioned according to relative pensionable payroll).

15 One risk for the original Council is that it (and other employers in the pool) would bear all the cost of unmet pension liabilities in the

event of an Academy School insolvency. Under the current arrangement any cost would be spread across all Fund employers. However, the Department for Education has previously written to the Council to emphasise its commitment to academy schools, to confirm that academy funding agreements are open-ended and to express the view that any insolvency risk is minimal.

16 One further complexity for all participants in a pooling arrangement is the presentation of pension figures in the accounts of the Academy School and the original Council. Organisations that are involved in a pooling arrangement will probably need to consult with their auditors to ensure the pension figures are appropriately represented within their accounts.

Recommendation

17 Pooling will not be compulsory but would be another option for Councils and Academy Schools to consider when determining how Academy Schools will participate in the Fund. Members are asked to agree to pooling arrangements potentially being established between the original Councils (either Durham County Council or Darlington Borough Council) and an Academy School, provided both parties agree to the arrangements.

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