

<p><b>Individual Mayoral Decision</b></p> <p>26 May 2021</p>	 <p><b>TOWER HAMLETS</b></p>
<p><b>Report of:</b> Interim Corporate Director - Resources</p>	<p><b>Classification:</b> Unrestricted</p>
<p>Pass Through Policy – London Borough of Tower Hamlets Council Procedure for granting Tower Hamlets Contractors Admitted Body Status to the London Borough of Tower Hamlets Fund</p>	

<b>Lead Member</b>	<b>Councillor Ronald, Lead Member for Resources and the Voluntary Sector</b>
<b>Originating Officer(s)</b>	Hitesh Jolapara Miriam Adams
<b>Wards affected</b>	All wards
<b>Key Decision?</b>	Yes
<b>Forward Plan Notice Published</b>	15 April 2021
<b>Reason for Key Decision</b>	Financial Threshold
<b>Strategic Plan Priority / Outcome</b>	<ol style="list-style-type: none"> <li>1. People are aspirational, independent and have equal access to opportunities.</li> <li>2. A borough that our residents are proud of and love to live in.</li> <li>3. A dynamic outcomes-based Council using digital innovation and partnership working to respond to the changing needs of our borough.</li> </ol>

### **Executive Summary**

The Council presently does not have an agreed procedure for Pass Through-granting Contractors Admitted Body Status to the London Borough of Tower Hamlets Pension Fund. To date this has been done on a case by case basis. It is good practice to have a standard agreed policy in place to provide certainty for all impacted organisations.

Occasionally, the Council may opt to outsource some of its functions. This is not the norm, however ensuring that employees of the Council who TUPE across to contractors receive the same pension protection on TUPE is key. The default position to date has been to outsource contracts with contractors taking full responsibility for all pension risk. This has meant that contractors normally price pension costs within the quoted contract price and, in some cases, may prevent smaller contractors, who may be best placed to deliver the service, from tendering. The alternative is for the Council to share some pension risk with the Contractor under a Pass Through arrangement.

## **Recommendations:**

The Mayor is recommended to:

1. Approve the Pass Through Policy for granting the Tower Hamlets Contractors Admitted Body Status to the London Borough of Tower Hamlets Pension Fund as set out in Appendix 1.

### **1 REASONS FOR THE DECISIONS**

- 1.1 If the Council were not to have this in place, a specific decision would be required each time the Council chooses to grant Contractors Admitted Body status to the Pension Fund.
- 1.2 The Process for admitting contractors into the Pension Scheme has, in the past, on occasions been inconsistent and challenging to administer. It has also, in certain cases, hindered Council intention to enter into the new contracts involving the smooth transfer of Council staff to another body.

### **2 ALTERNATIVE OPTIONS**

- 2.1 The alternative option is to do nothing.

### **3 DETAILS OF THE REPORT**

- 3.1 Adherence to this policy (including the necessary involvement of procurement, pensions and human resources) is the responsibility of the relevant service manager for any given outsourcing.
- 3.2 Appendix 1 sets out the proposed policy

### **4 EQUALITIES IMPLICATIONS**

- 4.1 There are no specific equalities implications arising from this report.

### **5 OTHER STATUTORY IMPLICATIONS**

- 5.1 This section of the report is used to highlight further specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration. Examples of other implications may be:
  - Best Value Implications,
  - Consultations,

- Environmental (including air quality),
- Risk Management,
- Crime Reduction,
- Safeguarding.
- Data Protection / Privacy Impact Assessment.

## 5.2 Risk Management

There are several potential risks that have to be considered as a consequence of the pensions pass through arrangement. The Council will now be reporting a higher net pensions liability than prior to the Pass Through arrangement. However, this does not represent a real material increase in the risk taken on by the Council as the Council is already the guarantor of all pension liabilities both for itself and for all controlled companies. In addition, the incorporation of a higher net pensions liability on the balance sheet of the Council does not have any broader impact on the financial standing or performance of the Council.

## **6 COMMENTS OF THE CHIEF FINANCE OFFICER**

- 6.1 There are no direct financial implications arising from this report, however the Council would be taking on more risk than it would otherwise have done if pass through arrangements were not put in place. The adoption of this policy will allow more informed financial decisions to be made; it would also facilitate more straight forward award of such contracts, should this be deemed desirable.

## **7 COMMENTS OF LEGAL SERVICES**

- 7.1 This report recommends the Cabinet to adopt a policy for admitting Contractors into the Local Government Pension Scheme. Employees outsourced from the Council must be offered pension benefits that are the same, better than, or count as being broadly comparable to, the Local Government Pension Scheme (Best Value Authorities Staff Transfer (Pensions) Direction 2007). This is achieved by:
- a. The employees remaining in the LGPS and the new employer becoming an admitted body to the Fund and making the requisite employer contributions; or
  - b. The employer offering the employees membership of an alternative broadly comparable scheme, as approved by the Government Actuary's Department (GAD).
- 7.2 Arrangements for admitting Contractors into the Council's LGPS fund must comply with the requirements of the LGPS (Administration) Regulations 2008 for the Administering Authority to enter into an Admission Agreement with the contractors. The contractors must meet the definition of a transferee admission body as set out in regulation 6 (2) i.e. a body that is providing or will provide either a service or assets in connection with the exercise of a function of a Scheme employer as a result of the transfer of the service or assets by means of a contract or other arrangement.
- 7.3 The Council has the legal power to share some of the pension risk in the manner referred to in the policy.
- 7.4 The operation of a pass-through policy assists the Council in achieving Best Value when outsourcing a part of its legal functions.
- 7.5 The pass-through arrangement means that a bidder in a tender process can have certainty of the value of pension contribution they will have to make throughout the lifetime of the contract if their bid is successful allowing them to price more accurately. Also, the bidder will not have to price in a contingency if there is any deficit at the end of the contract as the strain would be taken by the Council.
- 7.6 Therefore, the operation of the pass-through means that the Council pays against the actual deficit (if any) on contributions rather than as part of a potentially over inflated cost included in the service price inserted as potential contingency which might not arise.
- 7.7 There are no direct legal implications relating to the Equality Act 2010 arising from this report.
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## **Linked Reports, Appendices and Background Documents**

### **Linked Reports**

None

### **Appendices**

Appendix 1 – Pass Through Policy – London Borough of Tower Hamlets Council  
Procedure for granting Tower Hamlets Contractors Admitted Body Status to the  
London Borough of Tower Hamlets Local Government Pension Fund.

### **Background Documents – Local Authorities (Executive Arrangements)(Access to Information)(England) Regulations 2012**

- NONE

### **Officer contact details for documents:**

Hitesh Jolapara – Interim Divisional Director of Finance, Procurement & Audit

Miriam Adams – Interim Head of Pensions & Treasury

**London Borough of Tower Hamlets Council Procedure for granting Tower Hamlets Contractors Admitted Body Status to the London Borough of Tower Hamlets Pension Fund**

This policy has been produced by London Borough of Tower Hamlets Council (LBTH) as a Scheme Employer. LBTH is also the Administering Authority for the London Borough of Tower Hamlets Pension Fund (the Fund).

**Contents:**

Summary of general principles

Section 1: Legislative background

Section 2: Pass Through Arrangements for London Borough of Tower Hamlets Council contractors admitted to the Pension Fund

Section 3: Outsourcings of active employees

Section 4: Bonds

## **SUMMARY OF GENERAL PRINCIPLES**

- The employer's pension contribution as a percentage of pay is set at the outset of the contract.
- For most outsourcings the contractor will be paying a contribution rate equal to the Council's primary rate applicable at the start date of the contract (currently 18.9% of payroll for 2021/22) for the initial term of the contract.
- The Council reserves the right (for large outsourcings) to determine a bespoke employer rate, calculated by the actuary on a pass-through basis (primary rate applicable to an employer calculated on an ongoing participation basis for the specific membership involved) to ensure that it is closer to the actual rate for the workforce.
- In both cases, the Council retains responsibility for fund performance and longevity under its pass-through arrangement.
- In both cases a cessation valuation will still be carried out at termination. However, any deficit or surplus relating to the employers will become the responsibility of the Council (and be recovered over the same period as the rest of the Council deficit).
- Where the contract provides for an extension or where there is a contract renewal after the initial contract period the issue of whether to amend the rate for the extension/renewal period will be considered.
- A bond to cover the potential **redundancy** strain impact due to an employer becoming insolvent will be required. The Council decides whether a bond to cover any deficit (market-related bond) arising upon insolvency of an employer, is also required. However, the actuary will calculate both bond figures at the same time as the opening position calculations for all outsourcings.

## **1. LEGISLATIVE BACKGROUND**

- 8** Employees outsourced from the Council must be offered pension benefits that are the same, better than, or count as being broadly comparable to, the LGPS (Best Value Authorities Staff Transfer (Pensions) Direction 2007). This is achieved by:
- c. The employees remaining in the LGPS and the new employer becoming an admitted body to the Fund and making the requisite employer contributions; or
  - d. The employer offering the employees membership of an alternative broadly comparable scheme, as approved by the Government Actuary's Department (GAD).

## **2. PASS THROUGH ARRANGEMENTS FOR LONDON BOROUGH OF TOWER HAMLETS COUNCIL CONTRACTORS ADMITTED TO THE FUND**

- 2.1 Pass-through is an arrangement whereby the Council retains the main risks of fluctuations in the employer contribution rate during the life of the contract and the risk that the contributions paid may be insufficient to meet the employees' pension benefits at the end of the contract. Examples of risks which could cause the employer contribution rate to fluctuate could include the interest on the surplus / deficit, investment performance, changes to the discount rate, changes to longevity assumptions, a change in the membership profile. The contractor is responsible for early retirement strain costs, disproportionate salary increases and ill health retirements not approved by the Fund's occupational health physician.
- 2.2 Therefore, the Council has allocated risk to the party best able to manage it which allows for a smooth and structured transition from the Council to the Contractor, as well as smoother ongoing arrangements.
- 2.3 The Council has a method of determining the employer contribution rate, but reserves the right to use a more member-specific approach to calculating the applicable contribution rate for large outsourcings.
- 2.4 It is the Council's understanding that the contractor would account for the pension fund admission on a defined contribution basis and therefore no formal FRS102 / IAS19 report is required (the Contractor does not bear any of the liability risk). However, as the Council is retaining the pension fund risk relating to the Contractor, these liabilities will need to be included in the Council's IAS19 disclosure.
- 2.5 Whilst Regulation 64 of the Local Government Pension Scheme Regulations 2013 requires an actuarial valuation of liabilities whenever an admission agreement ceases to have effect, because any liability in the fund will be assumed by the Council, the cessation valuation will simply record no cessation debt or exit credit is payable to or from the Fund.
- 2.6 The Actuary can undertake modelling work to help the Council understand the risks that it is taking on through this pass-through arrangement.
- 2.7 The requirement for a bond is a separate issue and is covered separately in this policy.
- 2.8 Adherence to this policy (including the necessary involvement of procurement, pensions and human resources personnel) is the responsibility of the relevant responsible service manager for any given outsourcing.

### 3. OUTSOURCINGS OF EMPLOYEES WHO ARE ACTIVE MEMBERS IN THE FUND

- 3.1 The contractor will ordinarily be given the Council's applicable primary rate at the start date of the contract (currently 18.9% of payroll for 2021/22). However, for large outsourcings, the Council reserves the right to determine a bespoke employer rate, calculated by the actuary on a pass-through basis (primary rate applicable to an employer calculated on an ongoing participation basis for the specific membership involved) to ensure that it is closer to the actual rate for the workforce.
- 3.2 The actuary must be notified that an outsourcing has taken place.
- 3.3 The rate will be fixed for the initial term of the contract. A review will be carried out prior to any subsequent contract extensions or renewals to establish the applicable employer contribution rate for the extended/renewed contract period.
- 3.4 The Actuary's Rates and Adjustment certificate will reflect the rate applicable to the Contractor.
- 3.5 The contractor must pay the Fund the appropriate employer and employee contributions by the 19<sup>th</sup> day of the following month or 22<sup>nd</sup> of the month if paying electronically.
- 3.6 If any former Council employees leave the contractor's employment, the contract price will not be reduced to reflect a reduction in pension costs. However, cost-sharing provisions should exist in the contract and in these circumstances the Council may receive a reduction in the contract cost.
- 3.7 A cessation valuation is required at termination but no debt or credit will pass to the contractor. Any deficit or surplus relating to the contractor will become the responsibility of the Council (and be recovered over the same period as the rest of the Council deficit).

Risks	LBTH	Contractor
Surplus/deficit prior to the transfer date	✓	
Interest on surplus/deficit	✓	
Investment performance of assets held by the Fund	✓	
Changes to the discount rate that affect past service liabilities	✓	
Changes to the discount rate that affect future service accrual.	✓	
Change in longevity assumptions that affect past service liabilities	✓	
Changes to longevity that affect future accrual	✓	
Price inflation / pension increases that affect past service liabilities	✓	
Price inflation / pension increases that affect future accrual.	✓	
Exchange of pension for tax free cash (commutation rate).	✓	
Ill health retirement experience (approved by the Fund's occupational health physician)	✓	
Strain costs attributable to granting early retirements e.g. redundancy, to include strain costs attributable to granting ill-health retirements that are not approved by the fund's occupational health physician.		✓
Greater/lesser level of withdrawals	✓	
Rise in average age of employee membership	✓	
Changes to LGPS benefit package	✓	
Salary increases Increases in the employer's contribution rate which are attributable to the contractor granting pay rises that exceed those collectively		✓

negotiated for employees remaining in the Council (Excess Pay).		
Award of additional pension or augmentation		✓

3.8 The risk allocation is as follows:

3.9 The cost associated with the increased liabilities as a result of excess pay awards will be recovered over the remaining term of the contract.

#### **4. Bonds**

4.1 The contractor is obliged to carry out a risk assessment to the satisfaction of the Council on each outsourcing, and annually, to determine the level of bonds that are required.

4.2 The bonds would cover the Fund in the event that the contractor is unable to meet its liabilities, for example due to its insolvency, specifically, unpaid strain costs caused by early retirement (redundancy bond) and any outstanding deficit (market-related bond).

4.3 In all cases a redundancy bond will be required to cover early retirement strains caused by redundancies upon insolvency of the contractor.

4.4 The Council reserves the right to insist upon a market-related bond being put in place by the contractor, for example where there is a large workforce but the contract price is relatively low, or is paid up front, or where the provider is considered to have a high financial risk profile.

4.5 If the Council determines that a market-related bond is not required it must act as an explicit guarantor to the Fund.

4.6 The Admission Agreement will state the right of the Council to require the contractor to obtain a bond at any time during the lifetime of the contract.

4.7 The process for determining whether a bond is required is set out below.

4.8 The requirement for a bond, and the amount which needs to be covered by a bond, will be reviewed annually.

4.9 In addition to the bonds, the Council retains a right of set off against the contract price, which can be invoked during the term of the admission agreement if contributions are not made.

4.10 The procurement process will require all bidders to price for the redundancy bond for the life of the contract.

4.11 If a market-related bond is required, the procurement process will require all bidders to price for the bonds for the life of the contract. If the market-related bond is then not required (or the cost of obtaining the market-related bond is lower than envisaged), either on commencement of the contract or in subsequent years, the contractor will make a corresponding reduction in its contract price to reflect the costs allowed for the market-related bond for the relevant year(s).

4.12 If a market-related bond is not required, the bidders should not include a price for it but the contract should reserve the right to require a market-related bond at a later date. In this case, contractors will be permitted to pass on the costs of obtaining a market-related bond to the Council. The Council will consider whether it is more cost effective to proceed with that arrangement or whether to cover the risk to the Fund by offering an explicit guarantee from the Council.

This policy operates in agreement with the outsourcing guidance provided by Tower Hamlets Pension Fund.