REPORT FOR: **Licensing & General Purposes Committee**

Date of Meeting:	17 May 2011
Subject:	Academies – Employer Contribution Rates
Responsible Officer:	Tom Whiting, Assistant Chief Executive
Exempt:	No
Enclosures:	Appendix 1: Minutes of Pensions Fund Investment Panel Appendix 2: Minutes of Licensing & General Purposes Committee Appendix 3: Letter from Schools Appendix 4: DfE briefing note Appendix 5: Hymans Robertson briefing note Appendix 6: Hymans Robertson "Academies" Presentation. Appendix 7: Letter from the Local Government Pensions Committee

Harrow COUNCIL
LONDON

Section 1 – Summary and Recommendations

This is a report to support the special Licensing & General Purposes Committee (LGPC) meeting called in response to a formal request made by the seven high schools seeking academy status.

The schools have requested that the Committee reconsider its decision on the calculation of the employer contribution rate for academies. In particular the academies have asked the Committee to reconsider its decision in relation to the deficit recovery period and calculation of the share of the deficit.

At the LGPC meeting on 19 April 2011, it was resolved that a deficit recovery period of 7 years would be used and the share of the deficit would be calculated taking account of current LGPS staff who transfer to the academy and deferred and pensioner members. The schools have since advised that this decision would significantly reduce the financial viability of conversion to academy status.

With the exception of one school, at the time of the meetings held on 11 and 19 April, the final actuarial calculations had not been received and so the financial impact on the remaining six schools was not fully known. Since this date the final figures have been received which shows an increase in the employer contribution rates for individual schools from those estimated and presented to the Committee on 11 and 19 April.

Recommendations
The Committee is requested to consider the information detailed in the report and presented by Hymans Robertson and agree the following recommendations:

1. A deficit recovery period of 20 years to be used to recover the share of deficit allocated to each academy.
2. The 20 year recovery period to only be applicable for as long as the academy or DfE does not give notice of exiting its status.
3. On receiving 7 years notice of exiting academy status, the outstanding deficit be spread over the remainder of the notice period and the contribution rate be recalculated with effect from the start of the following financial year.
4. The Committee to reserve its position regarding the actuarial basis to be used for the recalculation.
5. The share of the deficit to be transferred to the schools be calculated based on the liabilities of current LGPS staff who transfer to the academy and the estimated liability for deferred and pensioner members formally employed by the former maintained school.
6. Decisions 1 to 3 and 7 from the previous LGPC meeting held on 11 and 19 April (shown in 2.3 below) to remain the same.

Section 2 – Report

2.1 Background

2.2 On 5 April 2011, the Pensions Fund Investment Panel (PFIP) met and considered a report on calculation of employer contribution rates for academies, should the seven high schools currently considering conversion make a decision to convert to academy status. The minutes of the Panel (Appendix 1) details the agreed recommendations (shown below) that were submitted to the LGPC for determination:

1. Schools that apply for academy status will not be able to pool with Harrow Council;
2. A separate employer contribution rate for each academy be established;
3. No stabilisation of contributions to be applied;
4. A deficit recovery period of 20 years to be used to calculate the deficit contribution;
5. The Harrow Council ongoing funding level as at the date of transfer to be applied to the liabilities of transferred actives to determine the initial assets to be allocated to each academy.
6. The actuarial liabilities and deficit contributions for pensioners and deferred members remain with Harrow Council.
7. The cost of calculating academy specific contribution rates be charged to each academy.

2.3 On 11 April 2011, the LGPC considered the PFIP recommendation. Due to lack of time to fully consider the report, the Committee reconvened on 19 April 2011 to consider some aspects of the recommendation. The minutes of the Committee (Appendix 2 – minutes of the meetings on 11 & 19 April 2011) detail the following decisions that were made:

1. Schools that apply for academy status will not be pooled with Harrow Council;
2. A separate employer contribution rate for each academy be established;
3. No stabilisation of contributions to be applied;
4. A deficit recovery period of 7 years to be used to calculate the deficit contribution;
5. The Harrow Council ongoing funding level as at the date of transfer to be applied to the liabilities of transferred actives, to determine the initial assets to be allocated to each academy;
6. The actuarial liabilities and deficit contributions for pensioners and deferred members are transferred to the academies;
7. The cost of calculating academy specific contribution rates to be charged to each school (academy).

2.4 Following the LGPC decision, the High School head teachers raised concerns about the decision and on 11 May 2011 submitted a letter requesting that the Committee reconsider its former decision (Appendix 3). The letter raises a number of concerns, which are dealt with in detail in this report.

2.5 DfE Advice and PFIP Recommendation

2.6 The Schools have stated that the LGPC decision goes against the DfE advice and the recommendations made by the Council's PFIP, both of which recommend a 20 year deficit recovery period based on active members only.

2.7 The DfE issued a briefing note on Local Government Pensions Scheme in August 2010 (Appendix 4). In relation to pooling contributions, the briefing note states:
"The employer contribution rate will be calculated on the basis of the academy's staff profile and relates only to the academy, whereas nearly all maintained schools in the LA pay the same pooled rate. This means the rate can be higher than the rate which applied to the school when maintained."

2.8 The briefing note states that the pension scheme may be in deficit or surplus and that a share of the deficit will transfer to the academy. However, it is silent on how the share should be calculated. In relation to the deficit spread period, the briefing note states that this will normally be taken to be 20 years for academies, although it is for the actuary to take a view on this.

2.9 When making its decision, the Committee should take account of the recommendations made by the PFIP and the briefing note from the DfE, as well as advice from the Council's actuary and officers, where appropriate. However, it is for the Committee to make a decision and it is not required to follow the recommendations of the PFIP.

2.10 Different Position of FE Colleges and North London Collegiate School

2.11 The schools have stated that the decision of the Committee would put academies in a different position to FE colleges despite the similarity of their history of being part of the Council and similar remit to provide state-funded education for local communities. In addition, they have stated that North London Collegiate School, an exclusive fee-paying independent school, is pooled while state funded local academies are not.

2.12 Prior to the decision on 11 April 2011, Nower Hill High School had made a formal request for all academies formed in Harrow to participate in the Council's pool. This request was based on the principle that academies should be treated the same as the three Further Education (FE) Colleges (Harrow, Stanmore, St. Dominic's) in addition to North London Collegiate School (NLCS) who all currently participate in the pool.

2.13 There are compelling grounds against extending the current pooling arrangement on the basis of the following:

- The Department for Education (DfE) briefing note (Appendix 2) referred to separate employer contribution rates being set for each academy.
- Each academy would be responsible for its own decisions with regards to the release of early retirements and the application of its discretionary policies (which could generate a cost to the pension fund) without these decisions having a negative impact on the other employers.
- The application of individual contribution rates is considered reasonable and not detrimental to the academies.
- Although there is an employer pool currently in operation, this does not necessarily warrant extending the pool. On the contrary, current pooling arrangements should be subject to a future review to determine whether de-pooling should be considered.

2.14 Balance between protecting the fund and ensuring the contribution rate payable by academies is affordable.

2.15 The schools have stated that the decision fails to strike a balance between "protecting the fund and ensuring that the contribution rate payable by the academy is reasonable" as outlined in the Investment Panel minutes.

2.16 The Briefing Note from Hymans Robertson (Appendix 5) states that there is no clear guidance on the approach to allocating LGPS assets and liabilities for academies, nor to calculating their contribution rates. It goes on to state that 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". It also states that the potential impact on the fund will depend on the number of academies seeking conversion, but that the fund may wish to adopt a consistent approach for all their academies (including unknown future academies).

2.17 Presence of the actuary at the meeting of 19 April 2011

2.18 The schools have stated that the actuary was not present at the second part of the LGPC meeting on 19 April and they have concerns that this prevented members benefiting from the actuary's advice regarding risk to the pension fund.

2.19 The Council's actuary, Hymans Robertson, were present at the meeting of the PFIP and the meeting on 11 April. A representative delivered a presentation at both meetings. A representative was not present at the meeting on 19 April. However, two officers from finance were present to answer Members' questions and the briefing note and presentation notes were available at the meeting on 19 April 2011.

2.20 A representative from Hymans Robertson will be present at this committee meeting should any member wish to seek actuarial advice. The original Hymans Robertson presentation document is shown in Appendix 6.

2.21 Members' declaration of interest

2.22 The schools have stated that members declared interests at the meeting on 11 April and abstained from voting, but do not appear to have declared any interests at the subsequent meeting on 19 April 2011.

2.23 All members are advised to consider whether they have an interest that needs to be declared at the meeting and if required, should seek advice from the Council's Monitoring Officer or his representative.

2.24 Inclusion of Deferred and Pensioner Members in the calculation

2.25 The schools have stated that they do not understand the rationale for the inclusion of deferred and pensioner members in the employer contribution rate calculation when the prospective academies will never have employed those deferred and/or pensioner members.

2.26 The DfE briefing note suggests that each academy should be responsible for a share of the pension fund deficit; however it does not elaborate on how this should be calculated.

2.27 There are two different approaches that could be considered to determine the share of deficit calculation:

1. the academy could only be responsible for a share of the deficit that applies to those current LGPS staff who transfer to the academy, or
2. the academy could be responsible for a share of the whole Council deficit i.e. that applying to current LGPS staff who transfer to the academy and that attributable to deferred and pensioner members.

2.28 The initial officer recommendation was to apply a share of deficit to the current LGPS staff only (i.e. option 1) however, after having carried out further analysis, the recommendation changed to option 2 (i.e. applying a share of the whole Council deficit).

2.29 In view of the fact that a proportion of the Council's employer contribution rate relates to deficit contributions which covers the liabilities of current LGPS staff as well as pensioner and deferred members, it would seem reasonable to allocate a share of these liabilities to the academies. This is arguably a fairer approach on the basis that it recognises the Council 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.

2.30 After lengthy discussion on the matter at the Committee meeting on 19 April 2011 it was resolved that academies should be responsible for a share of the whole Council deficit which covers current LGPS staff as well as pensioner and deferred members.

2.31 Deficit recovery period

2.32 The schools have stated that they do not understand the rationale for a 7 year recovery period and referred to the fact that the funding agreement with DfE is a rolling contract, with a 7 year notice termination clause.

2.33 The DfE briefing note implies that the deficit recovery period, (i.e. the period of time the pension deficit allocated to the academy is to be paid over) should be the same as the Council's (currently 20 years), although it does go on to say that it is for the actuary to take a view on this.

2.34 However, there is an alternative view that suggests the deficit recovery period adopted should be for 7 years in line with the 7 year notice period for termination of the contract specified in the funding agreement.

2.35 The argument for this approach takes the view that the 7 year notice period weakens the strength of covenant of the academies, so to recoup the pension deficit over a shorter period would reduce the risk of non recovery should the academy fail and the staff and funding not revert to the local authority.

2.36 The implication of adopting this approach would result in a significant increase to the employer pension contribution rate payable by the academy. A comparison of the employer contribution rates for each of the seven schools together with associated pension payroll costs based on the two deficit spread periods is shown below (2.45).

2.37 In a letter to the DfE (Appendix 7), it has been suggested by the Local Government Pensions Committee, which represents LGPS administering authorities, that the Government provides a legislative guarantee that will meet any LGPS underfunding deficit relating to an academy should it fail. This, they argue, would provide pension funds with the necessary assurance in order to extend the deficit recovery period to 20 years.

2.38 However, it should be noted that the Government does not share this viewpoint on the basis that the Academies Act 2010 is prime government legislation and as such believes the academies should be considered as long term bodies not requiring any form of guarantee. They have advised that the 7 year period relates to the 7 year notice period that academies are obliged to give to exit from academy status.

2.39 For the avoidance of doubt, the Committee could advise the academies at the outset that the 20 year spread period would only be applicable for as long as the academy did not give notice of exiting its status. On receiving 7 years notice of exiting academy status, the Fund could recalculate the academy's contribution rate with effect from the start of the following financial year; the revised rate would spread the existing deficit at that time over the remainder of the notice period, rather than 20 years. This would therefore trigger a material increase in the academy's contribution rate, which would be necessary for the Fund's protection.

2.40 The Committee may also wish to reserve its position regarding the actuarial basis to be used for this recalculation: it could be argued that something more akin to a cessation basis (eg using gilt yields without any assumed investment out-performance) would be more appropriate to protect the other employers in the Fund. This would be similar to the approach when an admitted body terminates early. However, no definite decision would be needed on this (other than to reserve its position), as this would need to be consistent with the Fund's funding strategy for other bodies.

2.41 Council's commitment to the family of schools and maintaining equity between schools

2.42 The schools have stated that the impact of the committee decision would significantly reduce the financial viability of conversion to academy status and therefore be against the Council's commitment to the family of schools.

2.43 The Committee has to reach a decision taking account of the impact of the decision on the pension fund and the impact of the decision on the affordability of the contribution rates payable by the academies. The weight given to these considerations is a matter for the committee to determine.

2.44 Financial Implications

2.45 A comparison of the employer contribution rates applicable to each of the seven schools should they convert to academy status is shown below.

Schools	Payroll (non-teaching)	20 year deficit spread	Monetary value	7 year deficit spread	Monetary value	20 year deficit spread	Monetary value	7 year deficit spread	Monetary value
		Share of Fund: actives only				Deferreds and Pensioners Fully Funded			
Nower Hill	£1,146,181	18.70%	£214,336	22.00%	£252,160	21.50%	£246,429	29.30%	£335,831
Bentley Wood	£605,266	18.50%	£111,974	24.30%	£147,080	23.40%	£141,632	37.20%	£225,159
Rooks Heath	£976,449	19.50%	£190,408	23.80%	£232,395	23.10%	£225,560	33.40%	£326,134
Hatch End	£1,376,770	19.20%	£264,340	23.30%	£320,787	22.70%	£312,527	32.70%	£450,204
Harrow	£885,274	18.30%	£162,005	22.00%	£194,760	21.40%	£189,449	30.10%	£266,467
Cannons	£768,747	18.30%	£140,681	21.70%	£166,818	21.20%	£162,974	29.20%	£224,474
Park	£890,134	19.30%	£171,796	24.50%	£218,083	23.70%	£210,962	36.10%	£321,339

2.46 The calculations show a significant difference to each employer contribution rate when comparing the 7 year deficit recovery period to that of 20 years.

2.47 However, it is worth noting that should the 7 year deficit recovery period be applied the academy would pay off the deficit much quicker thereby materially reducing the contribution rate thereafter.

2.48 In assessing affordability of the contributions, the Committee may wish to consider the likely additional funding that the academy schools will receive both initially and in the future.

2.49 Academies will receive their current school budget, plus additional funding which the local authority currently provides. The local authority LAGSEG (Local Authority Central Spend Equivalent Grant) has reduced significantly and the DfE has decided that schools that convert before 1 September 2011 will receive protection funding limiting the reduction to 10%. Schools would only receive this protection if they transfer before 1 September 2011 and is initially for one year only. This additional money is provided to schools to cover the cost of services that they will have to provide, which were previously provided by the local authority. DfE has stated that schools should not be better or worse off by converting to academy status, although they may have more flexibility as to how to spend the money.

2.50 The table below shows the estimated total additional funding based on the 2010/11 LAGSEG rates, the 2011/12 LAGSEG rates assuming no protection and the 2011/12 rates assuming protection limiting the reduction to 10%. These illustrative figures are based on pupil numbers as at January 2011.

	LACSEG 2010/11 £	LACSEG 2011/12 £	LACSEG 2011/12 Assumes protection at 10% £
Bentley Wood	346,022	221,136	311,420
Canons	383,581	254,178	345,223
Harrow	333,860	220,029	300,474
Hatch End	639,777	415,018	575,799
Nower Hill	656,561	417,092	590,905
Park	577,035	365,955	519,332
Rooks Heath	396,005	264,478	356,405
Total	**3,332,841**	**2,157,886**	**2,999,557**

2.51 The impact on the Council should it decide to transfer the liabilities for current LGPS staff only could potentially increase the Council's theoretical employer contribution rate by 0.25% of pay. However, this amount is considered as immaterial whilst the application of the stabilisation mechanism is in operation. [The stabilisation mechanism takes a long term view on the Council's contribution rate but at the same time ensures there is no long term damage to the health of the pension fund].

2.52 Risk Management Implications

2.53 Risk included on Directorate risk register? No

2.54 Separate risk register in place? No

2.55 The Panel should note that applying a shorter deficit recovery period will result in higher contribution rates for the academies in the initial 7 years (see 2.47 above for explanation). This may have a major impact on the schools' decision to opt for academy status, hence the request from the schools for the Committee to reconsider the decision.

2.56 Whilst the matter of maintaining the best position for the Council as an employer in relation to the Pension Fund is extremely important, it is equally important to strike a balance between protecting the Fund and ensuring the contribution rate payable by the academy is affordable.

2.57 Corporate Priorities

2.58 NA

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 12 May 2011	√	Chief Financial Officer
Name: Sarah Wilson Date: 13 May 2011	√	on behalf of the Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: Linda D'Souza (Service Manager – Shared Services), Te: 020 8424 1426, Email: linda.d'souza@harrow.gov.uk

Background Papers:

Report for the Licensing & General Purposes Committee – 11 & 19 April 2011
Report for Pensions Fund Investment Panel
Cabinet Report – March 2011