Protecting employment rights for transferring employees (TUPE)

Under provisions in the Transfer of Undertaking (Protection of Employment) Regulations 2006 (TUPE), the pay, terms and conditions of employment for transferred local authority employees are protected, preventing these entitlements from being changed without agreement. The Transfer of Employment (Pension Protection) Regulations 2005 cover the pension and contribution arrangements for employees to which TUPE applies.

With effect from 1 October 2007, best value contracting authorities in England have been required to comply with The Best Value Authorities Staff Transfers (Pensions) Direction 2007. This means that, in outsourcings, a best value authority must secure pension protection for each TUPE transferring best value authority employee which must be the same as, broadly comparable to, or better than those they had a right to acquire prior to the transfer. In practice, this usually means that the new service provider will become an admission body in the relevant LGPS fund and continue to offer LGPS membership to the TUPE transferring staff.

Fair Deal for staff pensions: staff transfer from central government (new Fair Deal)

The Fair Deal for staff pensions: staff transfer from central government does not apply to best value authorities, but it does apply to maintained schools, including academies. In respect of schools, new Fair Deal applies to maintained schools in England where the employer is **not** a best value authority. It therefore applies directly to employees of foundation schools, foundation special schools and voluntary aided schools, as although such schools are maintained schools, the staff in those schools are employees of the governing body of the school and not the local authority. New Fair Deal also applies directly to academies.

Where new Fair Deal applies, staff who

- are members of a public service pension scheme, and
- who are compulsorily transferred from the public sector to an independent contractor by way of a transfer to which TUPE applies, or who move by way of a non-voluntary transfer to a public service mutual or to other new models of public service delivery

should, while they continuously remain wholly or mainly employed by the contractor, any subsequent contractor or sub-contractor on the delivery of the outsourced service or function, be provided with ongoing access to the public service pension scheme they were in immediately before the transfer. In the LGPS, this would be achieved by way of an admission agreement.

Current Fund Policy

Under the Fund’s current policy, the following principles apply in relation to pension provision for the relevant outsourced staff:

- all past service pension benefits in respect of outsourced members are transferred within the Fund from the letting authority to the 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 that 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/paid to the exiting employer.

The Fund also requires any early retirement pension strain and augmentation costs that arise during the contract to be paid via an immediate additional lump sum payment.

Under the current approach, all of the main pension risks transfer from the letting authority to the contractor for the duration of the contract. Volatile market conditions can lead to uncertainty over costs for contractors e.g. large increases to contributions, large cessation debts etc. In addition, membership for contractors is typically small and therefore their funding is particularly sensitive to changes in membership. Bidders for contracts are increasingly aware of these problems and may seek to price them into contracts via additional service charges which can undermine the purpose of outsourcing.

The letting authority will want to obtain the best price for the outsourced service. Offering contractors pass-through as a means for removing some of the uncertainty of the cost for paying for the outsourced member’s pension benefits may be a way of helping to achieve this.

Whether using the current approach or pass-through, the letting authority still retains the long term responsibility for the risks as all of the members’ accrued benefits transfer back to the letting authority at the end of the contract. Furthermore, the letting authority remains the ultimate guarantor for all pensions obligations throughout the contract in the event of the contractor becoming insolvent. This position remains whether adopting the current approach or the pass-through approach.

Proposed Fund Policy from 1 April 2022

The Fund is proposing to adopt a default position of a pass-through arrangement for all contractors who are required to participate in the Fund after 1 April 2022.

A pass-through arrangement is one in which the risks inherent in participating in the LGPS are shared between the contractor and the letting authority, typically with the majority of the pensions risk being retained by the letting authority rather than passing to the contractor. Importantly it also means that the contractor would not be required to fund any deficit at the end of the contract. Any deficit/surplus at the end of the contract will be consolidated into the letting authority’s deficit/surplus, subject to any agreed exceptions. By removing this difficult to quantify risk from bidders, bids for an outsourced service will be much more closely aligned to the actual cost of providing the service.

In most cases the contractor would still be expected to pay for the cost of any enhancements to members' benefits, including those payable via early retirement redundancies as well as meeting the contributions payable. If the contractor does not want to take responsibility for these risks, it needs to be clearly stated in the contract or side agreement with all parties being clear what their responsibilities are at the outset.

For accounting purposes, under a full pass-through arrangement where all the pensions risk remains with the letting authority, the liability would be included on the balance sheet of the letting authority.

Approaches to pass-through arrangements
There are three common approaches to setting the contributions payable under a pass-through arrangement which are:

Simple fixed rate
A simple fixed rate approach is one in which the pass-through contribution rate is fixed at the outset and not re-calculated during the remainder of the contract. This will usually be set out as part of the commercial contract between the letting authority and the contractor. Where this rate differs from the cost of future benefits calculated by the actuary, the balance would be incorporated into the letting authority's certified rate.

It may be that the contractor pays contributions into a Fund throughout the life of the contract based on the pass-through contribution rate agreed at the outset. Another approach may be that the rate the contractor pays into the Fund varies (for example, following each triennial valuation) but the difference between the rate and the original pass-through contribution rate is reimbursed to the contractor/letting authority in some way, for example via adjustment to the contract pricing. Under this approach, as any differences are reimbursed, the overall effect remains that the contractor pays the pass-through contribution rate. Actuarial calculations will be required on commencement and at each triennial valuation to determine the calculated rate.

At the end of the contract, there would be no exit deficit or credit for the contractor as the letting authority has retained all of the funding risk.

For accounting purposes, the contractor's obligation is simply to pay a fixed contribution rate so they would not be expected to include any liability in respect of their LGPS pension participation on their balance sheet. Instead the letting authority would include it in their disclosures. The contractor may report its participation in the LGPS as if it were a defined contribution scheme.

Varies in line with the cost of benefit accrual
This approach is most likely to be found on longer contracts. 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 that the contractor picks up the cost of changes in the profile of their membership, the 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 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.

This approach means that if there are any updates to the future expected cost of benefits, the contractor's rate is updated. For accounting purposes, under this approach it is less clear whether the

contractor needs to include a liability on their balance sheet, they are subject to some pensions risk but they never have the possibility of a past service funding deficit so it could be argued that they have no accounting balance sheet obligation. In these cases, the contractor and letting authority should check with their auditors what their requirements are.

Matches the letting authority

This is a simple approach which means that the contractor starts out 100% fully funded and pays the same future service rate as the letting authority. When the letting authority rate is updated, the contractor's rate is also updated. This is similar to conventional pooling in an LGPS Fund where employers are grouped and pay the same contribution rate. This arrangement also involves no exit deficit at the end of the contract for the contractor as any deficit is added to the letting authority's deficit.

In this approach, the contractor shares in all pensions risks while they are operating the contract but, assuming the letting authority is much larger than the contractor, the rate that they pay should be less volatile than it would have been if the risk had been fully transferred to the contractor.

As the contractor is now sharing in some of the pensions risk, it may be that there is stronger argument that they should include a liability on their balance sheet. However, it may be that the absence of an exit deficit or credit means that this is not required. Auditor's advice should be sought in these cases.

Academies

The Department for Education (DfE) expect academies to obtain permission before entering into passthrough provisions. The DfE guarantee covers members who have been employed by the academy at some point. Therefore, difficulties arise if a member starts their LGPS membership with the contractor via an 'open' admission agreement.

Proposed Fund Policy

From 1 April 2022 the default position for the Buckinghamshire Pension Fund will be on 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 is for a long period.

The Fund will require a copy of the legal agreement between the letting authority and the contractor. In particular, the letting authority will require confirmation of whether the difference in pricing between the fixed rate and the actual cost will be re-imbursed elsewhere, as this will require additional actuarial calculations.

Comments

If you have any comments regarding the Fund's proposal, please email them directly to Claire.Lewis-Smith@buckinghamshire.gov.uk by 12pm on Friday 11 March 2022.