FIXED RATE POLICY

August 2019

Hertfordshire Pension Fund

Local Government Pension Scheme

Contents

1. Introduction

1.1 What is this document?

This is the voluntary Fixed Rate Policy of the Hertfordshire Pension Fund ("the Fund"), which is administered by Hertfordshire County Council ("the Administering Authority").

Once an employer body signs up to this policy, it will apply to all Local Government Pension Scheme ("LGPS") admission agreements for employees transferring under *Transfer of Undertakings (Protection of Employment*) Regulations 2006 (as amended) ("TUPE") from a ceding employer to a service provider.

The aim of this policy is to set out clearly when an admission agreement may take place on a Fixed Rate or pass-through basis and the subsequent treatment of the stakeholders where this approach is used.

1.2 What is a TUPE Transfer?

In broad terms where a service or business is transferred from one provider to another, TUPE ensures that the employees of that service or business transfer to the new provider on the same terms as their existing contract of employment.

TUPE's main purpose is to safeguard the rights of employees in the event of a business transfer. When a ceding employer outsources services to an external service provider and employees are TUPE transferred as a result, the employees remain eligible to continue their participation in the LGPS[1]. For the eligibility of each employee to the LGPS to be protected, the employer will apply to become an admitted body in the Fund and this process is detailed below.

[1] Where employees TUPE transfer from a ceding employer their right to continued membership of (or eligibility to join) the LGPS is protected by the Best Value Staff Transfers (Pensions) Direction 2007.

Employment with a new service provider is treated as continuous from the date of the employee's start date at the ceding employer, subject to the new service provider signing the Admission Agreement with the Hertfordshire Pension Fund. Please refer to our Admission Agreements Policy.

1.3 What does the Fixed Rate Policy aim to do?

The Fixed Rate Policy ("the Policy") has been developed by the Fund with Hertfordshire County Council, in its capacity as Administering Authority, to encourage potential service providers to bid for service contracts by giving them reassurance over the potential risks and costs associated with pensions. The key advantage is that it gives the potential service provider greater certainty about the pension costs that they will incur during the contract term.

The Policy specifies varied approaches which are dependent on the type and size of outsourcing exercise being undertaken. These are detailed in Section 3.

1.4 What does "Fixed Rate" mean?

The term "rate" refers to the employer contribution rate which is paid into the Fund by the service provider.

All employers' contributions are reassessed by the Fund's Actuary at the subsequent actuarial valuation. In the absence of a fixed rate arrangement, a service provider would be admitted into the Fund on a variable rate which would fluctuate according to the outcome of the subsequent valuation.

A fixed rate is a commercial arrangement whereby the ceding employer agrees to "fix" the rate for the whole duration of the contract. At the next valuation, the Actuary may decide the rate should increase, but as it is fixed the service provider does not have to pay the increases.

As well as monthly payments into the fund, the additional feature of a fixed rate arrangement is that the service provider has certainty over their treatment at the end of their admission. The ceding employer agrees to pay any market related deficit that may occur when the employer ceases participation in the fund (when the contract ends or the last active member leaves or retires). Similarly, any market related surplus which occurs upon cessation will be retained by the ceding employer.

1.5 Other Key Terms

Ceding employer	The scheme employer outsourcing the contract or divesting the service.
Risk sharing agreement	Any arrangement where the ceding employer retains some or all of the pension risk. (e.g. fixed rate or pass through arrangement).
Pass through	Another name for a Fixed Rate or risk sharing arrangement.
Variable rate	The actuarially assessed contribution rate that would apply if the service provider retains all pensions risk.

2. General Principles of the Fixed Rate Policy

The following general principles will apply where a Fixed Rate approach is being used. The specifics, however, will vary as per Section 3.

- The admission agreement will normally be closed, meaning that it is only available to eligible LGPS members who, on the date of transfer, are active members or have the right to join at a future date.

- A separate admission agreement is required for each service contract.

- Where there is a TUPE transfer, the ceding employer will be required by the Fund to act as the guarantor for the admission agreement.

- Depending upon the classification of the TUPE transfer, the employer contribution rate may be reassessed by the Fund at future actuarial valuations. The general principle is that where there is a variation in this contribution rate, the service provider will be protected from any variation in rate at subsequent valuations. All contracting officers will need to ensure that appropriate financial mechanisms are in place to implement this protection.

  The following generic example illustrates how a fixed rate agreement (initially set at 21%) might work when a new contribution rate emerges from a subsequent actuarial valuation:

  Table 1: Application of a Fixed Rate Agreement

Rates arising at subsequent valuation	Fund receives	Service provider Pays to Fund	CE[2] top up to Fund
16% of pensionable pay	16%	21%*	0%

[2] CE – Ceding employer

22% of pensionable pay	22%	21%	1%
25% of pensionable pay	25%	21%	4%

*5% will be subsumed into the service provider's funding level. At the end of the contract, any surplus or deficit in the service provider's funding level will be retained by the ceding employer.

- Where a Fixed Rate policy is in place, the general principle is that the service provider will also be protected from making any payments when the employer ceases participation in the fund (in respect of market related cessation deficit). On the other hand, they will not benefit from receiving payments upon cessation (in respect of market related cessation surplus).

- Where a Fixed Rate policy is in place, the ceding employer will be the guarantors as they are the contract awarding Employer. Given this, the Fund will expect them to use their discretion to decide whether a bond is required. Where one is required, the pension bond for a Fixed Rate Policy will only relate to the risk of redundancies for members aged 55 or over. This bond value will be calculated by the Pension Fund Actuary and should be kept under review for the duration of the contract. At a minimum, the ceding employer may wish the bond to be reviewed at each actuarial valuation or where there has been a significant change in the service provider's membership profile. The service provider will be required to provide a revised pension bond in the event there is a change in the bond value.

- The standard actuarial fees involved with the service provider gaining admitted body status in the LGPS vary but will not exceed £3,500 (excluding VAT). They will be recharged to the service provider unless agreed otherwise. Any change to this amount will be specified in the invitation to tender documents, (subject to clear instructions from the ceding employer).

- Costs associated with obtaining a pension bond (and any revisions to the original bond) are payable by the service provider.

- Actuarial and administrative costs in relation to any service provider's participation in the Pension Fund will be recharged to the service provider. These costs generally relate to annual reports for financial accounting, bespoke valuations and bond revaluations; the presence of a Fixed Rate policy may well reduce the level of costs incurred. The Pension Fund will generally seek to provide estimates before commissioning any work and require the service provider to confirm they accept those costs.

- Where there is a Fixed Rate agreement in place, greater reassurance is given to service providers about their pension costs. There are, however, a few areas of potential cost which are considered to be in the service provider's control. Given this a service provider on a Fixed Rate agreement can still expect to be liable to make payments to the Pension Fund in respect of:

    - Any strains due to early retirement or the early payment of benefits on the grounds of efficiency, redundancy, voluntary grounds with the permission of the service provider or compassionate grounds, ill health or due to augmentation of benefits or the exercise of any discretion by the service provider.

        - Strains arising due to early retirement and the award of additional membership will be calculated using factors issued by the Actuary that are in place at the date of calculation.
        - Strains arising due to ill health retirements can be managed by pursuing external insurance from Legal & General[3].

    - Any additional liability arising from the service provider allowing a scheme member to transfer in membership from a previous employment into the Scheme beyond the 12 month statutory timeframe.

[3] Contact information available from Fund Actuary upon request.

3. Fixed Rate Policy – when and how will it apply

The Policy is applied to service contracts where there is a transfer under TUPE of employees who are members of or eligible for admission to the LGPS.

All contracting officers must familiarise themselves with and consider the TUPE Guide and the Admissions Agreement Policy where TUPE applies to a service contracts the ceding employer is proposing to enter into. The TUPE Guide also provides guidance about admission into the LGPS. The TUPE Guide is not however intended to be a substitution for TUPE or pensions regulations.

3.1 TUPE Classification Summary

The sub-sections below set out how TUPE transfers will be categorised, how the different circumstances of each category will be reflected in the application (or not) of the Fixed Rate policy and how any application will then reflect that category's specific circumstances. All contract lengths per the classification in Table 2 includes any right to extend the contract.

Table 2: TUPE Transfer Classification

		Size of membership		
		Up to 10	**11 to 30**	**Over 30**
Term in years	**3 or less**	Small or short	Small or short	Small or short
	3-10	Small or short	Medium	Medium
	Over 10	Small or short	Medium	**Large (or "significant")**

3.2 Small or short TUPE Transfers

All small or short TUPE transfers will have a pass through arrangement with the ceding employer, whereby the risks inherent in participating in the LGPS are shared between the ceding employer and the service provider.

In such an agreement, the service provider simply takes on the ceding employer's contribution rate and this is fixed throughout the life of the contract regardless of any change to the ceding employer's contribution rate at subsequent valuations of the Fund. This provides pension contribution rate certainty to bidders for service contracts. Upon cessation, the service provider ceases participation in the Fund without a cessation deficit in relation to market performance and without the right to a surplus.

3.3 Medium TUPE Transfers

Medium TUPE transfers can be awarded a pass through arrangement subject to discretion being applied by the ceding employer as the contracting authority. Where they choose to do this then

i. the approach specified under Section 3.2 may apply, or

ii. the ceding employer may choose to have a specific fixed contribution rate actuarially assessed to better reflect the transferring membership of this "medium" transfer (alongside other factors).

Where the ceding employer decide that a risk sharing approach is not appropriate and choose not to apply their discretion, then the new body will be set up as a standalone employer in the Fund and will carry all the pensions risk associated with their admission.

Given the greater materiality of these transfers, the pensions position and contributions required in respect of the transferred members will be monitored by the Fund at future valuations and contribution requirements may vary. Under the Fixed Rate arrangement service providers will be subject to adjustments (refer to table 1) if employer contributions vary from the fixed employer contribution rate agreed at the outset of the contract. Such adjustments may also apply at the end of any such Fixed Rate admission when a cessation valuation may be carried out. All contracting officers must, therefore, ensure that financial processes are agreed for these adjustment mechanisms in advance of the effective date of the service contract. Budget Managers should be made aware of the potential variation in costs associated with this Fixed Rate service contract.

For instances where the actuarially assessed contribution rate exceeds the fixed rate at a subsequent valuation; the adjustment mechanism acceptable to the Fund is for the service provider to continue paying the same rate and the ceding employer to top up monthly contributions to meet the increased rate. A separate LG221 form will be required from the ceding employer for the additional contributions.

When the contribution rate decreases, the service provider will continue to pay the same rate and the contribution in excess of the calculated contribution rate will be subsumed into the service provider's funding level.

3.4 Significant TUPE Transfers

The ceding employer must obtain details of the pension liabilities and indicative cost from the Fund's Actuary before the publication of any invitation to tender. This will help inform ceding employer's understanding of the pensions risk involved in the TUPE transfer. Each of these transfers will be individually assessed by the ceding employer to determine whether a risk sharing agreement is appropriate. The following are some of the factors that may contribute to ceding employer's decision-making process:

- The size and nature of the pension liabilities
- The materiality of pensions risk relative to other aspects of the contract
- Market conditions at the time of outsourcing
- The length of the contract period

Where a pass through approach is agreed upon it is likely that approach (ii) under section 3.2 will apply.

The pension position and contributions will be monitored as outlined in Section 3.3. The adjustment mechanism specified is also applicable for significant TUPE transfers.

4. Ceding employer's Contract Monitoring Officers' Responsibilities

The ceding employer's Contract Monitoring Officers must ensure that they are fully conversant with the requirements of this Policy and understanding the classification of the TUPE transfer. If the Policy applies to a contract, the Contract Monitoring Officer shall ensure that service providers are made aware of their obligations during the procurement stage. Where appropriate, Contract Monitoring Officers should notify service providers promptly following any change specified by the Actuary following a subsequent valuation and also any change following a review of the pension bond value by the Actuary. We would strongly recommend that Contract Monitoring Officers direct the service providers to the Pension Fund website to access policy documents setting out the service provider's responsibilities as a scheme employer in the Pension Fund and guidance on administration of the LGPS scheme.

Contact Us

If you have any queries on the above policy or about general pension queries, please do not hesitate to contact us or visit our website:

Email: Pensions.Team@hertfordshire.gov.uk

Website: http://www.yourpension.org.uk/Hertfordshire/Pensions-Home.aspx

Appendix A – Employer Bodies who have agreed to the Policy

Hertfordshire County Council