Appendix A

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Your ref
Our ref LCPF/AL
Date 04 April 2019

Dear Sirs

Local Government Pension Scheme
Fair Deal – Strengthening pension protection

I refer to your consultation entitled "Local Government Pension Scheme: Fair Deal – Strengthening pension protection".

The response here is provided by Lancashire County Council in its capacity as administering authority to the Lancashire County Pension Fund. As requested my details are:

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The response below addresses each question raised with the consultation document.

Q1	RESPONSE
Do you agree with the definition of Protected Transferee?	The draft regulations define a “protected transferee” as someone who has transferred from the Fair Deal employer at the outset, and also clarify that an employee who joins after the contract has started does not acquire protected status when the contract is retendered.

	We agree that the definition seems sensible although we see this as an employer consideration. However, as a Pension Fund it is critical that the protected status of employees is communicated to the Fund clearly at the outset of a contract and any subsequent re-letting. It is therefore paramount that the employers (including any subsequent employers) are compelled to maintain this information on their records in a clear and concise fashion and that it is provided automatically. Their payroll providers also need to be aware of this.

Q2	**RESPONSE**
Do you agree with the definition of Fair Deal Employer?	It seems to us that the definition will cover all LGPS scheme employers other than admission bodies, charities, further education corporations, sixth form college corporations and higher education corporations, although such employers could choose to apply the provisions if they wished. It now specifically <u>includes</u> academy schools and police and crime commissioners. We see the definition of Fair Deal employer as a general policy decision by the Government, but it does not seem unreasonable. The scope is similar to existing provisions, albeit a little wider, which simplifies matters and provides greater clarity. It does mean that employers will need to be clear on their policy decisions and ensure the Fund is kept up to date on these. However, under draft Regulations 3B(1) and 3(B)11 it appears that employees working for a different Fair Deal Employer from the one carrying out the outsourcing are not protected. This seems unlikely to be a policy decision so needs clarity for all parties. The Regulations seem to us to introduce an anomaly in this area, best illustrated by an example. If, say, an academy school sources its cleaning service from the local authority in its area, but decides it wants to outsource that service then the academy is not the "Fair Deal Employer" in relation to those employees, and our reading of the draft Regulations is that these employees' pension rights are not protected. If, on the other hand, they had been working directly for the academy school then the academy would be their "Fair Deal Employer" so the employees would be protected. For consistency of treatment we would

	suggest that such employees should be protected by virtue of the fact that they are working for a Fair Deal Employer, but either way we feel this should be a deliberate policy decision which needs clarifying.

Q3	RESPONSE
Do you agree with the transitional arrangements?	Overall, this seems to us a sensible proposal. Broadly comparable schemes are now relatively rare in practice and we think this will achieve more consistency of approach with other public sector schemes. Equally any historic staff under the existing protections should be brought into the new regime otherwise you would be operating two regimes for many years to come. Where a service provider currently has a broadly comparable scheme, that service provider and the Fair Deal Employer will need to prepare for a change of approach when the contract is next retendered. It is important that authorities review their historic contracts to consider if they are affected and decide on their policy. **This should be made compulsory under any new guidance.**

Q4	RESPONSE
Do you agree with our proposals regarding the inward transfer of pension rights?	The employees concerned will be able to take a transfer from their existing scheme and use it to secure career average benefits within the LGPS, we suspect using the normal individual LGPS transfer in terms (although the intention here needs to be clarified). Under the proposals, the relevant LGPS or Fair Deal employer will <u>not be able</u> to refuse such a transfer. This will mean additional (and potentially large) risk and cost is taken on by the Fair Deal Employer. The number of contracts operated on the basis of a broadly comparable scheme is relatively small, and the proposal will apply only to those still in service at the end of the contract, so we suspect it will have only limited effect in practice. It also does not necessarily provide the employees with full continuity of pension benefits. However, given that the transfer in terms offered by the LGPS are currently relatively generous compared to those normally offered in private sector schemes, on average we suspect members will not lose out if this proposal is implemented and may in fact gain (possibly

	materially) in relative terms. Nevertheless, we would expect there to be a mixture of gainers and losers. Also, if there are guaranteed bulk transfer terms written into the original contract then these could be very generous and could produce windfall gains for members and increase the exposure for the new employer and ultimately the Fair Deal Employer through the pass through arrangement where before there would not necessarily have been any exposure to additional cost/risks. Overall we understand the policy intention here but have some concerns over the possibility of windfall gains for members given the individual transfer-in terms on offer in the LGPS. What might be preferable is that some standardisation of the terms offered on transfer back (depending on the original LGPS benefits secured in the broadly comparable scheme) would be more equitable. However, given the relatively low number of broadly comparable schemes still in existence, on balance it is something that could be overall acceptable to the LGPS to achieve the policy outcome.

Q5	RESPONSE
Do you agree with our proposals on Deemed Employer status?	It appears it will be the Fair Deal Employer's choice, when initially putting the contract out to tender, whether the Admission Agreement or Deemed Employer approach will be used. ***This makes it imperative that each Fair Deal Employer has a clear policy on the treatment of each type of employer.*** This is a simplified method of achieving pension protection for the employees, as it avoids the new employer having to consider and sign an admission agreement with the Fund which is a positive from an administrative viewpoint. It could be used in conjunction with some limited risk sharing (i.e. where the contractor is only responsible for redundancy costs etc.) between the Fair Deal Employer and the new employer, but in our view any significant passing of the pensions risks to the new employer would be better served by the existing approach using an admission agreement with the Fund. Therefore, the policy of the Fair Deal Employer is critical to the successful operation from a Fund perspective.

Q6	RESPONSE
What should advice from the SAB contain to ensure that Deemed Employer status works effectively?	***At a high level the advice should cover that the Fair Deal employer must have a clear policy on the approach it will take. Equally the advice should cover what Funds are required to do both on a policy basis and operationally in terms of dealing with both "Employers" in the arrangement given there will be no admission agreement to define all parties' obligations.*** It should also cover when the Deemed Employer route works better versus the Admitted Body route and vice versa. We have set out below the main benefits and issues for further clarification in the advice from SAB. Main benefits of Deemed Employer Route: • Simple to put in place as no admission agreement needed • Very convenient for contracts done on a pure "pass-through" or "fixed cost" basis • Can incorporate some limited risk sharing arrangements relatively easily, albeit probably only the more straightforward ones such as early retirement strains and awards of additional pension • It avoids the need to assess exit debt or credit for the Fund at the end of the contract. Issues needing further advice: • The admission agreement approach works better than Deemed Employer where the outsourced employer takes on wider risks, as the admission agreement route provides for a better segregation of the assets and liabilities from the those of the Fair Deal Employer • Clarity will be needed on whether the Fund deals for administrative purposes with the Fair Deal Employer or the new employer (it could be a mixture of both, and Funds may still need to establish a separate employer code for the new employer e.g. for dealing with payroll queries) • Clarity will be needed on whether the new employer operates its own discretions policy or whether the Fair Deal Employer's policies will

	apply • Clear communication will be needed and Funds/employers will need to update the relevant policies • The contribution rate in respect of the outsourced employees will need to be agreed and documented, as will the mechanism for making payments under any risk-sharing arrangements: given that there is no direct link between the Fund and the new employer, we would expect these would be matters between the Fair Deal Employer and the new employer and as such would need to be covered under the contractual arrangements. However, there would need to be a clear agreement on how costs (e.g. strain costs on redundancy etc.) would be funded and by whom. Specific allocation of costs would mean that the Deemed Employer would still need to be monitored somehow unless it was a complete pass through of all costs • It needs to be clear on whether the service provider is required to account for pension costs (under IAS 19 or otherwise) in the same way as under Admitted Body status. Therefore the advice from the SAB needs to address this point, whilst at the same time recognising that the service provider and its auditors may need to have the final say.

Q7	RESPONSE
Should the LGPS Regulations 2013 specify other costs and responsibilities for the service provider where deemed employer status is used?	We believe the responsibilities of the service provider need to be made absolutely clear and they are **compelled to adopt these** as per the service contract or a separate agreement with the Fair Deal Employer. Essentially this needs to replicate the provisions of an admission agreement where relevant and could be embedded in the Regulations but we would prefer the Regulations to refer to specific guidance from the SAB as this would allow easier updates to the process as undoubtedly it would need some adaptation as all parties become accustomed to the new environment. It would then seem sensible for this to be part of the advice from the SAB with template clauses or wording for Fair Deal Employers to include in their bidding documentation.

	With regards to costs we would not agree that the Regulations or Guidance should prescript this for all costs but instead give guidance on Fair Deal Employers adopting their policy. For example where the ill health costs are insured outside the Fund it may be sensible for those costs to be passed across in a different way.

Q8	RESPONSE
Is it right that the Admitted Body route is retained and that risk sharing arrangement can be included in the Admission Agreement?	We agree that the existing arrangements should be retained as they are more appropriate in certain circumstances e.g. a separate local authority trading company set up by the Council. However, the change should add more flexibility to the drafting of admission agreements although we see no barrier to including risk sharing arrangements under the current regulations. Traditionally our preference has been for admission agreements to be standardised and simply reflect the responsibilities of all parties on participation. Any risk sharing arrangements could be covered in the contractual agreements as they are a matter for the authority and the outsourced employer. On a general basis this would still be our preference (as the risk sharing is a matter for the two parties not the pension fund) but allowing for this explicitly in the Admission Agreement would help all parties with clarity on how the employer should be treated and what arrangements are in place. This is particularly important given the introduction of Exit Credits.

Q9	RESPONSE
What further steps can be taken to encourage pension issues to be given full and timely consideration by Fair Deal Employers when services or functions are outsourced?	We agree that the Regulations and advice from SAB needs to prescript and encourage timely consideration of the pension issues. However, this is likely to only have limited impact given that often the problem is those departments or officers (who aren't pension specialists) in a Council are usually unaware of the obligations in the Regulations or guidance and are understandably focused on the service being outsourced. This is principally the reason for the lack of engagement under the current arrangements.

	Initially an effective way will be to educate the various parties on the new requirements and this would likely be best through each pension fund so some guidance from the SAB on how that should be done would seem sensible. However, this is not always effective unless a continued campaign is sustained. A long term solution that we think would be effective is make consideration of the pension issues part of the mandatory tendering process and guidance which would mean a Fair Deal Employer's procurement department (or national framework) would need to include reference to the approaches as a mandatory requirement. This could even cover standard clauses to include in contracts and/or bid documents and could refer to the SAB advice, the LGPS Regulations and the Fair Deal Employer's policy on the matter. We do not know how easy this is to achieve but we would recommend it is at least considered by the SAB and MHCLG.

Q10	RESPONSE
Are you aware of any other equalities impacts or any particular groups with protected characteristics which would be disadvantaged by our Fair Deal proposals?	We have not considered this issue in detail the context of general equality impacts but none immediately come to mind. However, as identified in Q2 in relation to a subset of employees it would appear to us that under draft Regulations 3B(1) and 3(B)11 it appears that employees working for a different Fair Deal employer from the one carrying out the outsourcing are not protected therefore causing some inequality in terms of pension treatment. This seems unlikely to be a policy decision so needs clarity for all parties. The Regulations seem to us to introduce an anomaly in this area, best illustrated by an example. If, say, a fire authority sources its cleaning service from the local authority in its area, but decides it wants to outsource that service then the fire authority is not the "Fair Deal employer" in relation to those employees, and our reading of the draft Regulations is that these employees' pension rights are not protected. If, on the other hand, they had been working directly for the fire authority then the fire authority would be their "Fair Deal

	employer" so the employees would be protected. For consistency of treatment we would suggest that such employees should be protected by virtue of the fact that they are working for a Fair Deal employer, but either way we feel this should be a deliberate policy decision which needs clarifying.

Q11	RESPONSE
Is this the right approach?	There has been concern amongst some Funds about the potential for employers to be dissolved without paying off any exit debt (whilst in some cases even transferring the active members to a successor employer). This amendment seeks to change that, by making any successor employer responsible for the original employer's LGPS assets and liabilities, even if the successor employer is in a different LGPS Fund. This seems a positive step to us as it gives clarity and certainty to all parties. In our view the aim of this policy is sensible, and on the whole it will work well when the intention is for the assets and liabilities to simply consolidate into one Fund. However, we have concerns about it not needing the consent of at least the receiving Fund as essentially it could increase risk to taxpayers if the employer could not support the combined liabilities in the long term – for example where an employer with a weak covenant consolidates a large pension deficit in one Fund. We would therefore prefer it to **<u>still require consent</u>** subject to that not being unreasonably withheld to provide protection to the receiving Fund.

Q12	RESPONSE
Do the draft regulations effectively achieve our aims?	We cannot of course give a legal view on the enforceability/application of the Regulations but they do appear to achieve the aims of the policy set out in the consultation document assuming the guidance is clear on how this should be done effectively.

Q13	RESPONSE
What should the guidance issued by the Secretary of State state regarding the terms of the asset and liability transfers?	As per the answer to Q11 above we believe some sort of consent should be needed taking into account the circumstances of the transfer. With regards to the terms of the transfer of assets and liability transfers the main issue is usually to

	determine the assets transferred (as normally the liabilities transferred are determined by the membership records). We think the guidance should as a minimum include: • Details of how the date and transfer of administration and payroll records to the successor employer and Fund should be dealt with (in terms of verification and transitional arrangements such as pension payments). If the original and successor employer are in the same Fund some of the requirements will fall away but verification of the data should still be a requirement to avoid dispute at a later date when it is possible that the original employer records do not exist anymore. • Details of the acceptable approaches to determining the asset amount which could be based on a roll forward from the previous valuation or a share of assets if the original employer was part of a group of employers for contribution purposes. This asset value should be agreed and certified as reasonable by the Actuary (or the Actuary to each Fund where a transfer is to another Fund) • Confirmation that the costs of the transfer should be incurred by the successor employer including any asset transition costs or other fees.

Yours faithfully

A. M. Leech

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Lancashire County Pension Fund