briefing note

When a guarantee is not a guarantee?

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When is a guarantee not a guarantee?

On 2 July 2013, The Secretary of State for Education confirmed in a statement to Parliament that the Department for Education (DfE) will now provide a guarantee to meet the outstanding pension liabilities, should an academy close.

We welcome this development. The provision of a (limited) guarantee from central government is a step in the right direction. We do question the effectiveness of a guarantee which DfE and HM Treasury reserve the right to ‘withdraw at any time’ (allowing for a reasonable notice period).

This Briefing Note examines the impact the proposed guarantee will have on Academy contribution rates.

Background

When a Local Authority School converts to Academy status, they assume responsibility for the pension obligations of employees entitled to membership of the Local Government Pension Scheme (LGPS). From the point of conversion, each Academy is recognised as a separate employer in the LGPS Fund and the Administering Authority must set the starting asset position and ongoing contribution rate based on the risk the Academy poses to the Fund and all other employers participating in the Fund.

At present, a wide range of approaches have been adopted by Administering Authorities, leading to Academies paying a wide range of contribution rates and, in many cases, rates which are currently (or, following the 2013 valuation, could be) significantly higher than the rates paid by schools under Local Authority control.

Objective of the guarantee

The provision of the guarantee is intended to allow Administering Authorities to *“treat academies equitably”* with Local Authorities when setting employer contribution rates.

We believe the expectation of central government is for the rates paid by Academies to be similar to those paid by Local Authorities, but does the detail of the guarantee allow Administering Authorities to do this?

The devil in the detail

The specific details of the guarantee are set out in a parliamentary minute, which confirm that HM Treasury have approved the guarantee in principle. DfE are seeking to rush this through parliament on grounds that they expect this guarantee to underpin proposals for Academy pooling arrangements (which are to be consulted on shortly).

However, when is a guarantee not a guarantee…perhaps when it can be withdrawn at any time! Under the terms of the guarantee, the DfE and HM Treasury reserve the right to '*withdraw the guarantee at any time*'. Instances when the guarantee may be withdrawn include;

- Estimated contingent liability (CL) ceilings are exceeded (which could mean the withdrawal of the guarantee when it is most needed).
- Projected costs are no longer affordable from within DfE's existing budget.
- Projected costs are not approved by HM Treasury.
- HM Treasury reserve the right to remove the guarantee due to spending considerations or policy developments.

While many (including ourselves) have been calling for a guarantee from central government, the form of this guarantee may leave Administering Authorities feeling hesitant about making significant changes in their approach to setting Academy contribution rates. This is considered further below.

Contingent liability (CL) ceiling

The annual estimates of CL ceilings which represent the maximum total exposure to DfE, as set out in the parliamentary minute, are set out below.

FY	13-14	14-15	15-16	16-17	17-18	18-19	19-20	20-21
CL (£m)	6.5	8.5	10.5	11.5	12	13	13.5	14

To give an idea of the potential scale, assuming there are currently c2,500 Academies each with a substantial deficit and numbers expected to double over the next 10 years, the CL ceiling represents a failure rate of Academies of something in the region of 1-2%.

The DfE's assertion in the parliamentary minute is that that the likelihood of an Academy failing is extremely low, and the current failure rate is much lower than the 1-2% implied in the CL ceilings. However, we should recognise the risk that pension liabilities for failing Academies could exceed the CL ceilings in all future years.

Involvement of HM Treasury

It is understandable that HMT would want to limit its potential exposure. However, Administering Authorities also need to control their risks and have a duty to protect other employers participating in their Funds. Administering Authorities may be concerned that HM Treasury's 'get-out' clause could leave Funds exposed and other participating employers at risk.

Other unanswered questions

The terms of the guarantee may determine the extent to which Administering Authorities will want to alter their approach to setting Academy contribution rates, for example;

- What measure of pension liabilities will the guarantee cover, the ongoing cost, or the cost on a more prudent 'least risk' basis?
- What events will the guarantee cover, i.e. will the guarantee trigger if the Academy somehow elects to re-join the Local Authority at a later date?
- Further information relating to how the contingent liability ceiling would work in practice.

What could this mean for Academies

Starting assets

The provision of a guarantee should not affect the approach the Administering Authority uses to set the level of assets allocated to Academies on conversion. This is generally designed to ensure that Academies contribute their fair share to the deficit in respect of former employees.

Contribution rates

Administering Authorities will need to consider to what extent the provision of this guarantee would lead them to change the approach and assumptions used when setting contribution rates (including for example any deficit recovery periods). The proposed guarantee, in its current form, does not offer the same degree of security that Administering Authorities assume for employers with the strongest covenant. They may therefore be wary setting contributions using the same approach.

In general terms, the sorts of change in approach that Administering Authorities might consider due to the existence of a guarantee include:

- **Deficit spread period** – As the DfE previously only guaranteed Academy funding for a period of 7 years, this has been used by some Administering Authorities as the period over which past service deficits should be recovered. Deficit spread periods could justifiably be extended with a funding guarantee to a similar period adopted for Local Authorities (around 20 years). A longer deficit recovery period leads to a lower contribution rate.
- **Contribution stability policies** – For the most secure employers, many Administering Authorities have long term contribution stabilisation policies (effectively taking a longer term view). Administering Authorities might consider whether this guarantee permits the extension of contribution stability policies to Academies.
- **Pooling with ceding authorities**; Administering Authorities may want to see the detail of the promised consultation on pooling before committing. Over the long term, pooling with the ceding authority could turn out to be better or worse for the Academy than paying a contribution based on being a stand-alone employer.

For existing academies, there may need to be a revision of the rates currently paid to reflect the existence of the guarantee. This would take place as part of the 2013 valuations and be reflected in rates payable from April 2014.

2013 valuation planning for Administering Authorities

The timing of this announcement during the key stage of the 2013 valuation process means that Funds must think fast on how to interpret this guarantee and how this should be reflected in funding policy.

Extension of the contribution stability mechanisms (normally reserved for the most secure employers i.e. those with tax-raising or precepting powers) to Academies may require additional analysis before you make a final decision. Existing valuation project plans should be revisited to allow for this. Valuation timescales and costs will be placed under additional pressure from the planned consultation on pooling arrangements for Academies.

The timing of these developments is difficult (especially as these issues have been known but unresolved for several years now). If there was ever a time to be flexible with project plans it is now! We can help you consider the various options for contribution setting.

FRS17 results as at 31 August 2013

As the cost of benefit disclosed in each reporting entity's FRS17 report represents the cost of benefits accruing over the accounting year, rather than the contribution rates being paid, there will be no impact of this guarantee on Academies FRS17 position as at 31 August 2013.

Conclusions and next steps

The proposed guarantee is a welcome development but it is limited in amount and may no longer be there when it is needed most.

The limits and conditions on the guarantee mean that the degree of security is less than for the most secure employers in the Fund.

There is no need to change approach in setting initial assets.

Administering Authorities will need to make a judgement on the extent to which this guarantee allows them to adapt their approach to setting contributions and meet the DfE's objective of paying similar rates to Local Authority run schools.

Some Academies may ask questions about retrospective adjustments once any new policy is implemented.

A further consultation on pooling is expected. Administering Authorities may want to delay a final decision on changes in contribution policy for academies until that consultation is completed.

The timing of the announcement means that this can all be factored into contribution strategy decisions later this year as part of the 2013 valuation exercise which will determine contribution rates from April 2014.

If you would like to find out more, please get in touch with your usual Hymans Robertson contact.