

# **Avon Pension Fund**

## **LOCAL GOVERNMENT PENSION SCHEME**

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Date: 15<sup>th</sup> June 2011

Dear Sir / Madam

### **AVON PENSION FUND SUBMISSION ON THE CONSULTATION ON THE FAIR DEAL POLICY (MAR 2011)**

This is a technical response on behalf of the Avon Pension Fund [APF] which highlights a number of serious concerns for the sustainability of the Pension Fund. Mercers, our Fund Actuary, have raised similar concerns within their submission, which reinforces the issues highlighted within this response.

The Avon Pension Fund [APF] is part of the Local Government Pension Scheme (LGPS). Our submission considers the issues from the perspective of an administering authority. All employers in the APF have been informed of the consultation and of their opportunity to put forward their own comments from an employment viewpoint.

Although the Fair Deal policy does not directly apply to local government the essence is still contained within the Best Value Authorities Pensions Directive 2007 [2007 Directive] and therefore any changes could have a significant bearing on the LGPS going forward.

#### **FUNDING IMPLICATIONS**

The abolition of Fair Deal could lead to funding problems that the LGPS would need to overcome to remain affordable and sustainable going forward, especially when considered in conjunction with the proposed 3% increase to employees' contributions as outlined in the Chancellor's Comprehensive Spending Review.

If the Fair Deal policy was abolished and entry to LGPS prohibited for contractors it would lead to a reduced active membership base. This in turn would lead to a reduced cash flow and result in Funds maturing more rapidly than their funding strategy currently anticipates and this would lead to an increase employer's contributions. It also needs to be acknowledged that, due to public sector spending cuts, the membership is already falling and employer contributions are being paid from a shrinking payroll. This will increase employer contribution rates and the perception that costs are increasing.

If the Funds mature more quickly, in order to protect the solvency of the Funds, investment strategies will need to be revised to reflect the fact that the Funds will become cash flow negative at an earlier date. Funds will need to invest in a higher proportion of “liability matching assets” which will impact on the level of returns from assets achievable and reduce the discount rate used to calculate funding levels and contribution rates.

Employers within each LGPS Fund share the risks involved with investment strategy changes but in this instance the changes will be caused only by the few employers who are covered by the 2007 Directive. Smaller employers not party to this directive will undoubtedly be more vulnerable if subjected to lower funding levels and higher contributions as a result of other employers’ actions. Some of these smaller employers are not underwritten so the absolute loss would be born by the Fund further pressurising contribution rates.

In such circumstances, when faced with a shrinking membership, a maturing fund demanding matched assets and lower returns the Fund will find it increasingly difficult to develop and maintain a sensible investment strategy. The Fund’s trustees will quickly become conflicted between protecting the funds sustainability and maintaining employer affordability.

The proposed 3% increase in employee contributions and the further potential increases as a result of the recommended changes to public sector schemes by introducing a ceiling for employer contribution rates could accelerate the number of opt-outs creating a further reduction in membership, thus causing a downward spiral. The outcome of this will result in a higher pension liability being borne by the taxpayer, as funds will no longer be able to deliver a long term strategy aimed at bridging the gap.

**This therefore undermines the whole basis of providing an affordable and sustainable pension scheme and runs contrary to the findings of the Hutton report.**

Even if the Fair Deal policy was to be retained, if the recommendation from the Independent Public Service Pensions Commission that non-public service workers are prohibited from joining the LGPS were adopted a similar scenario of reduced membership base would still occur. Any contractor, in this instance, would only have the option of providing a Broadly Comparable pension scheme.

## **OPTIONS**

### **1. Retain current Fair Deal policy**

If Fair Deal is retained there should be some consideration to widen the extent of the 2007 Directive beyond Best Value Authorities.

Since 2000, the LGPS has allowed contractors to participate in the Scheme as an alternative to providing a broadly comparable scheme. Despite some initial problems, procedures are now in place that provide:-

- *smooth staff transition accepted by employers [CBI] and Employees [Unions]*
- *potential for LGPS to retain active membership base*
- *contractors the choice of LGPS or broadly comparable scheme*

Currently the existing Admission Body framework allows funding issues that arise to be adequately managed so that there are no significantly higher costs for employers.

## **2. Remove policy**

The perceived disadvantages of Fair Deal are:-

- *a possible barrier to plurality of public service provision*
- *time consuming / last minute*
- *increase costs for independent providers*

These supposed disadvantages can reasonably be challenged since potential solutions do exist. The key issue is set out quite succinctly on page 13 of the Consultation Paper under the section headed "Allocating the costs and risks of pension provision appropriately, viz.

*"The Government must decide what costs and risks it is prepared to bear in the delivery of public services, which are ultimately borne by the taxpayer. One way of promoting plurality of public service provision without changes to the Fair Deal policy is to extend access to public service pension schemes to non-public service employees, as occurs in some parts of the public sector. The Government then bears the pension liabilities in these cases but without control of the drivers."*

Since the Government controls the terms of the contracts, it should be in control of the cost drivers. Leaving this aside, the only scheme which external bodies could reasonably join is the LGPS, because this is funded. Otherwise the Government would simply add to its store of unfunded liabilities.

## **3. Reform Policy**

It may be more appropriate to reform the Fair Deal policy incorporating it with the current local government directive in order to obtain "a level playing field" as abolishing it could impact on the competitiveness of in-house bidders who would still be compelled to offer LGPS membership.

Although there are areas that can be improved there needs to be a robust mechanism to deal with pension issues on outsourcing. Lord Hutton referred to not having a "race to the bottom" with regards public sector pensions and this goes some way in providing adequate pensions for staff involved in local public sector work.

If the concept of Fair Deal is retained then there must be changes to the way benefits are transferred by removing the "bulk transfer" arrangements which are very time consuming and, in many cases, not taken up.

From a funding viewpoint it is essential that the Fair Deal policy is retained in some form, otherwise the sustainability of the LGPS may require serious consideration.

## **CONCLUSION**

If it is decided to reduce the pension rights of public service workers transferred to the private sector, then acceptance of the full implications must be recognised. Despite the Hutton Commission's stated objective of avoiding a "race to the bottom" that is precisely what the abolition of the Fair Deal policy would achieve, not only as far as outsourced employees are concerned but also with the potential opt-outs of other members.

At the same time, as indicated in this response, it would probably hasten the demise of the LGPS and result in even fewer people having an adequate pension in retirement.

**It is also imperative that the LGPS is allowed to retain the facility for providing admitted body status to outside contractors.**

Yours faithfully

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Administering Authority for the Avon Pension Fund**