HM TREASURY

Consultation on the Fair Deal Policy:

treatment of pensions on compulsory transfer of staff from the public sector

March 2011

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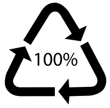

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1 Introduction

Overview of chapter

1.1 At the Spending Review 2010, the Government announced its intention to undertake a review of the Fair Deal policy, reporting by summer 2011.[1] This chapter explains why there is a need to review the Fair Deal policy and outlines the scope and timing of this consultation.

What the Fair Deal policy requires

1.2 Introduced in 1999 and further clarified in 2004, Fair Deal is a non-statutory policy[2] applying to pension provision for public sector staff when they are compulsorily transferred to a non-public sector employer.[3]

1.3 The Fair Deal policy requires that the new employer provides a broadly comparable pension scheme for the transferred staff and bulk transfer arrangements for those staff who wish to transfer their public service pension benefits. The Fair Deal policy applies where a public service is outsourced to be delivered by an independent provider, including private sector businesses and non-profit making organisations such as charitable bodies and social enterprises.

1.4 Further details on how the policy operates can be found in Chapter 2, and Annex B lists the public service pension schemes to which it applies.

Reason for reviewing the Fair Deal policy

1.5 The Independent Public Service Pensions Commission[4] (IPSPC) led by Lord Hutton published an interim report on 7 October 2010. One of the findings of the report was that the Fair Deal policy, coupled with current public service pension structures, creates a barrier to the plurality of public service provision. This makes it more difficult to achieve the efficiencies and innovation which new providers can bring to public service delivery. As discussed in more detail in Box 1.A, the IPSPC interim report[5] outlines two main causes of these barriers, linked to the Fair Deal requirement for provision of a broadly comparable, generally defined benefit pension. These causes are that:

- the employer contributions required to pay for similar levels of defined benefit pension liabilities are generally higher in the private sector; and
- providing defined benefit pensions exposes independent providers to particular risks, notably of higher than expected longevity and poor investment performance.

[1] *Spending Review*, HM Treasury, October 2010.

[2] *Staff transfers from central government: a fair deal for staff pensions, Guidance to Departments and Agencies*, HM Treasury, 1999, and *Fair Deal for staff pensions: procurement of bulk transfer agreements and related issues*, HM Treasury, 2004.

[3] The 2004 Fair Deal guidance clarified that: "The Fair Deal relates to staff transferred to the private sector where TUPE (the Transfer of Undertakings (Protection of Employment) Regulations) apply. The Cabinet Office Statement of Practice (COSOP) advises that in transfers of public sector staff the norm should be for TUPE to engage, and where as a matter of law it does not, protection should be given to staff equivalent to that which would apply if it did."

[4] For more information on the Independent Public Service Pensions Commission go to http://www.hm-treasury.gov.uk/indreview_johnhutton_pensions_tor.htm

[5] *Independent Public Service Pensions Commission: Interim Report,* Independent Public Service Pensions Commission, October 2010

This may discourage some smaller independent providers from taking part in the outsourcing process.

1.6 The IPSPC concluded that "it is for the Government to consider carefully the best way of moving forward with Fair Deal in a way that delivers its wider objective of encouraging a broader range of public service providers while remaining consistent with good employment practices".

Box 1.A: Independent Public Service Pensions Commission interim report findings on Fair Deal

At present, when employees are transferred to non-public service bodies, the organisation they move to is required to ensure that there is 'broadly comparable' pension provision for future service, through the Fair Deal provisions... This arrangement has maintained the level of pension provision for those compulsorily transferred out of the public sector. However, given current public service pension structures, this can make it harder for private sector and third sector organisations to provide public services because providing a 'broadly comparable' defined benefit pension scheme can be significantly more expensive and risky for private sector organisations than for public sector employers.

There are two central reasons why providing a broadly comparable pension scheme can be difficult for private sector or third sector organisations. First cost, the public service and the private sector use different bases for calculating accruing pension liabilities and the contributions required to pay for them. Employer contributions in unfunded public service pension schemes are calculated using a real discount rate of 3.5 per cent, which may be too high, resulting in contribution levels that could be too low. Employer contributions in the private sector are calculated on a 'prudent' basis within a framework monitored by the Pensions Regulator. This addresses the risk that pension fund assets under-perform, or that the size of pension liabilities is greater than expected. This typically leads to greater costs than in the public sector, where contributions are set taking into account the ultimate government guarantee. In particular, in the funded Local Government Pension Scheme, the guarantee allows more freedom to achieve long-term investment out-performance.

Second risk, by taking on employees with defined benefit pension rights, private sector bodies expose themselves to the investment and demographic risks... For larger firms, these risks might be considered manageable, although evidence submitted to the Commission indicates their concerns. But evidence also suggests that smaller firms and charities in particular feel unable to take on risks that could seriously harm their organisations if investments do badly or if longevity increases unexpectedly. As a result, they can either withdraw from the outsourcing process or purchase a pension from a third party. These pensions can involve contribution rates of about 40 per cent of salary, more than double the average employer contribution in the non-uniformed public service pension schemes...

Ultimately, it is for the Government to consider carefully the best way of moving forward with Fair Deal in a way that delivers its wider objective of encouraging a broader range of public service providers while remaining consistent with good employment practices. For its part, the Commission will focus in its final report on addressing the issue of how long-term structural reform to public service pensions can support greater labour market mobility and improved productivity in a way that conforms to the general principles outlined in Chapter 3.

Source: Independent Public Service Pensions Commission: Interim Report, October 2010, pages 109-112.

Those affected by this consultation

1.7 The nature of the Fair Deal policy, as described in Chapter 2, means that the following people and organisations will be affected by this consultation:

- employees who:
  - are members of the current public sector workforce who are compulsorily transferred to non-public sector employer in the future; and
  - have been transferred out of the public sector under the Fair Deal policy in the past.
- employers, that is:
  - in-house public sector and independent providers[6] who may wish to bid to deliver public services under a new outsourcing contract in the future, in situations where a change of employer would involve a compulsory transfer of staff;
  - in-house public sector and independent providers who may wish to bid to deliver public services as above, but in a re-tendering process; and
  - independent providers who have taken on public sector staff under the Fair Deal policy in the past, and who are part of a re-tendering process in the future.
- public sector contracting authorities putting public services out to tender in the future.

1.8 When considering who is affected by this consultation, it is also important to also note that future policy may influence the shape of public service provision, including the nature of providers.

Question for consultation

Question 1: The Government welcomes views on whether there are any other people or organisations who may be affected by this consultation.

Other related reviews

1.9 There are several related reviews concerning public service pensions occurring at the moment, including:

- **the final report of the Independent Public Service Pensions Commission** which is due by Budget 2011. This will focus on the structural reform of public service pensions, including addressing the issue of how this can support greater market mobility and improved productivity. The Government recognises that respondents may wish to take the Commission's recommendations into account when considering their responses; this consultation will therefore remain open for twelve weeks after the Budget; and
- **the Government's consultation on the discount rate** used to set contribution rates for the unfunded public service pension schemes through valuations following the Superannuation Contributions Adjusted for Past Experience (SCAPE) methodology, which closes on 3 March. [7] The IPSPC has estimated that, for the unfunded schemes

[6] These include private sector businesses and non-profit making organisations such as charitable bodies and social enterprises.

[7] *Consultation on the discount rate used to set unfunded public service pension contributions*, HM Treasury, December 2010

as a whole, the effect of reducing the discount rate by each 0.5 per cent per annum could increase the calculated total contribution required for pension benefits being earned by an average of about 3 per cent of pay bill. A reduction in the discount rate may, therefore, reduce the cost advantage of public service providers when bidding against independent providers to deliver public services.

1.10 In addition, respondents may be interested in the Public Service Reform White Paper, due to be published shortly. This will set out the Government's plans to reform public services to increase innovation and choice. It should be noted that in the devolved areas of policy, it is for the devolved administrations to take forward their own public service reform policies.

Scope and timing of consultation

Scope

1.11 The focus of this consultation is on the future of the Fair Deal policy, in particular:

- what future policy for new outsourcing arrangements should be. Chapter 3 sets out objectives for future policy and invites respondents to put forward proposals evaluated against these and any other objectives considered relevant; and
- arrangements for employees whose pensions have been transferred under the Fair Deal policy in the past. Chapter 4 discusses the situations where the public service involved is subsequently re-tendered to an alternative independent provider, or is returned to the public sector.

1.12 This consultation does not cover:

- the structural reform of public service pensions;
- the discount rate used to set contribution rates for the unfunded public service pension schemes;
- the Code of Practice in Workforce Matters in Public Sector Service Contracts (commonly referred to as the Two-Tier Code). The Government withdrew this with effect from 13 December 2010, and introduced a set of Principles of Good Employment Practice in contracted out services[8]; and
- any change of regulations required within public service pension schemes if there is a change to the Fair Deal policy after this consultation. Once an outcome is announced, schemes will undertake any appropriate consultations if scheme rules need to be changed (see Annex B for schemes that may be affected).

Timing

1.13 The consultation will remain open until 15 June, twelve weeks after the Budget. The Government will report on the consultation in the summer.

[8] *Principles of Good Employment Practice,* Cabinet Office, December 2010 http://www.cabinetoffice.gov.uk/resource-library/principles-good-employment-practice

2 The Fair Deal policy

Overview of chapter

2.1 This chapter sets out how the Fair Deal policy fits with the Transfer of Undertakings (Protection of Employment) Regulations. It explains the requirements of the Fair Deal policy, also setting out where it does not apply. The Government welcomes views from respondents on how the Fair Deal policy operates, where this is considered relevant for future policy.

TUPE regulations

2.2 The Transfer of Undertakings (Protection of Employment) Regulations, known as TUPE,[1] preserve the employment contracts of employees where the business, part of the business or service provider they work for transfers from one owner to another across both the public and private sectors.

2.3 The TUPE regulations explicitly excluded occupational pension entitlements. However, with effect from 6 April 2005, some protection for pensions is provided by the Pensions Act 2004 upon a relevant transfer within TUPE. Minimum requirement options now include employer contributions matching employee contributions of up to six per cent of salary into a stakeholder pension or equivalent occupational pension alternative.

The Fair Deal policy

2.4 As discussed in Chapter 1, the Fair Deal policy was introduced in 1999[2] and is a non-statutory policy applying to pension provision for public sector staff when they are compulsorily transferred under TUPE to a non-public sector employer (an independent provider).

2.5 The Fair Deal policy builds on the requirements under a TUPE transfer for the occupational pension entitlements of these individuals, providing for a higher level of pension provision. It applies where:

- public sector staff are compulsorily transferred to a new employer; and
- an outsourced public service where staff were transferred out under the Fair Deal policy in the past is re-tendered or returned to the public sector.

2.6 This chapter considers each of these situations in turn. The Fair Deal policy covers both employees' future pension accrual (due to further years of service) and the treatment of their accrued benefits. It should be noted that while Fair Deal is a non-statutory policy, elements of the resulting pension provision will be reflected in the outsourcing contractual arrangements, the details of which will vary.

[1] *The Transfer of Undertakings (Protection of Employment) Regulations*, February 2006

[2] *Staff transfers from central government: a fair deal for staff pensions, Guidance to Departments and Agencies*, HM Treasury, 1999

Future pension provision following transfer

2.7 The Fair Deal policy requires that the new employer should offer transferring staff membership of a pension scheme which is "broadly comparable" to the public service pension scheme which they are leaving. Public service pension schemes generally offer defined benefits – where this is the case, broad comparability requires that a defined benefit scheme is provided for transferring staff.

2.8 However, the schemes do not need to be identical in all respects: a broadly comparable scheme is one where an actuary certifies (on principles set out in a statement of practice issued by the Government Actuary's Department) that there are no identifiable employees or groups of employees who will suffer material detriment overall in their future pension accrual compared to the public service pension scheme.

2.9 The effects of this policy are that:

- transferring employees see no material reduction in the overall value of their pension provision as a result of the outsourcing arrangement; and
- the independent provider needs to provide a specific type and level of pension. It will reflect the costs of the pension provision in the bid price it submits to the public sector contracting authority.

Treatment of accrued pension benefits on transfer

2.10 In addition to requiring a broadly comparable pension for future accrual, the Fair Deal policy covers the treatment of previously accrued pension benefits. It requires a more generous approach to transfers than that generally provided by the statutory minimum Cash Equivalent Transfer Value (CETV). This is the value which individuals can take to another pension scheme instead of holding a deferred pension, as discussed further in Box 2.A.

Implications for the employee

Options when transferring between defined benefit schemes

2.11 In general, when individuals leave one defined benefit scheme to join another, they will have accrued pension benefits in the first scheme up to the point of leaving. Upon leaving, they can choose between:

- becoming a deferred member and preserving their benefits in the original pension scheme.[3] The value of their benefits on leaving the scheme will generally be uprated by price inflation until they come into payment at normal retirement age; and
- transferring the value of their accrued pension benefits into the new pension arrangement, which will translate into a past service credit (where the scheme offers this option), or transferring the value into a personal or stakeholder pension plan.

2.12 When individuals choose the second option, the first pension scheme is required to pay the new scheme a CETV. If the new scheme is providing a past service credit for the member, it is free to decide what service credit to award on the basis of that payment. Often, the service credit will be lower than the time the individual had served with the previous employer, as discussed in more detail in Box 2.A.

[3] Pension scheme rules generally require that a member has accrued a minimum level of service before they can become deferred. If a member leaves the scheme with a lower level of service, they generally receive a reimbursement of their employee pension contributions.

Transferring past benefits under the Fair Deal policy

2.13 The Fair Deal policy requires a more generous approach to transferring past service benefits into the new broadly comparable pension scheme. This approach means that the employee benefits from a service credit in the new scheme on a day-for-day basis (or the actuarial equivalent where there are significant differences between the schemes), thus maintaining a link between their future earnings growth and their past service with the previous employer.[4]

Box 2.A: Transferring past pension benefits under Cash Equivalent Transfer Value

In general, when a member leaves a pension scheme, a Cash Equivalent Transfer Value (CETV) is the value which they can take to another pension scheme instead of holding a deferred pension. The scheme that the employee is leaving is required to provide this transfer value to the scheme receiving the employee.

When an employee decides to take a CETV, a lump sum is paid to the new pension scheme and, where the individual is transferring into another defined benefit scheme, the transfer value translates into a service credit (where the scheme offers this option).

This is not generally a simple case of transferring the individual's past service into the new scheme. A CETV is a valuation of a member's benefits that assumes they have left active membership of the scheme, so the transfer value does not take into account any future real earnings growth.

It is up to the new scheme to decide what past service credit to award on the basis of the transfer value received. In doing so, it generally takes into account the fact that future salary growth will apply to the service credit within a final salary pension.

The new scheme therefore generally awards a lower service credit than the individual actually held in the previous scheme. However, the individual then benefits due to the application of their future salary growth to that service credit.

The individual has the choice as to whether to transfer their benefits into the new scheme, or preserve them in the original scheme. The optimal decision will vary depending on individual circumstances.

Implications for employers

2.14 At the point where staff are transferred from the public sector to an independent provider under the Fair Deal policy, the new employer is responsible for the costs and risks of pension benefits accrued via the future service of transferred staff. In addition, the new employer also bears the liability of any past service pension benefits which are transferred into the new scheme.

2.15 The new employer takes on these liabilities under a "bulk transfer agreement". This sets out the terms of the transfer of liabilities including the amount the public service pension scheme will pay into the new scheme, called the bulk transfer value. This bulk transfer value is generally higher than the statutory CETV minimum requirement for those employees that elect to transfer their past benefits, to ensure that they receive service credits on a day-for-day or equivalent basis as outlined above.

[4] This is the case for members of final salary defined benefit schemes. Some public sector workers are now members of career average defined benefit schemes, such as Nuvos under the Principal Civil Service Pension Scheme.

2.16 The scheme actuary to the public service pension scheme calculates this bulk transfer value in the first instance. The new employer may then negotiate a further top-up payment to cover costs and risks associated with the bulk transfer, because:

- the calculation of the bulk transfer value is based on various assumptions, including future earnings growth, investment return, inflation and life expectancy. The new employer may take a different view of the liabilities and risks being taken on to the public service pension scheme actuary, and therefore the amount of assets required to cover the cost of these; and
- the new employer is also required under the Fair Deal policy to fund a bulk transfer value on any subsequent re-tendering, which must be calculated on no less favourable terms than under the initial bulk transfer agreement from the public sector. This is discussed in further detail below.

2.17 Any agreed further cost may be reflected in a higher bulk transfer value paid via an additional charge included within the contract price paid by the public sector contracting authority. The cost is therefore borne by the public finances - ultimately the taxpayer.

Subsequent transfers

2.18 After a public service has been outsourced and the employees transferred under the Fair Deal policy, further compulsory transfers can take place. The Fair Deal policy still applies to those staff in these situations, that is:

- where the public sector contract is re-tendered to a new independent provider; and
- where an outsourced public service returns to the public sector.

Re-tendering

2.19 The Fair Deal policy (as clarified in the 2004 guidance note) sets out the approach that should be taken when an initial contract that involved Fair Deal arrangements is subsequently re-tendered.

Staff initially transferred under the Fair Deal policy

2.20 The Fair Deal policy continues to apply where employees originally transferred under the policy are subsequently compulsorily transferred from one independent provider to another because of action taken by the contracting authority, that is, the public sector partner. The staff should:

- receive broad comparability of pension terms for future pension benefits compared with the original public service pension; and
- be offered the option of transferring past service benefits into the new pension scheme on a day-for-day basis (or the actuarial equivalent).

Importing and exporting employers

2.21 This puts requirements onto both the exporting employer relinquishing the staff and the importing employer receiving them:

- **the importing employer** must provide a pension that is broadly comparable to the pension in place when the staff were originally transferred under the Fair Deal policy. It is also obliged to transfer past service benefits into this scheme via a bulk transfer agreement where staff elect to take up this option; and

- **the exporting employer** must provide a bulk transfer value to the importing employer for those staff who were originally transferred under Fair Deal arrangements and wish to take up the option to transfer their past pension benefits. The bulk transfer value has to be calculated on no less favourable terms than the bulk transfer which the exporting employer's scheme received at the start of their contract. Where the value of the bulk transfer thus calculated is not considered to be sufficient to meet the liabilities arising from the bulk transfer, the contracting authority might be asked to cover the extra costs within the new contract.

2.22 It is recognised that these re-tendering requirements can place significant risks and costs on the exporting employer and that these will be reflected in the original contract price, as well as in subsequent re-let contracts.

Services returning to the public sector

2.23 There may be occasions when a public service that has been delivered by an independent provider returns to in-house provision within the public sector. In cases where former public sector employees were transferred out under the Fair Deal policy, it also applies on their return to the public sector.

2.24 During the intervening years, it may well be the case that the public service pension scheme to which those staff originally belonged is closed and a new pension scheme has been introduced. In some instances, this may mean returning former employees receive different pension provision than the current workforce, and also creates the administrative burden of running different schemes in parallel.

When the Fair Deal policy does not apply

2.25 There are situations where the Fair Deal policy does not apply, namely:

- where public sector staff were originally outsourced before the introduction of the Fair Deal policy, it also does not apply to them for any further transfers. It should be noted that while the Fair Deal policy came into effect on publication, there was a provision that advanced procurements should not incorporate it if this would cause delay or termination. In these situations, TUPE regulations will generally apply;
- where staff are recruited by an independent provider after the initial outsourcing has taken place, the Fair Deal policy does not apply to them on subsequent re-tendering. In these situations, TUPE regulations will generally apply or there may be specific contractual requirements; and
- where staff transfer voluntarily, either to a new organisation or back to their old public sector employer, rather than under a compulsory transfer.

Question for consultation

Question 2: The Government welcomes views from respondents on how the Fair Deal policy operates in their experience, where this is considered relevant to future policy.

3 Options for future policy - invitation for proposals

Overview of chapter

3.1 This chapter sets out some objectives for future policy, also discussing the range of options and their implications for those involved. The Government invites respondents to put forward proposals for future policy.

Objectives for future policy

3.2 It is helpful to consider what objectives future policy might meet, to assist in the evaluation of options. Objectives are listed and discussed below, and it is recognised that there are tensions between these objectives, so different approaches will satisfy each of them to differing extents:

- **Delivering value for money** for the taxpayer, so that the highest quality public services are achieved within available resources. This is particularly important at the current time.

- **Providing an appropriate level of protection to public sector employees' pension provision** when the services they deliver are outsourced. Retaining workforce engagement will help to ensure the effective delivery of public services, which requires the maintenance of key skills within the workforce.

- **Removing barriers to plurality of public service provision.** Opening public services up to competition is a key component of the Government's plans to improve quality and value for money in public service delivery. As discussed in Chapter 1, the Independent Public Service Pension Commission's interim report has highlighted that the current Fair Deal requirements present barriers to alternative public service providers, particularly smaller ones.

- **Allocating the costs and risks of pension provision appropriately.** The Government must decide what costs and risks it is prepared to bear in the delivery of public services, which are ultimately borne by the taxpayer. One way of promoting plurality of public service provision without changes to the Fair Deal policy is to extend access to public service pension schemes to non-public service employees, as occurs in some parts of the public sector. The Government then bears the pension liabilities in these cases but without control of the cost drivers.

Question for consultation

Question 3: The Government welcomes views on whether there are any other objectives which should be taken into account when developing future policy.

Range of options

3.3 There is a range of options for future policy on pension requirements for staff transferring out of the public sector due to outsourcing. This spans from keeping the Fair Deal policy in its current form to removing it.

No change to the Fair Deal policy

3.4 Retaining the current Fair Deal policy would preserve current pension entitlements for public sector employees transferring under an outsourcing contract. However, it would not tackle the current barriers to plurality of public service provision discussed in Chapter 1.

3.5 There is already a policy of allowing access to public service pension schemes to non-public sector employees delivering public services in some parts of the public sector, as an alternative means of meeting the requirements of the current Fair Deal policy. The Independent Public Service Pensions Commission's interim report raised concerns about widening access, as it would involve the Government bearing additional risks on the public sector balance sheet without being in control of managing them. For example, the Government would not set the pay of the non-public sector employees involved, which is a key driver of the cost of pensions. Further details are set out in Box 3.A.

Box 3.A: Independent Public Service Pensions Commission interim report findings on extending access to public service pensions

Some external stakeholders have suggested that extending access to public service pension schemes to non-public service employees would help to reduce the disadvantages faced by private sector and third sector organisations as a result of Fair Deal.[1]

Extension of access is already quite common in some public service pension schemes. For instance, the NHS and teachers pension schemes have, for historic reasons, long had many private sector employees. In the case of the NHS, this is to cover General Practitioners working as private sector practices.[2] In the teachers schemes, it is principally to cover teachers in independent schools. The Local Government Pension Scheme has for the last decade offered admitted body status to facilitate pension arrangements for local authority workforces transferred to private sector contractors. In 2007 there were around 2,500 admitted bodies in the scheme, in addition to the 500 principal local authority employers. These admitted bodies employ about seven per cent of LGPS members.

However, there are important arguments against widening the current provisions. Doing so would involve the Government bearing additional risks arising from pension liabilities accrued in the private sector. But the Government would have little control over the liabilities being accrued, since it would not set the wages of these employees.

Some of these risks can be managed. The Teachers' Pension Scheme requires indemnities from third party financial institutions as a condition of new admission for independent schools and its rules control pensionable pay increases in the final years. But such risks cannot be completely removed, and evidence to the Commission suggests many organisations cannot provide such indemnities.

[1] In some cases, access to public service pension schemes is not possible, for example, due to the Superannuation Act 1972.

[2] The NHS Pension Scheme also operates a directions policy that allows access to the pension scheme for voluntary, not for profit organisations in limited circumstances to support the delivery of healthcare services.

Moreover, extending access might not provide a viable solution for some private sector and third sector organisations. Evidence submitted to the Commission stated that smaller organisations are struggling with the exit charges levied by some parts of the Local Government Pension Scheme when contracts end. They can run the risk of becoming technically insolvent as they are required to recover any deficits under a shorter timescale than that allowed to public service local government employers

Future prospects

These issues mean that extending access to public service pension schemes is probably not the solution to the issues that Fair Deal currently creates. It is clear that structural reform of public service pensions could be part of a solution if reform creates a more level playing field with the private sector. The Commission's final report will deal with long-term structural reforms.

Ultimately, it is for the Government to consider carefully the best way of moving forward with Fair Deal in a way that delivers its wider objective of encouraging a broader range of public service providers while remaining consistent with good employment practices. For its part, the Commission will focus in its final report on addressing the issue of how long-term structural reform to public service pensions can support greater labour market mobility and improved productivity in a way that conforms to the general principles outlined in Chapter 3.

Source: Independent Public Service Pensions Commission Interim Report, October 2010, pages 111-112

Reforming the Fair Deal policy

3.6 A range of options exist to reform the Fair Deal policy, which would achieve different balances between the objectives discussed above. Any option will involve choices regarding:

- **the requirements for future pension accrual**, including for the level of pension provision to be provided and any specifications concerning the type of pension scheme to be provided; and
- **the treatment of previously accrued pension benefits**, and whether this involves provision above the minimum requirement of a Cash Equivalent Transfer Value. If so, does it require a bulk transfer or similar agreement?

3.7 Therefore, there are a range of options around the level of employer contributions, the degree to which the type of pension scheme is specified and what arrangements should be in place where staff wish to transfer accrued benefits.

Ending the Fair Deal policy

3.8 Another option would be to remove the Fair Deal requirements. This would mean that future outsourcing arrangements would be subject to the statutory TUPE regulations covered in Chapter 2. This could have a significant impact on the value of future pension arrangements for transferring public sector employees, and could consequently reduce costs for independent providers.

3.9 This would make it possible for more varied independent providers to bid for public services because the pension barrier had been removed. However, it would create a new cost differential across the range of potential public service providers, as the higher level of public pension provision would then impact on the competitiveness of in-house bidders.

Questions for consultation

3.10 Having set out objectives for future policy and discussed the range of possible options in broad terms, the Government invites proposals for future policy through the following questions:

Question 4: Is there a case for changing the current Fair Deal policy?

Question 5: If so, what should the policy cover, including:

a) what (if any) stipulations should be made regarding the level and type of future pension provision following transfer;

b) what should be the treatment of previously accrued benefits? For example, should CETV's be the norm or should bulk transfer agreements continue to be used and, if so, in what form; and

c) what should the requirements be on subsequent compulsory transfer to an independent provider or return to the public sector?

Question 6: In setting out a proposal for future policy, respondents are asked to set out:

a) how it would deliver against the objectives set out above and any others considered relevant;

b) the impacts on those involved, including employers and employees;

c) if possible, an indication of how much the proposal would cost or save the taxpayer compared to the current Fair Deal arrangements; and

d) any past experience, whether in the public sector or otherwise, which informs these proposals.

4 Subsequent transfers after an initial Fair Deal transfer

Overview of chapter

4.1 Chapter 3 considered what form future policy on pension arrangements should take where public sector employees are compulsorily transferred to a new employer. This chapter considers policy options where public services outsourced under the Fair Deal policy in the past are subsequently re-tendered or returned to the public sector.

4.2 If there is no change to the Fair Deal policy following this consultation, then these situations do not need to be considered. However, in order that the consequences of a policy change are fully understood this chapter assumes a change in policy.

Re-tendering

4.3 In reviewing the Fair Deal policy, it is necessary to consider (in the light of the objectives set out in Chapter 3) what approach should be taken to those contracts that are re-tendered where the current Fair Deal arrangements are in place. Two possible options are:

- maintaining the current Fair Deal policy for both exporting employers and transferred Fair Deal staff, as described in Chapter 2. This delivers parity of treatment for people with respect to the point at which their first compulsory transfer took place, but means that staff undergoing compulsory transfers at the same time would receive different treatment; or

- revising the approach to allow re-tendered contracts to implement future policy if there are changes, subject to any past contractual obligations in place which will take precedence. This delivers the same treatment for staff transferred at a given time, whether under an initial or subsequent transfer, regardless of when an individual's first transfer took place.

4.4 It is important to note that, while the Fair Deal policy itself is non-statutory, where there are specific contractual obligations which would require the current policy on re-tendering to continue, no change in policy will override these contractual obligations. In such cases, it will be a matter for those involved to resolve any contractual issues as appropriate.

Question for consultation

Question 7: The Government welcomes views on what approach should be taken when previously transferred public services involving compulsory Fair Deal staff transfers are re-tendered. The Government also welcomes details of any past experience informing respondents' proposals.

Services returning to the public sector

4.5 Since the Fair Deal policy was first introduced, public service pension schemes have evolved to take account of the changing needs of employers and employees, and against a background of issues such as improving life expectancy. While approaches may be different, the private sector has also been undergoing changes in pension provision. In public service schemes, this

has led to changes in retirement ages, the introduction of new risk sharing provisions to limit taxpayer exposure to cost increases and, in one scheme, a move away from final salary to career average pension provision to better reflect changing career patterns.[1]

4.6 As discussed in Chapter 2, the current Fair Deal requirements can therefore mean that returning former employees receive different pension provision than the current workforce where pension provision has changed in the meantime. This means that the public sector body may need to offer several different pension arrangements concurrently, resulting in additional administrative costs.

4.7 The final IPSPC report will be published during this consultation. The IPSPC has been asked to make recommendations for a fundamental structural reform of current pension provision so there is the prospect of further changes. In particular, in the IPSPC's interim report Lord Hutton has already highlighted concern that final salary schemes may no longer provide a robust and fair mechanism for the majority of the public sector workforce.

4.8 Against this background, two possible options for future policy are:

- maintaining the current approach as described in Chapter 2; or
- providing that future accrual for returning public sector staff should be via membership of the public service pension scheme that is open to new members.

Question for consultation

Question 8: The Government welcomes views on what approach should be taken for employees returning to the public sector having been transferred out in the past under the Fair Deal policy. The Government also welcomes details of any past experience informing respondents' proposals.

[1] *Chapter 2 of Independent Public Service Pensions Commission: Interim Report, the Independent Public Service Pensions Commission*, October 2010

5 Summary of questions

Question 1: The Government welcomes views on whether there are any people or organisations who may be affected by this consultation other than those listed in 1.7.

Question 2: The Government welcomes views from respondents on how the Fair Deal policy operates in their experience, where this is considered relevant to future policy.

Question 3: The Government welcomes views on whether there are any objectives which should be taken into account other than those set out in 3.2 when developing future policy.

Question 4: Is there a case for changing the current Fair Deal policy?

Question 5: If so, what should the policy cover, including:

a) what (if any) stipulations should be made regarding the level and type of future pension provision following transfer to be provided for future accrual;

b) what should be the treatment of previously accrued benefits? For example should CETV's be the norm or should bulk transfer agreements continue to be used and, if so, in what form; and

c) what should the requirements be on subsequent compulsory transfer to an independent provider or return to the public sector?

Question 6: In setting out a proposal for future policy, respondents are asked to set out:

a) how it would deliver against the objectives set out in Chapter 3 and any others considered relevant;

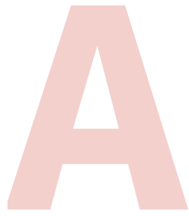
b) the impacts on those involved, including employers and employees;

c) if possible, how much the proposal would cost or save the taxpayer compared to the current Fair Deal arrangements; and

d) any past experience, whether in the public sector or otherwise, which informs these proposals.

Question 7: The Government welcomes views on what approach should be taken when previously transferred public services involving compulsory Fair Deal staff transfers are re-tendered. The Government also welcomes details of any past experience informing respondents' proposals.

Question 8: The Government welcomes views on what approach should be taken for employees returning to the public sector having been transferred out in the past under the Fair Deal policy. The Government also welcomes details of any past experience informing respondents' proposals.



The consultation process

How to respond

A.1 This consultation document is available on the Treasury website at www.hm-treasury.gov.uk. For hard copies, please use the contact details below.

A.2 Responses are requested by 15 June 2011. Please ensure that responses are sent in before the closing date. The Government will also engage directly with interested groups.

A.3 Responses can be sent by email to: fairdealconsultation@hmtreasury.gsi.gov.uk.
Alternatively, they can be posted to:

Public Service Pensions Fair Deal Consultation
Workforce, Pay and Pensions Team
Public Services and Growth Directorate
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

A.4 When responding, please state whether you are doing so as an individual or on behalf of an organisation.

Confidentiality

A.5 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

A.6 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

A.7 HM Treasury will process your personal data in accordance with the DPA, and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

The Government's Consultation Code of Practice

A.8 This consultation is being conducted in accordance with the Government's Code of Practice on Consultation. A copy of the Code of Practice can be found on the Business Innovation and Skills website: http://www.bis.gov.uk/policies/better-regulation/consultation-guidance.

The consultation criteria

1. When to consult - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. Duration of consultation exercises - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Clarity of scope and impact - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. The burden of consultation - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Capacity to consult - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

A.9 If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Better Regulation Unit at HM Treasury - 0207 270 4867/4517

B Public service pension schemes covered by the Fair Deal policy

Public service pension schemes and Fair Deal policy

B.1 The public service pension schemes covered by this consultation include:

- Principal Civil Service Pension Scheme (England and Wales)
- NHS Pension Scheme
- Teachers' Pension Scheme (England and Wales)
- Police Pension Scheme
- Firefighters' Pension Scheme
- United Kingdom Atomic Energy Authority Pension Schemes
- Research Councils Pension Schemes

B.2 In addition to the schemes mentioned above, there are a number of smaller schemes and many established to cover only one senior appointment which may be affected by the outcome of this review.

The Local Government Pension Scheme and the Fair Deal Policy

B.3 To ensure that the Fair Deal policy applies to local government, sections 101 and 102 of the Local Government Act 2003 confer powers on the Secretary of State, the National Assembly for Wales and Scottish Ministers to require Best Value Authorities in England, Wales or Scotland, when engaged in contracting-out exercises, to deal with staff matters (including pensions) in accordance with directions.

B.4 As a consequence, the Best Value Authorities Staff Transfers (Pensions) Direction 2007, issued under section 101, secures a 'broadly comparable' pension for staff transferring from a Best Value Authority in England and a Police Authority in Wales to a service provider. The Direction came into force on 1 October 2007.

Devolved Administrations and the Fair Deal policy

B.5 Where the Devolved Administrations have direct responsibility for public service pension schemes, they have generally chosen to follow the current Fair Deal policy when public sector staff transfer under TUPE to a new independent provider. It will be a matter for the Devolved Administrations to decide what approach they will take once this consultation is completed, within the overall public spending framework as appropriate. We will therefore share any comments that specifically relate to the Devolved Administrations for their consideration.

Glossary

Glossary of terms

C.1 Accrual: A payment earned in one period but not necessarily paid until a later date.

C.2 Accrual rate: The proportion of earnings that a defined benefit pension scheme pays for each year of membership. A smaller accrual fraction means lower benefits. For example, a 60ths accrual rate means that the schemes will provide 1/60ths'of earnings for each year of membership, which is higher than a pension based on an 80ths accrual rate.

C.3 Admitted Body Status: Admitted body status refers to the practice of the Local Government Pension Scheme of accepting as members the employees of bodies not covered by the original or primary ambit of the scheme as set out in its founding statute. It enables contractors, who take on an authority's services or functions with employees transferring from the authority, to offer the transferring staff continued eligibility of the transferring authority's pension scheme.

C.4 Broadly comparable: A scheme is 'broadly comparable' if the overall value of the scheme (on principles set out in a statement of practice issued by the Government Actuary's Department) is greater or equal to the current scheme and there is no identifiable group or individual who will be materially worse off.

C.5 Bulk transfer: The transfer of liabilities for a group of members from one pension scheme to another. For bulk transfers under the Fair Deal policy, members benefit from a service credit in the new scheme on a day-for-day basis (or the actuarial equivalent).

C.6 Bulk transfer value: The value placed on the benefits transferring under a bulk transfer.

C.7 Career Average Scheme (CARE): A defined benefit scheme that gives individuals a pension based on a percentage of the salary earned in each year of their working life (rather than the final years).

C.8 Cash Equivalent Transfer Value (CETV): The value of accrued pension rights when any worker leaves a scheme voluntarily. Members can request a CETV but receiving schemes can refuse to accept them.

C.9 Commission: The Independent Public Service Pensions Commission (explained below).

C.10 Deferred members: Deferred members are scheme members who have left employment, or ceased to be an active member of the scheme whilst remaining in employment, but retain an entitlement to a pension from the scheme at retirement.

C.11 Defined benefit (DB) pension scheme: A pension scheme where the pension is related to the members' salary or some other value fixed in advance.

C.12 Defined contribution (DC) pension scheme: A scheme where the individual receives a pension based on the contributions made and the investment return that they have produced. These are sometimes referred to as money purchase schemes.

C.13 Discount rate: The rate at which pension schemes discount pension provision (i.e. the future liability) to its 'present value' for inclusion in financial statements.

C.14 Employee contribution rates: The percentage of pensionable salary that employees pay as a contribution towards a pension.

C.15 Employer contribution rates: The employer's contribution towards an employee's pension, based on a percentage of an employee's salary.

C.16 Final salary scheme: A defined benefit scheme that gives individuals a pension based on the number of years of pensionable service, the accrual rate and final earnings as defined by the scheme.

C.17 Funded pension schemes: Pension schemes in which pension contributions are paid into a fund which is invested, from which fund pensions are paid out.

C.18 Independent providers: Private sector businesses and non-profit making organisations such as charitable bodies and social enterprises providing public services.

C.19 Independent Public Service Pensions Commission: An independent commission undertaking a fundamental structural review of public service pension provision to report by Budget 2011. Their interim report was published on 7 October 2010.

C.20 In-house bidders: Public sector organisations who bid for contracts to provide public services.

C.21 Liability: A measure of the value, in today's money, of all pension entitlements to be paid in the future that have been earned to date.

C.22 Life expectancy: Life expectancy at a given age, x, is the average number of years that a male or female aged x will live thereafter, and is calculated using age and gender specific mortality rates.

C.23 Longevity: The length or duration of human life.

C.24 Lump sum: A one-off payment from a pension scheme, for example a tax-free payment to a member on retirement, or a sum paid to another arrangement to transfer a member's pension rights.

C.25 Matching contributions: An arrangement common in employer-sponsored defined contribution pension schemes by which a contribution made by an individual is added to by their employer. For example, the employer may add 50p or £1 for each £1 of individual contributions made, up to a limit.

C.26 Normal retirement age: The earliest age at which, in the normal course of events, a scheme member may retire with payment of his or her accrued pension benefits without reduction for early payment. For people retiring now this is usually age 60 but for recently reformed schemes this is age 65. Members of some services (i.e. police, fire and the armed forces) retire earlier, as do some groups within a service with reserved rights such as NHS nurses, and mental health officers.

C.27 Occupational pension: A pension which is provided via the employer, but where the pension scheme usually takes the form of a trust arrangement and is legally separate from the employer.

C.28 Outsourcing: Public service provision carried out by independent providers.

C.29 Primary contractor: An independent provider with a direct contractual relationship with the public service organisation responsible for the public service being provided.

C.30 Public service pension schemes: Pension schemes authorised by statute where the relevant Ministers make the rules of the schemes. The main schemes are those for civil servants, the

armed forces, NHS employees, teachers, local government employees, the police and firefighters. There are over 200 public service pension schemes.

C.31 **Re-tendering:** Second and subsequent market testing exercises to provide public services.

C.32 **Superannuation Contributions Adjusted for Past Experience (SCAPE):** A methodology used to set employer contribution rates across public service pension schemes intended to mirror the operation of a funded scheme by keeping track of a notional 'Pension Account'.

C.33 **Service credit:** The length of service credited to an individual on which their defined benefit pension benefits are calculated.

C.34 **Unfunded pension schemes:** Pension schemes which are not backed by a pension fund. Instead current contributions are used to pay current pensions along with other funds provided by the employer. Most public service schemes are unfunded, except for the Local Government scheme, which is funded.

HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

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