FAIR DEAL FOR STAFF PENSIONS: PROCUREMENT OF BULK TRANSFER AGREEMENTS AND RELATED ISSUES

Guidance Note by HM Treasury, June 2004.

Summary

1. The purpose of this new guidance is to reinforce existing guidance on treatment of pension issues in compulsory transfers of public sector staff to private sector partners delivering public services[1] and:-

- to clarify the circumstances in which pension protection above the general statutory standard should be provided;
- to give guidance on the treatment of groups of staff not directly covered by the existing guidance;
- to draw attention to possibilities for improving arrangements by use of industry-wide schemes allowing staff to retain active membership of a single pension scheme when transferring amongst different private sector partners;
- and to improve the way in which public sector employers go about providing bulk transfer agreements for their staff to meet the requirements of existing guidance.

2. This new guidance aims to provide greater reassurance to the staff concerned; a more open, transparent, and predictable basis upon which potential private sector partners compete in modernisation and reform projects; and greater ease and efficiency for public sector employers and their pension scheme administrators involved in these projects. This new guidance also provides clarification on a number of issues which have arisen on practical implementation of the guidance since 1999. Nothing in this alters the standard of protection which public sector staff should receive from their employers, but it does cover important issues which employers need to address in order to deliver that standard of protection efficiently and effectively within the context of competitive procurement of service delivery partners.

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[1] The existing guidance was published by HM Treasury in June 1999 as *A Fair Deal for Staff Pensions*. It was subsequently republished in January 2000 as an appendix to the Cabinet Office Statement of Practice (or COSOP) *Staff Transfers in the Public Sector*, available from the Cabinet Office website (www.cabinet-office.gov.uk) and the Treasury website (www.hm-treasury.gov.uk).

3. The main points are:-

- when transferred staff have to become early leavers of a public sector pension scheme it is essential to provide them not only with a 'broadly comparable' private sector scheme for their future service, but also with the cover of a 'bulk transfer agreement' to allow them, if they wish, to maintain a link between their future earnings growth and their past service pension benefits (para 7);

- the costs of the bulk transfer agreement may be a significant element in the overall costs of the project (para 12);

- the procurement of the bulk transfer agreement should therefore be handled as an integral part of the competition for the overall procurement, with the terms of the agreement being advertised at the earliest stage and being finalised before staff transfer (para 23);

- the bulk transfer agreement should be complemented by enforceable provisions requiring the private sector scheme to provide a satisfactory bulk transfer value in a bulk transfer agreement with another scheme in an onward staff transfer to another employer (para 28);

- in second and subsequent generation transfers (para 32), contracting authorities should decide and make clear the treatment of staff not covered by existing guidance, such as those who transferred to the private sector before the existing guidance came into force (para 38) and those who were recruited to the private sector workforce rather than being transferred into it from the public sector (para 42); and

- contracting authorities should consider the advantages of industry-wide schemes allowing staff to continue in one private sector pension scheme when transferring amongst private sector partners (para 44).

4. This new guidance comes into effect immediately. The existing guidance in the Fair Deal for Staff Pensions (the 'Fair Deal') and the Cabinet Office Statement of Practice (COSOP) remains in force.

Background

5. Partnership with the private sector to modernise and reform the delivery of public services often involves the transfer of public sector employees to the private sector. The success of such projects will depend critically on the treatment of the transferring staff who need reassurance that their rights will be respected and that they will be treated fairly. In June 1999 the Government published guidance entitled 'Fair Deal for Staff Pensions' which set out the standards for protecting the occupational pensions of staff who are compulsorily transferred[2] to private sector employers in PFI and PPP projects, and other forms of public sector restructuring and outsourcing.

6. The Government remains committed to the standards of protection set out in that guidance. It has two main parts. First, where it is necessary for transferred

[2] 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, see footnote 1) 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.

employees to cease active membership of the occupational pension scheme provided by the public sector employer, they should be given access by their new employer to another occupational pension scheme which is certified by an actuary as being overall, materially, at least as good as the public sector pension scheme which they are leaving. This standard of "broad comparability" for future service is defined and explained fully in a note by the Government Actuary attached to the 1999 guidance. This does not require the new employer's scheme to be identical to the public sector scheme but it does mean that, taking all of the differences between the schemes into account, the effect should be that no identified individual or group of individuals in the transferred workforce should suffer material detriment overall to the terms for accrual of further pension rights through their future service.

7. Second, in these cases the transferred staff should be given the option, to transfer the accrued rights from their past service in the public sector pension scheme to the new employers pension scheme without suffering the normal disadvantages which apply to early leavers of defined benefit pension schemes.

8. Under pensions legislation, early leavers of occupational schemes have the right in most circumstances to preserve the benefits earned from their past service on a basis which uprates the benefits in line with price increases prior to the pension coming into payment. Some staff may prefer to transfer their past service to another final salary scheme so that their past service continues to be geared into their earnings progression. However, the transfer values which schemes are obliged to provide for early leavers[3] will not usually assume any future real earnings growth, while schemes accepting such transfers will normally make allowance for expected future real earnings prospects when determining the level of past service credit to award in return for the transfer value. This may result in a significant erosion of past service credit for employees switching membership of final salary related occupational schemes. Moreover there is no requirement on the new scheme to accept a transfer inwards from another scheme, and the new scheme may require indemnities which the former scheme refuses to supply, with the result that a transfer of past service on any terms becomes impossible.

9. To avoid the drawbacks for compulsorily transferred public service staff [4]of being denied an opportunity to maintain earnings-dynamisation of their past service, the government announced in 1999 under the Fair Deal for Staff Pensions that a prerequisite for a compulsory transfer of staff to the private sector where they are required to be early leavers of the public sector scheme should be an agreement between that scheme and the new employer's scheme giving staff the option to transfer their past service into the new scheme on preferential terms. Such a 'bulk transfer agreement' should allow transferred staff to secure credit for their past service in the new pension scheme on a day-for-day basis (or the actuarial equivalent if the differences between the schemes are significant). In return for this undertaking by the new scheme, the public sector scheme promises to pay the new scheme an enhanced transfer value, on different terms from those determining the level of the statutory

[3] Cash Equivalent Transfer Value (or CETV).

[4] Public servants who transfer voluntarily to another public service employer may be able to take advantage of the Public Sector Transfer Club to move their past service from one scheme to another (where both schemes participate in the Club, but Club terms do not apply to staff moved compulsorily.

minimum, calculated on a basis set out in the agreement, in respect of staff who choose to transfer their past service into the new scheme within a limited period following the staff transfer,

10. Prior to the 1999 guidance, provision of a bulk transfer agreement was considered to be desirable, but not essential, and many staff transfers took place without that cover. Under that policy, it was considered acceptable to handle negotiation of a bulk transfer on a separate track from the main business procurement and to leave it until late: often where bulk transfer agreements were successfully concluded this was not until some time after the staff transfer had occurred. The 1999 guidance means that provision of a bulk transfer agreement for compulsorily transferred staff is now a prerequisite, but this implies that a new approach to procurement is needed in projects involving staff transfers, which puts pension issues at the front and centre of communications with prospective private sector partners and with staff and their unions. The implications of this have not always been taken into account by contracting authorities.

Problems with current practice in primary transfers

11. This section explains the problems with current practice on procurement of bulk transfer agreements in primary (first generation) contracts where the workforce is transferring from the public sector to the private sector. The position on second and subsequent generations of contracts, where a workforce transfers from one private sector partner to another, is explained later (see para 32 below).

12. There are obvious drawbacks for staff and relations with them if something as important to them as the bulk transfer terms to be made available are left uncertain until a late stage. But there are also serious drawbacks for private sector bidders and the contracting authority itself. It means that in the earlier, competitive phase of the procurement the different bidders are unsure about the implications for employer costs of the requirement for their pension scheme to agree bulk transfer terms; and in final phases of the procurement unexpected difficulties may arise in the pensions negotiations requiring the public sector employer either to concede price adjustments or to delay, recompete, or abandon the procurement. The amounts of money at stake in a bulk transfer agreement, when large numbers of staff are involved, may run into hundreds of £ millions. A relatively small variance in the assumptions made by the public sector scheme and the private sector scheme can have a significant effect on the amount needed to cover the new liabilities. The amount of funding in dispute can be significant not only in absolute terms but also relative to the finance involved in the procurement overall.

13. The 1999 guidance removed the option of the staff transferring to the new employer without a satisfactory bulk transfer agreement in place. While reassuring to the staff involved, with unchanged procurement practices this means greater uncertainty for bidders and potential inefficiencies in cost management because of the difficulties surrounding bulk transfer negotiations.

14. The size of a bulk transfer payment cannot be predicted in advance because a key factor is the number of staff who will wish to exercise their bulk transfer option and

the assessment of the pension liabilities attached to each of those staff. The exercise of the option may differ by age and service length, and costs will tend to be much higher for older longer serving employees. Typically staff are given a three month period in which to decide whether to remain as deferred pensioners in the public sector scheme or to use the bulk transfer agreement to move their past service into the new employer scheme. In the past, take up rates for staff offered bulk transfer options have varied very widely. Outcomes commonly lie in the range between 20 per cent and 80 per cent uptake by eligible staff, but higher and lower uptake is not unknown.

15. The patterns defy correlation with tangible factors., and levels of take-up certainly cannot be predicted with a degree of accuracy which would be of practical use in settling a specific sum for a bulk transfer value as part of contract negotiations with private sector partners in advance of the transfer. The contractual agreements prior to the transfer therefore need to specify the basis on which the bulk transfer value will be calculated, rather than fixing a sum in advance. But the bulk transfer agreement cannot be left aside until other procurement issues are settled, as in past practice before the current standard for staff protection was introduced.

16. Another unsatisfactory legacy of past practice is a tendency to leave until late, the assembly of data on staff relevant to their pensions. Without the key facts on age, salary, length of reckonable service and so on, it is impossible to calculate bulk transfer values. Absence of timely data has been one factor contributing to unacceptable delays in processing of bulk transfers in the past. Collation of data relating to the pension entitlements of staff who opt to transfer should take no longer than a few weeks following the end of the options exercise if preparations have been made in advance. Given three months for the options exercise itself it should be possible to process the bulk transfer, at least to the stage of a substantial interim payment, within six months of the staff transfer.

17. To reassure staff that their pensions will be protected, it is important to decide and communicate the measures that will be put in place to achieve this, as soon as possible in planning for the project. Information should be provided to staff in the fullest possible detail after the project is announced, subject to clearance by pensions and legal advisors. From the perspective of the staff, once it has been established that the new employer is offering a scheme which has been certified as broadly comparable with the public scheme and once the differences between the two schemes have been explained, the other key information which they need is the amount of service they could get in the new employers scheme by transferring a day’s service from the public sector scheme. This should be close to a day-for-day basis as even if the new employer’s scheme is more valuable overall than the public sector scheme it is unlikely to be greatly so. It is not satisfactory for staff to be left in doubt about the provision of bulk transfer cover until close to (or worse, until after) the staff transfer and for them to be told, belatedly, that terms for the transfer of past service into the new scheme will involve a significant erosion of their pension expectations.

18. But to achieve early settlement of bulk transfer terms is extremely difficult within the current procurement practices. For the two pension schemes involved there are many factors which need to be settled before the bulk transfer agreement between

them can be concluded. The size of the bulk transfer payment will be governed not only by objectively verifiable factors such as numbers of staff electing to transfer their service, their length of reckonable service, their salaries, and so on; but also by various actuarial assumptions which are needed to make projections of how their future service and salary levels will develop, when their resulting pensions will come into payment and how long they will remain in payment, and how this stream of future pension payments should be discounted to a net present value for the liability of the scheme.

19. Private sector actuaries may be accustomed to using different assumptions from those appropriate to Exchequer-guaranteed schemes and amongst private sector actuaries there may be marked differences of view and practice. There is no single correct answer to the questions raised by the assessment of the costs of meeting these future pension payments. Nevertheless, actuarial assumptions about earnings growth, career progression, early retirement, incidents of ill-health retirement, patterns of marriage and other forms of partnership and bereavement, child dependents, and longevity of pensioners and their dependents all have to be fixed in a bulk transfer agreement.

20. The current practice is to hold ad hoc negotiations between the public sector schemes and the scheme of the chosen private sector partner once the procurement has ceased to be competitive. Although the negotiations usually take place within a narrow range of acceptable variation in the key actuarial assumptions, even small changes in critical assumptions can have fairly significant consequences for financial exposure.

21. The traditional practices inherited from before the Fair Deal policy became effective are unsatisfactory to all sides. For public sector bodies it means a risk that a procurement may be derailed by the discovery at a late stage of irreconcilable differences of opinion about a satisfactory basis for the bulk transfer agreement. For prospective private sector partners it means that a potentially significant element in the overall costs of the procurement is divorced from the main negotiations and is settled only at a later stage on a basis which is not transparent. There can be no assurance for the public sector body that the public sector pension scheme terms agreed for the bulk transfer are the best which could be attained for the public sector through competition or that the preferred purchaser offers best value for government taking account of the costs as a whole. For the private sector there can be no assurance that the selection of the private sector partner from the different bidders was fair in terms of overall cost taking account of the costs associated with the eventual negotiation of the bulk transfer. Lack of transparency in the selection of a preferred bidder or a single bidder would be an issue even if the procurement process involved parallel ad hoc negotiations with the scheme of each potential partner. Moreover separate parallel track negotiations with all short-listed bidders would significantly add to the overall length of procurement timetables and to the administrative costs both of the private sector bidders and the public sector employer.

22. The requirement is therefore to introduce a more streamlined procedure for handling bulk transfer agreements in the procurement of PFI and PPP projects, which

puts these issues and their costs on the central track of the procurement without introducing further delays, and which increases the transparency and accountability of the process.

A new procurement mechanism

23. In a procurement the public sector sets out its requirements and invites prospective partners to offer their terms for meeting those requirements. In principle the same approach can be used to improve the procurement of bulk transfer agreements. The terms which the public sector pension scheme is prepared to accept for a bulk transfer agreement should be set out fully and clearly at the earliest possible stage in the process and made available to all qualified bidders.

24. These terms would be conditional on benefit credits being awarded in the bidder's broadly comparable pension arrangement which in the view of the public sector pension scheme were of actuarially equivalent value to the rights immediately before the transfer. Compliant bids should then be on the basis that the partner's pension scheme will accept those terms. Bidders should indicate in their bid documentation if any price adjustment is proposed on account of any costs or benefits conferred by their acceptance of those bulk transfer terms. Any adjustment sought should be accompanied by a reasoned statement of need. Contracting authorities and their pension advisers will be expected, in liaison with the public sector scheme actuary responsible for setting the bulk transfer terms, to test the reasonableness of any price adjustment being sought[5].

25. This approach puts procurement of the bulk transfer agreement squarely into the mainstream competitive procurement selection and negotiation. For this to succeed, the public sector pension scheme will have to settle and make available its terms for a bulk transfer agreement in each project much earlier than is currently the custom. Moreover, those terms will have to represent a reasonable final position rather than a negotiating opening bid. It is not necessary for there to be one set of standard terms applying to all new projects for all time. What is needed is clarity about the terms applying to each project as that project comes forward. Where there are differences in the structure and demographies of workforces those should be reflected in terms tailored to the bulk transfer agreement for that project. Also the basis for terms may evolve over time in the light of experience with procurements as well as to reflect changes in the environment such as developments in financial markets, in demographic trends more widely, and in new pensions legislation. However, it seems likely that the general structure of standard bulk transfer agreement will be reasonably constant, with the numerical values for key actuarial assumptions being inserted by actuarial advisers to the public sector pension scheme at an early stage in each procurement.

26. Whilst of course it will be open to bidders and their advisers to make any observations or representations as they wish about the basis being set out for the bulk transfer agreement, as with any aspect of the specification against which bidders are

[5] For instance, it will not be acceptable to make a price adjustment to align the bulk transfer terms with assumptions used in reporting pension liabilities under FRS17. It is commonplace for schemes to conduct valuations to set employer contributions and to determine investment strategies on different bases from those used to prepare reports under the company accounting standard.

being asked to offer terms, the objective will be to provide a standard non-negotiable basis giving greater certainty and transparency in the handling of all bids.

27. One approach to handling the uncertain size of a bulk transfer where large numbers of staff are potentially involved is to invite bids which are contingent on the size of the bulk transfer value which is eventually calculated. This may be of assistance to bidders who are concerned that the bulk transfer terms specified in invitations to tender will impose a net cost on their pension scheme which they will need to make good if the trustees of the scheme are to accept those terms. In such cases where bidders believe that the prices they bid for a contract will need to be higher because of the requirement for the pensions bulk transfer agreement, it may be in the interests of both the bidders and the contracting authority to agree a mechanism by which the contract price can be adjusted to reflect the value of the pension transfer which results from the level of take-up by staff.

Exit provisions

28. There should be clear provisions about the exit from the partnership of the private sector employer and the handling of the implications of this for staff pensions. These should include an enforceable obligation on the partner's pension scheme or the employer's business which will allow for an onward bulk transfer agreement with another scheme on no less favourable terms than the initial bulk transfer agreement if the staff covered by the initial agreement are compulsorily transferred to another employer with another pension scheme because of termination and re-let of the business contract or sub-contracting which is integral to the public service contract.

29. Current practice is to require provision of an onward bulk transfer agreement as a condition of 'broad comparability' but not to stipulate the terms which the scheme would offer to the new scheme for such an agreement . As described below this can cause problems in second and subsequent generation contracting rounds. The remedy is to ensure that each contract and it's associated pension provisions ties the scheme receiving a bulk transfer and/or the sponsoring employer into providing funds for an onward bulk transfer value sufficient at least to match the value which would be generated by replicating the terms of the agreement under which the scheme received the inward bulk transfer at the beginning of the contract.

30. Because financial and demographic conditions may evolve over the life of a contract there can be no assurance that such an arrangement will result in a satisfactory bulk transfer at the end of the contract without further expense to the contracting authority to finance the difference between what the first generation scheme is offering and what prevailing conditions require the second generation scheme to seek in order to provide the required day for day (or actuarial equivalent) protection for staff. To insulate itself from this risk the contracting authority would need to require its partner to commit in advance to provide for an onward bulk transfer on whatever terms the contracting authority determined at the end of the contract. But clearly contractors will be extremely averse to such an open-ended commitment and if they were prepared to enter into it (which is unlikely) they would certainly place a premium price on the risk, which the contracting authority would need to meet in the price of the business contract. The result almost certainly would be less efficient and more costly to the contracting authority than if the requirement is

merely for the partner to provide for an onward bulk transfer on no less favourable terms than the bulk transfer which its scheme receives at the start of the contract, and the contracting authority carries the risk that by the end of the contract this may have proved to be a marginally inadequate amount.

31. Such arrangements will in any case represent a much lower risk and better deal for the contracting authority than current practice which may lead to wholly inadequate terms being offered by the incumbent contractor, with the contracting authority potentially needing to finance a significant additional injection of funds to the new contractor's scheme to ensure that staff do not lose accrued service.

Second generation contracts

32. The same principles should be applied in second and subsequent rounds of contracting. For staff covered by the Fair Deal who are compulsorily transferred from the first contractor to another because of action taken by the public contracting authority (re-lets or sub-contracting integral to contract delivery which is controlled by the public partner) there should be broad comparability of pension terms for future service complemented by bulk transfer cover for transferring past service into the new scheme. Procurement of this pension protection requires careful handling: the public authority is not a direct party in the transfer of the staff and the incumbent contractor may not perceive a direct interest in smoothing the transition of the workforce to the new contractor which is a competitor. Moreover the bulk transfer agreement will be concluded between two private sector schemes, each with independent trustees advised by their own actuaries and intent on achieving the best terms for members of the respective schemes other than those transferring between them. Problems in overseeing a satisfactory bulk transfer agreement between them will be compounded in circumstances where funding levels of defined benefit occupational schemes are under pressure from adverse conditions in investment markets.

33. Nevertheless the standard of protection desired for staff covered by the Fair Deal is not a subject for negotiation between the two contractors and it is the responsibility of the public contracting authority to manage the transition between the two contracts and the two contractors in a way which meets the Fair Deal requirements .

34. In managing the competition to appoint a successor contractor it should be made clear at the earliest stage in the process, as in a primary contract round, what the pension protection must be. Whereas in a primary round the terms for the bulk transfer agreement will be set by the public authority, in second and subsequent rounds the terms on offer to the new contractor will be those offered by the incumbent contractor. These should be obtained and specified in information to bidders. These terms should, of course, be consistent with the obligations of the incumbent contractor and their scheme created by the exit conditions in the primary contract.

35. As in a primary contract bidders will indicate the adjustment they propose to contract price on account of the requirement that they procure the agreement of their broadly comparable scheme to providing day for day service in return for a transfer value calculated on the terms specified. The cost of compensating for any shortfall in the terms demanded by bidders compared with what the incumbent contractor's scheme is offering thus falls on the contracting authority, putting a premium on the performance of the contracting authority in securing adequately safeguarded exit conditions each time a contract involving compulsory staff transfers is let.

36. Another consideration further reinforcing the importance of exit conditions is evenness of competition between the existing partner and new bidders contesting the procurement. Inadequacy of bulk transfer terms offered by the incumbent partner's scheme should not be allowed to skew the competition in favour of the incumbent whose bid will involve no staff transfer and associated pension transfers. Well designed exit conditions which will be engaged if the incumbent were unsuccessful should be an important factor in limiting scope for this kind of manoeuvre. In assessing the price and other costs of bids the contracting authority should make allowance to neutralise any advantage enjoyed by the incumbent on this account.

37. But the key outcome of staff protection is the responsibility of the contracting authority which will bear the costs in any case. The purpose of this new guidance is to help contracting authorities to manage those costs in an acceptable way, without diminishing or creating uncertainty about the standard of staff protection which will be obtained.

Pre-Fair Deal contract streams

38. Questions are often raised about the position under the Fair Deal for Staff Pensions of staff compulsorily transferred as the result of the re-let of contracts originally let before the Fair Deal came into effect. These may refer to second generation rounds or third or fourth generation rounds in contract streams originating prior to 2000.

39. The Fair Deal was published by the Treasury in June 1999, and subsequently incorporated into the Cabinet Office Statement of Practice on Staff Transfers in the Public Sector published in January 2000. The Fair Deal came into effect immediately on its publication but with the provision that contract procurements already underway would not be affected if incorporation of the new pension protections would require an advanced procurement to be aborted or delayed. There may thus be contracts finally let some time after 1999 where the contracting authority did not apply the Fair Deal. In practice contracts signed before 2000 are extremely unlikely to be covered by the Fair Deal and those signed prior to 1999 certainly will not be covered.

40. The Fair Deal was not intended to be retroactive. It set out a standard for the future in treatment of public sector staff when they were compulsorily transferred to the private sector; and it did not impact upon former public sector staff already working in private sector employment as a result of almost two decades of out-sourcing activity prior to its inception. When such contracts are re-let the Fair Deal will not apply.

41. However, the Fair Deal should not be taken to prohibit a contracting authority from applying its provisions to a re-let where the contracting authority recognises the costs of doing so and has made a value for money case for meeting those costs. Compliance with the Fair Deal cannot be prayed in aid of a decision by a contracting authority to commit to costs of staff protection to the Fair Deal standard in circumstances to which the Fair Deal itself does not apply (such as subsequent generation contracts in pre-2000 contract streams); but in all such cases contracting authorities should carefully consider the interaction between the interests of staff and the quality of service delivery and make their own judgement on the value for money which might be obtained by spending to ameliorate the impact on the pensions of

former public service staff of a compulsory transfer of those staff to another contractor at the behest of the contracting authority.

Other staff not covered by the Fair Deal

42. The Fair Deal is not intended to apply to transfers between private sector employers[6] except in the specific case of staff originally transferred to the private sector from the public sector under Fair Deal protection who have been continuously employed on delivery of the out-sourced public service since being transferred to the private sector. The Fair Deal does not therefore cover staff who may be involved in a second or subsequent generation contract who were recruited by the private sector partner(s) after the primary transfer. The protection of these staff is not a function of the Fair Deal.

43. Where contracting authorities judge it appropriate on value for money grounds to make some provision for protection of pensions for staff not covered by the Fair Deal in a re-let they are not prohibited from doing so by this guidance. If they choose to do so they will need to be satisfied that the costs they bear as a result can be justified; that there is no gratuitous increase in the terms and conditions of staff unrelated to standards of service delivery; and that the practice is consistent with any prevailing policies and practices on addressing 'two tier workforce' issues[7]. A pragmatic approach to treatment of members of the workforce in second and subsequent generation transfers may be necessary where, for some reason, it is impossible any longer to distinguish between staff originally transferred from the public sector and continuously employed on the contract thereafter, and others not thereby covered by Fair Deal protection.

Industry-wide schemes

44. Some of the issues complicating procurement of bulk transfer agreements in second and subsequent generation contracts can be avoided where an industry-wide scheme is in operation to cover the different contractors who may be involved. Such schemes are not unknown in the UK but have been relatively uncommon. The scheme would be a scheme for 'non-associated' employers, with no cross liability or cross subsidy between the sections of the scheme for which each individual employer is responsible. But with a single set of scheme rules and a single set of trustees the scope for disagreement when staff transfer between one employer and another is reduced. There are also potential economies for employers from sharing administrative overhead[8]. The Treasury welcomes the outcome of work by the Business Services Association which has led to the development by Prudential of the 'Platinum' scheme as a potential vehicle for continuity of membership by staff transferred from one public service contractor to another.

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[6] At the time of writing preparations are being made to introduce a statutory minimum level of pension for staff transferred under TUPE. This will apply to all employers, whether in the public or private sector, but the non-statutory guidance in the Fair Deal and the COSOP (see footnote 1) will remain in force and will apply to transfers involving public sector contracts where it would deliver a higher standard of protection than the new statutory minimum.

[7] Guidance on two-tier workforce policies may be had from the Cabinet Office.

[8] At the time of writing an approach along these lines is being explored for possible use in the contracts to be let for work on decommissioning of nuclear installations .

45. It should be clear, however, that such an approach does not conflict with the 'clean break' principle when staff are transferred out of the public sector: there is no residual public sector employer responsibility or liability (except in respect of the accrued pensions of staff who do not use their bulk transfer option and therefore become deferred pensioners of the public sector scheme) and it is the private sector employer who is solely responsible for the financing of defined benefit pensions accruing through service with that employer. A multi-employer scheme for private sector contractors to ease mobility of the workforce will not, therefore, carry any Government guarantee, any more than if each contractor provided their own broadly comparable scheme.

Continuity of membership in public schemes

46. In some cases it is possible for staff transferred to the private sector to continue in active membership of a public service pension scheme. This can be achieved where it is possible for the public service scheme itself to be restructured into an industry-wide scheme for non-associated employers. For instance this approach has been taken with the Local Government Pension Scheme to give Best Value contractors the option of bidding for local authority contracts on the basis of their staff participating in the LGPS instead of providing a separate scheme broadly comparable to it. The private contractor becomes an admitted body in the LGPS either through an 'open' admission agreement covering transferred staff and subsequent recruits or through a 'closed' admission agreement covering only staff transferred from the local authority.

47. Similar approaches have been taken to treatment of staff in some projects involving public corporations with trust-based non-statutory schemes. But this type of approach does not readily map onto statutory public schemes which do not have funds of real assets to support their liabilities. In such schemes it can be very difficult to separate responsibility for meeting the pension liabilities created by the private sector employer(s) from the responsibility of the public sector to meet the scheme's liabilities as they fall due. The admission of private sector employers to unfunded public schemes is therefore unlikely to be acceptable to the scheme administrators where it would in practice amount to putting a Government guarantee onto active pension liabilities created and controlled by private sector employers.

Liability for benefits from partner's schemes

48. The basic principle which contracting authorities should follow is that the private sector partner should carry the liabilities for the pensions of its own employees. The size and timing of payment of those liabilities will be controlled to a large degree by the employer which is responsible for the pay increases and promotion of its employees; for their occupational health and safety and the consequences for their ill health retirement; access to redundancy compensation and other early retirement benefits; and so on. Where a workforce is transferred to the private sector so that the public authority ceases to have any control over these factors which powerfully influence the cost of the staff pensions, the public authority would be accepting an unnecessary risk if it were to be responsible for meeting those costs. This would not represent an efficient allocation of project risks.

49. There should therefore be a clean break in responsibility at the point of the transfer with the private sector meeting all costs and carrying risks in respect of the

future service of the staff (in addition to responsibility for past service pension benefits transferred under a bulk transfer agreement). This has been standard practice for some time and it should continue to be so. Not only does this militate strongly against admitting private sector employers to unfunded public schemes where separation of liabilities in the scheme is problematic, but it also poses a strong objection to public sector guarantees on the pension schemes of private partners where the liabilities are active and therefore earnings dynamised (an additional consideration being that if the scheme were guaranteed by the public sector then not only should the public sector be controlling the relevant employment practices to manage its contingent liability, but it should also for the same reason be controlling the investment strategy of the scheme).

50. It is sometimes argued that private partners should not be expected to carry the risks imposed on employers by sponsorship of defined benefit occupational pension schemes, and that it is inefficient for public contracting authorities to require them to do so. But there are many such schemes maintained by private sector employers for reasons unconnected to winning public service partnership contracts and it is not difficult for them to price the risks when bidding for contracts covered by the Fair Deal for Staff Pensions; and effectively that price will be passed to the public contracting authority. The investment strategy adopted by the private scheme will be determined by the trustees in consultation with the employer and will therefore tend to reflect the employer's risk posture: higher yielding portfolios will convey greater risk but there are more secure options available and it is for the private partner to discuss the investment strategy with the trustees of its scheme and to price the resulting risk into the contract. It is not efficient for the public sector to control these decisions and carry the risks save in relation to its own employees.

Machinery of Government transfers

51. The Fair Deal guidance itself relates only to public sector employees transferred compulsorily to the private sector. It does not apply to transfers of staff within the public sector, such as 'machinery of government' changes. Different parts of the public sector are covered by different occupational pension schemes and they are not necessarily 'broadly comparable' with each other.

52. However, the Cabinet Office Statement of Practice on Staff Transfers advises, amongst other things, that the Fair Deal standard for pension protection should be applied to transfers of staff from one public sector employer to another. Pension issues should therefore be regarded as central to early planning for machinery of government changes and other public sector reorganisations. The pension costs can be significant, and resolving responsibility at a late stage can be problematic particularly if the transferor scheme is a funded scheme and it does not consider itself obligated to provide sufficient finance for a day-for-day bulk transfer into the scheme covering the new employment. There may also be issues about assimilation of transferred staff onto the terms and conditions of existing staff with implications for harmonisation of employee pension contribution rates which convey large employer costs. For all these reasons it is essential to work through pension issues in the early planning for machinery of government changes.

53. The Cabinet Office also expect the Fair Deal standard to be applied where out-sourced former public sector employees are brought back 'in house'. This may also

have serious implications for the provision of public service pensions to those staff after their transfer back into the public sector. Advice should be sought from the Cabinet Office on cases where there is doubt about application of the Fair Deal to an internal public sector transfer such as a machinery of government change or a transfer from the private sector into the public sector, including the consequences for the benefit structures of public service schemes of meeting the broad comparability standard and the provision of associated bulk transfer agreements.

General administrative issues

54. Efficient procurement will depend on timely availability of data relevant to the pension liabilities attached to the workforce. Data should be anonymised to protect the identity of individuals before the chosen partner has finally been appointed, but during the competitive phase of the procurement bidders will need general information about the size and characteristics of the workforce, and in particular the factors which will influence the size of the bulk transfer payment. A frequent source of complaint by private sector contractors is delay by public sector authorities in making this information available.

55. As also discussed above, there are in addition often delays in administration of bulk transfers themselves. There is no reason for it to take longer than six months following the staff transfer to complete the bulk transfer process: option forms should be issued to staff promptly after the transfer with three months for them to complete their election, during which time they can be given information on which to base their decision in writing, via office information systems and in organised presentations. (Employers should take care at all stages to ensure that any material on pensions communicated to staff in any medium has been approved by the professional pension and legal advisers.)

56. A further three months at the end of the options period should be sufficient to process the information necessary to make at least the interim payment of the bulk transfer value under the bulk transfer agreement. It is difficult to excuse situations in which bulk transfer negotiations are continuing several years after staff have been transferred, and in addition to defeating the purpose of this guidance by creating unnecessary uncertainty for staff, such a position must be symptomatic of a general inefficiency in the process.

57. Again with a view to management of the end of the contract with the potential exit of the contractor from the partnership, there should be contractual obligations on the partner to maintain records of information needed to manage the relet efficiently, and to make that information available as required. This will include identification of members of the workforce originally transferred from the public sector and covered by the Fair Deal protections.

Action for Employers

58. To implement this new guidance, all public sector bodies covered by the Fair Deal preparing for private sector partnership in the delivery of services should:

a. take advice from their pension scheme at the earliest opportunity on whether staff transferred to a private sector partner will be able to retain active membership of that pension scheme or will instead be required to be early leavers of the scheme;

b. consider the scope for use by partners of an industry-wide private sector scheme for staff who cannot retain active membership of the public sector scheme;

c. take advice from the scheme's actuarial adviser on the terms to be explained to potential bidders in the project documentation concerning the requirement for broad comparability for future service of the new employer's scheme and a bulk transfer agreement to be made available to staff transferring to that scheme;

d. obtain from their actuarial advisers a standard bulk transfer agreement with the relevant actuarial assumptions specified within it;

e. determine the appropriate conditions for the exit of the partner from the contract including provisions to enforce a satisfactory bulk transfer agreement for any onward TUPE transfer to another partner or back into the public sector;

f. specify the arrangements to be made by the partner to identify members of the workforce and record data relevant to any onward transfer to another partner, including identification of staff protected by the Fair Deal, to be made available as necessary;

g. begin at the earliest stage the process of extracting the necessary data from personnel records to identify the workforce to be transferred and the relevant factors which will affect the assessment of the pension liability to be transferred under the bulk transfer agreement;

h. prepare to share the details of the proposed bulk transfer agreement and the supporting information on pension liabilities with prospective bidders at the appropriate point in the process whilst the procurement is still actively competitive;

i. agree with pension and legal advisors the content of information to be given to transferring staff about the treatment of their pensions, and consult with staff representatives at the earliest stage: joint communications to staff from management and unions are to be preferred if feasible; and

j. if the project is the relet of an existing contract, establish the parameters for the bulk transfer in the light of the position of the incumbent contractor, and determine the policy on treatment of staff within the workforce not covered by the Fair Deal.

Timing

59. This guidance reflects the outcome of a general consultation exercise with employers and trades unions during 2003 and 2004 and it now comes into effect immediately. The previous guidance remains in force. This new guidance does not override statutory requirements, such as those imposed on Best Value authorities and associated guidance to them from the Office of the Deputy Prime Minister.

60. Questions on this guidance should be addressed to the administrators of public service schemes, their professional pension advisers, their sponsoring Departments or

to the Public Service Pensions Team of the Treasury (bill.guy@hm-treasury.gsi.gov.uk).

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