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Public sector outsourcing:
"Fair deal" pensions policy revised

The government has published its revised "Fair Deal" policy, setting out how pensions issues are to be dealt with when public sector employees are compulsorily transferred to independent service providers.

Headlines

- Public sector staff transferred to private contractors will normally be offered membership of a public service pension scheme.
- The policy is effective immediately, although affected pension schemes will need to time to adapt.
- The policy will also apply to existing contracts which are retendered.
- Contractors may have to pay a risk premium or provide indemnities/guarantees/bonds, on top of the standard public sector scheme contribution rate.
- Greater clarity is needed as to exactly which employers will be within the extended scope of the new policy.

Broadly, most public sector employees whose employments are transferred to private contractors will be offered membership of a public service pension scheme (rather than a broadly comparable scheme, as at present). Staff in the Local Government Pension Scheme will continue to be able to participate in that scheme, as is currently the case.

Timing and scope

The guidance is effective immediately and should be reflected in procurement practice as soon as is practicable – although the government accepts that it need not be applied to projects which are already at an advanced stage. However, changes must be made to the terms of some public sector schemes before the new policy can be applied to them. This may mean that the policy is not universally applicable until 2015.

The guidance applies to central government departments, agencies, the NHS, maintained schools (except those covered by other, local government arrangements), academies and other parts of the public sector under the control of Government ministers. However, contracting authorities in other parts of the public sector may also adopt the new Fair Deal principles where the policy does not apply directly. Similarly, private sector bodies whose staff participate in a public service scheme may seek to adopt an approach in line with the new Fair Deal.

The guidance does not apply to best value local government authorities (including Fire Authorities), where alternative arrangements already exist. However, The Department for Communities and Local Government is considering how the new Fair Deal principles can be extended to local government, if necessary.

The policy

Staff who are compulsorily transferred from the public sector will normally be offered continued access to a public service pension scheme rather than a broadly comparable private pension scheme. This will also apply to subsequent TUPE transfers.

A specific requirement to this effect should be included in contracts for transferred services. The employment contracts of outsourced staff must also grant a right to continued membership of their public service pension scheme. (The same applies to second or subsequent generation transfers.)

For each outsourcing project, a participation agreement must be in place between the contractor and the relevant public service pension scheme – unless equivalent provisions are included in the contractor's contract with the contracting authority. The contracting authority must put effective compliance mechanisms in place. The contract for the transferred service must give the contracting authority the right to terminate the contract where the terms of the participation agreement have been breached.

Exceptions

The guidance accepts that there may be exceptional circumstances where continued access to a public service pension scheme is not appropriate. In such cases, it would be necessary instead to comply with the old Fair Deal policy and ensure that staff are provided with a broadly comparable pension scheme. If it is not appropriate to offer either access to a public service pension scheme or a broadly comparable pension scheme, the contracting authority should consider compensating transferring staff on the basis of actuarial advice (and following consultation with any recognised trade unions or, in their absence, the staff themselves).

Retenders

Where retendering a contract involving the compulsory transfer of employees already transferred out under the old Fair Deal, contracting authorities should usually require bidders to provide affected staff with access to the appropriate public service scheme. (For staff who left a deferred pension in their public service scheme, it is down to the rules of the scheme whether, on rejoining, they will maintain a final salary link for their previous accrued service.)

Participation in public service pension schemes

The guidance sets out details of the terms on which independent contractors will participate in public service schemes. These include:

- Non-joiners should be enrolled in the scheme on the day that the new employment commences.
- Employer and employee contributions will normally be those paid by other scheme members/employers.
- However, scheme regulations may provide for differential employer contribution rates for Fair Deal employers, to take account of any higher risk of default or to reflect the nature of an employer.
- Employers may also be required to provide indemnities, guarantees or bonds to protect the scheme from potential costs arising from their participation in the scheme.
- If employer contributions are reduced after a contracting employer starts to participate in a public service scheme, the contracting authority may require that any saving is to be paid to the contracting authority, so as to prevent a windfall gain for the employer.
- On retendering, staff moving back into either a public service scheme or a new provider's broadly comparable scheme will have the option of protecting their accrued pension rights via a bulk transfer arrangement.

KPMG comment

1. Lord Hutton s report on public sector pensions expressly argued against contractors participating in public sector schemes. The decision to go against this recommendation might be explained by the fact that the new policy will bring about increased short-term cash flow to the Treasury (through increased numbers of contributing members, as well as bulk transfers in respect of retendered contracts).

2. The new policy may be more expensive for contractors to operate than the scheme s normal employer contribution rate may indicate, as a result of having to pay risk premiums or provide indemnities/guarantees/bonds. This is a major unknown for contractors, as we do not know what overall approach each scheme will take and, even then, detailed matters might be determined on a case-by-case basis.

   We understand that the need for this cost flexibility arises from concerns about contravening European state aid rules.

3. The guidance is not clear on exactly which public service schemes and employers will be within the scope of the new policy. It may take some time to fully clarify this.

   Some commentators were surprised by the inclusion of academies. However, we believe this makes sense, given that academies are already effectively in a first generation contract

   The new policy does not immediately extend to Further and Higher Education, or social housing.

   The prospect of other public sector employers (and private sector employers participating in public service schemes) being able to adopt the Fair Deal approach will require detailed consideration by these employers – for example NHS Foundation Trusts and other publicly funded bodies.

4. It is not immediately clear when public sector schemes will be ready to implement the new policy – though some will not complete their rule changes and administrative processes until 2015. Readiness will vary from scheme to scheme, creating further uncertainties for contractors.

For further information, please contact Steve Simkins:
0113 254 2975 (steve.simkins@kpmg.co.uk).

www.kpmg.co.uk

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