Committee and Date	Item
West Mercia Energy Joint Committee 24th September 2019	10 Public

Treatment of WMS Pension Liability

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1. Summary

1.1. At the point of sale of the West Mercia Supplies stationery division (WMS) in 2012, the existing pension deficit relating to the former WMS staff was retained within the continuing West Mercia Energy business. For the reasons outlined in this report, it is proposed to transfer this pension deficit directly to Shropshire Council, Telford & Wrekin Council, Herefordshire Council and Worcestershire County Council ("the Owning Authorities"), thus removing the financial responsibility for the pension deficit liability from the West Mercia Energy Joint Committee.

2. Recommendations

It is recommended that the Joint Committee:

2.1 agrees a proposal to the four WME Owning Authorities of Shropshire Council, Telford & Wrekin Council, Herefordshire Council and Worcestershire County Council for them to take direct responsibility for the pension deficit liability relating to former WMS employees (including Compensatory Added Years Benefits) and WME with effect from 1st April 2020; and

2.2 agrees, subject to the formal decisions to be taken by the four WME Owning Authorities in recommendation 2.1, to remove the pension deficit liability relating to former WMS employees (including Compensatory Added Years Benefits) and WME from the WME Balance Sheet from 1 April 2020.

REPORT

3. Risk Assessment and Opportunities Appraisal

1.1. WME Risk Register has identified a potential risk in bidding for future contracts while carrying the liability for former WMS employees on its balance sheet as potential customers will consider the financial position (through the accounts) of WME in assessing their bid. In order to facilitate WME in bidding for future contracts, the aim is to put it in a position where, at least initially, it is not carrying a pension deficit (and certainly not relating to former WMS employees) within the Shropshire County Pension Fund. To achieve this, the overall aim of the proposal to the Owning Authorities is that the liabilities relating to former WMS employees will be separated from the WME business and instead more clearly allocate the liability to the Owning Authorities. In practice this proposed change would make very little difference to the Owning Authorities which are currently responsible for a 25% share of the net liabilities of WME including the WMS pension liability.

1.2. To achieve implementation by April 2020, it is necessary for all four Owning Authorities to approve the proposal set out in a report to their respective Cabinets. Failure of any Owning Authority to meet the necessary timescales or approvals will result in the proposal not progressing.

1.3. There is still a technical (albeit unlikely) risk that the retained WME pension liability could, under unfavourable market and/or actuarial assumptions and circumstances still deliver a negative balance sheet position for WME in the future.

1.4. There are no direct environmental, climate change, privacy, equality and diversity and Public Health implications from this report.

4. Proposal

4.1. The proposal would result in the removal of the WMS Pension liability from WME's Balance Sheet by transferring the responsibility for the liability to the four Owning Authorities.

4.2. It is understood that the four Owning Authorities are considering options which include the deficit being managed through the establishment of a new WMS Pension Liability Joint Committee, whilst retaining the assets and liabilities within the Shropshire County Pension Fund. To achieve this separation of liability from the existing WME Joint Committee, the Owning Authorities would need to create a new Joint Committee whose sole remit will be to act as the 'employer' within the Shropshire County Pension Fund and manage the allocated pension liability. This resulting new 'employer' would manage the WMS pension assets and liabilities within Shropshire County Pension

Fund and enable all four Owning Authorities to take joint responsibility via a Joint Committee structure.

4.3. The Owning Authorities will need to agree appropriate governance arrangements for a new WMS Pension Liability Joint Committee, however it is anticipated that it would be based, as far as possible, on the existing WME Joint Agreement but with a single purpose remit to be responsible for the WMS Pension Liability, and historic WMS Compensatory Added Years Benefits.

4.4. The deficit contributions of the Owning Authorities would be subject to the same triennial valuations and treatment whether they are the responsibility of and accounted for within the WME Joint Committee or separately by the Owning Authorities under a new WMS Pension Liability Joint Committee therefore the risks associated with retaining a pension liability for WMS remain with the Owning Authorities and are not influenced in any way by the removal of responsibility for the deficit from the WME Joint Committee and resulting change in accounting treatment.

4.5. As the liability is proposed to sit with each Owning Authority to be funded by them, rather than being funded directly by WME from its income, the WME profits distribution would be proportionately higher as a result of the pension deficit contribution no longer being accounted for through this mechanism.

4.6. If the proposal is accepted, the pension liability arising from employees within WME (the WME Pension Liability) would continue to be shown within WME Accounts, with the expected accounting (IAS19/FRS102) calculations and (should this be necessary in the future) a deficit recovery plan drawn up and subject to the existing scrutiny and consideration by the business and the WME Joint Committee. The expectation is that these calculations would be significantly less impactful on the Balance Sheet, although the risk remains that an impact could be seen nonetheless.

4.7. Over and above the funded pension liabilities, WME is responsible for some historic WMS Compensatory Added Years Benefits. The recommendation is that these should be split equally between the four constituent authorities.

4.8. It is proposed to introduce the proposal from 1 April 2020. In doing so, the arrangements would be based upon the latest triennial actuarial valuation (as at 31 March 2019, and implemented across all employers from 1 April 2020) improving the quality of the information used at the strike date, and also removing the need for further actuary costs, as these will be absorbed within the existing workload. The 1 April 2020 date also removes the practical difficulties of eradicating any existing or proposed pre-payment arrangements made by WME.

5. Financial Implications

5.1. Worcestershire County Council, Herefordshire, Shropshire and Telford & Wrekin Councils have for many years been constituent members of a Joint Committee undertaking procurement activity. This business was originally called West Mercia Supplies, but following the sale of the stationery supplies business it has been renamed West Mercia Energy (WME).

5.2. At the point of sale of the WMS division (April 2012) the business had a pension fund deficit as identified in the actuarial valuation of the Shropshire County Pension Fund. The deficit related, in the main, to WMS employees whose employment was transferring as part of the sale. To deal with this position, the Owning Authorities had the following options:

a. Transfer the WMS pension deficit to the buyers of the WMS business.
b. Use the capital receipt from the sale, plus other Owning Authority funds (if necessary) to clear the WMS pension deficit retained by the Owning Authorities.
c. Allocate liability for the WMS pension deficit to the continuing WME business and continue to make deficit recovery payments from any WME profits delivered.

5.3. During the sale process it was identified that option (a) was unviable. Furthermore, the Owning Authorities concluded that they did not wish to forego a capital receipt from the sale of WMS as represented by option (b) which would also have necessitated a revenue payment from Owning Authorities to make up the shortfall between the value of the capital receipt and the larger pension deficit. As a result, the WMS pension fund deficit was retained by the Owning Authorities and the liability to meet that deficit was allocated to the continuing WME business. A deficit recovery plan was agreed with Shropshire County Pension Fund (SCPF) and revised every three years in line with the actuarial valuation. The latest valuation is being conducted at the time of writing, as at 31 March 2019, with contribution changes for all employers within the fund from 1 April 2020. In the 2019/20 Financial Year, the budget for WME deficit recovery payment is £161,726, plus £31,713 for Compensatory Added Years benefits (CAYs).

5.4. While the direct financial implications of this arrangement within the WME Profit and Loss Account currently are affordable, the impact on the company balance sheet is significant. The pension liability is in excess of £6m which is not offset to any great extent by the Company’s fixed assets (minimal) or working balance (generally in the order of £1m). This results in WME producing a negative balance sheet each year, with net liabilities of around £5m each year.

5.5. WME Risk Register has identified a potential risk in bidding for future contracts while carrying the WMS Pension Liability on its Balance Sheet. In order to facilitate WME in bidding for future contracts, the aim is to put it in a position where, at least initially, it is not carrying a pension deficit (and certainly not relating to WMS employees) under the Shropshire County Pension Fund. To achieve this, the overall aim of any proposal is that the WMS liabilities will be separated from WME.

5.6. While an arrangement to deliver this proposal will have a positive financial implication for WME (removing the WMS pension deficit from the balance sheet and removing the WMS pension deficit payments from the Profit and Loss Account), there will be a reciprocal negative financial implication for the Owning Authorities. The Owning Authorities will be required to cover the cost of 25% of the WMS pension deficit payment annually. The Owning Authorities will, however, benefit from marginally increased distributions from WME as a result of the pension deficit payments for WMS no longer being charged to the WME Profit and Loss Account.

6. Background

6.1. It is a decision for each Owning Authority, rather than the Joint Committee, to agree that the Owning Authorities take direct responsibility for their share of liability of the current WMS pension deficit so that it can be removed as a liability from the WME business.

6.2. The aim of the proposal identified in this report is to put WME in a position where, at least initially, it is not carrying a pension deficit (and certainly not relating to former WMS employees) under the Shropshire County Pension Fund. To achieve this, the overall aim of any proposal is that the liabilities relating to former WMS employees will be separated from the WME business and instead more clearly allocate the liability to the Owning Authorities.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) None
Member Councillor P Nutting of Shropshire Council (Chair of the Joint Committee)
Appendices None