BSA – The Business Services Association

Local Government Pension Scheme: Fair Deal – strengthening pension protection

April 2019

The BSA appreciates the opportunity to respond to this consultation on proposed changes to local government pension scheme regulations. The comments below reflect the views of BSA members expressed via written responses to the consultation questions and also during a roundtable with officials held in March 2019.

General observations

Overall we are supportive of the proposal as it brings broad alignment with the Fair Deal.

The consultation states, at paragraph 12:

"The proposed reforms mean that independent providers will no longer have the option of providing transferred staff with access to a broadly comparable scheme instead, employees will also have continued access to the LGPS."

This goes further than the HM Treasury Guidance on Fair Deal issued in October 2013 which does permit access to a broadly comparable scheme in certain circumstances (for example, where there may be a legal impediment to providing access to the public sector scheme or where there may be commercial reasons for allowing a broadly comparable scheme.

The most worrying changes however are at new Regulation 3B (2):

- First, the introduction of a direct obligation on the employer of a protected transferee to provide access to the Scheme to protected transferees. Under the Best Value Pension Direction and under the New Fair Deal guidance the obligation has been on the Fair Deal employer to include in their contracts obligations on the service provider and in the absence of these obligations in the contract the service provider was not obliged to provide pension protection. Given that most problems have arisen from a failure by Fair Deal employers to adequately address their Fair Deal obligations in contracts this amends the default position such that the service provider in the absence of a contractual obligation (and contractual provisions for risk share) is obliged by the regulations to provide pension protection and accept the full risk including funding risk and contributions risk.

This will be particularly onerous for SMEs who may not be aware of these risks when tendering and entering into contract if the contract is itself silent, but would also impact on us if we enter into an agreement without any protection.

- Secondly, the provisions whereby an employee who is not a protected employee may be treated as a protected employee. Although we welcome the freedom this gives, we are concerned that it could be used as a "stick" to beat a contractor with by employee

representatives and the permissive nature of the legislation could lead to challenges in diversity legislation where an employer (particularly a smaller company who may not have the means to fight such a case) determines not to treat new hires as non-protected employees.

The introduction of an option for Fair Deal employers to use a "deemed employee" route whereby protected transferees are treated for pension purposes as employees of the Fair Deal employer is useful but as this is only an option it is not clear to what extent this would be used. There is no default position to be used if the Fair Deal employer fails to make an election in the contract. We are suggesting that the "deemed employer" route should be the default option if no other position is set out in the service contract.

Academies are excluded from this guidance and specific guidance will be issued by DfE, although academies are also covered under the Fair Deal guidance issued by HMT in October 2013. Pending more certainty on the status of academies, there is a worrying statement that they will not accept any pass-through arrangement and all pension risk will sit with the service provider. We would like to engage with government and academies on this point to clarify guidance and address where risk should most appropriately lie in these cases.

Impact on long term contracts (e.g. PFI school deals) at market testing where obligation is now on the SPV (or Service Provider) to include specific pension provisions in contracts when subcontracting. If these contracts are not amended to comply with the new regulations the Fair Deal employer would on a future market test fail in its obligation under Regulation 3B (9).

Also on PFI deals (which now typically include a mixture of schools and academies but the PFI contract remains with the local authority rather than with the individual academy), the specific exclusion of academies from various provisions of the new regulations may lead to anomalies where different approaches to risk share may be required for different entities covered by the same contract.

There are included new provisions which are intended to allow for a new employer to step into the shoes of an existing Admission Body without an exit liability calculation when a new contractor takes over by way of acquisition or merger. During our discussions with officials from the MHCLG we suggested that this be "de-coupled" from the Fair Deal consultation as there are more specific risks involved in this exercise that need further and more detailed consideration.

In terms of risk sharing, we would be interested to know whether there would still be bond requirements where the 'deemed employer' approach is taken, but the service provider takes on some of the funding liability. The process of getting bonds in place can be particularly onerous and often there are commercial implications if bonds are not in place by the transfer date (although, historically, these have rarely been enforced).

The consultation document states that: 'protected transferee status for staff will require the agreement of both the Fair Deal employer and the service provider and it is proposed either party can determine at any time that such an individual is no longer a protected transferee.' We think a definitive and consistent approach to commercial negotiations to make sure the position was clear from the outset in this respect is required. We have previously opted for 'closed' Admission

Agreements and ideally we would want to get as close as possible to replicating this approach for contracts with LGPS entitlements if the proposed changes go ahead.

Specific Responses on Questions

Question 1 – Do you agree with this definition? (Protected transferee)

Regulation 3B (1) sets out who are protected employees at the time of the original transfer from a Fair Deal employer. It covers only transfers from a Fair Deal employer that occur after the introduction of the amendment regulations (although there are other circumstances where others are to be treated as Protected Transferees).

Regulation 3B (5) sets out for how long the employee remains a protected transferee and by implication the circumstances in which they lose protected transferee status. There appear to be some drafting anomalies that raise questions about the intention, especially about how long the protected transferee retains protection.

Implication under regulation 3B (5) is that a protected transferee will lose their status as a protected employee if they are no longer wholly or mainly employed on the delivery of the same service they were employed in at the time of the original transfer from the Fair Deal employer.

If the employee is transferred (with no break in continuity of employment) to work on another service which would itself have provided protection do they lose protected employee status? E.g. an employee is moved from a cleaning service contract with Fair Deal employer "A" to a catering service with Fair Deal employer "A" delivered by the same service provider.

The same point applies in respect of regulation 3B (9) (b)(ii)

This does not appear to reflect the intention of paragraph 2.6 of the New Fair Deal Guidance. "*Where a person ceases to be employed on the transferred service or function, but is employed in another role where staff undertaking that service or function are eligible to be members of the same public service pension scheme, they may be permitted to remain a member of the scheme if they elect to do so, and the contracting authority and employer consent*."

The pension protection appears to continue for the period while the protected transferee is engaged in delivery of the service. Historically the lines have been blurred for LGPS and we understand that, for the 2016 re-enrolments, as it did not specify an obligation to re-enrol into the LGPS in the Admission Agreements or the regulatory guidance an alternative automatic enrolment scheme might be permitted for non-active LGPS employees. However, the changes outlined in the proposal would leave no room for interpretation and this would be an administrative nightmare if there was an employee who had opted out and needed to be re-enrolled where there was not a valid Admission Agreement in place. Each Admission Agreement, which has to be in place before we can enrol employees into the LGPS, can take 6-12 months to execute (we've even had one that took the best part of 2 years), which highlights the incompatibility of the current admission process with re-enrolment duties in these particular circumstances.

New Regulation 3B (11) – "*A person who is an employee of a service provider working on the delivery of a service or function transferred from a Fair Deal employer who has not been compulsorily transferred to the provider* <u>*from that Fair Deal employer*</u> *in relation to the delivery of that service or function is not a protected transferee for the purposes of these Regulations*"

Question – this appears to restrict the definition of "protected transferees" to employees who have been transferred directly to a service provider from a Fair Deal employer which appears to be in conflict with 3B (5) which extends protection to subsequent transfers.

Question 2 – Do you agree with the definition of a Fair Deal employer?

Question extension to academies who are also caught by the New Fair Deal? Especially in respect of new 3B (2) which imposes direct obligations on the service provider in the absence of any contractual obligation and the tendency of academies to 1) ignore any pension implications and 2) seek tenders on the basis of the EU "open procedure" with no opportunity for negotiation/ clarification and 3) a tendency to gloss over any implications on conversion of a school to academy status. The default position in the absence of any contractual obligation should be that risk remains with the Fair Deal employer even when this is an academy.

More discussion is required around which organisations constitute a Fair Deal employer for the purposes of these regulations.

Question 3 – Do you agree with these transitional measures?

(Transfer from broadly comparable schemes on retender and transfer of past benefits from such a scheme)

We believe these proposals are equitable provided that an incumbent service provider whose contract is renewed shall not be obliged to become an employer under the scheme if this exposes them to full pension risk unless they have had an opportunity to price for the additional risk or to decline to accept the renewal. It should not apply when a renewal may be effected by the Fair deal employer acting unilaterally under a contractual right to extend a contract.

We would welcome more flexibility as set out above and to reflect the provisions of the HM Treasury Guidance on Fair Deal issued in October 2013, for example where there are genuine commercial reasons for a contractor to provide a broadly comparable scheme as opposed to entering in to an ABS or deemed employer arrangement.

Question 4 – Do you agree with our proposals regarding the calculation of inward transfer values?

While we believe the proposals for calculation of inward transfer values is equitable, this is a complex area. Simply allowing for CETVs is not in line with most public sector bulk transfers which use the past service reserve basis and may result in an outcome which selects against outgoing contractors by leaving deferred past service rights with the outgoing contractor's scheme and resulting in employees having a multitude of deferred pension pots. This risk will diminish as the new Fair Deal provisions progress but is something of which all stakeholders need to be aware.

Question 5 – Do you agree with our proposals on deemed employer status?

We believe deemed employer status is a step forward and this option should be encouraged. Allowing for two options however will lead to problems where a Fair Deal employer neglects to select an option at tender stage. We believe the “deemed employer” route should be the default position unless the contract expressly specifies otherwise.

We also believe that the deemed employer status should be capable of being used as a temporary holding position to avoid periods when protected transferees may be in limbo awaiting the finalisation of an admission agreement to avoid problems where e.g. A protected employee may retire or die whilst not a member of the scheme because of delays in finalising an admission agreement. The relevant employees could then move from being deemed employees of the Best Value employer to being employees of the service provider when the service provider achieves admission body status.

These provisions should apply equally to academies. It would be for the academies to ensure that pension protection is achieved via admission agreements and contractual obligations to avoid taking on the deemed employer role. The protected transferees and the service provider should not be put in a position where they may be disadvantaged by the failure of a Fair Deal employer to comply with the guidance.

However, as discussed at the round table with MHCLG officials, we are concerned that there may be both employment law and TUPE issues with the "deemed employer" status that need to be further considered. Issues around who controls the employees' pensions and the implications of the *Celtec-v-Astley* case need careful thought.

Question 6 – What should advice from the scheme advisory board contain to ensure that deemed employer status works effectively?

We would suggest that the DCLG Guidance on risk share in LGPS Admission Agreements “Admitted body status provisions in the Local Government Pension Scheme when services are transferred from a local authority or other scheme employer” (2009) which was widely consulted on at the time should be used as a starting point.

Further detailed employment legal advice, including the effects of TUPE and how this proposal fits with the requirements of TUPE, and advice relating to obligations under Part 1 of the Pensions Act 2008 (automatic enrolment) is required including how those areas of law interact with the proposal.

Question 7 – Should the LGPS Regulations 2013 specify other costs and responsibilities for the service provider where deemed employer status is used?

We would suggest that the DCLG Guidance on risk share in LGPS Admission Agreements “Admitted body status provisions in the Local Government Pension Scheme when services are transferred from a local authority or other scheme employer” (December 2009) which was widely consulted on at the time should be used as a starting point; in particular paragraphs 70 to 75.

With respect to e.g. early ill health retirement It should be borne in mind that DB pension provisions rely heavily on actuarial assumptions and that these are more likely to be accurate when applied to a larger body of people such as typically are employed within an LGPS pension fund by a Fair Deal employer rather than to a small group of people. At present Admission Agreements are required to be set up on an individual contract basis meaning in some cases there is a single active member in an ABS section of a scheme. We believe early ill health retirement should remain at the Fair Deal employer's risk.

Question 8 – Is this the right approach? (Using Admission Agreement rather than contract to set out agreed risk share)

We agree that there should remain an option to use Admission Agreements to set out any risk transfer agreement however our view is that the deemed employer approach should be the default option so that an Admission Agreement will only be used after careful consideration. While it may be sensible to set out risk sharing provisions in the Admission Agreement care should be taken that there is no conflict between the provisions of the service contract and those of the Admission Agreement. The Admission Agreement is a three party agreement and any pension risk transfer agreement should be between the Fair Deal employer and the Service Provider. The administering authority (if not the Fair Deal employer) should not be in a position where it may be disadvantaged by a dispute between the Fair Deal employer and the Service Provider nor be asked to arbitrate. For this reason it may be preferable to require any risk share to be set out in the bipartite service agreement although it may be acknowledged and incorporated by reference into the Admission Agreement.

We do, however, see this as a potential barrier to efficient contracting; the administering authority have no commercial involvement in most contracts so no commercial imperative to enter into negotiations in a timely manner. Further, is there an appetite within administering authorities to engage in third party commercial negotiations that will use up resources and incur costs that may be better used elsewhere?

Also at present the Admission Agreement is frequently not finalised at the time of entering into the Service Agreement or indeed at the time of commencement of service delivery and staff transfer. Important decisions on risk transfer should be agreed at the time the service contract is agreed and not be capable of being deferred. The default position where there is no agreement to the contrary should be the deemed employer approach.

Question 9 – What further steps can be taken to encourage pensions issues to be given full and timely consideration by Fair Deal employers when services or functions are outsourced?

As set out above we believe the protected transferees, the service provider and the administering authority should not be in a position where they can be disadvantaged because of the failure of the Fair Deal employer to address pension issues in a timely manner. For this reason we believe the regulations should include default provisions which would apply if the Fair Deal employer neglects to follow the requirements of the New Fair Deal or the LGPS Amendment Regulations. We believe the default provision should be for the deemed employer route to apply in the absence of any other agreement. This would encourage Fair Deal employers who intend for other risk share profiles to apply to address the issue early in the tender process.

We believe proposed new Regulation 3B (2) which imposes an obligation on the employer of a protected transferee to ensure he/she has access to the Scheme should be amended to apply only to employers who are themselves Scheme Employers under Parts 1 and 2 of Schedule 2. Otherwise the obligation should remain on the Fair Deal employer to include provisions in the service contracts (as Regulation 3B (3) does)

As a minimum, there should be statutory guidance for contracting authorities on engagement on pensions at the earliest opportunity, probably at invitation to tender stage for the protection of employees who will or might transfer.

Question 10 – Are you aware of any other equalities impacts or of any particular groups with protected characteristics who would be disadvantaged by our Fair Deal proposals?

None.

Question 11 – Is this the right approach? (Transfer of assets and liabilities on merger etc**)**

We welcome this approach in respect of mergers and acquisitions but believe the provisions should be expanded to allow for e.g. restructuring within a group of companies or even the transfer of a contract by consent of the parties without a formal acquisition of an entire business. As each service contract requires a separate Admission Agreement the transfer of a single contract between related companies without a merger or sale of a business could still trigger an exit payment. If the new employer is prepared to accept the historic liabilities of the exiting employer and the Fair Deal employer (and Administering Authority) is satisfied that the covenant of the new employer is adequate and presents no greater risk there should be no objection to the successor body stepping into the shoes of the outgoing service provider.

However, as discussed during the meeting with MHCLG officials, we do have a concern that this might encourage poor behaviour from some employers. For example, employers might engage in "pre-pack" insolvencies to circumvent their obligations.

We consider this area to be complex but we welcome the consultation opening the dialogue. As discussed, we believe that this topic merits de-coupling from the Fair Deal consultations and becoming a consultation in its own right.

Question 12 – Do the draft regulations effectively achieve our aims?

It is not clear whether new Regulation 64 (10) is intended to replace Regulations 64 (1) and 64 (2) such that no rates and adjustment certificate is required or whether a rates and adjustment certificate is still required but in assessing the exit payment due the administering authority should take account of new regulation 64 (10). If no exit payment is required will it still be the case that all liabilities of the exiting employer are extinguished under regulation 64 (5)?

Question 13 – What should guidance issued by the Secretary of State regarding the terms of asset and liability transfers?

We have raised some guidance needs under question 9 above. However, the outsourcing process and the admission body application process are not dealt with consistently by Fair Deal employers. For example, many maintained schools and academies do not understand the consequences of admission body status nor of the pension obligations on contractors more widely.

Whilst we appreciate that it may be more for the Department for Education than MHCLG to prepare such guidance, guidance for schools on outsourcing would be welcomed to obtain a consistent approach.

Similarly, administering authorities take very different views on issues such as contractor covenant, the requirements for bonds and indemnities and the value to be covered by any bond or indemnity. Our understanding is that, when ABS was first permitted for "non-community" bodies, the value of the bond or indemnity was to protect a Fund against the risk of a contractor becoming insolvent and the redundancy strain for the contractor's employees over age 50 (now 55). This has changed and different administering authorities take very different approaches including to protect against any payment due to the Fund including exit payments.

It would be helpful, therefore, if there could be a standard method for assessing a contractor's covenant adopted by the SAB and passed down to the administering authorities. We realise that there would need to be some flexibilities in this method to allow for different contractors but some consistency would be welcomed.

Finally, we believe that there should be some guidance – preferably binding, so perhaps a statutory guidance issued by MHCLG – on how bonds or indemnities are to be valued and this should revert to the original intention of the protection, to protect administering authorities from strain payments caused by the insolvency of a contractor leading to redundancy early retirements for employees over the age of 55.