New Fair Deal for pensions

Overview
Following a lengthy consultation process, the long-awaited new Fair Deal guidance was published by HM Treasury on 4 October. Despite being a non-statutory policy, it changes the landscape in relation to how pensions are to be dealt with when staff are compulsorily transferred from the public sector to independent providers delivering public services.

Broadly, the new Fair Deal provides for staff who have their employments transferred from a public sector employer to a private contractor to continue to be members of the public service scheme that they were in before. This marks a significant change from the previous guidance, which provided for private sector contractors to have to set up ‘broadly comparable’ pension schemes for the staff join. The new Fair Deal provides instead for private sector providers to participate in public sector schemes, thus enabling employees involved in the outsourcing to remain in that scheme or rejoin it in circumstances where the contract they are working on is re-let.

Where is new Fair Deal relevant?
The guidance applies directly to central government departments, agencies, the NHS, maintained schools (including academies) and any other parts of the public sector under the control of Government ministers where staff are eligible to be members of a public service pension scheme. It does not apply to best value authorities but alternative arrangements exist in respect of those bodies. Its applicability to maintained schools (including academies) is an unexpected development.

How does the new Fair Deal differ from the old?
Some of the main differences are as follows:

- In relation to future service, under the old guidance employees who were compulsorily transferred from the public to the private sector were expected to be given access to a pension scheme that was certified by the Government Actuary’s Department as broadly comparable to the scheme provided by their public sector employer. Under the new guidance, transferring employees can simply continue to be members of (or continue to be eligible to join) the public sector pension scheme that applied to their employment prior to the transfer of their employment. They will continue to accrue further pension benefits in that scheme in respect of their new employment and their pensionable service will be treated as continuous, notwithstanding the change of employer.

- In relation to past service, the old guidance provided that the transferring employees had a choice: they could either leave their past service benefits behind in their former public service scheme, or they could transfer their accrued benefits into the contractor’s broadly comparable scheme. That would involve complex bulk transfer arrangements being negotiated as part of the procurement process. In relation to first generation transfers out of the public sector the new approach removes the need for this - employees will continue to accrue benefits under their public sector scheme and accrued benefits stay where they are.
Under the old Fair Deal it was not uncommon for staff to move along a chain of broadly comparable schemes as their employment was transferred between private contractors on re-tendering of the relevant outsourcing contract. This will no longer be the case. Save in exceptional circumstances, where a contract is re-tendered and new Fair Deal applies, staff will return to their old public sector scheme. This means that bulk transfer arrangements must still be factored into the procurement process to ensure that employees can transfer the rights that they have accrued in the broadly comparable scheme into the public sector scheme. This is considered further below.

The new guidance also has a broader application. As with the old Fair Deal, it applies when staff who are members of public service pension schemes move from the public sector to an independent contractor by way of a transfer to which TUPE applies. However, the new Fair Deal also applies to a non-voluntary transfer to a public service mutual or to other new models of public service delivery (regardless of whether or not TUPE applies).

Key features of the New Fair Deal

Commencement
The new guidance should be followed where possible with immediate effect and necessary changes to public service pension schemes will be made as soon as practicable. Note that the old Fair Deal guidance may still apply:

- Where transfers take place before the relevant pension scheme has made the necessary changes to permit continued access (in this case a broadly comparable scheme must be provided as per the old guidance).
- In exceptional circumstances where it would not be appropriate to provide continued access to the public service pension scheme for transferred staff. The new Fair Deal makes it clear that these reasons must be exceptional and their strength rigorously tested.
- Where procurement is already at an advanced stage and it is not practicable to apply the new policy. The contracting authority should still consider whether it would be legitimate or desirable to implement the new guidance and so adjust the terms of the procurement.

There is a long-stop date of April 2015, by which time the new guidance should be followed in all cases.

Enforceability
The contracting authority will be expected to ensure that the contracts of employment of staff who are compulsorily transferred to an independent contractor will contain a right to continued membership of their public service pension scheme. These rights will therefore ultimately be enforceable by staff, although contracting authorities have a responsibility to ensure that independent contractors comply with the new Fair Deal policy, as outlined in the guidance.

Independent contractors, as scheme employers in the public service pension schemes, will be subject to the regulations governing those schemes and the jurisdiction of the Pensions Regulator and the Pensions Ombudsman.
Participation Agreements

The guidance provides that the independent contractor and the relevant public service pension scheme will put in place a Participation Agreement for each public service contract whereby the contractor will participate in the scheme. This will not be necessary if the contract between the two parties and scheme regulations impose equivalent obligations upon the contractor and the responsible authority agrees to this approach. Either way, the contracting authority should ensure that the contract it has in place with the contractor contains a termination provision which has effect where the provider is in breach of a Participation Agreement. It is worth noting that any failure to pay contributions will also trigger a requirement to notify the Pensions Regulator and so contractors must ensure that they have processes in place to avoid inadvertent failings here.

Participation Agreements will be a key feature for independent contractors as they will set out the terms on which they are permitted to participate in the public sector scheme, similar to admission agreements in relation to the Local Government Pension Scheme. They will establish employer contribution rates and address any requirements for indemnities, bonds or guarantees to protect the scheme from risks associated with private sector participation. They are also likely to address how additional pension costs that may arise are to be dealt with, for example those arising on early termination of employment, as a result of increases in salary in final years or as a result of the exercise of employer discretions.

Employer and employee contributions

Both employers and employees will be required to pay contributions to the relevant public sector pension scheme, but there can, in certain circumstances, be implications for the contracting authority:

- Employees will pay contributions in line with those paid by members of the scheme working in the public sector. These will be determined by the scheme regulations and may change following an actuarial valuation of the scheme.

- The contractor must collect the employee contributions and ensure that they are paid to the public sector scheme on time. They must also pay the employer contributions – normally set at the same level as the employer contribution rate paid by all other employers in the scheme. Scheme regulations may provide for the charging of differential rates of employer contributions to employers participating in the scheme under new Fair Deal where it is reasonable to do so on account of any higher risk of default associated with that particular participating employer.

- The new guidance provides for the contracting authority to be able to add to or reduce funding to the contractor depending on the outcome of any scheme valuation and any subsequent change in employer contribution. If the employer’s contributions increase, the contracting authority can agree with the contractor to provide additional funding and so remove the need for the contractor to price for the risk of increased contributions, which may never materialise. Similarly, the contracting authority may wish to require that any savings in employer contributions that are made by the contractor as a result of reduced employer contribution rates are paid to the contracting authority so as to prevent a windfall gain by the contractor.

Re-tenders of existing Contracts

The new Fair Deal guidance applies to employees who have already transferred out of the public sector under the old Fair Deal guidance where the contract they are working on is re-tendered. Where this occurs contracting authorities should require bidders to offer staff the opportunity to join (or in most cases re-join) the appropriate public service scheme. This will normally be the scheme that the staff would have been in had they remained in the public sector and not been transferred out originally.
The contracting authority must, however, be mindful to comply with their obligations under procurement law to treat economic operators equally. If this is not possible (were they to require the incumbent employer to provide access to a public service pension scheme) then the incumbent should be given the option of following the old guidance and providing a broadly comparable scheme. They must inform any recognised Trade Unions or, if none, the employees, of any proposals where a broadly comparable scheme will be offered before the retendering process commences.

**Bulk Transfer Arrangements on Re-Joining a Public Service Scheme**

Staff moving back into a public service scheme (or in exceptional circumstances, another broadly comparable scheme) must be given the option to transfer their benefits accrued in their broadly comparable scheme to the scheme they are set to move to (either the public sector scheme they are joining or the new broadly comparable scheme). That will involve the parties to the outsourcing making arrangements for bulk transfers should the employees wish to exercise their transfer option. Where they do so, a transfer payment will be made by the transferor scheme into the receiving scheme. The bulk transfer terms offered will in most cases be no less generous than the terms that applied when the staff originally left the public service scheme (updated as required). However, as has always been the case with such arrangements, there will be a risk that the onward bulk transfer terms are considered insufficient to cover the liabilities arising in the receiving scheme, giving rise to a need for the shortfall to be met by one of the contracting parties. Subject to any contrary provision in existing contracts and to the contractor properly following the new Fair Deal guidance, where a shortfall arises the contracting authority will be expected to make the payment and it will be treated as a price adjustment.

**An encouraging development?**

The new measures are an encouraging step towards a clearer and simpler process for dealing with the protection of pensions during an outsourcing, particularly for new contracts. However, we foresee continued difficulties in dealing with bulk transfers back to the public sector schemes, particularly where lack of data or robust contractual terms relating to previous outsourcings complicate matters.

Participation Agreements will be an important factor. Contractors must ensure that they properly understand the requirements of participation in public sector schemes, not only in terms of costs associated with participation and the implications they have on the pricing of a bid, but also in terms of compliance with scheme rules and the public sector scheme’s administrative requirements.

With the likely surge in the number of employers participating in their schemes and the large numbers of people being re-admitted to membership as contracts are re-tendered or terminated, public sector scheme administrators will face challenges in setting up processes to deal with managing data, deal flow, risk and communications. Similarly, trustees and administrators of broadly comparable schemes will need to start planning for the transfers back to the public sector schemes of ex-authority employees who are members of their schemes and the bulk transfer arrangements that will have to be carried through.
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