

WEST MIDLANDS



PENSION FUND

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Information and Guidance on Arrangements for Admitting Non-Scheduled Bodies into the Local Government Pension Scheme

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Objectives:

To provide information and guidance on:

- the arrangements enabling non-scheduled bodies (eg, community admission bodies, private sector service providers) to join the Local Government Pension Scheme; and
- how the ongoing participation of such bodies in the Scheme is managed.

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1. Introduction

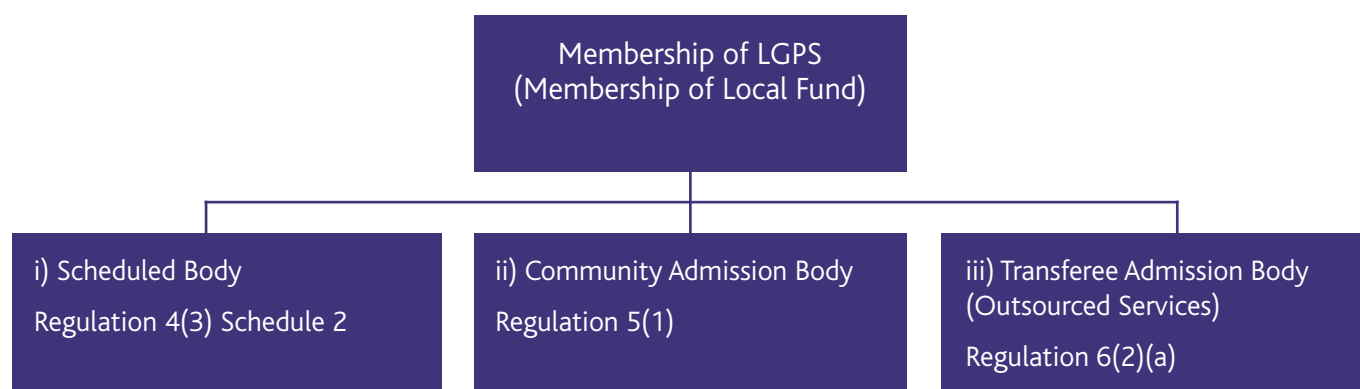
- 1.1. There are, in broad terms, three groups of employers allowed by regulation to participate in the Local Government Pension Scheme. The three groups are scheduled bodies, transferee admission bodies and community admission bodies.
- 1.2. The arrangements for non-scheduled bodies to become 'admission bodies' in a fund of the Local Government Pension Scheme such as the West Midlands Pension Fund (the 'Fund') are heavily prescribed by regulation and can be complex. All interested parties should be clear about their objectives, responsibilities and potential liabilities before entering into an admission agreement.
- 1.3. The Fund will endeavour to facilitate the admission of new organisations and bodies to the Local Government Pension Scheme to enable the efficient and effective delivery of public services. However, the Fund must ensure it is not adversely affected by such admissions. Therefore, the Fund must establish that:
 - (a) appropriate funding will be available to pay benefits due now and in the future; and
 - (b) the costs of the benefits for employees transferring to a contractor/service supplier should be managed in such a way that they do not adversely affect other employers in the Fund.
- 1.4. This guide draws on the experience of the West Midlands Pension Fund, Wragge & Co and Mercer. It is only a guide to the issues, and all parties considering entering into an admission agreement should seek appropriate expert advice before doing so in order to fully understand the implications of being admitted to the Local Government Pension Scheme and particularly the potential cost implications of doing so.

2. High Level Overview of Admission Characteristics for Employing Body Members of the Local Government Pension Scheme

2.1. Organisations can only participate in the Local Government Pension Scheme if they meet the relevant requirements of the Local Government Pension Scheme (Administration) Regulations. The key regulatory requirements for

- (a) scheduled bodies (eg, a county council);
- (b) community admission bodies (eg, a charitable body); and
- (c) transferee admission bodies (eg, a private sector contractor),

are summarised below:



2.2. The key characteristics of the participation of each of the three types of organisations can be summarised as:

Scheduled Body*	Community Admission Body	Transferee Admission Body
(i) No employing body discretion on membership.	Employing body discretion on membership.	Employing body discretion on membership. Closed or open to new members to be determined at times of admission and has contractual issues for outsourcing employing body.
(ii) No employer discretion on who can join.	Employer discretion on who can join.	Employer discretion on who can join possible.
(iii) Open to new members.	May be open to new members	May be open to new members
(iv) No parent guarantee or bond.	May require parent guarantee, indemnity or bond.	May require an indemnity or bond - outsourcing employing body stands as ultimate guarantor.
(v) Restricted to geographical area of fund.	May operate outside geographical area of fund, and potentially participate in more than one fund (separate admission agreement required).	May operate outside geographical area of fund, and potentially participate in more than one fund (separate admission agreement required).
(vi) Individual contribution rate.	Individual contribution rate.	Individual contribution rate.
(vii) Standard actuarial assumptions.	Standard actuarial assumptions, but may be adjusted to reflect organisation's covenant, if no parent guarantee.	Standard actuarial assumptions, but contributions payable may be adjusted to reflect any 'pass through' arrangements in the service contract with outsourcing employing body or concerns of the Fund.

*A small number of scheduled bodies under Part 2 of Schedule 2 of the Scheme regulations do not have all of these characteristics.

Scheduled Body	Community Admission Body	Transferee Admission Body
(viii) Participation governed by regulation. No contract with Fund.	Participation governed by admission agreement.	Participation governed by admission agreement, which is itself 'linked' to the service contract with the outsourcing employing body.
(ix) Some limited risk mitigation requirements by Fund.	Risk mitigation - possible options: <ul style="list-style-type: none"> - parent public sector body guarantee - bond or indemnity - stronger funding assumptions 	Risk mitigation - possible options: <ul style="list-style-type: none"> - parent guarantee - bond or indemnity - stronger funding assumptions
(x) Limited but regular risk assessment required.	Regular risk assessment required	Regular risk assessment required.
(xi) Key monitoring requirements: <ul style="list-style-type: none"> - general workflow - yearly return 	Key monitoring requirements: <ul style="list-style-type: none"> - regular payments - workforce profile/changes - employer's financial covenant 	Key monitoring requirements: <ul style="list-style-type: none"> - regular payments - workforce profile - employer's financial covenant
(xii) No set up costs.	Set up costs to be met by body (may be waived for community associations).	Set up costs to be met by outsourcing employing body and normally part of tender costs.
(xiii) Ongoing participation.	Ongoing participation	Participation for a fixed term - linked to duration of service contract.

3. Relationships Between Parties Involved

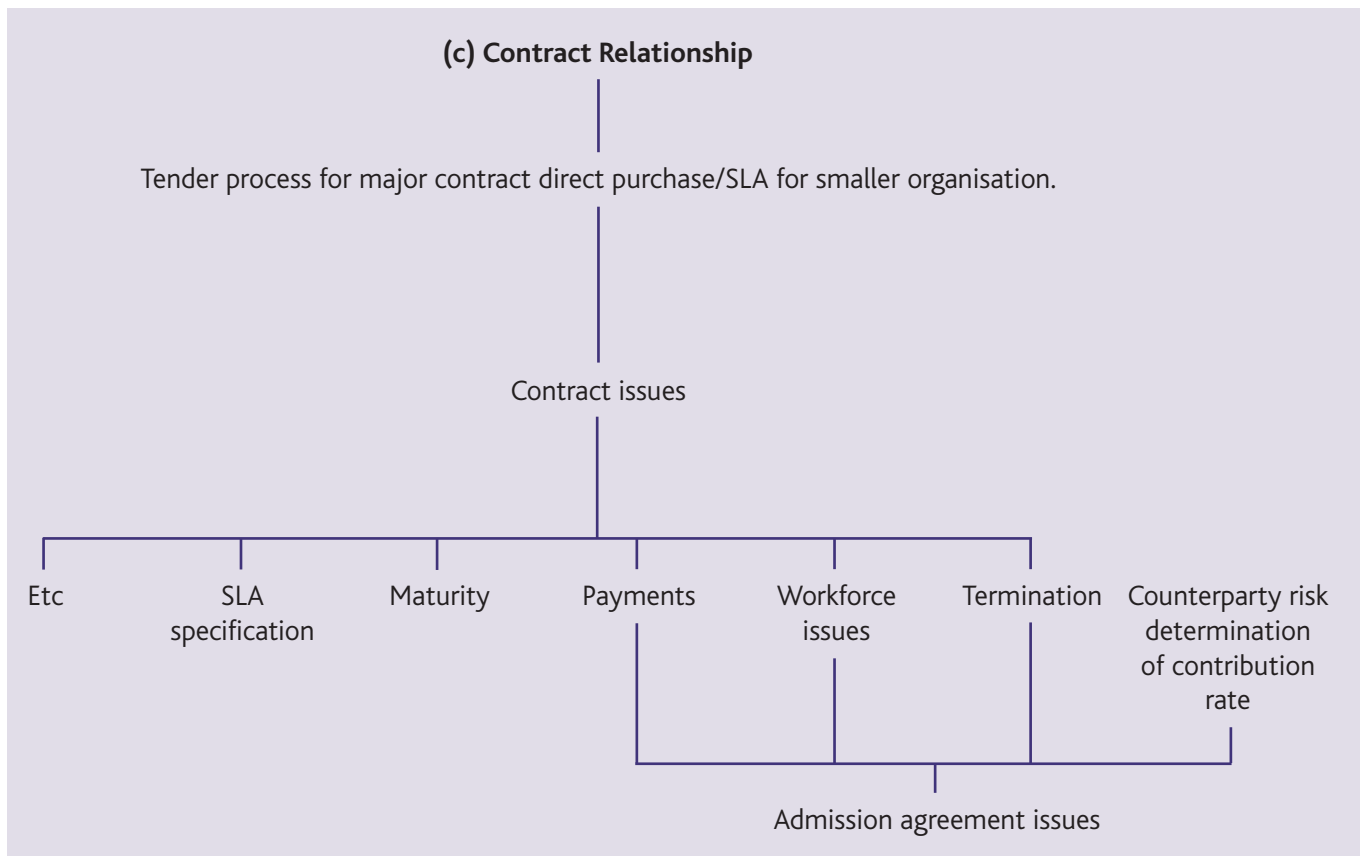
3.1. There are three parties to an admission agreement for those admitted under Regulation 6(2)(a)(i) (Transferee Admission Body). The Fund's standard admission agreement for community admission bodies admitted under Regulation 5(1) also requires three parties – although this is not a statutory requirement. The arrangements can be summarised as follows:

(a) Parties to Arrangement

Transferee Admission Body/ Community Admission Body	Parent or Sponsoring Council	Pension Fund (Administering Authority)
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(b) Objectives of the Parties

Achieve company or employing body objectives, for example: <ul style="list-style-type: none"> - enable employees to remain members of the Fund; - provide appropriate pension in a cost-effective manner; - comply with the pension provisions of the service contract. 	Achieve service objective by means of: <ul style="list-style-type: none"> (i) a contract with private contractor; (ii) through support of community organisation; (iii) comply with the requirements of 'Fair Deal'. 	Facilitate appropriate pension arrangements to: <ul style="list-style-type: none"> (i) enable parent council to achieve its objectives; (ii) provide access to a quality pension scheme; (iii) Protect the Fund and the other employers participating in the Fund;
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3.2. The pension arrangements are only a supporting element in the arrangements between the service provider and the outsourcing employing body but the implications, particularly costs, are significant and should be included as an integral part of the overall contract discussions and consideration. The Fund will look to the outsourcing employing body for determination of arrangements when required in order to finalise the admission agreement.

3.3. The contract arrangements and agreement need to be clear on the following:

- (i) who is eligible to join the Local Government Pension Scheme;
- (ii) whether new recruits (as well as transferring staff) can join or not;
- (iii) how pension costs will be funded and by whom initially and variations in those costs going forward;
- (iv) if the organisation generates significant additional pension costs through its own actions, eg. regradings, are these eligible pay for pension purposes and if they are, who pays the additional pension costs?
- (v) pension liabilities when agreement ends;
- (vi) any bond requirements.

Accurate details of staff transferring may not always be known until the closing of the contract arrangements. The employer's rate and bond value may need to be recalculated in these circumstances.

3.4. Before any contracts are completed the Fund should obtain a risk assessment from the actuary which will require payroll details for all staff transferring. Based upon the outcome of the assessment, the outsourcing employing body needs to determine who is responsible for future pension liability changes. When the risk is transferred to the contractor, the outsourcing employing body will need to determine if it requires the protection of a bond or guarantee. The requirement for a bond and its costs should be provided for in the contract documentation. The Fund may require a bond.

3.5. The Fund's actuary is responsible for setting contribution rates and will take into account that with an outsourcing contract, the outsourcing employing body is the body at risk and actuarial decisions have contractual implications. The actuary and Fund will be looking for guidance from the outsourcing employing body, when required.

4. Summary of Contracting Arrangements with Private Sector Service Providers

4.1. Introduction

Note: CLG is reviewing the guidance it issues on managing pension issues for 'best value authority contracts'. This section reflects the position as at July 2009.

4.1.1. Summary

Protecting the pension provision of public sector staff transferred to private sector contractors as part of an outsourcing exercise is a fundamental aspect of public/private partnership arrangements.

Government guidance and statutory directions have established a clear framework within which the pensions' aspects of employee transfers from the public sector must operate. This framework provides transferring employees with significantly greater pension protection than that afforded by the TUPE legislation alone.

This protective framework has direct implications for both outsourcing employing bodies and contractors involved in outsourcing exercises. Therefore:

- outsourcing employing bodies should provide detailed information in their tender documentation setting out what is expected from contractors in relation to pension provision;
- outsourcing employing bodies and contractors should both obtain actuarial and legal advice in relation to the pension issues involved in the exercise; and
- parties should involve the administering authority in the process as soon as practicable.

4.1.2. Contents

This section summarises:

- the requirements of the relevant 'Fair Deal' guidance and the 2007 Direction;
- the options available to outsourcing employing bodies and contractors;
- the legal documents potentially involved:
 - the service contract;
 - the admission agreement; and
 - the bond; and
- the key practical issues for parties engaged in public to private outsourcing exercises.

4.2. Background

4.2.1. 'Fair Deal' Guidance/2007 Direction

HM Treasury issued guidance in June 1999 entitled: '*Staff Transfers from Central Government: A Fair Deal for Staff Pensions*' (Fair Deal 1999).

Fair Deal 1999 sets out the principles that outsourcing employing bodies (including local authorities) should apply in relation to the pension benefits of employees who are transferred to private sector employment.

In January 2000, the Cabinet Office issued '*Staff Transfers in the Public Sector: Statement of Practice*', which was revised in 2007 (Statement of Practice). The Statement of Practice incorporates Fair Deal 1999 but also looks beyond pensions and provides guidance on the broader employment issues involved in the transfer of employees to the private sector.

Fair Deal 2004 (issued in June 2004) reinforces certain aspects of the existing guidance.

In June 2007, the Department for Communities and Local Government issued the Best Value Authorities Staff Transfers (Pensions) Direction 2007. The 2007 Direction applies to best value authorities in England and puts several aspects of the Fair Deal guidance framework on a statutory footing.

Outsourcing employing bodies are expected to adhere to the Fair Deal requirements. It should be noted that the Fair Deal guidance and the Direction have no direct application to private sector contractors. It is therefore incumbent on outsourcing employing bodies to ensure that their service contracts require contractors to provide transferring employees with an appropriate level of pension benefits.

The protections afforded to employees on 'first generation' outsourcings should also be afforded to former public sector employees involved in second and subsequent generation transfers.

4.2.2. Fair Deal Requirements

Fair Deal 1999 states that outsourcing employing bodies (including local authorities) should adhere to the following principles when transferring employees to the private sector:

- to treat staff fairly;
- to do so openly and transparently;

- to involve staff fully in consultation about the process and its results; and
- to have clear accountability to the Government for the results.

Within this context, Fair Deal 1999 also requires that transferring employees must be offered the opportunity:

- to accrue an appropriate level of pension benefits in respect of future service after the transfer; and
- to secure the pension benefits they accrued pre-transfer.

4.2.3. Future Service – Access to a 'Good Quality Occupational Pension Scheme'

Fair Deal requires that transferring employees should continue to have access to a 'good quality occupational pension scheme' under which they can earn future pension benefits.

This requirement can be met by enabling transferring employees to:

- remain members of the LGPS (contractor obtains admitted body status in the relevant LGPS fund – see section 4.3 below); or
- join a scheme that is 'broadly comparable' to the public sector scheme of which the employee was a member before the transfer (eg, the LGPS). 'Broad comparability' must be certified by the Government Actuary's Department (GAD), or another appropriate actuary (see section 4.7 below).

It is generally accepted that the choice as to whether to offer a 'broadly comparable' pension scheme or to obtain admitted body status rests with the contractor and not the outsourcing employing body.

4.2.4. Treatment of Accrued Benefits

Fair Deal requires that transferring employees are provided with 'options' for securing their past service pension benefits accrued before the transfer of employment. These options are set out below:

- contractor provides a broadly comparable pension scheme - transferring employees offered the opportunity to transfer their accrued LGPS benefits into the contractor's scheme.

- contractor obtains admitted body status - transferring employees' accrued benefits are essentially unaffected as their pensionable service in the LGPS and their salary link will be unbroken.

4.3. Admitted Body Status

4.3.1. Introduction

A contractor providing services to an outsourcing employing body can become an admission body in the LGPS in accordance with Regulation 6(2) of the LGPS Administration Regulations.

To become an admission body a contractor must enter into an admission agreement.

It should be noted that an admission agreement is a separate legal instrument to the 'main' service contract entered into by a contractor and an outsourcing employing body. However, an admission agreement works very much in tandem with the service contract with which it is associated. Both contractors and outsourcing employing bodies should obtain appropriate actuarial and legal advice before entering into an admission agreement.

4.3.2. Admission Agreement

An admission agreement is a tripartite agreement between:

- the contractor,
- the outsourcing employing body; and
- the administering authority of the relevant LGPS fund.

4.3.2.1. Key Provisions

The contents of an admission agreement are heavily prescribed by regulation (Schedule 3 of the LGPS (Administration) Regulations). Nevertheless, admission agreements do vary from LGPS fund to LGPS fund.

The key provisions of an admission agreement deal with the following matters:

- the relevant service contract to which the admission agreement relates;
- the contractor's liability to pay employer contributions including:
 - 'normal' ongoing contributions and how and when they can be varied;
 - additional contributions to meet certain strains on the Fund; and
 - termination liabilities;

- the requirements to put in place and review any bond or indemnity;
- the contractor's obligations relating to the preparation and maintenance of discretionary policy statements; and
- termination provisions.

4.3.2.2. 'Open' or 'Closed' Admission Agreement

Admission agreements may be 'open' or 'closed':

- An open agreement potentially allows any employee of the contractor involved in the provision of the outsourced services to become a member of the LGPS. For example, new recruits the contractor employs in the provision of the outsourced service may become members of the LGPS.
- A closed agreement relates only to a fixed population of employees. Only those employees who transferred to the contractor from the outsourcing employing body can remain members of the LGPS through the admission agreement.

4.4. Bond/Guarantee

Private sector bodies contractors, unlike Schedule 2 bodies, are not backed by Government/the tax payer. If a contractor becomes insolvent, it is unlikely to be able to meet its funding obligations to the Fund. Allowing contractors to become an admission body, therefore, creates an element of risk for the Fund, for the other employers participating in the Fund and, in particular, for the outsourcing employing body.

In recognition of this risk, regulation requires that relevant admission agreements must contain a provision requiring outsourcing employing bodies to undertake an assessment of the level of financial risk posed to the Fund in the event that the service contract terminates prematurely as a result of the contractor's insolvency, winding up or liquidation.

Regulation requires that such assessments must take into account actuarial advice and must be carried out to the satisfaction of the relevant administering authority.

If an assessment identifies a material level of risk, the outsourcing employing body can require the contractor to provide an indemnity or bond to protect against the identified risk.

Outsourcing employing bodies should regularly review the level of risk relating to an admission agreement and require the admission body to put in place a revised bond or indemnity as appropriate.

The bond is the third legal instrument required in respect of a contractor's admission to the LGPS (together with the service contract and the admission agreement).

4.5. Admission Body's Costs

4.5.1. Introduction

Contractors should be aware that:

- Admission agreements place relatively onerous obligations upon them;
- The contributions they are required to pay can be substantial and can vary significantly over the life of the admission agreement; and
- In certain circumstances, they may be required to pay a significant termination payment at the end of the admission agreement.

Outsourcing employing bodies should be aware that in the event of a contractor being unable to meet its funding commitments to the Fund, the outsourcing employing body may be required to assume responsibility for the contractor's outstanding liabilities.

Contractors and outsourcing employing bodies alike should understand the potential costs and risks associated with the pension aspects of any outsourcing exercise they are proposing to enter into and should take actuarial and legal advice as appropriate. These costs and risks should be reflected in the pricing structure of the relevant service contract.

4.5.2. Perceived Problems with Current Arrangements

Over recent years, concerns have increasingly been expressed that the existing arrangements for admission bodies do not operate as efficiently as they might. In the main, these concerns relate to the pension costs incurred by admission bodies. Perceived problems include:

- Pension costs are volatile and contractors have limited control over them. Contractors can be required to pay higher than anticipated contributions and/or significant termination liabilities. Contractors may not be able to accurately cost their pension risk when preparing their bids.

- As a result, certain contractors will not bid for some authority contracts. Other contractors 'inflate' their bid costs in an effort to prudently estimate their pension risk.
- Consequentially, outsourcing exercises do not always deliver 'best value'.

In recognition of these issues, CLG has undertaken several consultation exercises in respect of the current admission body arrangements. CLG is expected to issue further guidance shortly.

4.5.3. 'Pass-Through' Arrangements

4.5.3.1. Introduction

Under the terms of an admission agreement, a contractor is required to pay:

- ongoing contributions at the rate determined by the relevant fund actuary from time to time;
- any additional contributions required to meet certain strains on the Fund (eg, the payment of an ill-health pension or awarding additional pension); and
- any termination liability as calculated by the Fund actuary.

As noted above, exposure to such liabilities may not be commercially acceptable to certain contractors.

Contractors and outsourcing employing bodies may therefore reach an agreement whereby the pension costs payable by a contractor under the terms of an admission agreement are shared between the contractor and the outsourcing employing body. Such agreements are referred to as 'pass-through' arrangements.

4.5.3.1. Examples of Pass-Through Arrangements

It is important to note that pass-through arrangements are the result of a contractual agreement between a contractor and an outsourcing employing body to share the costs a contractor is required to pay under the terms of an admission agreement. A contractor's liabilities under an admission agreement are themselves unaltered by a pass-through arrangement. The relevant administering authority will typically not be involved in the agreement of any pass-through arrangement.

The details of the agreed pass-through arrangements should be clearly documented in the service contract. Both contractors and outsourcing employing bodies should obtain actuarial and legal advice before entering into such arrangements.

How a contractor's pension costs are shared or passed-through to the outsourcing employing body is a matter of agreement between the outsourcing employing body and the contractor. Any such agreement should be considered in the context of the wider commercial agreement reached by the parties in the service contract.

There are a number of potential cost sharing mechanisms available to the parties. Examples include:

- **Fixed contributions.** If a contractor is required to pay employer contributions greater than X% of pensionable pay, or £X, the outsourcing employing body will reimburse the contractor for the excess.
- **Cap and collar.** The parties agree an upper and lower level of employer contributions. If the contribution rate payable by the contractor, as determined by the Fund actuary, is within the agreed range the contractor pays the required rate. If the contribution payable is outside the range, the monthly or quarterly service fee payable by the outsourcing employing body to the contractor is adjusted accordingly.
- **Termination liabilities.** The parties agree to share the cost of meeting any termination liability the contractor is required to pay at the end of the admission agreement.

Any agreed cost sharing mechanism should reflect the circumstances and objectives of the negotiating parties.

4.6. The Two Tier Workforce Code – New Recruits

4.6.1. Introduction

Outsourcing employing bodies are required to consider the level of pension provision a contractor should offer to new recruits, as well as the pension provision offered to transferring employees.

4.6.2. 'Reasonable' Pension Arrangements

Outsourcing employing bodies must adhere to the requirements of Annex D of ODPM Circular 03/2003. Annex D is entitled '*Code of Practice on Workforce Matters in Local Authority Service Contractors' (the Two-tier Workforce Code)*.

The two-tier workforce code establishes a degree of protection for new recruits hired by a contractor to work alongside transferred employees performing the outsourced services. Outsourcing employing bodies should make it a condition of the service contract that the contractor complies with the requirements of the two-tier workforce code.

Contractors should be required to offer new recruits 'reasonable' pension arrangements, ie:

-
- Membership of the LGPS (via and 'open' admission agreement).
-
- Membership of a 'good quality' occupational pension scheme. This should be either a defined benefit scheme, or a defined contribution scheme where the employer matches the employee contributions of up to 6%.
-
- A stakeholder pension scheme, where the employer matches the employee's contributions of up to 6%.
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4.7. 'Broadly Comparable' Pension Schemes

4.7.1. Introduction

As noted above, rather than obtain admitted body status, a contractor may elect to meet the Fair Deal requirements by offering transferring employees membership of a of a trust-based 'broadly comparable' pension scheme.

If a contractor selects this route, the outsourcing employing body must require the contractor to demonstrate that the pension scheme it is proposing to offer transferring employees has been certified by the Government Actuary's Department (or another appropriate actuary) as broadly comparable to the LGPS.

A scheme can only be certified as broadly comparable if there are no identifiable employees who will suffer material detriment overall in terms of their future accrual of pension benefits under the new employer's scheme.

If a contractor is to offer a broadly comparable scheme, the outsourcing employing body should ensure that the contractor's obligations are clearly set out in the relevant service contract.

If this route is followed, there is no requirement for the admission agreement and bond referred to above. However, detailed consideration of the bulk transfer terms available will be required. Both the contractor and the outsourcing employing body should obtain legal and actuarial advice before agreeing any bulk transfer terms. The Fund should also be informed of the proposals as early as possible in the process.

4.7.2. Bulk Transfer Terms

Contractors who provide transferring employees with access to a broadly comparable pension scheme for future service must also offer those employees the option to transfer the benefits they have accrued in the LGPS to the contractor's scheme.

Outsourcing employing bodies should require contractors to offer those employees who do transfer their accrued LGPS benefits with day-for-day past service credits in the contractor's scheme.

The calculation and payment of an appropriate bulk transfer value from an LGPS fund to a contractor's scheme can be complex and time-consuming. The service contract should clearly document:

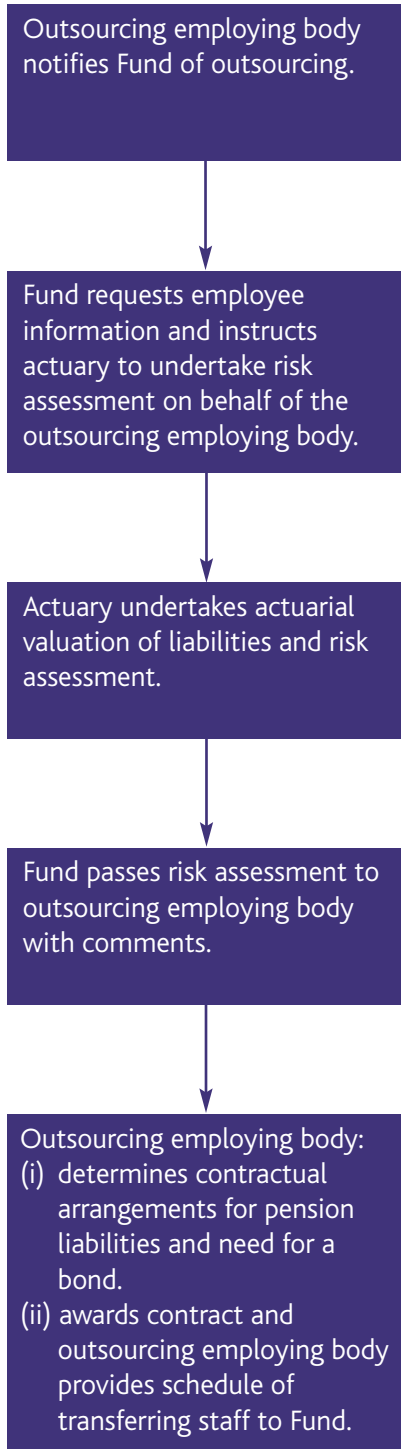
-
- how and when the bulk transfer value is to be calculated;
-
- when any bulk transfer value is to be paid; and
-
- how any bulk transfer value payable from the contractor's scheme at the end of the service contract is to be calculated and when it is to be paid.
-

Further information in respect of the cost and actuarial issues discussed above is provided in section 9 'Actuarial Issues'.

5. Admission Procedure Checklist for the Fund

5.1. The Fund should be involved in the arrangements between the parties as soon as practical.
An outline of the process for an organisation to obtain admitted body status is as set out below:

Pre-contract



Post-contract



Termination of contracts

See separate section (page 14).

6. Ongoing Arrangements/Annual Health Check

6.1. There is an ongoing requirement to manage the admission arrangements and the broad roles of the three parties are as follows:

Activity	Pension Fund	Employing Body	Parent or Sponsoring Council
(i) Valuation	Arrange three-yearly valuation and consultation	Consultation	Consultation
(ii) Regular information exchange	Review monthly contributions	Collect and pay monthly contributions	-
	Update member records: (i) in year (ii) full year end update	Advise promptly on staff/membership changes	-
	Bring into payment benefits	Notify of actions linked to benefit rights	-
	Send out statements, etc	-	-
(iii) Monitoring	(i) Cash paid promptly to Fund;	Respond to concerns	Respond to concerns from Fund
	(ii) AVC contributions promptly paid to provider;		
	(iii) Data up to date;		
	(iv) Staffing changes affecting liability;		
	(v) Financial standing;		
	(vi) Annual health check;		
	(vii) Bond arrangement;		
	(viii) End of year data and financial reconciliation.		

7. Termination Issues

- 7.1. It is important that termination is considered before an admission agreement is entered into to be clear on the responsibilities at the end of the contract. These should be reflected in the contract arrangements from the start where appropriate.
- 7.2. The Fund has a termination policy which is as follows:

Policy on Termination Funding for Admission Bodies ('Termination Funding Policy')

1. Introduction

- 1.1. This document details the West Midlands Metropolitan Authorities Pension Fund's (the Fund) policy on admissions into the Fund, the methodology for assessment of a termination payment on the cessation of an admission body's participation in the Fund, and considerations for current admission bodies. It supplements the general policy of the Fund as set out in the Funding Strategy Statement (FSS).
- 1.2. Admission bodies are required to have an 'admission agreement' with the Fund. In conjunction with the regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund. Wherever possible, the Fund will seek a guarantor body within the Fund for all admissions.

2. Principles

Termination of an Admission Agreement

- 2.1. When an admission agreement comes to its end, or is prematurely terminated for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case, the employees will retain pension rights within the Fund, ie, either deferred benefits or immediate retirement benefits.
- 2.2. In addition to any liabilities for current employees, the Fund will also retain liability for payment of benefits to former employees, ie, to existing, deferred and pensioner members.
- 2.3. In the event that unfunded liabilities arise that cannot be recovered from the admission body, these will normally fall to be met by the guarantor or successor body within the Fund. If not, they are the liabilities of the whole Fund.

- 2.4. The Fund's policy is that a termination assessment will be made based on a least risk funding basis, **unless** the admission body has a guarantor within the Fund or a successor body exists to take over the admission body's liabilities (including those for former employees). This is to protect the other employers in the Fund as, at termination, the admitted body's liabilities will become 'orphan liabilities' within the Fund, and there will be no recourse to the admission body if a shortfall emerges in the future (after the admission has terminated).
- 2.5. If instead, the admission body has a guarantor within the Fund or a successor body exists to take over the admission body's liabilities, the Fund's policy is that the valuation funding basis will be used for the termination assessment. The guarantor or successor body will then, following any termination payment made, subsume the assets and liabilities of the admission body within the Fund (sometimes known as the 'novation' of the admission agreement). This may, if agreed by the successor body, include the novation to the successor of any funding deficit on closure, in place of a termination payment being required of the admission body itself.

Funding Basis

- 2.6. An admission body may choose to pre-fund for termination, ie, to amend their funding approach to a least risk methodology and assumptions. This will substantially reduce the risk of an uncertain and potentially large debt being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the least risk basis.
- 2.7. For any admission bodies funding on such a least risk strategy a notional investment strategy will be assumed as a match to the liabilities. In particular, the admission body's notional asset share of the Fund will be credited with an investment return in line with the least risk funding assumptions adopted rather than the actual (largely equity related) investment return generated by the actual asset portfolio of the Fund. The Fund reserves the right to modify this approach in any case whether it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

Administering Authority Options

2.8. As noted at paragraph 1.2. above, a guarantor within the Fund will be sought for all admissions. In order to protect other Fund employers, when considering applications for admission body status where there is no guarantor within the Fund, the administering authority can determine that:

- The admission body must pre-fund for termination with contribution requirements assessed using the least risk methodology and assumptions; or
- The admission body's application is refused; or
- Other requirements as considered appropriate in the circumstances will apply.

2.9. Some aspects that the administering authority may consider when deciding whether to apply any of the options under 2.8. above, in the absence of a guarantor, are:

- Uncertainty over the security of the organisation's funding sources, eg, the admission body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;
- If the admission body has an expected limited lifespan of participation in the Fund;
- The average age of employees to be admitted and whether the admission is closed to new joiners.

3. Implementation

New Admissions

3.1. The Fund will apply the above principles to the admission of new bodies into the Fund and to the methodology for assessment of a termination payment on the cessation of such an admission body's participation in the Fund.

Transferee Admission Bodies (TABs)

3.2. Transferee admission bodies generally will have a guarantor in the Fund since the regulations require that, in the event of any unfunded liabilities on the termination of the admission, the contribution rate for the relevant Scheme employer should be revised. Accordingly, in general, the least risk approach to funding and termination will not apply for TABs.

3.3. On termination of a TAB admission, any orphan liabilities in the Fund will be subsumed by the relevant Scheme employer.

3.4. The Scheme employer is required to carry out an assessment of the level of risk on premature termination of the contract. This assessment would normally be based on advice in the form of a 'risk assessment report' provided by the actuary to the Fund. As the Scheme employer is effectively the ultimate guarantor for these admissions to the Fund, the decision over the level (if any) of any bond required for the transferee admission body is the responsibility of the Scheme employer.

3.5. Deficit recovery periods for TABs will be set in line with the Fund's general policy as set out in the FSS.

3.6. An exception to the above policy applies if the guarantor is not a participating employer within the Fund, including if the guarantor is a participating employer within another LGPS fund. In order to protect other employers within the Fund, the administering authority may in this case treat the admission body as if it has no guarantor.

Community Admission Bodies (CABs)

3.7. At present under the regulations, there is no **requirement** to carry out an assessment of the level of risk on termination of the admission agreement for a CAB. The administering authority may, nevertheless, decide to carry out such a risk assessment where appropriate.

3.8. The Fund's policy is to consider applications on a case-by-case basis, in line with the principles set out above. In general, a guarantor body in the Fund will be sought for any CAB wishing to join the Fund. If a guarantor (of sufficient standing acceptable to the Fund) is not forthcoming the admission will either not be approved, the admission body will be required to pre-fund for termination with contribution requirements assessed using a least risk methodology and assumptions, or other requirements may be applied.

3.9. Deficit recovery periods will be determined consistent with the policy set out in the FSS. Alternatively, the administering authority may determine an employer specific deficit recovery period will apply.

Earlier Existing Admissions

- 3.10.** The Fund has a number of very long standing admission agreements all relatively small in membership numbers.
- 3.11.** The Fund's policy is that these existing admissions will be notionally 'ring-fenced' with the valuation funding basis used for the termination assessment and calculation of ongoing contribution requirements. In the event that unfunded liabilities arise that cannot be recovered from the admission body at termination and in the absence of a guarantor or successor body, these will fall to be met by the Fund as a whole.

Notification of Termination

- 3.12.** In many cases, termination of the admission is an event that can be foreseen, for example, because the organisation's operations may be planned to be discontinued. In this case, admission bodies are requested to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance, the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of the admission. Effectively, this will be achieved by 'locking in' to financial conditions for the termination prior to that date, and the hypothecation of a notionally matched investment strategy for the period to termination. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Scheme, or depending on any case-specific circumstances.

8. Closing an Admission Agreement to New Employees

8.1. It is becoming more and more frequent for employers to consider closing the LGPS to new employees. This is seen as a less radical move than seeking to exit from the LGPS altogether (which would generally trigger a termination assessment and payment of an 'exit debt'). However, closing to new entrants starts the clock ticking on the time when the last member will leave and an exit event is triggered, so closing is not a decision that should be taken lightly or without proper consideration.

8.2. It is usually the case that employers want to consider closing LGPS membership to new employees for cost-saving reasons. This section sets out further information on the implications of closure, and importantly notes that, at least in the short- to medium-term, costs could increase rather than reduce.

8.3. This note is intended for admission bodies in the LGPS, but can also apply to some other organisations that can 'deem' or 'designate' membership of the LGPS for their employees. In general, however, for scheduled bodies, membership of LGPS is an employee right under the regulations, so that the employer may not unilaterally withdraw access to LGPS to its employees.

Implications of Closure to New Employees

8.4. By closing the Fund to new employees, employers could possibly make long-term savings through not having to pay LGPS contributions in respect of future recruits. However, there are various implications of closing the Fund which could actually lead to increased short-term costs. Therefore, it is important to consider all the cost implications regarding closing the Scheme to new employees before a decision is made. Set out below is a list of various points to consider:

- Closing the Scheme to new employees means that the employer will not have to pay contributions to the Fund in respect of employees who join in future. This could lead to potential savings in the long-term.
- The employer may need to provide the future employees with replacement benefits in lieu of membership of the LGPS. These benefits will have an associated cost.

- The cost of any replacement benefits will need to be netted of the savings from closing to new employees when considering the actual long-term savings.

- Existing active members will remain in the LGPS and continue to accrue benefits for as long as they remain in active service with the employer.

- The timing of the contribution requirements payable to the Fund in respect of the existing members will normally be accelerated due to the closure to new employees.

- The contribution rate in respect of the cost future accrual and the contribution rate in respect of recouping any deficit would be likely to increase for the existing active members at future valuations. Further details are given in the next two points.

- The average age of active members would increase at future valuations as this would be calculated for a closed set of people. The cost of future accrual would therefore increase as the membership aged.

- If there is a funding deficit for the employer then for a closed scheme additional contributions would usually be paid over the future working lifetime of the active members. This may well be a shorter period compared with the deficit recovery period which is currently applies to the employer. The additional deficit contributions could increase significantly as a result.

- Conversely, if there is a funding surplus then this would be eliminated over the future working lifetime which could lead to lower contributions.

- The closure to new employees would mean a shorter time until the last active member either left or retired. At this time, the admission would cease and an exit debt could be payable. The exit debt on cessation can be substantial because the Fund then needs to hold sufficient reserves to pay the future benefits due without ongoing support from the employer.

- The Fund's policy for admission bodies provides more details on admission terminations and the exit debt assessment.

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- In summary, closing LGPS membership to new employees could lead to long-term savings for the employer but, in the short-term, it is quite likely that increased costs could arise.
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Reopening Fund to New Employees

- An employer could choose to reopen the Fund to new employees at a later date. The comments above regarding the acceleration of costs would no longer apply.
 - It is important to keep the Fund administrators fully informed of the employer's policy for new employees, so that the appropriate funding arrangements can be applied.
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9. Actuarial Issues

Introduction

9.1. This section of the guide provides information on the approach and mechanisms typically adopted by LGPS funds and their actuaries in managing the funding arrangements for participating employers, including admission bodies.

It covers the following areas:

- Overview of operation of the Fund as regards funding;
- New admissions – initial funding treatment;
- Assets shares and allowance for experience;
- Application to contractors;
- Attribution of risk.

Overview of Operation of the Fund

9.2. LGPS provides continuity of pensionable service for employees as they move from employer to employer throughout their working lives. Where an employee moves from one employer to another (whether within the same Fund or to a different LGPS fund), there is no change in the pensionable service already built up, and benefits for all service will continue to count in full on ultimately leaving or retiring from LGPS with the final employer.

The financial management of the Fund as regards the participating employers then is built on the basis of two key principles:

- Each employer stands responsible for the funding costs arising in relation to its employees, both for current employees and former employees which have now left service or retired. This means that the employer should meet the costs of any funding deficits which might arise, and equally should gain the benefit from any funding surpluses.
- In setting employer contribution rates payable to the Fund, there is a 'no cross subsidy' objective. The costs which fall on an employer should relate solely to the experience of the Fund as it relates to the employer's own membership, and the nature and profile of its own employees' (and former employees') benefit entitlements through the Fund. Factors relating to an individual employer should not impact on the costs falling on other employers.

9.2. The financial situation within the Fund of any one employer, as identified at an actuarial valuation, will then reflect the specifics of membership, experience (eg, pay growth, ill-health retirements etc), and past history (eg, assets accumulated up to the prior valuation, actual contributions paid etc) for each employer. The result of this process is, therefore, a notional surplus or deficit position for each employer, which will be reflected in setting contributions at the valuation.

9.4. Also for each employer a future service contribution rate is established, pertaining specifically to the current membership of that employer. The contribution rate set for the employer at the valuation is then made up of two principal parts:

(a) The employer-specific future service contribution rate; and

(b) An adjustment to the future service contribution rate relating to the employer-specific assets/liabilities/surplus (deficit) position.

Actuarial Assumptions

9.5. A key factor in the valuation calculations for each employer is the set of actuarial assumptions used for the valuation. The most significant assumptions are around **financials** (expected investment returns, discount rate for liabilities, projected salary growth, pension increases etc), **demographics** (mortality, ill-health retirements, commutation rates) and **funding strategy** (length of recovery period, phasing, segmentation of employers etc).

9.6. The assumptions used for the valuations are not prescribed, and formally are set by the actuary (in consultation with the Fund's administering authority). The actuary is also required to have regard to the Fund's Funding Strategy Statement (FSS). The process for consultation and review of the FSS by the administering authority, therefore, provides the formal route for employers to have input into the actuarial valuation process.

Flexibility for Employers

9.7. In general, the main areas of employer flexibility (which would be subject to consultation through the FSS process as part of each valuation) are:

- Allowance for early retirements.
- Length of recovery period (within parameters set by the Fund).
- Adoption of phasing for any contributions rate increases (again within parameters set by the Fund).
- Any other matters identified as part of the FSS consultation. For example, some Funds may allow a degree of limited flexibility over the notional investment strategy pertaining to the employer.

New Admissions – Funding Treatment

9.8. At the outset of an admission, the new employer takes on the ongoing financial responsibility to provide for the future pension benefits in respect of those employees whose employments transfer from a previous employer and for any new employees who join the Fund. The financial responsibility will therefore include:

- the pension benefits accruing for service after the date of commencement for the initial employees;
- the accrued pension benefits from previous service for those initial employees whose pensionable service is continuous before and after the transfer;
- the pension benefits accruing for future service for new employees;
- other pension benefits for the employees (eg, due to transfers in to the Fund).

9.9. It is usual on the transfer of staff to a new admission body for assets to be notionally reallocated within the Fund from the previous to the new employer to cover 100% of the accrued liabilities assessed as at the outset of the admission. This means that no surplus or deficit applies at day one, but from that point in time the new employer stands responsible for the funding of the pension benefits. It is possible, however, for an admission agreement to be structured so that the new admission body takes on a share of any existing deficit in respect of the previous employer so far as this

relates to the transferring staff. In this case, the terms for this allocation need to be agreed and documented at the time of the transfer.

Assets Shares and Allowance for Experience

9.10. Going forward from the commencement of an admission, the actuary will, at the next valuation, identify the notional sub-funds (ie, assets and liabilities) pertaining to each participating employer, and then continue to track these at each subsequent valuation. While this tracking is necessarily to a degree approximate (for example, there is in general no formal, separate accounting for individual employers' asset allocations within the Fund) the actuarial processes are designed to have the same overall effect.

9.11. The approach generally adopted by the actuary is to assess an attribution of assets every three years, reflecting the main sources of profit and loss to the Fund (as they impact each individual employer), and recognising the major cash flow data, bulk transfers, etc, for each employer. This is done by obtaining the cash-flow data for each employer, and combining that with the 'analysis and surplus' actuarial technique. The purpose of this approach is to enable the setting and monitoring of individual employer contribution rates applying the 'no cross subsidy' principle.

9.12. At each valuation the actuary will credit to the employer's sub-fund a notional investment return in line with that achieved by the Fund as a whole over the period. Alternatively, if arrangements have been put in place for alternative investment strategy options for employers, the return credited will be in line with that strategy. Any such alternative strategy might be notional (for example, by reference to some index or basket of indices) or instead, in some cases, related to the actual return achieved on a specified asset portfolio within the Fund.

Application to Contractors

9.13. It is usual in the case of a function being transferred to an external provider that the staff involved transfer under the TUPE legislation and, in addition, either an admission agreement is entered into by the contractor to enable continued participation for the staff in the LGPS, or staff are offered membership of a broadly comparable pension scheme in respect of their new employment. The generally applicable practice for the treatment of contractors is in line with the following principles:

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- 1) The contractor should fund the benefits accruing during the period of the contract to the LGPS members covered by the admission agreement over the period of the contract.

 - 2) Actuarial gains and losses arising in the period of the contract would be the responsibility of the contractor, unless other arrangements are agreed with the letting authority (see attribution of risk below). These gains and losses include the effect of the experience during the contract on benefits accrued prior to the starting date.

 - 3) Surpluses or deficits assessed as at the start of the contract will not normally be transferred to the new employer. Initially, therefore, admission agreements will be set up with assets transferred to cover 100% of the accrued liabilities of the relevant staff (but see the next paragraph).

 - 4) In some circumstances, for example when a service is removed entirely from the local authority's budget, it may be appropriate for the new employer to fund for any deficiency in respect of the transferring employees existing at the commencement of the contract.

 - 5) If a broadly comparable scheme is offered (in place of LGPS membership) bulk transfers made available from LGPS would normally consist of full past service reserves (ie, to cover 100% of accrued liabilities).

 - 6) In this case the objective of agreeing bulk transfer terms is to achieve a service credit in the receiving scheme equal in length to accrued pensionable service in the LGPS, adjusted as necessary for differences in the benefit terms of the scheme as compared to LGPS.
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9.14. Deficit recovery periods (where any deficit has arisen), or the treatment of any surplus where applicable, will be determined in accordance with the Funding Strategy Statement (FSS). This might require adjustment of contributions to be fully funded at the end of the contract period or alternatively a longer period might be acceptable to the Fund. In this latter case it would be normal for the contractor and the letting authority to have the flexibility to agree the appropriate length of recovery period to apply, within parameters as set out in the FSS. In general, a short deficit recovery period will give rise to more volatile contribution requirements.

Attribution of Risk

9.15. When an admission comes to an end (including if a contract is prematurely terminated for any reason), the value of the pension liabilities built up can be very substantial. At this point, the financial obligations are likely to crystallise. How the liabilities are then dealt with will depend on a range of factors including the precise circumstances of the case, the nature of the admission, and whether there is a guarantor or successor body. The Fund will normally have a specific policy on its treatment for dealing with liabilities arising in the circumstances.

9.16. The risks associated with potential underfunding of the liabilities (whether crystallised at termination or arising during the ongoing term of the admission agreement) derive from many sources, including:

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- Investment returns
 - Longevity
 - Inflation
 - Salary growth
 - Ill-health retirements and benefit enhancements
 - Early retirement costs
 - Other membership movement (eg, transfers)
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9.17. The 'no cross subsidy' principle requires that the costs and financial effects of the employer's participation in the LGPS are attributed to the employer concerned under the admission agreement. This approach means that the risks associated with the defined benefit pension promise, in respect of the members, transfer to the new employer. This will include, for example, longevity risks relating to expected length of payment of pension after retirement, and investment risks related to the investment strategy adopted by the Fund. Similarly, costs relating to salary increases and early retirements, for example, are the responsibility of the new employer under the admission agreement.

9.18. However, there are alternative approaches other than this full 'separation' approach which are often negotiated between the contractor and letting authority as part of letting a contract. Some examples are described briefly in the following paragraphs.

Fixed costs

The admission agreement would be written on the basis of a fixed contribution rate (possibly subject to review in particular circumstances or at particular intervals) with the upsides and downsides of actual costs being greater or less than the fixed cost falling on the letting authority. A variation of this is for the admission agreement to be drawn up on a 'separation' approach, but for the contractual arrangements between the letting authority and admission body to provide for balancing adjustments to be made to the extent that the contributions required under the admission agreement differ from an agreed fixed cost basis.

Cap and collar

Similar to the fixed costs arrangement described above, except with an agreed band of contributions within which responsibility lies with the contractor, with costs outside of that band being passed back to the letting authority.

Pass through costs

Here the admission agreement would be on a separation basis, but the contributions required would be provided for in the contractual arrangements between the employer and the letting authority as an add on to the pricing mechanism agreed for the services.

Grouped approach

The admission agreement would be set up so that the experience of the new employer in relation to pension liabilities would be grouped with that of the original letting authority, and therefore the employer would pay the same contribution rate, as reviewed from the time to time at actuarial variations, as the letting authority pays to the Fund.

Specified attribution of risks

The admission agreement would be written on a separation basis, but contractual terms are agreed which provide for some risk to be met by the contractor and others by the letting authority. Typically, costs relating to salary growth and early retirements would be attributed to the contractor. Risks which might be attributed to the letting authority could include investment risks and/or changes in actuarial assumptions.

9.19. Letting authorities entering into contractual arrangements along such lines need to consider carefully the risks which they will retain in relation to the transferring staff, and the potential impact of these risks on their own financial position in relation to the LGPS.

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Help and Information

Further information

We will ensure that all of our members are provided with relevant further information on request.

Comments and complaints

We welcome and value your comments on the standards of service we provide. If you have any comments you wish to make, please contact us at the above address.

We would also like to hear from you if you are not satisfied with the way you have been treated. If you wish, you can speak to Brian Bailey, Director of Pensions, on his personal number (01902) 552020 on any weekday between 9.00 and 9.30am or via email: brian.bailey@wolverhampton.gov.uk

If you wish to make a formal complaint, write to:

Complaints and Compliments

Office of the Chief Executive, Civic Centre,
St. Peter's Square, Wolverhampton WV1 1NX

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