Introduction

Cheshire West and Chester is the administering authority for the Cheshire Pension Fund and as such is responsible for the administration of the LGPS for over 90 employers.

The Fund has some 32,000 active members, around 18,000 deferred members and pays pensions to over 20,000 pensioners. On the 31 March 2011 the assets managed by the Fund exceeded £2.7bn.

This submission represents the view of Cheshire West and Chester in its capacity as the Administering Authority for the Fund. As such the issues raised are viewed predominantly from the perspective of the funded Local Government Pension Scheme; although where appropriate, comments are made on the position of the unfunded public service schemes.

Fair Deal applies to Best Value Authorities by means of the Best Value Authorities Staff Transfers (pensions) Direction 2007. Technically, changes to Fair Deal would not affect Local Authorities unless the Direction Order is also amended. We have assumed that any changes to Fair Deal would be mirrored in an appropriate directive so as to also apply to Local Authorities.

Summary

The Cheshire Pension Fund believes that Fair Deal should, for the present at least, continue to apply to workers compulsorily transferred out of the Public Sector.

The most appropriate mechanism by which to achieve this within the LGPS is by means of the admission agreement, which allow private sector contractors to participate in the LGPS.

The reasoning for our position is that;

1) It is premature to fundamentally change Fair Deal before it is known to what extent the recommendations of the IPSPC will be adopted. Many of the recommendations put forward by Lord Hutton’s commission could, if they come to pass, help address some of the perceived problems with Fair Deal. For example;
• The new look public service schemes should, if properly implemented, be more affordable and so allay some of the cost fears that may discourage plurality of provision.

• Proposed mechanisms to cap employer costs and to link retirement age to longevity (by means of a revised state pension age) will help to more fairly spread risk between employers and members.

2) There are already mechanisms which could be adapted or improved to provide private sector employers access to the LGPS by means of Admission Agreements but which can provide contractors with a greater degree of contribution stability. We feel that more use might be made of pass-through arrangements and these are explored in greater detail in response to Question 5.

3) We believe there is scope for simplifying the existing Admission Agreement process by making use of pooling arrangements where the number of staff being transferred and the scale of liability involved can be demonstrated to be immaterial. Such decisions would need to be made on a local level, subject to risk analysis and be appropriate for Funds, letting authorities and contractors.

4) An insufficiently robust version of Fair Deal would result in a situation where contractors would only need to provide the TUPE minimum standard of pension provision\(^1\). This would not only make any in-house bids uncompetitive but would also see an inevitable increase in outsourcing. From the perspective of the LGPS there would be a drop in contribution income resulting in the accelerated maturation of funds. The effect of this would be upward pressure on the contribution rates of employers and employees remaining in the fund. Ultimately the long term sustainability of the LGPS could be threatened.

\(^1\) Employer contributions matching employee contributions up to a maximum of 6%
**Question 1:** The Government welcomes views on whether there are any people or organisations who may be affected by this consultation other than those listed in 1.7.

We consider that Local Government Pension Funds, the member constituted committees that provide their governance and the individuals who rely on them for adequate income in retirement are also affected by this consultation.

This is because decisions about Fair Deal may ultimately affect the sustainability of the LGPS. For example if Fair Deal is removed, there is likely to be a significant increase in the rate at which Funds mature, as the degree of outsourcing increases. This will, in turn have consequences for those employees and employers remaining within the Scheme. These ideas are explored further in Question 3.

**Question 2:** The Government welcomes views from respondents on how the Fair Deal policy operates in their experience, where this is considered relevant to future policy.

Fair Deal did not originally apply to Local Authorities but instead has statutory effect by means of the Best Value Authorities Staff Transfers (Pensions) Direction 2007.

The LGPS differs from other Public Service Schemes in that private sector employers who have successfully contracted for Local Authority functions are able to provide LGPS membership to transferring staff associated with that contract by means of Admission Agreements.

Effectively, since 2003, employers bidding for Local Authority contracts have had the choice between seeking Admitted Body status within the LGPS or providing a GAD certified comparable scheme as happens in other parts of the public sector.

Within the Cheshire Fund we currently have over 50 Admitted Bodies but the number of outsourcing arrangements which have resulted in the affected staff becoming members of a comparable scheme are so tiny as to be insignificant.

Clearly, within the local government sector there has been a strong preference for the use of Admission Agreements over comparable schemes as a way to provide pension protection for Local Authority staff transferred to the private sector. The system is now well bedded in and understood by the parties involved and in our experience works well.

Problems do occur from time to time but they are mainly a consequence of letting authorities only considering the pension implications of outsourcing late in the day. As a Fund we have worked hard in communicating the importance
of early notification of outsourcing projects and feel that that message is beginning to be heard.

**Question 3: The Government welcomes views on whether there are any other objectives which should be taken into account when developing future policy.**

The Fund considers that a further objective should be borne in mind when deciding the outcome of this consultation.

**Maintaining the future sustainability of the Local Government Pension Scheme**

Recommendation 1 of the IPSPC report is that the primary purpose of public sector schemes is to “ensure adequate levels of income for public service pensioners”. Recommendation 15 of the report acknowledges that “it remains appropriate for the Government to maintain the different financing arrangements for the LGPS in future, so the LGPS remains funded and the other major schemes remain unfunded”. These objectives can only be met if the LGPS continues to be open to a wide range of new entrants. Any review of Fair Deal that results in outsourced staff no longer having access to the LGPS is likely to see that active membership base rapidly shrink. The consequence of this is a deterioration in near term funding positions, rapid maturing of LGPS funds and a consequent rise in the contribution rates of members and employing authorities. This would begin a vicious circle in which employers begin to view outsourcing as a way of reducing their pension costs while members opt-out of the Scheme unable to meet the rising contribution rate.

**Question 4: Is there a case for changing the current Fair Deal policy?**

We believe that it would be premature to radically revise Fair Deal until the true cost of the new-look Public Sector Schemes are known. In The IPSPC report, Lord Hutton outlined the mechanisms by which pension provision in the public sector could continue to provide adequate retirement benefits while remaining affordable and fair to taxpayers. Among the recommendations were:

- A Career Average Scheme with the accrual rate, contribution rate and revaluation in deferment rate to be determined by the Government, according to their own cost parameters.

- Linking retirement age to state pension age, which itself should continue to be monitored to ensure it accurately reflects changes in longevity.
• A fixed cost ceiling for the Government (which in the context of the LGPS should mean employers) above which the value of benefits payable to members is reduced.

It is to be hoped that the Government’s response to the IPSPC, due in the autumn, will provide a clear indication on how they see public service pensions in the future. There are clearly conflicting pressures between some of the recommendations of the IPSPC, but it is for Government to resolve these to their satisfaction. If the Government can resolve these competing aims and provide a blueprint for public sector pensions that does provide adequate and fair benefits to members while remaining affordable in the long term, then some of the perceived difficulties with Fair Deal would be overcome.

It would also seem inconsistent to remodel public sector pension schemes to achieve the goals of affordability and adequacy and then deny access to certain employees simply because their particular service or function has been outsourced.

Question 5: If so, what should the policy cover, including:

a) what (if any) stipulations should be made regarding the level and type of future pension provision following transfer;

b) what should be the treatment of previously accrued benefits? For example, should CETV’s be the norm or should bulk transfer agreements continue to be used and, if so, in what form; and

c) what should the requirements be on subsequent compulsory transfer to an independent provider or return to the public sector?

We believe that Fair Deal should continue in its present form subject to certain, simplifications and refinements. The fact that the shape and cost of public sector pensions has been reviewed and is due for change means that now is not an appropriate time to be radically altering the principles of Fair Deal.

We also feel that there exist mechanisms such as pass-through that can be used to address some of the problems associated with Fair Deal and access to the LGPS by private employers by means of Admission Agreements.

Finally, we do believe that the admitted body process can be simplified through the use of pooling arrangements where there are small numbers of individuals transferring, the impact is deemed to be immaterial and the risk has been properly considered.
Arguments against Fair Deal and Admission Agreements

The IPSPC report raises the following arguments against allowing access to Public Service Schemes by workers employed in the private sector.

- It places risks onto government in the form of liabilities which they cannot control. For example, the private sector employer could award pay rises in excess of those assumed in the setting of employer contribution rates.

- Smaller organisations can struggle with exit charges levied by some parts of the LGPS when contracts end and can run the risk of becoming technically insolvent as they are required to recover deficits under a shorter timescale than that allowed to public service local government employers.

Furthermore, the Commission’s interim report identifies the following two key reasons why Fair Deal acts as a barrier to plurality of public service provision;

- The cost of comparable pension provision is greater in the private sector than the public. For the unfunded schemes, it is argued that the discount rate used to set employer contributions is unrealistic and much higher than the rate that a contractor setting up a broadly comparable scheme could prudently use. In the LGPS the cost difference arises because private contractors are not deemed to have the same covenant as local authorities and so cannot make use of the same deficit recovery periods or stabilisation methods that apply to long-term and tax raising bodies.

- Smaller contractors and charities are not comfortable bearing the investment and longevity risk that may sit more easily with a larger employer.

Finally, the case is sometimes made that the increasing number of admitted bodies results in increased administration costs and higher legal and actuarial costs. Significantly, the process for transferring one or two individuals to a private sector employer can often seem as labour intensive and costly as large outsourcing projects involving hundreds.

It is the view of the Fund that many of these problems can be addressed by reforming the public sector schemes in line with the principles of adequacy for members and fairness for employers, government and tax payers. We also feel that there already exist mechanisms within the current admitted body framework which can also help to allay some of these fears.

These points are addressed individually and in greater detail below.
Remodelled Public Sector Schemes

As noted under question 4, the Government is due to announce in the autumn, the future shape of public sector schemes. Assuming the ultimate benefit structure chosen is close to that proposed by the IPSPC final report and that the cost parameters of the schemes are properly set then many of the concerns raised above will be eased.

- By definition, the new look schemes should be affordable in the long term, which should address some of the concerns about affordability and high termination payments on leaving the Scheme.

- The new schemes will have fixed cost ceilings above which costs to employers/taxpayers will not be allowed to rise. Within the funded LGPS there is clearly work to be done in identifying which costs should properly and fairly fall within such a cost sharing mechanism. However, once this work is done, it will serve to remove some of the cost and volatility fears that the IPSPC identified as acting as a barrier to plurality.

- The recommendation to link retirement age to state pension age will have the effect of shifting the risk of increased pre-retirement longevity away from employers and onto members. This, again, will provide more reassurance to employers over cost and unknown future liabilities.

Current mechanisms

We believe that, there are already ways in which some of the concerns identified above can be addressed.

As a funded scheme the LGPS undergoes a valuation every three years at which a future contribution rate is determined. If an employer had consistently awarded pay rises in excess of the rate assumed in setting the last contribution rate, this fact would be identified at the valuation and the employer’s contribution rate adjusted accordingly.

Within, the LGPS there is presently the opportunity to allow an admitted body to benefit from a pass-through arrangement. This means that the contractor pays a single rate throughout the period of the contract, with the letting authority picking up any risk that the agreed rate is in the long term insufficient to meet liabilities. This will inevitably mean that there is some risk maintained in the public sector which is outside the direct control of the public body that is letting the contract. However, this could be addressed by excluding certain risks from the pass-through agreement. For example, the contractor might be required to maintain salary growth within certain parameters or the increasing liability would be reflected in their contribution rate. Naturally, where a
contractor makes use of any LGPS employing authority discretions that produce a cost such as awarding extra service or allowing retirement before age 60, they would be expected to pay for this up front.

A variation on the above is to allow some movement of the contractor’s contribution rate but only within an agreed range. The contractor would enjoy stability within certain parameters with the letting authority making up the shortfall if assets perform worse than assumed (or liabilities increase more than expected) and enjoying some of the surplus if assets outperform assumptions (or liabilities increase more slowly).

On balance we feel that a form of pass-through can provide a good way of allowing private sector bodies access to the LGPS at a cost that is reasonable and fair, while at the same time not placing undue risk onto the taxpayer.

Finally, we feel that decisions over the costs associated with small scale outsourcing projects can best be taken at a local level. LGPS Funds, in consultation with their actuaries and bearing in mind local considerations can use mechanisms such as pooling small employers, to address concerns over the costs of obtaining bonds or setting contribution rates.

Question 6: In setting out a proposal for future policy, respondents are asked to set out:

a) how it would deliver against the objectives set out in Chapter 3 and any others considered relevant;

b) the impacts on those involved, including employers and employees;

c) if possible, how much the proposal would cost or save the taxpayer compared to the current Fair Deal arrangements; and

d) any past experience, whether in the public sector or otherwise, which informs these proposals.

The Fund believes that Fair Deal should be retained, albeit in an improved form and in the context of the new-look public sector pension schemes.

Table A, below compares to what extent such an approach satisfies the objectives set out in Chapter 3 of the consultation,

Table B considers the impact on interested parties.

If all else was equal, our proposals would be broadly cost neutral albeit with some scope for administrative saving though a simplified approach for immaterial outsourcing projects. However, it is not possible to make a meaningful consideration of cost savings until details of the new-look public
sector schemes are known. Clearly, the aim of Government, in considering Lord Hutton’s proposals, will be to realise an affordable and sustainable framework for public sector pension provision.

With regards to point d) above, the experience of the Cheshire Pension Fund in dealing with admitted bodies is discussed under Question 2.
| Objective 1: Delivering value for money | Objective 2: Providing an appropriate level of protection to public sector employee’s pension provision | Objective 3: Removing barriers to plurality of public service provision | Objective 4: Allocating costs and risks of pension provision accordingly | Additional objective 5: Maintaining the future sustainability of the Local Government Pension Scheme |
|---------------------------------------|-------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------*|
| New-look public sector schemes must be designed to provide pension benefits that remain affordable in the long term. That means both in benefit design and, for unfunded schemes, use of an appropriate discount rate. If this is achieved, then retaining Fair Deal will be an affordable, value for money option. | Admitted body status within the LGPS will fully address this issue. Protection should apply to accrued rights, transfers of previous rights and subsequent compulsory transferring. | We feel that our recommendation provides a balance between allowing plurality and avoiding the undesirable consequences of completely removing Fair Deal. Contractors wishing to contract for local authority functions will be able to provide transferring employees with membership of a revised LGPS. The new-look scheme will be affordable, with clearly defined cost parameters, providing contractors with a | New-look public sector schemes should look to re-balance cost and risk by transferring pre-retirement longevity risk to members and away from employers (taxpayers). Cost ceilings will mean that within appropriately designed parameters, cost increases will fall to members. Use can also be made of pass-through arrangements to remove some of the volatility from admitted body employers. The exact nature of pass-through arrangements | By allowing compulsorily transferred workers to remain members of the LGPS, the broad, active membership is maintained. This will ensure that the Scheme remains viable in the long term. |
The wholesale removal of Fair Deal might have adverse effects on plurality as it would act against the Government’s desire to see public sector workers take control of local services, as outlined in the Localism Bill: Community Right to Challenge. Local government workers inclined to take over the running of services might be dissuaded if their pension rights were not protected.

The use of simplified approaches for small and immaterial transfers will help to smooth the process of gaining admitted body status for small employers. and the degree of risk shared should be decided at a local level, where letting authorities and Funds can decide what is appropriate.
## Table B: how proposals impact on interested parties

<table>
<thead>
<tr>
<th>Letting Authorities</th>
<th>Private contractors</th>
<th>Employees</th>
<th>Taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under pass-through, letting authorities to determine what level of risk they are comfortable in taking on. But this must be considered in the context of the new-look LGPS in which risk is already more evenly spread.</td>
<td>Pass-through allows sharing of some risk with letting authorities where that is locally acceptable. New-look Scheme could provide a cheaper less volatile scheme.</td>
<td>Those who are compulsorily transferred will be protected by means of an admission agreement and bulk transfer arrangements. Public sector employees wishing to take over the running of local services will be protected for pension benefits.</td>
<td>New-look scheme designed to fairly balance cost between member and taxpayer. Where outsourcing provides the best value way of providing a service, there will be fewer barriers.</td>
</tr>
</tbody>
</table>
Question 7: The Government welcomes views on what approach should be taken when previously transferred public services involving compulsory Fair Deal staff transfers are re-tendered. The Government also welcomes details of any past experience informing respondents’ proposals.

The view of the Fund is that full protection for future and past service should continue to apply when the re-tendering of a contract results in an individual being compulsory transferred to a subsequent private contractor. Within the LGPS this would mean that the new contractor provides access to the LGPS by means of the admitted body route.

Question 8: The Government welcomes views on what approach should be taken for employees returning to the public sector having been transferred out in the past under the Fair Deal policy. The Government also welcomes details of any past experience informing respondents’ proposals.

The Cheshire Pension Fund understands that changes to other public service schemes have tended to apply only to new entrants, while benefit accrual for existing members continues unaffected. Unlike most other public sector schemes, reforms to the LGPS have affected all active members, subject to certain protections. There are therefore, no parallel schemes in operation.

By allowing compulsorily transferred out members to retain access to the LGPS, members who return to the Public Sector at the end of a contact will be treated as having continuous scheme membership.