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Newcomers to public sector outsourcing

Offloading pensions risk from the public sector has never been the main intention behind outsourcing of public services and the associated employees. Fair Deal guidance introduced from 1999 helped to reduce the impact on employees, but introduced barriers to entry for those outsourcers unable to take on the risk of providing 'broadly comparable' pension benefits.

The updated Fair Deal guidance, effective from October 2013, allows pension risk to remain with the public service scheme, which in turn allows outsourcers to make more competitive bids, without having to account for the large risk margins associated with defined benefit pension schemes. This has opened up the barriers, enabling more potential outsourcing providers to enter the market.

What types of contract does Fair Deal apply to?

Whether or not the guidance applies to a particular contract depends upon who employs the transferring staff. It 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. The guidance does not generally apply to local authorities, where an 'Admitted Body' framework is already in place to allow direct participation in the scheme.

Background

The Transfer of Undertakings (Protection of Employment) Regulations (TUPE), which were first introduced in 1981, provide relatively little provision for the protection of pensions. The government introduced a separate non-statutory policy, known as 'Fair Deal', in 1999 for the protection of public sector pensions that applies whenever public sector employees are transferred under TUPE.

This required contractors to set up a scheme that was 'broadly comparable' to the one employees were transferred from, with the associated costs and statutory requirements.

Revised guidance under the Fair Deal policy was published on 4 October 2013 following a number of consultations since the first announcement of the intended changes in July 2012. The new guidance came into immediate effect, but suggests that contracts at an advanced stage should not be held up due to the change of policy. It is likely to be in contractors' best interests, though, to push for the new Guidance to be applied whenever possible. All contracts tendered or renewed from April 2015 should comply with the new policy.

What has changed?

The new guidance has the intention of opening up the outsourcing market to new players who either lacked the resources to establish broadly comparable schemes, or found the costs and risks previously associated with these to be untenable. It should also make it easier to understand the total costs of a contract, without the waters being muddied by ongoing pension deficits.

Under the previous guidance, the new employer had to give protected employees access to an occupational pension scheme which was 'broadly comparable' to the public service scheme they were leaving. Staff could choose whether to leave their past service entitlement in the public service scheme (as a deferred pension) or transfer it to the new employer's broadly comparable scheme under a day-for-day (or equivalent) bulk transfer arrangement.

Under the new guidance, the new employer will instead participate directly in the public service scheme. This is expected to be a simpler and less costly approach for new contracts, giving benefits to all parties:

- No need for the contractor to establish a separate scheme.
- The contractor is not left with deferred and pensioner members at the end of the contract.
- The pension contributions are likely to be significantly lower, resulting in a better value contract.
- Members generally prefer to stay in the public service scheme.

There will be cross-subsidies between employers in the public service scheme which may or may not work in the contractor's favour. Even for a contract where this has a negative impact, though, the cost is likely to be much lower than through a broadly comparable scheme.

The revised Fair Deal has removed many issues that could have previously put off outsourcers from bidding for public sector contracts.

All of the following key issues under the previous guidance have now been removed:

- Significant costs of setting up a broadly comparable scheme.
- High ongoing contribution rates relative to those within the public sector scheme.
- Risks in relation to past service benefits accrued.
- Difficulty in pricing bids due to unknown pension costs.
- Significant advantage for in-house bidders (having access to the public sector scheme).

It is therefore anticipated that many newcomers will enter the public sector outsourcing market over the next few years. The key point for these newcomers is to ensure that the contract will be administered under the new Fair Deal guidance (do not take this for granted) and that any funding shortfall from an existing contract is identified, so that it will be covered by the contracting authority.

More detail is available from our general leaflet on public sector outsourcing, which provides information relating to Local Government Pension Scheme arrangements (which were already similar to the new Fair Deal arrangements and are currently under review) and further information for contractors already involved in public sector outsourcing arrangements.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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