Reform of Fair Deal: latest details emerge

HM Treasury has published more details about reform of the Fair Deal pensions policy which applies when public sector staff are compulsorily transferred to private sector contractors.

The story so far...

Fair Deal protects valuable public sector pension benefits enjoyed by staff who are moved to the private sector. To date, this has been achieved by the new employer having to provide a broadly comparable (ie defined benefit) pension scheme because direct participation in most public sector schemes was not permitted. In addition, accrued public sector pension rights are protected, so employers must provide bulk transfer arrangements for staff transferring their public sector pension benefits. Contractors who provide services to local authorities operate under a slightly different policy known as "Best Value". For some time, contractors have been able to participate directly in the Local Government Pension Scheme as "admitted bodies".

This summer the Treasury announced plans to allow transferred employees to remain in public service schemes, even on subsequent transfers between private sector contractors. It has now published draft guidance setting out how the new Fair Deal policy will operate for first transfers and subsequent re-tenders. It also sets out the terms under which staff transferred under the existing Fair Deal will be allowed renewed access to public service pension schemes when contracts are re-tendered.

These proposals are set against a background of major reform in public sector pensions. Parliament is currently considering a move to future benefit accrual on a career average (CARE) basis from 2014 (for local government) or 2015 (for other public sector schemes), with transitional protection for those closest to retirement. Normal retirement ages will also be linked to the state pension age for many public sector scheme members.

The new proposals

For outsourceings under the new regime, contractors will generally need to participate in the public service scheme of the transferred employees.

The contributions will generally reflect the employer contribution rate paid by the public sector employers, and may vary during the lifecycle of the contract. The practicalities (such as the process for determining employer contribution rates) will be decided by individual schemes, subject to Treasury consent. Further details will be published in the final form guidance. Contracting authorities will be responsible for ensuring that records of transferred employees are up to date and that correct contributions and benefits are paid.

Access to the public sector scheme will cease when an employee stops working on the public service contract which they worked on at the time of the transfer.
**Existing Fair Deal contracts**

When existing Fair Deal contracts are re-tendered, the Government wants employers to choose between providing broadly comparable CARE schemes or providing access to a public service scheme. Re-tendered staff could transfer their accrued rights to the chosen scheme or decide to become a deferred member of their old employer’s scheme.

This is an attempt to prevent a disparity emerging between employees transferred under the new Fair Deal (who would retain access to public service schemes likely to become career average schemes after 2015) and employees transferred under the existing Fair Deal (who are likely to be on better, and hence more costly, pensions terms).

**Returning to public service schemes**

Staff moving back to public sector schemes will have their accrued rights protected via a bulk transfer arrangement. The relevant public service scheme will set the bulk transfer terms, so that staff can secure past service credit on a day-for-day basis (or the actuarial equivalent).

Under the existing Fair Deal policy, many contracts require schemes receiving bulk transfers to provide funds for onward bulk transfers at the end of the contract and specify the value. If these funds don’t cover the new liabilities, the cost of meeting the shortfall falls on the contracting authority. This will continue to be the case under the new proposals.

**Exclusions**

The new regime will not apply to staff transferred before the existing Fair Deal took effect in 1999/2000. However, contracting authorities can apply the new Fair Deal to re-tendering if it recognises the costs of doing so and can make a value-for-money case for doing this.

**When will the new regime begin?**

The Treasury has confirmed that the existing Fair Deal policy will continue to apply until a start date for the new policy is announced. The draft guidance is open for consultation until 11 February 2013.

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**Our comment:** When the Treasury first announced changes to Fair Deal, they seemed to herald a shift towards the “admitted bodies” approach applied on local authority outsourcing. Now that we have more detail, it is still unclear how far the “admitted bodies” framework will be replicated for schemes such as the Principal Civil Service Pension Scheme and the NHS Pension Scheme. Will Fair Deal and Best Value effectively merge or will any important differences remain? Currently, contractors who become admitted bodies in the Local Government Pension Scheme may take on past service liabilities and exit liabilities. Under the new Fair Deal, it seems a contractor would not be exposed to these risks. On this basis, central government outsourcing will seem more attractive than local government outsourcing because the pension costs could be significantly less. The new Fair Deal proposals offer contractors the chance to manage pension costs on a more commercial basis, particularly once the move to CARE benefits has been implemented across the public sector.

The new draft guidance describes how employees who transferred out under the current Fair Deal will be moved back into a public sector scheme (probably on a CARE basis) when the contracts are re-tendered. In practice, though, it is not clear what would happen if the contract was simply extended rather than re-tendered. In these circumstances, there would not be scope to move employees to CARE accrual; existing (and more costly) pension promises would still apply.

Contractors who are currently negotiating contracts or submitting tenders should try to anticipate these changes. They may want to press for flexible terms to avoid contracts becoming fixed in the current Fair Deal regime. Contractors may also want to review current contracts and consider if these are flexible enough to allow them to take advantage of the new Fair Deal.
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