APPENDIX 3

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BRIEFING NOTE

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Academies – what does this mean for the LGPS?

Following the introduction of the Academies Act 2010, schools have the opportunity to become independent from the Local Authority, and assume responsibility for their own finances. Non-teaching staff are eligible to join the LGPS and academies will be wholly responsible for pension contributions in respect of their staff, and any funding deficit.

There are a number of issues that the Administering Authority, ceding employer and the Academy should be aware of when the initial pension calculations are carried out. Julie Morrison considers the different approaches to determining the starting funding position of an Academy, and their implications.

Background

The Academies Act 2010 saw the coalition government introduce legislation allowing schools to break free from Local Authority control, and assume responsibility for managing their own finances. Whilst Academies can set pay and conditions for staff, our understanding is that staff must have access to the LGPS.

To date there has been no clear guidance on the approach to allocating LGPS assets and liabilities for Academies, nor to calculating their contribution rate. However, a briefing note issued by the Department of Education[1] states that each Academy should have its own contribution rate calculated and will be responsible for a share of the LGPS deficit.

[1] http://www.education.gov.uk/~/media/00197BD5A9824D248C3325C94FC431D6.ashx

We understand that in rare circumstances an Academy may participate in the LGPS under a PFI contract, in which case it may be appropriate for there to be no transfer of deficit. Such special circumstances must be discussed with your actuary to ensure the most appropriate approach is taken.

This briefing note only considers what we understand will be the norm, where an Academy is set up as a scheduled body and will be responsible for a share of the funding deficit. As with all things actuarial, "a share of the funding deficit" has no single definition.

There are different approaches which may be taken to determining the share of deficit (and hence the initial asset allocation) and though the differences may seem subtle, they have important implications for both the Academy and the ceding employer.

Share of deficit: which deficit?

Schools are typically pooled with the Council responsible for education services for the purpose of setting employer contributions to the LGPS, and in many cases their membership may be indistinguishable from other Council members. In all cases, it is our understanding that the share of deficit calculation is based on the pool or Council's deficit not that for the fund as a whole. Further, unless there are strong arguments for doing otherwise, our assumption is that the deficit should be calculated using the ongoing valuation basis (albeit this will usually involve updating the assumptions to those appropriate to the transfer date) and assuming the whole Fund investment strategy applies.

Share of deficit: actives only

Under this approach, the Academy would be awarded the same funding level as the ceding employer (or pool of employers) as determined at the

date of the transfer. For example, if the liabilities attributable to the new Academy are 20, and the funding level of the ceding employer (or pool) is 75%, then the new Academy will be allocated assets of 15 (= 75%*20).

Adopting this method, the contribution rate for the Academy is likely to be lower than the ceding employer or pool was previously paying (assuming the same deficit recovery period). The reason for this is that the Academy has only active members so its deficit is recoverable over a proportionately larger payroll. There are of course other variables:

- to the extent that the Academy's active membership is different to that of the Council or pool, the contribution rate for future service will also be different (lower if the average age is lower);
- if market conditions at the date of transfer are materially different to those at the last valuation both the assessed funding level and future service contribution rate may be different to those calculated for the Council pool as at 31 March 2010;
- if the Council or pool rate is based on a "stabilised" approach, and the Academy's rate is based on the theoretical rate, this will also lead to differences in the actual contribution rate payable.

In practice, these differences may actually cancel out such that the contribution rates end up being similar. In this case it is even more important to understand the underlying differences in the calculations. We have included an illustrative example for this purpose below.

Implications for ceding employer or pool

Whilst the deficit for the ceding employer remains unchanged, this will be spread over a lower payroll (since active members have transferred to the Academy). This "maturing" of its membership profile means that at future valuations, deficit recovery contributions, expressed as a percentage of payroll, will increase (unless the monetary amount of the deficit reduces).

Share of Deficit: Including deferreds and pensioners

An alternative approach, which we understand some actuaries are adopting, is to allocate assets to the Academy which allow for a proportionate share of the deferred and pensioners remaining with the LEA, to be fully funded.

In the example below, allowing for sufficient assets to cover the total deferred and pensioner liabilities, the ceding employer or pool has 300 of assets available to meet the total active liability of 600. Thus the new Academy is notionally allocated assets at the same funding level, i.e. 50% in this case.

	Ceding employer	New Academy Actives only	New Academy Allowance for deferreds and pensioners
Active liabilities	600	20	20
Deferred liabilities	200	0	0
Pensioner liabilities	400	0	0
Assets	900	15	10
Deficit	(300)	(5)	(10)
Funding level	**75%**	**75%**	**50%**
Future service rate	16%	16%	16%
Past service adjustment (spread over 20 years)	8%	2%	4%
Total contribution rate	24%	18%	20%
Actual contribution rate payable	21%	18%	20%

This example is for illustrative purposes only. The initial funding level and contribution rate will vary depending on the timing of the transfer, the membership profile of the Academy, the funding position of the ceding employer (or pool) at the date of transfer and the deficit recovery period adopted. We have assumed that the ceding employer retains responsibility for the deferred and pensioner members.

ACADEMIES – WHAT DOES THIS MEAN FOR THE LGPS?

Whilst the Academy will see a significantly decreased funding level, and larger deficit, for the reasons explained previously, it does not necessarily follow that the Academy's contribution rate will be higher than that of the ceding employer or pool.

Proponents of this approach argue that it is "fairer" on the grounds that it recognises that the Local Education Authority will lose funding in respect of the provision of education services but will remain responsible for the pension liabilities of former education staff whose benefits will not transfer to the Academy. Whilst it will provide more protection for the ceding employer or pool against the issues associated with maturing membership, it is not possible to identify the former education staff within the pool's membership and it is not clear whether the Department of Education will be supportive of this approach or whether any additional funding will be available to academies to meet this additional deficit.

Using this method, academies will assume a substantial deficit at the date of the transfer, which will directly impact on their balance sheet. Whilst the briefing note issued by the Department of Education states that the academy should not be deemed insolvent, even if the deficit is greater than its assets, as contributions are being paid towards repayment of the deficit, it is not obvious that it is the best approach for the fund, particularly if the financial strength of the new academies is considered inferior to that of the LEA.

Responsibility for deferred and pensioner members

It should be noted that under both approaches above, the ceding employer or pool is assumed to retain the risk in respect of former education staff. What this means is that if investments underperform or those members live longer than expected, any future deficit arising on those liabilities will fall to be met by the ceding employer/pool.

The reason for this is that it is our understanding that no explicit provision exists within the LGPS Regulations to transfer deferred and pensioner members to the new Academy, and the Schools and Standards Framework Act 1998[2] states that all liabilities relating to staff transfer back to the LEA on dissolution of the School (and this is only overridden in respect of active employees transferring to the Academy).

Deficit recovery period

The example set out above assumes that the deficit allocated to the Academy is to be recovered over a twenty year period. We understand that the Department for Education has guaranteed funding for academies for a period of 7 years. It is not clear what will happen thereafter, but if further funding is not guaranteed administering authorities may need to consider the strength of covenant of the Academies and future financing constraints when setting the length of time over which any deficit should be recovered.

Different approaches to setting the deficit recovery period may be taken by different funds; we are aware that different funds already take different approaches for further education colleges which, whilst being scheduled bodies, are considered to be less financially strong than councils. We suggest unless there is a strong reason to do otherwise, a consistent approach should be taken to all academies in a fund.

Practicalities

In some cases, former education staff may be separately identifiable to the administering authority by means of a separate employer code. However, given the provisions of the Schools and Standards Framework Act 1998, we assume that this will include only those who were active at the time the separate employer code was established. What this means is that the schools employer code will not capture former education members who remained coded to the LEA and so if the second option above is chosen, it is still appropriate to consider the overall pool deferred and pensioner liabilities rather than only those attributable to the school in question.

[2] Paragraph 7, Schedule 22, School and Standards Framework Act 1998.

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In order that an individual employer contribution rate can continue to be calculated for the Academy in future, the employee members of the Academy should be allocated to a new employer code at the date of the transfer.

Conclusion

The Administering Authority's objectives should be to strike the right balance between protecting the fund and ensuring the contribution rate payable by the Academy is affordable. Whatever approach is taken, it is important to ensure that both the ceding employer and the Academy understand the approach and its implications (they should also ensure that it is consistent with the Transfer Agreement). Whilst setting the contribution rate may be most pressing, with accounting figures likely to be due as at 1 August 2011 it is also important to agree the method used to allocate fund assets to the Academy.

The potential impact on the Fund, and the ceding employer, will depend on the number of academies that have sought or may seek academy status. Where the number of members (and amount of liabilities) involved is small, there is likely to be less pressure to assess the relative effects of different approaches and to consider allocating a share of the deficit in respect of pensioners and deferred members. However, funds may wish to adopt a consistent approach for all their academies, (including unknown future academies) so it may still be worth considering the options before proceeding with any calculations.

POST SCRIPT

This briefing note is intended to facilitate discussions between Administering Authorities and the actuary on the approach to be taken for future calculations. Please supply us with any information available to you in respect of these academies, to allow us to discuss with you the best approach going forward.

This briefing note considers only the actuarial aspects of the admission of academies to the LGPS. Whilst pensions are an important consideration, care must be taken to ensure that pension provision is not the sole factor for the success or otherwise of the Academies initiative. There may be political or local pressures encouraging schools to make the move to Academy status, and hence administering authorities may need to strike a balance between protecting the ceding employer without unduly affecting the new Academy.

It is not clear what protections are in place for funds on termination of the contract, or insolvency of the Academy. As there are no provisions in the LGPS Regulations to levy a cessation payment on a Scheduled Body further consideration may need to be given to the financial security offered by academies.

Your usual Hymans Robertson contact will be in touch to discuss how you wish to proceed with these calculations.

For further information, or to discuss any matter raised by the Briefing Note, please speak to your usual contact at Hymans Robertson LLP.

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