REPORT FOR: Pension Fund Committee

Date of Meeting:	25th June 2013
Subject:	Pension Implication of Service Outsourcing
Responsible Officer:	Simon George, Director of Finance and Assurance
Exempt:	No
Enclosures:	None

Section 1 – Summary and Recommendations

Members have requested an opportunity to discuss the pension implication of the proposed libraries outsourcing, for which part of the risks relating to past service liability and assets will be retained by the Council to optimise the overall commercial arrangements.

Recommendation:

The Panel is invited to discuss the proposed pension arrangements and note the intention to review the admission policy to ensure that the financial risk to the Fund and its employers are appropriately identified and managed.

Section 2 – Report

1. This item has been included at the request of members, who wish an opportunity to discuss the pension implications of the outsourcing of the libraries contract. Gemma Sefton, from Hymans Robertson will be attending the meeting.

2. The norm on a service outsourcing that involves the transfer of Harrow staff is for the new employer to request admitted body status in the scheme. Harrow Council cannot object provided the new employer abides by the regulations and agrees reasonable terms.

3. To date, the standard practice has been that the value of the past service liability for the transferred staff is calculated and allocated to the new employer together with an equal allocation of assets, such that any deficit is retained by the existing employer, e.g. Harrow Council. The Actuary then calculates an initial contribution rate based on the ongoing cost of providing new benefits. The new employer is subject to changes in contribution rates (up or down) at each tri-annual valuation, including due to changes in the value of past service liabilities and assets.

4. It should not be read that transferring matching assets and liabilities will mean future contribution increases. The change in a valuation position will reflect all experience in the inter-valuation period. Changes in the financial assumptions used, salary experience, ill health retirements, mortality experience will all impact on the balance sheet and resulting required employer contributions. For example, if bond yields were to increase from current levels, the value of the liabilities would reduce and all else being equal may result in a contribution reduction.

5. The standard treatment on outsourcing is not mandatory and can be varied by the Council.

6. The ongoing libraries outsourcing involves 109 employees with a past service liability of £6.2 million. The initial standalone contribution rate determined by the Actuary is 25.3% (approximately £0.4 million p.a.), considerably higher than the 19.35% currently paid by the Council, such that the pension fund will receive higher contributions as a result of the out-sourcing, to reflect the calculated cost of new benefit accrual for the transferring members being higher than the stabilised contribution rate currently being paid by the Council.

7. The initial contributions rate payable by the new employer will be reviewed at each valuation in light of:

   a) Changes in the cost of providing future benefits,
   b) Actuarial gains and losses on assets and liabilities acquired post the date of transfer of employment, and
   c) Any action taken by the employer than impacts on pre transfer benefit liabilities e.g. salary increases or ill-health retirements that differ from those assumed.

8. One aspect of the libraries outsourcing that differs from 'standard' practice is that the Council will retain some of the pension risks relating to the historic liabilities and assets as at the date of transfer. In particular, those risks that are not controllable by the new employer e.g. investment performance, discount rates, longevity, changes in inflation etc will remain with the Council. This decision has been made on commercial grounds to encourage a competitive bidding process and eliminate uncertainties that appeared likely to cause pricing adjustments that were excessive in relation to the risks being transferred.

9. The impact of the Council retaining part of the risk relating to the historic liabilities has in this instance not been reflected within the new employer's initial contribution rate. It has been known for an additional contribution charge to be levied in these circumstances, but as additional costs will impact on the contract cost, it has not considered appropriate.

10. At the point of the outsourcing the deficit remains with the Council. A successful outsourcing will reduce the costs of providing the services and as the Council's revenue is unaffected will have a positive financial impact for the Council. Of course if future actuarial outcomes are worse than expected, then a greater burden will fall on the Council due to retaining some of the pension risks, but this is the same position as retaining the staff in-house and forgoing the outsourcing savings.

11. The Committee should note that if significant outsourcings were to occur, the Fund may require additional contributions if contributions continue to be expressed as a percentage of pay. As the deficit is unchanged, that deficit still needs to be repaid, but as it is spread over a reduced payroll it may mean a higher "rate" is required to ensure that the monetary value of deficit contributions is maintained. Therefore, the pensions saving from an outsourcing cannot be assumed to be the rate currently in payment times the outsourced payroll.

12. Risk sharing arrangements such as these usually operate outside of the Fund. This means that at each valuation the Fund continues to calculate the balance sheet of and contribution rate required from, the Employer, regardless of the risk sharing that is in place. It is that certified contribution that the Fund needs to receive from the Employer. Thereafter, there would be an additional calculation to figure out how the contribution rate is split between the Council and the Employer. The Council would then either pay more to the Employer so that it can meet its obligations to the Fund if the required contribution is higher than that priced in the contract or the price of the contract would be reduced if the required contribution is less than that allowed for the original pricing.

13. Comparison has been made with the policy adopted for academies, in which a proportion of the past service deficit was transferred to the academies. This treatment was different because the Council's funding was reduced as part of the move to academy status and the Council has fewer resources to fund the associated deficit. This is not the case with the libraries out-sourcing.

14. The growth in the level of outsourcing and increase in the number of admitted employers has required more time to be devoted to similar pension issues. Some employers are large and sophisticated and understand the pension issues, while others have little understanding and seek simpler solutions to providing pension provision. It is proposed to consider a range of tailored solutions that might be applied to different circumstances while protecting the fund and the Council. These proposals will be discussed with the Committee prior to implementation.

15. One final consideration is that the methodology for recovering deficits may have to change if Harrow's work force continues to shrink, from a percentage of salary to a defined monetary sum. This need not change the value of the deficit contribution but will protect the fund against receiving lower contributions. This is an approach that perhaps should be considered for all Fund employers as part of the 2013 valuation. At a minimum the value of deficit contributions being paid should be monitored.

Financial Implications

16. The impact on the Council from the libraries outsourcing arises both from the commercial aspects of providing services and the impact on the pension fund. The Pension Fund Committee will wish to ensure that the fund is not adversely impacted

Risk Management Implications

17. Risk included on Directorate risk register? No

18. Separate risk register in place? No

19. Setting risk tolerances and measuring outcomes is central to the strategy.

Equalities implications

20. Was an Equality Impact Assessment carried out? Yes

21. There are no direct equalities implications relating to the pension fund.

Corporate Priorities

22. Corporate Priorities are not applicable to the Pension Fund as it does not have a direct impact on Council resources.

Legal Implications

23. The report has been reviewed by Legal Department and comments received are incorporated into the report.

Section 3 - Statutory Officer Clearance

Name: Simon George Date: 11 June 2013	√	Chief Financial Officer
Name: Matthew Adams Date: 11 June 2013	√	Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: Linda D'Souza (Shared Services Manager) and George Bruce (Treasury and Pension Fund Manager) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: [None].

If appropriate, does the report include the following considerations?

1.	Consultation	N/A
2.	Corporate Priorities	N/A