Report to Pension Fund Committee

Date:	21 March 2022
Title:	**Admission Agreements - Passthrough Arrangements**
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Recommendations:	**The Committee is asked to approve the passthrough approach for admission agreements.**

1. Executive summary

1.1 This report considers the options available to letting authorities when commissioning services (outsourcing), to another employer that intends to participate as an admission body in the Buckinghamshire Pension Fund.

The proposal from 1 April 2022 is to move from the existing approach, where a bond or form of indemnity is required when a contractor enters into an admission agreement with the letting authority and the Fund, to a "passthrough" admission agreement arrangement. The default position for the Fund will be a simple fixed rate passthrough basis. Consideration will be given to a passthrough arrangement based on a variable rate in line with the cost of benefit accrual, where the contract being let is for a long period.

Whether using the existing approach or passthrough, the letting authority retains long term responsibility for the risks, as all the members' accrued benefits transfer back to the letting authority at the end of the contract. The letting authority remains the ultimate guarantor for all pension obligations throughout the duration of the contract in the event of the contractor becoming insolvent.

2. Content of report

2.1 Under the Funds' current policy for outsourcing, the following principles apply:

- all past service pension benefits in respect of outsourced members are transferred within the Fund from the letting authority to the new contractor;

- the contractor enters into an admission agreement with the Fund and the Scheme employer;
- the contractor is set up on a “fully funded” basis with the assets notionally allocated at outset equal to the value of the transferring pension liabilities based on market conditions at the transfer date (or earlier calculation date) and the funding valuation basis applicable at that time;
- the starting contribution rate is the amount required in respect of the cost of future accrual only, assessed by reference to the outsourced staff;
- the contribution rate is reviewed at every formal valuation date during the contract period to allow for experience and changes to assumptions/market conditions, and adjusted to take account of any past service surplus or deficit that has arisen since the last valuation (or outset);
- as required by the LGPS Regulations, a bond or other form of indemnity is taken out by the contractor and is triggered in the event of its failure during the contract period. The bond value is reassessed following each Fund valuation; and
- when the contractor reaches the end of its contract, the LGPS Regulations require a cessation valuation to be undertaken and any deficit or surplus is required from or paid to the exiting employer.

2.2 Letting authorities may choose to outsource services to improve service delivery, increase efficiency and reduce service costs. However, under the Fund’s current approach to outsourcing, all of the key pension risks transfer from the letting authority to the contractor for the duration of the contract.

This approach can lead to a great deal of uncertainty over costs for contractors during volatile market conditions, e.g. large increases to regular contributions, large cessation debts etc. Bidders for contracts are aware of these uncertainties and may seek to price this into contracts via additional service charges which can undermine the purpose of outsourcing.

The letting authority’s aim will be to obtain the best price for the outsourced service. Offering contractors passthrough arrangements as a way of removing some of the uncertainty surrounding the cost of paying for the outsourced member’s pension benefits, is a way to help achieve this.

3. Other options considered

3.1 Retain the current method – although the current method provides all that is legally required, the uncertainty over pension costs for contractors can lead to additional service charges being included in contract prices. This does not assist letting authorities in achieving the best price for a service when they are aiming to improve service delivery, increase efficiency and reduce service costs. From the Fund's perspective the requirement to obtain a bond or other form of indemnity is administratively intensive and requires additional monitoring, particularly where the contract is for a short period of time. For the contractor, the cost of securing a bond or other form of indemnity is often expensive.

3.2 Passthrough arrangement which varies in line with the cost of benefit accrual – this approach is more appropriate for longer contracts and although not the default position, will be considered where the outsourcing is for a long period of time. In these cases, an initial rate is set and then adjusted at each valuation in line with the change in the cost of future benefit accrual.

This means the contractor is liable for the costs of changes in the profile of their membership, life expectancy of their members and the actuary's updated assumptions, such as future investment returns, inflation and salary increases. The letting authority retains much of the market risk (e.g. asset performance) and experience (e.g. if inflation has been higher or lower between the valuation periods than that assumed). This arrangement also involves no exit deficit or credit at the end of the contract for the contractor and the letting authority retains all of the past service deficit risk.

4. Legal and financial implications

4.1 Letting authorities will need to ensure details regarding the passthrough arrangement are included in the contract or side agreement when outsourcing the contract. The admission agreement template will be updated to reference the contract/side agreement but will not materially change.

Whether using the existing approach or passthrough, the letting authority retains long term responsibility for the risks, as all the members' accrued benefits transfer back to the letting authority at the end of the contract. The letting authority remains the ultimate guarantor for all pension obligations throughout the duration of the contract in the event of the contractor becoming insolvent. The financial risk to the Fund therefore remains unchanged.

5. Corporate implications

5.1 Not applicable.

6. Consultation and communication

6.1 All Fund employers were issued with the consultation document attached at appendix 1. No comments have been received to date.

6.2 If approved, further communication will be issued to Fund employers confirming the new passthrough arrangements.

7. Next steps and review

7.1 Employers will be notified that the proposal has been approved and the admission agreement manual and any associated documentation and templates issued to employers will be updated. There is no requirement to review this decision.