COUNCIL
19 JULY 2012

ITEM NO. 7 (a)

ACADEMIES – PENSION ARRANGEMENTS

Responsible Cabinet Member – Councillor Stephen Harker
Efficiency and Resources Portfolio

Responsible Director – Paul Wildsmith, Director Resources

SUMMARY REPORT

Purpose of the Report

1. To provide Members with information on the current treatment of academy schools within the Local Government Pension Scheme (LGPS) and advise members of the Government's recent proposed method for dealing with Academy School participation in the LGPS along with the subsequent decision made by Durham County Council's Pension Fund Committee as the administering authority.

2. Explain the advantages and risks involved for the Council and Academy Schools on both methods.

Summary

3. Academy Trusts are 'scheduled body' employers in the Pension fund meaning that all non-teaching staff employed by the Academies are automatically eligible for membership of the LGPS. Under current arrangements Academies are treated in the same way as other 'scheduled body' employers, established as separate employers and using the same assumptions to value their liabilities and a 19 year deficit correction period.

4. The Government has written to all Local Authorities **(Appendix A**) with the preferred approach to allow Academies to be pooled with their former local authority for LGPS purposes. The letter acknowledges there is no power at present to impose a pooled solution, but notes that Ministers will consider regulatory changes at a later date if deemed necessary.

5. There are advantages and risks to Academies and Local Authorities of allowing pooling, the main advantages being ease of calculation and more certainty of contribution rates. The main risk being the potential for an Academy Trust to become insolvent in which case all employers in the Pooled Fund would pick up the deficit.

6. Durham Pension Fund Committee have agreed pooling arrangements could be established between the Darlington Borough Council and an Academy providing both parties agree to the arrangement.

Recommendation

7. It is recommended that Council;

    (a) Agree to allow non profit making Academy Trusts in Darlington to pool their pension liabilities with Darlington Borough Council (DBC) liabilities once suitable arrangements have been made with the LGPS administrator.

    (b) Allow Darlington Academies that have already been established the opportunity of pooling their pension liabilities with DBC.

Reasons

8. The recommendation is supported by the following reasons: -

    (a) The Government have given Local Authorities a clear steer that this is the preferred approach.

    (b) Pooling arrangements may reduce Darlington Borough Councils deficit contributions.

Paul Wildsmith,
Director of Resources

Background Papers

No Background papers were used in the preparation of this report.

Elizabeth Davison 2601

S17 Crime and Disorder	This decision will not have an impact on Crime and Disorder
Health and Well Being	This decision will not have an impact on Health and Wellbeing
Carbon Impact	This decision will not have a direct impact on the Council's carbon footprint.
Diversity	This decision will not have an impact on Diversity
Wards Affected	This decision will not affect any wards
Groups Affected	This decision will not have an impact on any groups.
Budget and Policy Framework	This report does not recommend changes to the Budget and Policy Framework
Key Decision	No
Urgent Decision	No
One Darlington: Perfectly Placed	This decision will not have an impact on the objectives of the Sustainable Community Strategy
Efficiency	This decision may reduce Darlington Borough Councils pension deficit contributions.

MAIN REPORT

Background

9. Academy Trusts are ‘scheduled body’ employers in the Pension Fund meaning that all non-teaching staff employed by the Academies are automatically eligible for membership of the LGPS, and all existing scheme members retain their scheme membership on conversion. Within Darlington all sixteen of the Academies established at the time of writing the report have employees in the Pension Fund.

10. Durham County Council is the Administrator of the LGPS for Darlington. Working closely with their actuaries the Administrator decided Academies would be treated in the same way as other ‘scheduled body’ employers in the Pension Fund, using the same assumptions to value their liabilities and using the same 19 year deficit correction recovery period as the Council. This is how the all Academies established in Darlington have been treated to date.

11. Previously ‘scheduled body’ status in the LGPS has almost exclusively been reserved for public sector or quasi –public sector bodies that could not become insolvent. Academy Trusts can become insolvent or can be closed down at short notice so there is a potential risk to all other employers in the pensions fund which means they technically have a weaker employer covenant than local authority controlled schools.

12. In December 2011, Communities & Local Government and the Department for Education issued a joint letter to Local Authority Leaders and Chief Executives regarding Academies and the LGPS. This letter set out concerns regarding the calculation of contribution rates for some Academies across the country and the Minister’s wishes for a consistent approach, and that no Academy would pay an unjustifiably higher rate than maintained schools in the area.

13. The Ministers set out their preferred approach was to allow Academies to be pooled with their former local authority for LGPS purposes. The letter acknowledges there is no power at present to impose a pooled solution, but notes that Ministers will consider regulatory changes at a later date if deemed necessary.

14. It is understood a major reason for Ministers concerns is that some Pension funds are only allowing academies a seven year period in which to recover any deficit in funding which increases the contribution rate markedly, this is not the case with the Durham fund which is allowing the same time period of nineteen years as other scheme members and as such contribution rates should be broadly similar to those prior to conversion.

15. To date we have had enquiries from two transferring schools expressing an interest in being pooled with the Council for pension purposes.

Current treatment of Academies within the Durham Pension fund

16. From the date of conversion a new academy is established as a separate employer in the Pension Fund with (notional) separate assets and liabilities. The (notional) asset transfer to a new academy is determined after initially ensuring the original Council’s non-active

liabilities are ‘fully funded’ as at the last valuation date (31 March 2010) and applying an adjustment to take account of changes to the overall funding level of the Pension Fund since the last valuation.

17. The transfer of pension liabilities to the new academy is based solely on the pension liabilities of the transferring employees and the assumptions used in setting the new academy’s employer contribution rate are the same as those used for other Scheduled Body employers in the Fund. The deficit recovery period used for the new academy is nineteen years

18. The method set out above will be subject to review at the next valuation (due as at 31 March 2013, with any contribution changes applying from 1 April 2014).

Advantages and risks associated with the current approach

19. Under the current approach, the Academy School has its own separately calculated ongoing employer contribution rate based on the profile of the employees that transfer to the school, and a deficit contribution rate based on the size of the deficit transferred to the academy when it is established.

20. An advantage of this approach for the Academy School is that its employer contribution rate will not be affected in future by the actions of its former local authority (as would be the case with a ‘pooled’ approach). Similarly, an advantage for the original Council of this approach is that going forward the Academy School is responsible for its own pension liabilities. Any employer action that affects pension costs (such as increasing employees’ pay above actuary assumptions) will be the responsibility of the Academy School.

21. There are some risks involved in the current approach for both parties, for the Academy School the following risks are relevant:

    - There is uncertainty about future employer pension costs. Actuarial work is required before the costs can be determined and market conditions at the time the academy is established can have a significant impact on the actuarial valuation and subsequently the employer pension costs.
    - With a small overall pensionable payroll the Academy School will have a much more volatile employer contribution rate than a larger employer. So, for example a small number of ill-health retirements at an Academy School could have a significant impact on the employer contribution rate.

    For the original Council the following risk is relevant:

    - The actuary allows a reduction in the deficit contributions for the original Council equal to the level of deficit contributions paid by the Academy School. When an Academy School is set up as a separate employer this reduction in deficit contributions may be lower than the original Council anticipates, meaning the original Council’s deficit contributions increase as a proportion of its overall pensionable payroll. This can have a real impact on the original Council’s financial position.

Proposed Pooling arrangement approach

22. The Government has indicated they would like all Academy Schools (existing and future) be given the option to have their LGPS pension liabilities 'pooled' with their former Council so giving them a shared employer contribution rate. There is little detail of how this would operate at this point in time but from discussions with the LGPS administrator it is anticipated that the following approach would apply:

    - Following conversion the Academy School would continue to pay the same ongoing employer contribution rate as their former Council.
    - The deficit contribution amount would be determined by comparing the payroll size of the Academy School with the size of their former Council's payroll and allocating an appropriate proportion of the deficit contributions to the Academy School.
    - Work would be required to understand how a pooling arrangement would be reflected within the pension figures within the accounts of both the Academy School and the original Council.
    - After subsequent valuations the same approach would be adopted, the Academy School would have the same ongoing employer contribution rate as its former Council and would be responsible for a proportion of the deficit contributions based on the relative size of their payroll compared to other employers in the pool.

Advantages and risks associated with the proposed 'pooling' approach

23. The main advantages of the suggested pooling approach are simplicity and initial certainty of contribution costs. An Academy School would have the advantage of knowing its employer contribution rate would be broadly similar to the rate it paid as a maintained school and the rate it was asked to pay would not depend on market conditions at the time of conversion.

24. Going forward, the Academy School's employer contribution rate in a pooled arrangement would be less volatile as the impact of experience (such as salary changes and ill-health retirement) would be shared across all the employers in the pool.

25. For the original Council the advantage of the pooled approach would be that the reduction in its deficit contributions (which would equal the deficit contributions paid by the Academy School) would probably be higher than under the existing approach.

26. There are a number of risks associated with adopting a pooled approach compared with the current method. For the original Council and for the Academy School there is a cross-subsidy risk. For example, if one of the employers in the pool increased its pension liabilities significantly by perhaps increasing salaries above assumptions, all the employers in the pool would have to fund this. Similarly, if one of the participants significantly reduced its pensionable payroll, perhaps through a large outsourcing exercise, the other employers in the pool would pick up a bigger share of any deficit payments (which are apportioned according to relative pensionable payroll).

27. One risk for the original Council is that it (and other employers in the pool) would bear all the cost of unmet pension liabilities in the event of Academy School insolvency. Under the current arrangement any cost would be spread across all Fund employers. However, the Department for Education has previously written to the Council to emphasise its commitment

to Academy Schools, to confirm that academy funding agreements are open-ended and to express the view that any insolvency risk is minimal.

28. One further complexity for all participants in a pooling arrangement is the presentation of pension figures in the accounts of the Academy School and the original Council. If Darlington agreed to Pooling arrangements we would need to consult with our auditors to ensure the pension figures are appropriately represented within their accounts.

Durham Pension Fund Recommendation

29. On the 5 March 2012 the Durham Pension Fund Committee agreed that Pooling would not be compulsory but would be another option for Councils and Academy Schools to consider when determining how Academy Schools will participate in the Fund. It was agreed that pooling arrangements could be established between the original Councils (either Durham County Council or Darlington Borough Council) and an Academy School, provided both parties agree to the arrangements.

Further considerations

30. If pooling were to be allowed there would need to be an agreement that once a decision was made on whether the Academy was to pool or not that this would be a permanent arrangement and that the Academy could not subsequently be admitted or withdraw. This would be to safeguard all employers in the Darlington pool from Academies picking and choosing to move in or out dependant on actuarial valuations at a point in time.

31. It is advised that as number of Darlington Schools have already converted to Academy status it would be appropriate to give those schools the opportunity of joining the pool.

Conclusion

32. There are advantages and risks to both Academies and DBC in pension pooling arrangements. The main risk to DBC is a potential insolvency of an Academy and the subsequent deficit, however the Department for Education has previously written to the Council to emphasise its commitment to academy schools, to confirm that academy funding agreements are open-ended and to express the view that any insolvency risk is minimal. Although there is no power at present to impose a pooled solution Ministers have noted that they will consider regulatory changes at a later date if deemed necessary.

33. If the Council decide to allow pooling, detail on how this would work will need to be discussed and worked up with the LGPS administrator. Academies would also need to take independent advice prior to a request to join the pool as there are both advantages and risks to be considered.