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

Response from the Employment Lawyers Association

15 June 2011

ELA Response to Consultation on treatment of pensions on compulsory transfer of staff from the public sector

INTRODUCTION

The Employment Lawyers Association ("ELA") is a non-political group of specialists in the field of employment law and includes those who represent Claimants and Respondents in the Courts and Employment Tribunals. It is therefore not ELA's role to comment on the political merits or policy aims of proposed legislation, but rather to make observations from a legal standpoint. The ELA's Legislative & Policy Committee is made up of both Barristers and Solicitors who meet regularly for a number of purposes including to consider and respond to proposed new legislation.

A sub-committee was set up by the Legislative & Policy committee of ELA under the chairmanship of Emma Burrows (Trowers & Hamblins LLP) to consider and comment on the consultation document issued by HM Treasury "Consultation on the Fair Deal Policy: treatment of pensions on compulsory transfer of staff from the public sector". Its comments are set out below. A full list of the members of the sub-committee is annexed to the report.

Specific 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.

Representatives of employees in the private sector who would work alongside staff protected by the Fair Deal Policy.

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.

- 1 There are perimeter/scoping issues with the Fair Deal Policy at the moment, i.e. it currently applies to transfers from "central government departments and agencies" and the UK Government expects it "to be adopted by other public sector employers". This has led to a number of situations where it is unclear if it applies, e.g.
 - 1.1 Does it apply to the university sector? It is our understanding that it does not, but this has never been made explicitly clear. If the university sector is excluded, does that exclusion apply equally to established and new universities (some of whom may, at some point in the past, have been run by a local authority, to whom the Fair Deal Policy now applies)?
 - 1.2 Does it apply to quangos, such as the Pension Protection Fund?
 - 1.3 Does it apply to private companies that are owned (or partially owned) by public sector employers?

If the Fair Deal Policy survives, it would be extremely helpful if its scope were clarified.

- 2 In our experience, employers find complying with the Fair Deal Policy very expensive. For example, some of our members have clients who have been advised that the employer contribution rate they would have to pay to a GAD approved scheme is around 45%.
- 2.1 Obtaining admission body status in the LGPS can be cheaper than contributing to a GAD approved scheme, at least initially, but there are a number of commercial risks that need to be negotiated, i.e. will the accrued benefits be 100% funded at transfer; will there be collar/cap mechanism put in place in relation to the employer contribution rate throughout the term, and will there be any exit deficit payable when the admission body ceases to participate in the LGPS? Our members' experience is that local authority employers tend to insist that bidders participate in the LGPS, rather than a GAD approved scheme, thereby exposing them to risks that are exceptionally difficult to quantify. A lot of actuarial and legal time is spent trying to deal with these issues, particularly exit deficit, which is unknown at the outset and can be substantial.
- 2.2 This is complicated by the view of Lord Hutton who states in his final report dated March 2011 that "it is in principle undesirable for future non-public service workers to have access to public service pension schemes, given the increased long-term risk this places on the government and taxpayers".
- 2.3 Notwithstanding point 2.1 above, it can be disproportionately expensive to comply with the Fair Deal Policy where there are only a handful of employees transferring, especially if the transferee is itself a small employer. If the Fair Deal Policy survives, it may be helpful to limit application to large transfers (where 'large' is classified either by reference to the number of employees transferring or the size of the transferee employer (e.g. as assessed by turnover or number of employees) or a combination of both.
- 2.4 The cost of applying the Fair Deal Policy is, anecdotally, non competitive as it detracts SME employers and third sector organisations for bidding for work.
- 2.5 It gives rise to additional costs to employers on termination of contracts by the crystallisation of debts on employers under S.75 of the Pensions Act 1995 or Regulation 38 LGPS (Administration) Regulations.
- 3 The penalties for failing to comply with the Fair Deal Policy are not clear.
- 4 The Fair Deal Policy says that whenever a GAD approved scheme is offered, bulk transfers from the public sector scheme must also be offered, whereby employees get day-for-day service in the receiving GAD approved scheme, i.e. if an employee had ten years' service in a public sector scheme, he would have to get 10 years' service in the GAD scheme. The problem is that, the public sector scheme may be underfunded and the Fair Deal Policy (and the subsequent Guidance Note issued by HM Treasury in June 2004) does not say how any funding gap is to be made up. There are commercial workarounds, but they are not entirely satisfactory and it would be extremely helpful if this point could be clarified, e.g. by prescribing the basis upon which bulk transfer values have to be calculated and paid in these circumstances.
- 5 The Fair Deal Policy can create disparity in terms and conditions between ex-public sector employees and employees in private sector terms, who generally do not have access to DB schemes. This can give rise to employee relations issues.

- 6 From an employee perspective, the Fair Deal Policy gives some certainty to public sector workers who transfer into the private sector. It protects a vital part of the pay and benefits package that employees in the public sector have, and gives employees certainty.
- 7 Where admitted body status has been arranged, and if employees subsequently move back into the public sector, there are subsequently no issues about continuity in the relevant public sector pension scheme.

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.

As this is a matter of policy we chose not to answer this question.

QUESTION 4: IS THERE A CASE FOR CHANGING THE CURRENT THE FAIR DEAL POLICY?

As this is a matter of policy we chose not to answer this question.

QUESTION 5: IF SO, WHAT SHOULD THE POLICY COVER, INCLUDING:

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

8.1 The options are:

8.1.1 keeping the Fair Deal Policy;

8.1.2 removing the Fair Deal Policy; or

8.1.3 some form of mid-ground which is more favourable to the former public sector employees than the protection afforded by existing minimum statutory provisions.

8.2 **Keeping the Fair Deal Policy**

8.2.1 Please see our comments above.

8.3 **Removing the Fair Deal Policy**

8.3.1 If the Fair Deal Policy is removed, the former public sector employees will have minimum pension protection under the Transfer of Employment (Pension Protection) Regulations 2005/649 (**TEPP**) and the Pensions Act 2004. Those regulations permit the subsequent employer to replace the public sector final salary scheme with a money purchase scheme where the subsequent employer matches the employees' pension contributions, with a ceiling of 6% on the employers' contributions. This is better than the minimum requirements under the Pensions Act.

Some form of mid-ground which is more favourable to the former public sector employees than the protection afforded by existing minimum statutory provisions

8.3.2 Possible options for the mid-ground between the Fair Deal Policy and TEPP might be to increase to, say, 8% the limit in TEPP for compulsory transfers of

public sector or former public sector employees. Under this option the 'matching' requirement may be reduced so that employees have to contribute only, say, 4% in order to get an employer contribution of 8%.

8.3.3 Another mid-ground option would be the amendment of the TEPP for staff transferred out of the public sector (and second generation contracting). Rather than having the option of Regulation 2 (Final Salary Pension) or Regulation 3 (Money Purchase Pension Scheme), public sector employees could continue to be entitled to a final salary pension only, as above, the level of protection under TEPP could be enhanced so that this a better quality final salary pension than the current statutory minimum e.g. by increasing member contributions and the value of the level of benefits from 6% to 8%.

9 **What should be the treatment of previously accrued benefits? For example should CETVs be the norm or should bulk transfer agreements continue to be used and, if so, in what form; and**

9.1 It is for the Government to decide whether bulk transfer agreements should continue to be used as an alternative to Cash Equivalent Transfer Value, when members leave the public sector pension scheme.

9.2 If bulk transfer agreements continue to be used, then this could either be on a voluntary basis, if the public and private sector parties both agree, or a compulsory basis. Given our comments above at paragraph 8 above, if CETVs are not used, it would be extremely helpful if legislation were issued or detailed guidance given on how bulk transfer values are to be calculated.

10 **What should the requirements be on subsequent compulsory transfer to an independent provider or return to the public sector?**

10.1 In relation to future benefits, the options for after a subsequent compulsory transfer to an independent provider of services or return to the public sector are the same as the options set out above, but note that under current legislation local authorities probably do not have the vires to offer anything other than admission to the LGPS, and other public sector employers may be in a similar position.

10.2 This is complicated by the view of Lord Hutton who states in his final report dated March 2011 that "it is in principle undesirable for future non-public service workers to have access to public service pension schemes, given the increased long-term risk this places on the government and taxpayers".

10.3 In relation to accrued benefits, the options for transfer values are the same as those set out above, but note that, if the employees of the transferring provider are in a money purchase arrangement, the question of which basis to use when calculating transfer values largely disappears, as, in very broad terms, you simply use the fund value.

QUESTION 6: IN SETTING OUT A PROPOSAL FOR FUTURE POLICY, RESPONDENTS ARE ASKED TO SET OUT:

11 **How it would deliver against the objectives set out in Chapter 3 and any others considered relevant**

- 12 Retaining the Fair Deal Policy would closely meet the objective of providing an appropriate level of protection to public sector employees' pension provision. It would also help maintain, amongst public sector employees, an optimal degree of confidence in the process of contracting-out since they may anticipate that their level of pension entitlements will not collapse following such an exercise. It would not remove barriers to plurality of public service provision.
- 12.1 Removing the Fair Deal Policy would achieve the objective of delivering value for money for the taxpayer in that the pension costs for public sector employers transferring employees to the private sector would be greatly reduced, but this option would provide less protection to public sector employees' pension provision. The Fair Deal policy was introduced to fill the gap created by the fact that pension rights do not transfer under TUPE. Its removal is likely to increase hostility amongst public sector employees to contracting-out. It would be effective in removing barriers to plurality of the public service provision.
- 12.2 The mid-ground options would deliver better value for money for the taxpayer than the current Fair Deal Policy and would remove barriers to plurality of public service provision, whilst providing enhanced person protection to public sector employees' pension provision.
- 13 **The impact on those involved, including employers and employees;**
- 13.1 A possible impact of removing or changing the Fair Deal Policy might be a reduction in workforce engagement and the effective delivery of public services.
- 13.2 There is likely to be increased antipathy to contracting-out of public sector employment among both employees and trade unions. So, a further consequence could be an increase in industrial action around transfers. In calling for industrial action, a trade union must, if the trade unions can establish that there is a "trade dispute" pursuant to Section 244 of the Trade Union and Labour Relations (Consolidation) Act 1992. Section 244(1)(a) provides that a trade dispute means a dispute between workers and their employer which relates wholly or mainly to terms and conditions of employment, or the physical conditions which any workers are required to work. It has long been accepted that a dispute over pension rights is capable of being a trade dispute. However, the dispute must be between workers and their current employer. Thus, it is possible for industrial action to be taken against an employer who, following a transfer, does not provide the pension that the workforce demands.
- 13.3 It is worth noting that a dispute with an employer (say, a public sector organisation) over its failure to ensure that a future employer (say, a contractor following a contracting-out exercise) will guarantee pension rights after a transfer cannot be a trade dispute with the current employer (UCLH NHS Trust v. Unison [1999] IRLR 31). Accordingly, in cases where the workforce fears that pension rights will be reduced after a prospective transfer, the relevant trade union is likely to focus a dispute on the merits of the transfer itself, since the identity of the employer is capable of being a trade dispute (Unison v. Westminster City Council (2001) Times 3 April).
- 13.4 It seems likely therefore, that any industrial action would have to take place after the transfer. TUPE Regulation 6 provides that the trade union should be deemed to be recognised by the transferee employer only where the organised grouping of resources or

employee maintains an identity distinct from the remainder of the transferee's undertaking. Those factors may well limit the potential risk of industrial action.

- 13.5 The risk of litigation by employees against employers as a result of the possible removal or amendment of the Fair Deal Policy seems low as there is no immediately obvious cause of action, provided the employer complies with TUPE, the 2005 Regulations and any guidance which replaces the Fair Deal Policy.
- 13.6 The transfer of a gender specific group of public sector employees who lose their public sector pension rights if the Fair Deal Policy is removed, could give rise to equal pay claims, as the women would be able to compare their individual terms and conditions with those of their male colleagues who remain with the public sector employer and this could lead to male piggyback claims.
- 13.7 A further consequence of the removal of or amendment to the Fair Deal Policy might be a reduction in contracting out by public sector employers, due to concerns about the employees losing their pension entitlements.
- 14 **if possible, how much the proposal would cost or save the taxpayer compared to the current The Fair Deal Policy arrangements; and**
- 15 **any past experience, whether in public sector or otherwise, which informs these proposals.**
- 15.1 The experience of most members is that smaller private contractors and charities are discouraged from bidding for public sector service contracts by the Fair Deal Policy costs and delays. Only one of the eight members of the ELA Working Group felt that bidders were not put off by the Fair Deal Policy and only then with reference to larger contractors. The experience of the employer clients of most of the Group is that alternative pension provision under the Fair Deal Policy is very expensive, typically adding 45% to the payroll costs for transferred employees and driving a wedge between the former public sector employees and everyone else on less beneficial pensions. The Group felt that admitted body status was not an easy option either, because of the level of debt on crystallised status.

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.

- 16 If tendering today, with the Fair Deal Policy in place, the obligation to provide a 'broadly equivalent' pension scheme will apply and could become a contractual right if written into the contract of employment.
- 17 If the Fair Deal Policy is then abolished, anyone tendering after that will be at an advantage as they will not be under the duty to provide the pension rights whereas the business under the previous tender was. This could be seen as unfair from a competition law point of view.
- 18 If it is looking likely that the Fair Deal Policy may be abolished then that could lead to delays in re-tendering in the interim period as businesses wait to see what the outcome is. This could lead to uncertainty in the market.

- 19 Any revision of the Fair Deal Policy may prompt negotiations between the public body and the contractors and if there are proposed changes to the existing contract which are sufficiently material then under EU procurement rules, the public body will be required to conduct a full re-tender exercise.

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.

- 20 In cases where the current Fair Deal Policy applies, at the point at which a former public sector employee transfers back to the public sector from the private sector they would be entitled to membership of a scheme 'broadly comparable' to the private sector scheme that they were leaving, which in turn should be 'broadly comparable' to the public sector scheme that they were originally a member of.
- 21 In the event that the current Fair Deal policy were to end, and in the absence of any provisions to replace the Fair Deal policy, the effect of TUPE and the relevant provisions of the Pensions Act 2004 would be that the transferring employee's private sector occupational pension entitlement would not transfer, but the employee would be entitled to employer contributions into a stakeholder or equivalent occupational pension alternative up to 6% of salary. That is the starting position.
- 22 In terms of new provisions to enhance the rights of the former public sector employee returning to the public sector, there appear to be two main options:
- 22.1 Option 1 – continuing the current 'The Fair Deal Policy' approach of providing the employee with membership of a 'broadly comparable' scheme; or
- 22.2 Option 2 – reverting to a more basic approach, whereby the employee is entitled to join whatever relevant public scheme is open to new members at the point of transfer and either becomes a deferred member of the private sector scheme or transfers the value of the accrued pension benefits (from the private sector scheme) into the relevant public sector scheme.
- 23 When deciding which approach to adopt, the Government will need to balance the need to provide an appropriate level of protection to public sector employee's pensions against the need to deliver value for money to the tax payer. Considerations relating to the Government's desire to open up public services to competition from the private sector do not apply here, because the transfer is from private to public sector and should not therefore give rise to any increased cost to the private sector employer.
- 24 Option 2 is likely to be the simplest to administer and the least expensive in terms of the cost of future benefits to the taxpayer. However, it is also likely to be the least attractive from the transferring employee's perspective. In particular, any changes made to the scheme since the employee was originally transferred out of the public sector under the Fair Deal policy are likely (given the current climate) to be to the detriment of the employee, meaning that they may return to the public sector with a significantly decreased pension entitlement, possibly after only a relatively brief period away from the public sector and having accrued many years worth of service credits in the original scheme.

- 25 For example, many transfers of employees from public to private sector will arise from outsourcing, which in some cases will relate to relatively short term contracts that could result in subsequent 'in-sourcing' after a relatively brief period of time. Where the relevant public sector pension arrangements have changed to the transferred employee's detriment during the 'outsourced' period, the employee is likely to perceive unfairness if they are required to re-join the public sector scheme on the new, less favourable terms.
- 26 Option 1 would overcome such perceived unfairness because it would ensure that employees returning to the public sector are provided with access to a scheme which is 'broadly comparable' to that which they originally left. However, there is likely to be a considerably higher cost to the tax payer in comparison to Option 2, both in terms of the cost of pension benefits and administrative costs associated with the burden of having to enter into separate pension arrangements with transferring employees (although we imagine no higher than under the current Fair Deal arrangements). It may also lead to a perception of unfairness on the part of employees who have remained within the public sector pension scheme and have been subject to changes to the scheme to their detriment.
- 27 On balance, we consider that Option 1 is preferable to Option 2 for the following reasons:
- 27.1 it ensures that employees returning to the public sector have access to a defined benefit pension scheme which is 'broadly comparable' to that which they were originally a member of;
- 27.2 it ensures that public sector employees do not suffer adverse consequences as a result of being involuntarily transferred out of the public sector, possibly only for relatively brief periods of time;
- 27.3 the administrative burden and cost for public sector employers in situations where the relevant public sector scheme is no longer 'broadly comparable' is unlikely to be any more onerous than under the current Fair Deal Policy arrangements;
- 27.4 the principal motivation for considering amendments to the current Fair Deal policy, i.e. the Government's desire to open up public services to competition from the private sector, does not apply to transfers back into the public sector.

Appendix of contributors

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