

Funding approach for Academies

On 23 December 2011 Communities and Local Government (CLG) and the Department for Education (DfE) issued a “joint letter of understanding” on the treatment of Academies in the LGPS. This was the result of discussions between the two parties that had been called to address certain pension related problems incurred in the set up of Academies. A copy of this letter is attached for ease of reference.

The joint letter notes that the way that some Academies have been set up by LGPS funds has meant a large jump in the pension contributions when a school converts to Academy status; some Academies are paying significantly more than Local Authority maintained schools in the same area. The increase in rate from the one that the old school was paying has become an obstacle to new Academies being formed, and any such obstacles to its flagship education policy are a cause of concern to the Government.

Existing guidance

The existing DfE guidance on the approach to allocating LGPS assets and liabilities, and setting contribution rates, for Academies is not clear. This has led to LGPS funds adopting a wide variety of funding approaches for Academies.

Funding approach adopted

It was agreed at the last Pension Committee meeting that the following principles would apply to future new Academies that participate in the Fund:

- The share of deficit would be allocated after allowing for a proportionate share of the deferreds and pensioners remaining with the Council to be fully funded,
- The deficit recovery period would be 14 years.

In general this is likely to lead to a contribution rate for Academies that is higher than that of the Council. It is worth noting that the 14 year deficit recovery period is a compromise period that lies between the 20 years used for the Council and the 7 years over which Academies are expected to receive guaranteed funding from the DfE.

What the joint letter doesn't say

Importantly, there is nothing concrete in the letter to give Local Authorities comfort about the likely response from DfE were an Academy to fail. The main letter notes that the Academies are also funded out of the “public purse” and the attached notes state that the “Government would be bound to consider all available options” if an Academy were to come to an end. There is no suggestion as yet that DfE might act as guarantor of the pension liabilities of any failed academy. It would be no surprise to many if Local Authorities have been left wanting more (in terms of security).

What the joint letter does say

The letter gives an overview of the Academies programme, notes the government's desire for consistency of treatment across LGPS Funds, notes the Government's desire for post conversion pension contributions to be the same as those for a LEA maintained school and suggests that Administering Authorities “positively consider” requests to be pooled with the former Local Education Authority employer that maintained the school. There is also a suggestion that legislation may be brought forward imposing this approach if Administering Authorities do not toe the line.

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What's the problem?

The aim of the Academy programme has been to give schools the opportunity to remove themselves from the LEA and take responsibility for their own decisions. One such area is their pension responsibilities to the LGPS. In many cases, the academy's current and former staff will have built up significant pension rights prior to the point of conversion. These pension rights bring with them funding responsibilities.

The fact that Academies only take the school's contributing members into the new body means that there is a legacy pensions risk to be addressed. Where there is the potential for a large number of employees to be involved (as many new Academies may be formed) then this legacy pensions risk becomes material and the treatment of these new bodies becomes critical for the ceding Council.

For this reason it was always going to be vital that a proper risk assessment was carried out in advance and that a funding approach was both understood and agreed by all sides. Unfortunately, neither the risk assessment nor agreement on approach happened and problems are now surfacing as a result – problems that are exacerbated by the fact that, in the absence of a DfE guarantee, administering authorities do not feel they can offer the same funding approach* to academies as they can to LEA controlled schools backed by the Local Authority with tax raising powers. In addition, a lot of new bodies are being set up at what appears to be a "bad" time in terms of funding levels and market yields.

*For example, most authorities take the view that (in the absence of a guarantor or other security) the same stabilisation overlays on employer contributions are not appropriate and deficit recovery periods should be shorter.

What are the issues with pooling?

The main thrust of the joint letter is that pooling with the former Local Authority employer is the solution to all the Academy funding problems in the LGPS. Unfortunately, we do not agree with this conclusion as we struggle with several aspects of the proposed pooling solution.

One of the major issues is that (depending on the definition of the pooling arrangements) other employers in the LA pool are effectively underwriting the pension liabilities of academies.

Assuming that pooling with the relevant former LEA employer is intended, there are two possible approaches to the pooling:

Pooling with tracked individual positions - in this approach to pooling there is no sharing of experience. The "pooling" is simply a means of controlling the contribution rate. The contribution will not reflect the underlying funding position of an individual Academy and it is unlikely that it is making inroads into its share of deficit sufficiently quickly as an employer without a guarantor. This, however, can be considered a pace of funding argument as the Academy will eventually have to fully meet its obligations. The loose connection between the contribution rate and the underlying position raises serious concerns about the security of the employer (see paragraph below).

On the plus side the contribution rate will be set across the pool and the Academy will be paying something towards the deficit relating to former members and pensioners. This will be the case whatever their initial asset allocation.

Pooling without tracked individual positions - this would be consistent with the current treatment of schools in many funds (where administration systems do not separately identify them as schools). There is sharing of nearly all experience between the former Local Authority employer and the academy (early retirements possibly being an exception). The cross-subsidies in this approach seem to go against the basic principle of Academies as stand-alone employers that are responsible for their own actions. (For example, we are aware of academies that have awarded material pay increases to some members).

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It is quite possible that some Academies may want to stick with the position they have been given - others may object to being hitched to a Council contribution rate forever more that they cannot control. This may be especially the case where they anticipate that the Councils are going to see big hikes in contributions (when expressed as a percentage of pay) as a result of significant outsourcing programmes.

The inclusion of Academies within a Council pool also raises some issues relating to accounting requirements. If accounting positions are still required, then these will need to be extracted from the total pool position and there are alternative ways of doing this.

Security and guarantor issues – whichever approach to pooling is taken there remains a significant concern over the impact of a failed Academy on the pool. Although the strict legal interpretation suggests that any shortfall in these circumstances should fall on all employers in the Fund it would make more sense for it to fall on the pool or the ceding employer – the “default” guarantor.

Any of these parties is likely to object to the imposition of this extra risk on them and should be looking to protect itself – unfortunately the obvious guarantor (DfE) has not stepped forward. The parties may consider that the words in the Joint Letter (paragraph 9) are strong enough for them and that they are therefore happy to deal with any shortfall at the point of failure (including possibly asking DfE to meet any pensions shortfall, although there is no indication that DfE is likely to oblige in those circumstances), but this attitude and approach seems to go against current trends in governance and also seems to us to be storing up problems for the future.

The joint letter covers all sorts of Academy arrangements. We find it particularly hard to understand why DfE would expect a Council to act as the guarantor for the likes of Free Schools and Studio Schools where they have never had any involvement and they are not receiving any funding. As with any pooling arrangement it is vital that (before set up) there is clarity about how the pooling will operate and how employers will join and/or leave the pool. A “pooling agreement” could be used to specify how the pool will operate and in particular who takes responsibility for any shortfall in the event of the failure of an academy, e.g. the ceding Council or the Council pool. As an aside, it is worth noting that most Funds have been trying to break up pools in recent times as a result of the perceived lack of transparency and the problems that they have caused.

Practicalities of pooling

Of course there are various practical issues associated with:

- The stated desire for consistency going backwards – this raises all sorts of issues e.g. refund of contributions,
- Initial allocation of assets within the Council pool,
- Accounting - as noted above there will need to be clarity about IAS19 / FRS17 requirements for Academies,
- Deficit contributions – what is to be done where the Council is paying off its deficit via monetary payments (as opposed to a percentage of pay). This could be done but may lead to additional administration.

In the accompanying note there is the promise of supporting guidance – this will be of vital importance as there are currently too many practical areas that are unclear for practitioners.

Forthcoming miscellaneous regulation changes may include a provision to allow termination valuations for scheduled employers. This will not help though if failed academies have no cash and/or DfE is unwilling to step in.

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In practice some administering authorities might prefer if the government did legislate and force administering authorities to pool academies with the ceding Council. This could protect administering authorities from complaints from other parties, e.g. any other employers in the Fund who might end up cross-subsidising a failed academy.

Alternative approaches

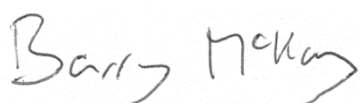
Some Funds may consider changing to the DfE / CLG preferred approach. Others may consider keeping their current approach or changing to one that does not fully comply but does help reduce contribution increases for schools converting to academies. These alternative approaches might include:

- Continuing with current approach but allowing a longer deficit recovery period (*typically academies pay a standalone rate based on their own membership data and the agreed approach to setting share of assets at commencement, without the benefit of any stabilisation approach that applies to the Council or other secure employers),
- Setting up academies only pools with longer deficit recovery periods than allowed previously,
- Allowing academies to pay the Council pool rate before applying any stabilisation overlay available to the Council and other secure employers, or
- Allowing academies to pay the stabilised Council pool rate but with an additional "risk premium" (e.g. if the Council is paying 20%, academies pay 23%).

It is not clear at this stage whether CLG will tolerate alternatives that go some way (but not all of the way) to meeting the objectives of DfE or whether CLG would simply move to legislate quickly.

A better solution

The words in the joint letter seem to suggest that the likelihood of a Local Authority being left holding the (Academy) baby is not material – it is suggested that a successor body or other solution will be found. If this is the case, then it should not be a big deal for them to say that the DfE will provide a guarantee and protect the Local Authority from the financial implications of any failed Academy. Such a guarantee would allow Administering Authorities to be much more relaxed when it comes to setting contribution rates.



Barry McKay FFA

For and on behalf of Hymans Robertson LLP

5 February 2013

Annex 1: Department for Education Local Government Pension Scheme Guidance dated August 2010

Local Government Pensions Scheme – DfE briefing note

1. Non-teaching staff in a maintained school converting to academy status are likely to belong to the Local Government Pension Scheme (LGPS) and have their pension dealt with by the administering authority applicable to schools in that Local Authority (LA). The pensions authority is sometimes the same local authority as that maintaining the school, but in London there is a separate pensions authority, and in areas affected by local government reorganisation there is often a lead authority which acts as pensions authority for several LAs. When a school is about to convert to academy status, the relevant pensions authority should be contacted at the earliest possible stage.

2. Academies are separate scheme employers under the LGPS. Academies are 'scheduled body' employers, being listed in Part 1 of Schedule 2 to the LGPS Administration Regulations 2008 [SI2008/239] (as amended). They are not 'admitted bodies'.

3. Academies' funding agreements require them to offer LGPS membership to all non-teaching staff. Where maintained schools apply to convert to Academies under section 3 of the Academies Act 2010 and an Academy order is made under section 4, those existing staff who are already members of the LGPS by virtue of the Administration Regulations would not be affected by the conversion. Their membership of the LGPS would continue unaffected. After conversion, new non-teaching staff will be eligible to join the LGPS and will be automatically enrolled in the Scheme when employed, but will have the option to opt out of the Scheme if he or she gives notice within three months. It is also open to an Academy to pay contributions into private pension schemes, but this normally happens only if an academy was previously an independent school and some staff wish to remain in the private scheme.

4. The pensions authority should be asked for a calculation of the employer contribution rate for the academy. The actuarial assessment will be done by the LGPS administering authority's fund actuary but the school may wish to have their own assessment performed by an independent actuary. The employer contribution rate will be calculated on the basis of the academy's staff profile and relates only to the academy, whereas nearly all maintained schools in an LA pay the same pooled rate. This means the rate can be higher than the rate which applied to the school when maintained. There is likely to be a charge for the actuarial calculation.

5. Unlike the Teachers Pension Scheme (TPS), LGPS is a funded scheme and can be in surplus or deficit according to investment performance. Most pension funds are currently managing a deficit, and the deficit in respect of pensionable service prior to conversion transfers from the LA to the academy through the transfer agreement signed prior to conversion. The actuarial calculation of the employer contribution rate will take into account the amount needed to pay off any past service deficit and meet future accruals over a specified period, which is normally taken to be 20 years for Academies, although it is for the actuary to take a view on this.

6. Whatever arrangements apply currently for remitting contributions as a maintained school, the academy will itself be responsible for remitting employer and employee contributions to the pensions authority, although a payroll provider may do this on its behalf. The LA may itself be the payroll provider if the academy decides to use its services.

7. If there is a deficit in the relevant pension fund, the Charities Statement of Recommended Practice (SORP) requires that the academy's statutory accounts show the deficit as a liability in the balance sheet. The total deficit can be substantial. However, the Charity Commission has advised that this liability, even if it exceeds the academy's assets, does not mean that the academy is trading while insolvent, because the deficit is being reduced by the contributions made, using the grant payable to the academy. See the advice at

http://www.charitycommission.gov.uk/Charity_requirements_guidance/Charity_governance/Managing_resources/pensions.aspx#2

especially paragraphs 2 and 3.

Conclusion

8. When a school is converting, it is therefore vital to obtain details of the pension authority contacts as quickly as possible (usually from the HR/pay department of the maintaining LA), to ensure that staffing information required by the pension authority's actuary can be supplied by the school or the maintaining authority, and to ensure that the implications for the academy have been fully discussed with the pensions authority.

DfE
August 2010

Annex 2: Joint Letter from the Department for Education and Communities and Local Government dated December 2011

A note from the Secretaries of State for Education and Communities and Local Government

To Local Authority Leaders and Chief Executives in England

copied: Local Government Pension Scheme administering authorities

Academies and the Local Government Pension Scheme (LGPS).

Academies in all their forms are central to improving education. They promote innovation and diversity in the school system, give power and freedom back to heads and teachers and raise school standards across the board. The Academy conversion programme ensures that the highest performing institutions help the weakest to improve. Where maintained schools are performing poorly the Government is encouraging their conversion to Academy status with the help of an outstanding school or experienced sponsor. The Government is committed to expanding the Academy programme. There are now 1,463 Academies across England, with many more schools wishing to convert. In addition, the first Free Schools opened in September 2011 and the range and choice of education provision is changing rapidly across the country. Free Schools, University Technical Colleges (UTCs) and Studio Schools are being opened as Academies in direct response to parental demand and will drive up standards in the communities they serve.

We are, therefore, writing to set out in further detail an approach to pooling that we recommend be adopted. The clear aim is that there is a consistency of approach across Local Government Pension Scheme (LGPS) administering authorities so that an Academy in one part of the country is not treated in a different manner to one in another and no Academy pays unjustifiably higher employer pension contributions to the LGPS compared to maintained schools in the local area. This applies to existing Academies as well as those yet to convert or open, including Free Schools, University Technical Colleges and Studio Schools.

Many LGPS administering authorities have worked hard to help those schools becoming Academies resolve issues but we know that some administering authorities have been uncertain about how to treat Academies in their fund with some Academies being set employer pension contributions significantly more than maintained schools in the local area. Where a maintained school converts to Academy status it is Government's intention that the overall costs for the Academy as a participant in the Scheme should not increase. Like maintained schools, all forms of Academy continue to receive their funding from the public purse and, consequently, should not be treated in the LGPS less favourably than maintained schools.

Some converting Academies have been discussing with their LGPS administering authority the wish to be pooled with the local authority that formerly maintained the school.

Pooling arrangements between employers are permissible within the LGPS regulatory framework and we strongly recommend that where an Academy wishes to be pooled, administering authorities positively consider this. Academies would then pay the same LGPS employer contribution rate as maintained schools in the local area which includes an element for accrued past service liabilities. If it is found that inconsistencies or unjustifiably high employer pension contributions to the LGPS remain, consideration will be given to what other steps, including regulatory changes, would be needed.



MICHAEL GOVE



ERIC PICKLES

December 2011

Academy arrangements and the Local Government Pension Scheme - pooling of Academy arrangements with local authorities

Legal and financial status of Academy arrangements

1. Academies set up under the Academies Act 2010 are independent schools but they are publicly funded. Governance arrangements are agreed with the Department for Education and the Funding Agreement entered into with the Secretary of State sets out clear and robust financial and accounting requirements. Under the Funding Agreement the Academy Trust (the legal entity that runs the Academy Trust), has to ensure that its accounts are audited annually by independent auditors and it must allow access by the Secretary of State to its accounts and related records.
2. Section 1 of the Academies Act 2010 contains provisions that allow for the Secretary of State for Education to enter into an Academy arrangement with any person to establish and maintain and to carry on, or provide for the carrying on of, an Academy. The Act enables existing maintained schools to convert to Academy status and for Academy arrangements to be entered into with an Academy Trust that is replacing a maintained school. Additionally, the Act allows the creation of new schools (i.e. schools that do not replace a converting or closing maintained school), including Free Schools, University Technical Colleges and Studio Schools. These new schools are also Academies set up under Academy arrangements under Section 1 of the Academies Act 2010.
3. Funding Agreements made between the Secretary of State for Education and the Academy Trust are not signed for a set or limited period of time, rather they are open-ended.

The Local Government Pension Scheme and pooling Academy arrangements with the relevant local authority

4. A proprietor of an Academy¹ who has entered into Academy arrangements, is a Scheme employer in the Local Government Pension Scheme (LGPS) and is listed in paragraph 21 of Part 1 of Schedule 2 to the LGPS (Administration) Regulations 2008 (as amended). This means that the non-teaching staff employed by Academies are automatically eligible for membership of the Scheme and existing members in a maintained school retain eligibility when a school becomes an Academy. The change in legal status, when a former maintained school is replaced by an Academy, means that the Academy Trust becomes an LGPS employing authority in its own right. Academy Trusts for new provision, such as Free Schools, Studio Schools and UTCs will also be LGPS employers.
5. While there is no express regulatory provision in the LGPS for the pooling of employers in the Scheme, Regulation 36 of the LGPS (Administration) Regulations 2008 is considered a sufficiently broad power to enable employers (if they wish) to enter into joint arrangements with the Scheme funds, as already happens in some cases, that will

¹ Commonly referred to as an "Academy Trust": A qualifying Academy Trust proprietor is a charity under section 12 of the Academies Act 2010. This includes Academies that opened prior to the 2010 Act.

facilitate the setting of harmonised employer contribution rates under pooled arrangements.

6. Where an Academy pools with the local authority it is intended that this should result in the Academy Trust having the same employer contribution rate as the local authority would have in respect of its maintained schools. This is because the assumptions used to set the rate will be common to the Academy and local authority. Actuarial assumptions are shared across the pool and all participants in the pool are responsible for meeting the cost of the full past service deficit relating to those in the pool and share the same deficit recovery period.
7. It is recognised that consideration has to be given about the risk to the fund should a school or Academy fail. Should a maintained school ever be wound up it will be the function of the local authority to transfer pupils to another educational institution. Pension liabilities would be managed within the local authority's employer contribution rate.
8. Equally, if the Secretary of State for Education considered that an Academy was performing poorly, he would review the position, broker support and, where necessary, take steps either to replace the Academy Trust sponsors (the members of the Academy Trust) or the Academy Trust. If either party to the Academy arrangements ever decided that those arrangements should be brought to an end, it would have to give notice to the other party. The education provision for the affected children and young people would need to continue in an appropriate educational establishment.
9. The Government would be bound to consider all available options for dealing with an Academy's outstanding LGPS pension liabilities including, but not limited to, the assignment of assets and liabilities to a new or an existing educational establishment where this was the desired outcome.
10. This note is intended to clarify the position regarding Academy funding and the Secretary of State for Education's role should there be any question about the performance or continued operation of an Academy. This clarification has been provided to remove the uncertainty for administering authorities about the treatment of Academies in their fund and also allow requests, from an Academy to be pooled with the local authority for LGPS purposes, to be positively considered. The clear aim is that there is a consistency of approach across LGPS administering authorities so that an Academy in one part of the country is not treated in a different manner to one in another and no Academy pays unjustifiably high employer pension contributions to the LGPS compared to maintained schools in the local area. If it is found that inconsistencies or high employer pension contributions remain, consideration will be given to what other steps, including regulatory changes, would be needed following discussions with LGPS experts, including Scheme actuaries.
11. The preferred approach in this note is recommended to apply to all Academies, including existing Academies as well as those yet to convert or open, including Free Schools, University Technical Colleges and Studio Schools.
12. To help practitioners in both educational establishments and LGPS administering authorities, supporting guidance is being developed and will be issued shortly covering

Academy arrangements and the LGPS both for existing Academies and those schools considering conversion to Academy status. It will also cover how to manage an existing Academy's employer contributions for those who wish to join a pooling arrangement but have not been treated this way previously.

13. Communications about this note should be addressed to either:

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From: the Department for Education and Department for Communities and Local Government

Date: December 2011