PUBLIC SECTOR PENSIONS – PROGRESS ON 'FAIR DEAL'

December 2012

There has recently been some further progress in the Government's review of 'Fair Deal' – the policy that requires public sector workers to be provided with broadly comparable pension benefits when their employment is transferred into the private sector as part of an outsourcing arrangement.

In March 2011 the Hutton Report on public sector pension reform advocated changes to the present Fair Deal policy, in order to remove a perceived "barrier to plurality" in the provision of public services. The Government subsequently issued a consultation paper and was seemingly open to all possible alternatives (keeping Fair Deal intact, reforming it or getting rid of it completely). However, in a ministerial statement in July 2012 the Government confirmed that the overall principle of Fair Deal would be retained but, in future, the protection it affords to transferring employees would be delivered by widening contractor access to all public sector schemes.

Some further detail as to how this is to be implemented has now been provided in the Government's response to its consultation on 19 November 2012.

1. It has been confirmed that, in future, employees transferring out of the public sector for the first time will remain in their existing public sector scheme. The terms on which contractors will participate in that scheme (including how the contribution rates will be set) are to be determined by each individual scheme, subject to HM Treasury consent. Further information will be provided in the final version of the Government's guidance on Fair Deal, but no indication is given as to when this will be published.

   This is a critical missing point of detail. The consultation response, however, indicates that the cost of participation in a public sector scheme will be lower than providing broadly comparable benefits in the private sector. It suggests that contractors will usually participate on the same terms as other public sector employers and implies that contractors will benefit from the employer cost cap to be incorporated in the regulations for each scheme. The consultation response does not address the position of any funding deficit at the end of the contract (which is only likely to be relevant to the LGPS as the sole funded scheme).

   We anticipate that contractors will continue to try to negotiate cap and/or collar arrangements in the relevant contract, to protect them in the event that contribution rates increase during the life of the contract (after a valuation) or a funding deficit arises. Individual contractors' covenants will therefore be traded off against the economy of scale that automatic participation in the relevant public sector scheme will bring.

2. Employees who have *already* been transferred to the private sector under Fair Deal will continue to be protected when the contract is re-let. The contractor who wins the contract (whether or not the incumbent) will be entitled either to participate in an appropriate public sector scheme or to provide a broadly comparable scheme. Any broadly comparable scheme must, however, mirror the scheme available to comparable public sector employees at the time of the contract re-let (and not, as is presently the case under Fair Deal, at the time of the original transfer out of the public sector). Employees transferred back into the public sector will join an "appropriate" scheme (which may or may not be the scheme from which they were originally transferred). Bulk transfer arrangements will continue to apply at the end of a contract as at present – in particular, if there is a shortfall between the bulk transfer amount and the cost of providing the relevant service credit, the public authority must pay the additional cost.

   Contractors who renew existing contracts will be obliged to offer existing employees CARE benefits once the new public sector schemes are introduced, either under their own passported scheme or via the applicable public sector scheme. There is no specific proposal to enable a switch to CARE prior to a contract re-let, but this could be an option for contractors with a passported scheme (subject to employee consultation) if the terms of the individual contract are sufficiently flexible or can be amended. It is not yet clear whether, going forwards, contractors providing broadly comparable schemes will be obliged (or able) to mirror any further changes in the comparable public sector scheme (for example, due to increases in normal retirement age in line with State Pension Age increases) unless the contract provides otherwise.

3. Fair Deal is a central government policy that is implemented via individual outsourcing contracts, but it has been put on a partially statutory footing for local government and other "best value authorities". Consequently, the Government's consultation response states that the new Fair Deal will not technically apply to transfers from best value authorities, which will remain governed by the Best Value Authorities Staff Transfers (Pensions) Direction 2007. Very broadly, this Direction enshrines the present form of Fair Deal and so makes provision for broadly comparable schemes (except that on a contract re-let the new employer is already obliged to match the benefits provided by the relevant public sector scheme at that time).

   We hope that, for consistency and to avoid confusion, the Best Value Direction will be amended to follow any changes to Fair Deal but no announcement to this effect has yet been made. A proposed amendment to the Public Service Pensions Bill that would have put Fair Deal on an entirely statutory footing was recently rejected in the committee stage of proceedings in the House of Commons. We consider that a consistent approach to pension protection on outsourcing across the whole of the public sector is more important than the method by which that protection is given.

4. No commitment as to the timescale for changing Fair Deal has been given.

   In our view, it would make sense for the present Fair Deal policy to remain in place at least until the new public sector scheme regulations are published or, preferably, until the changes to public sector benefits are implemented (April 2014 for the LGPS and April 2015 for all other schemes). We accept that this could lead to unwelcome budgetary uncertainty for contractors pricing bids in the interim period but, until the contribution rates for the new arrangements are known, it will in any event not be possible for contractors to price a bid accurately on the basis of participation in the relevant public sector scheme. One solution to this uncertainty could be for new contracts to make provision for pension costs and obligations to be re-negotiated once the new Fair Deal policy is finalised, potentially allowing contractors to change the benefit provision and any consequential cost savings to be passed to the contracting authority.

There is still much detail to come on Fair Deal and on forthcoming changes to public sector schemes more generally, as highlighted in our Progress on Public Sector Pensions Reform in September 2012.

If you have any questions on this topic then please get in touch with one of the partners listed or your usual Squire Sanders contact.

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