Public Sector Pensions Briefing Note

Prepared by Graeme D Muir **Date** 13 January 2011

Academies – LGPS Issues - Update

1 Introduction

1.1.1 This note is an update on the note we prepared in early December.

1.1.2 We have retained sections 1 and 2 for ease of reference but in light of completing actual calculations we have modified our approach as set out in section 3.

1.1.3 We are finding that the membership profiles (age and service etc) can vary quite considerably between groups of transferring staff. We are essentially reverting back to the approach we previously adopted with some slight modifications.

2 Background

2.1.1 The Academies Act 2010 received Royal Assent in July 2010. It essentially allows schools to opt out of local authority control and essentially make their own decisions.

2.1.2 Non teaching staff may be members of the LGPS and so any schools who opt to become academies will become separate (scheduled body) employers in the LGPS Funds.

2.1.3 As a result these new employers will require separate employer contribution rates although it is possible to pool employers from the same Local Education Authority ("LEA").

2.1.4 Guidance from the Department for Education ("DfE") to schools seeking academy status is for the school to ask their LGPS Fund's administering authority for the share of the deficit that they will inherit and the required level of employer contribution rate..

2.1.5 We have carried out a number of calculations as have the other firms of actuaries. However it has emerged that administering authorities and their actuaries may have been adopting different approaches to determining deficit shares and required employer contributions, particularly in relation to deficit recovery periods.

2.1.6 A meeting was therefore held on Wednesday 1 December between CLG and a sprinkling of LGPS actuaries to discuss a number of issues but primarily how these new academies should be treated in terms of their participation in the LGPS. Terry Edwards representing LGE was also present.

3 Meeting Discussions

3.1.1 The assumption that we believe was made by DfE was that, as a share of deficit was to be transferred, then the contribution rate that the new academies would be expected to pay should

be similar to the LEA rate although the guidance from DfE did indicate that the required rate could be higher than the existing LEA rate as it would be based on the membership profile of the school staff rather than the LEA as a whole.

3.1.2 We understand that some administering authorities have taken the view that in order to protect the Funds and local taxpayers that the recovery periods for the share of deficit that is passed across should be funded over a period of something of the order of 7 years which has, we believe, something to do with the period of time that these new academies will receive funding from Central Government – no doubt not quite as simple as that.

3.1.3 With most LGPS Funds adopting deficit recovery periods for the LEA a lot longer than 7 years, then this produces contribution rates that are much higher than the current employer rate that is being applied as an LEA school. Schools therefore who have been drawing up business plans to operate as academies are having to revisit these in light of much higher than anticipated pension costs.

3.1.4 This recovery period was discussed at length. The consensus view was that if the intention is that the new academy should be funded along the same lines as the LEA with long recovery periods, then, provided they can find some sort of guarantor (central Government being probably the only candidate), LGPS Funds and their actuaries would be relaxed about adopting long recovery periods. Thus if an academy failed before the deficit was fully funded then the unfunded deficit would not fall to the other employers in the Fund and ultimately local taxpayers.

3.1.5 It was left therefore that CLG and DfE would discuss further and hopefully agree an approach before 1 April.

4 Approach to Calculations

4.1.1 So what do we do in the meantime for those academies that are already in existence and those that are planning to convert and want to know what their deficit will be and their required contribution rate?

4.1.2 For all requests that we have still to respond to and any future requests, our approach will be to recommend that the new academies pay the existing LEA rate until 1 April 2011.

4.1.3 We will also revert to assessing the share of deficit that on an “active cover” approach. In our previous briefing note we said that we would adopt the “same LEA rate” approach. However we have encountered some issues with this approach. Further details of the this approach and our rationale is set out in the Appendix.

4.1.4 In terms of setting contribution rates for academies then if adopting the same recovery period as the LEA produces a total contribution rate higher than the proposed LEA rate for 2011/12 then we will certify the higher rate – in other words academies will not be allowed recovery periods longer than the LEA. This tends to be the case where the average age of the academy membership is older than the average age of the LEA.

4.1.5 If adopting the same recovery period produces a lower contribution rate than the LEA rate then we will adopt a shorter recovery period that produces the same rate as the LEA. This will mean the academy pays off its deficit more quickly which means less contributions in the long term in the same way as paying off your mortgage saves you future interest payments.

4.1.6 As always, happy to discuss further if required.

Appendix – Share of Deficit Calculation

Guidance from the Department for Education ("DfE") to schools seeking academy status is for the school to ask their LGPS Fund's administering authority for the share of the deficit that they will inherit and the required level of employer contribution rate.

In LGPS pension funds it is possible to track individual employers' share of the assets and liabilities provided they have historically been treated separately within the Fund.

When a new employer is created out of another then assuming the new employer is to leave the previous employer pool of assets and liabilities, we need to establish the new employer's liabilities and asset share.

It is of course possible to calculate the liabilities of the staff of the new employer as we can identify the transferring staff. In the case of the new academies we have a new employer being created out of the previous LEA.

However it is not possible to establish the share of assets that have accumulated in the Fund in respect of the new employer as the new employer has effectively been pooled with the previous employer (in the case of academies, the LEA).

Thus when a new employer or academy is being created we have the following information:

- Total assets for the previous employer/LEA ("TA")
- Total liabilities for the previous employer/LEA including active members of the new employer/academy ("TL")
- Active member liabilities for the previous employer/LEA ("AL")
- Pensioner and deferred pensioner liabilities for the previous employer/LEA ("PL")
- Total deficit for the previous employer/LEA ("TD")
- Active member liabilities for the staff that will transfer to the new employer/academy ("XL")
- Pensionable payroll for the previous employer/LEA including the transferring staff ("TP")
- Pensionable payroll for the transferring (academy) staff ("XP")

Where it is agreed that the new employer will start off on a fully funded basis, as is usually the case for Transferee Admission Bodies, then the Asset Share is calculated as the active member liabilities for the staff that will transfer to the new employer/academy ("XL").

Where there is to a transfer of a share of deficit then a different approach is required to establish the Asset Share.

The approach that is adopted is to first of all establish the share of the Total Deficit ("TD") that transfers to the new employer, or Deficit Share ("DS").

Once we have established the Deficit Share ("DS") we can then establish the Asset Share for the new employer ("AS") as new employer liabilities ("AL") less Deficit Share ("DS").

There are then a number of ways of calculating the Deficit Share ("DS") depending upon what we are trying to achieve as follows.

Objective	Method	Comment
Method 1 New employer has the same funding level (assets/liabilities) as the LEA	Apportion Total LEA Deficit (“TD”) in the relation to the total liabilities of the LEA (“TL”) before transfer to the active member liabilities of the new Academy. (“XL”). Deficit Share (“DS”) is then XL / TL * TD	The new academy does not pick up any share of deficit attributable to former employees of the LEA school which then gets left with the LEA. The new academy will then generally see a reduction in their contribution and the LEA contribution rate will increase to compensate.
Method 2 New employer’s deficit contribution is the same as the LEA assuming the same deficit recovery period.	As deficits are funded via payroll then we apportion the Total Deficit in relation to the Total Payroll of the LEA (“TP”) to the payroll of the new academy (“XP”). Deficit Share (“DS”) is then XP / TP * TD	This approach will mean that the required contribution rate for the new academy will be broadly the same as the existing rate – which is what we understand DfE were expecting. The potential problem with this approach is that if the active members of the new academy have significantly less service than the LEA as a whole then the value of future deficit contributions or Deficit Share (“DS”) can exceed the new academies liabilities (“XL”). The Asset Share (“AS”) is then negative!
Method 3 The new employer has the same “Active Cover” as the LEA. Active Cover is similar to funding level but we calculate net assets once we have fully reserved for deferred benefit members and pensioners and then divide net assets by active member liabilities. This is the equivalent of apportioning the Total Deficit in the ratio of Transferring Liabilities (“XL”) to active member liabilities of the LEA (“AL”)	The Deficit Share (“DS”) is then XL - (TA – PL) / AL * XL or equivalently (after some algebra!) XL / AL * TD	This approach will produce the same Deficit Share as Method 2, provided the membership profile (average age and service) for the transferring staff is the same as for the LEA. However where the average service of the transferring staff is less than the LEA then this will produce a lower Deficit Share and generally a lower level of contribution than the existing rate but with much less likelihood of negative assets.

As we see there are various pros and cons of adopting one of the 3 approaches.

We rule out Method 1 on the grounds of fairness. We can see a lot of merit with Method 2 but negative asset shares cannot be rationalised particularly as asset shares are disclosed in employer’s accounts via FRS17.

On balance therefore our preference is for Method 3. If the average service of the transferring staff is less than average then one could argue that they have been in the Fund for less time and so arguably are less responsible for the accrued deficit which may have built up over a long period of time.