TRAVERS SMITH

What's happening in Pensions

Issue 42 *October 2013*

In this issue:

Pension Liberation

HMRC announcements

HMRC has changed two of its processes to try to combat pension liberation. These took immediate effect from 21 October 2013:

- HMRC will no longer register a pension scheme upon submission of its online form. Instead, it will conduct a detailed risk assessment before making a decision on whether or not to register a scheme.
- In relation to transfers, HMRC will only provide confirmation that a proposed recipient scheme is registered where the information that HMRC holds does not indicate a significant risk that the scheme is a pension liberation scheme. This is intended to help trustees deal with transfer requests from schemes that they suspect may be liberation vehicles.

HMRC has also published a new note for individuals on the tax consequences of pension liberation.

HMRC announcements:
http://www.hmrc.gov.uk/news/pensionliberation.htm

Note for individuals:
http://www.hmrc.gov.uk/pensionschemes/liberationfs.pdf

High Court case

The High Court has given its ruling in the cases involving the Pensions Regulator, *Pi Consulting (Trustee Services) Ltd v Pensions Regulator and others* and *Dalriada Trustees Limited v Pensions Regulator and others*. It held that the documents creating the nine registered pension schemes considered by the Regulator to be liberation schemes were consistent with them being "occupational pension schemes". This meant that they would be both within the scope of the Regulator's powers but also legitimate recipients of transfers from other registered pension schemes unless they could be shown to be "shams" (ie, legal arrangements created by parties for the sake of appearance only without any intention of complying with the obligations apparently created).

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2013/3181.html

The deeds and rules of the schemes included language saying that they were both occupational and personal pension schemes, which is not legally possible. All parties accepted that the schemes were not personal pension schemes. The judge considered two technical requirements for a scheme to be an occupational pension scheme, concerning the sponsoring employer and purpose of the scheme, and found that the schemes met those requirements.

The Pensions Regulator issued a statement on the judgment. It said:

"We welcome the legal clarity provided by this ruling, which will help inform our wider strategy and enable us to take the appropriate steps to combat activities that could undermine confidence in the pension system. ... We have a suite of powers we can use to disrupt pension liberation fraud including suspending and prohibiting trustees, appointing independent trustees to schemes to protect assets, freezing bank accounts and repatriating monies. The actions that we took in relation to these schemes still stand and the independent trustees put in place by us remain appointed."

Pensions Regulator statement:
http://www.thepensionsregulator.gov.uk/press/pn13-38.aspx

Pension Protection Levy 2014/15

Press release:
http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=335

The Pension Protection Fund has consulted on the 2014/15 pension protection levy. The key proposals of interest are as follows.

- The overall levy estimate will rise by about 10% from £630 million to £695 million. The levy rules are largely unchanged.
- There is a change in the trustee certificate that must be given in connection with a PPF recognised guarantee. For 2013/14, the required certification was:

  > "*The trustees have no reason to believe that each certified guarantor, as at the date of the certificate, could not meet its full commitment under the contingent asset as certified*."

  It is now proposed that it will read:

  > "*The trustees, having made reasonable enquiry into the financial position of each certified guarantor, are reasonably satisfied that each certified guarantor, as at the date of the certificate, could meet its full commitment under the contingent asset as certified, having taken account of the likely impact of the immediate insolvency of all of the relevant employers.*"

  This requires trustees to give a positive statement about the guarantor's ability to pay and imposes a positive obligation to enquire about the guarantor's financial position. However, when read in conjunction with the PPF's guidance, this change is not intended to represent a material change of current PPF policy on guarantee certification. The PPF is consulting on whether this change should come into force for the 2014/15 levy year or the following year.
- There will be a change allowing contingent assets to be recertified even if they were not certified for the previous levy year, provided that they were certified in one of the previous five levy years and have remained in place since then. This change is intended to avoid trustees recertifying contingent assets in years where this makes no difference to the levy. Trustees might otherwise have done this because the annual recertification process is simpler than the process for fresh certification.
- The consultation asks if levies should be recalculated if any scheme benefits cease to be money purchase benefits when the relevant provisions of the Pensions Act 2011 (see **WHiP Issue 30**) come into force (probably in April 2014).

Automatic Enrolment

Regulations to improve the regime

Regulations:
http://www.legislation.gov.uk/uksi/2013/2556/contents/made

Consultation web page:
https://www.gov.uk/government/consultations/workplace-pensions-proposed-technical-changes-to-automatic-enrolment

The Government has issued a response to its consultation on possible changes to the automatic enrolment regime (see **WHiP Issue 39**) and has laid amending regulations. They take effect from 1 November 2013 and 1 April 2014 as noted below. There is generally no retrospection: employers must comply with the existing law until the amendments take effect. The key changes are as follows.

<u>Pay reference periods for assessing worker category (1 November 2013)</u>
Worker category is currently assessed by reference to workers' actual pay periods, ie, usually calendar months or weeks. Some employers have difficulty in identifying from their payroll which category a worker falls within because their PAYE payroll systems record pay in tax months (eg, 6 April to 5 May) or tax weeks (eg, 6 April to 12 April), even if the worker is paid by reference to a calendar month or week.

Under the new regulations, employers will be allowed, if they wish, to use tax weeks or months or other tax periods (based on the worker's usual pay frequency, but not less than a week) to determine what category a worker falls within as an alternative to the existing method.

<u>Pay reference periods for assessing DC scheme quality (1 November 2013)</u>
The pay reference periods for assessing DC scheme quality are different from those used to assess worker category. Scheme quality pay reference periods are 12 month periods

running from the employer's staging date to each anniversary of that date (NB the first period is shorter than 12 months for new joiners, other than those who start work on an anniversary of the employer's staging date). It is possible for qualifying earnings assessed over a 12 month period to exceed the aggregate of qualifying earnings assessed by reference to monthly or weekly pay reference periods. This can occur, for example, if a bonus payment causes pay in a pay reference period to exceed the upper end of the qualifying earnings band. This can require annual reconciliations to be performed.

Employers are now to be allowed, if they wish, to use actual pay periods (or the alternative option for using tax periods outlined above) to assess scheme quality, as an alternative to using the existing 12 month period. This would avoid the need for reconciliations.

In a further concession, employers will only need to start making contributions in respect of the first complete pay period after the automatic enrolment date. (Postponement can currently be used to achieve the same result, but the new concession is a more straightforward solution for employers to this problem.) Scheme rules and payment schedules may need to be amended to enable employers to take advantage of this concession. Member literature may also need to be revised.

Contribution payment deadlines (1 November 2013)
The automatic enrolment legislation currently allows employers to hold on to initial member contributions that they have deducted from pay until the last day of the second month after the jobholder's enrolment date. This is already longer than the normal statutory deadline and is designed to facilitate the processing of contribution refunds following member opt-outs. Legislation will now further extend this deadline so that member contributions deducted during the first three months of membership need not reach the scheme until the 19th (22nd if paid electronically) of the fourth month after the member's enrolment date.

The amended regulations also provide for the extended deadline to apply in respect of any new joiner to a scheme, irrespective of his or her enrolment circumstances. As a result, this extended deadline will now apply to those enrolled "contractually" or otherwise enrolled outside the statutory requirements.

Payment dates for employer contributions remain governed by the scheme's schedule of contributions or payment schedule (and, in some cases, scheme rules).

Opt-out notices (1 November 2013)
The regulations are clarified so that opt-out notices need only be in substantially the same form (rather than exactly the same form) as the form prescribed by regulations. Any notices already accepted that satisfy the amended regulations are retrospectively validated.

The automatic enrolment joining window (1 April 2014)
The one month enrolment window will be extended to six weeks. This is designed to avoid problems caused by the time it can take to categorise workers with fluctuating earnings and those on zero hours contracts.

Information and registration deadlines (1 April 2014)
The deadline for employers to provide information to individuals on opt-in and joining rights is similarly extended from one month to six weeks.

Postponement notices and notices that the employer intends to defer enrolment in a DB scheme until 1 October 2017 (at the latest) will have to be issued within six weeks (currently one month) from the date which would otherwise be an individual's automatic enrolment date.

The deadline for registration will be put back from four to five months from an employer's staging date. The deadline for re-registration (after triennial automatic re-enrolment) is put back from one to two months.

The DB test scheme standard (1 November 2013)
The DB test scheme standard currently requires DB schemes to pay pensions from, at the latest, an age that aligns with the state pension age applicable from time to time. This is now improved, to allow DB schemes to meet the quality standard if they pay individuals' pensions from, at the latest, the state pension age that applies to them under existing legislation.

There are also two amendments correcting inconsistencies as regards the minimum requirements for cash balance (referred to as "lump sum") schemes.

Miscellaneous
It had originally been proposed that jobholders need not be enrolled if they ceased active membership of a qualifying scheme by their own act or omission in the 12 months before the automatic enrolment duty would otherwise have applied in respect of them. The Government has concluded that this proposal was not workable and will consider addressing this point through the power in the current Pensions Bill (see **WHiP Issue 39**)

to exclude certain groups or categories of worker from the enrolment requirement. The consultation on proposed exclusions is expected shortly.

Work is ongoing to consider further improvements.

Revised certification guidance
The Government has revised its guidance note on certifying money purchase schemes as qualifying schemes and its guidance notes for employers and actuaries on certifying DB or hybrid schemes as qualifying schemes. The most significant changes and clarifications are as follows.

Money purchase guidance
Although workers (and their job titles) who are not covered by a certificate need to be listed in the certificate, there is no need to update this for new joiners during the period for which the certificate is in place (but employers should keep an up-to-date list anyway).

Guidance:
https://www.gov.uk/government/publications/automatic-enrolment-guidance-on-certifying-money-purchase-pension-schemes

The guidance confirms the Government's view that all money purchase arrangements (including those within hybrid schemes) can take advantage of the transitional arrangements for phasing in contribution rates. Legislation is to be amended to make this clearer.

DB/hybrid guidance for employers
Schemes automatically pass the DB scheme quality test in respect of members in contracted-out employment. Members who have reached state pension age cannot be in contracted-out employment. The revised guidance confirms that the scheme should be treated as a qualifying scheme if such members accrue the same benefits as contracted-out members. It is not clear if instances of this need to be certified.

Guidance:
https://www.gov.uk/government/publications/automatic-enrolment-guidance-for-employers-on-certifying-defined-benefits-and-hybrid-pension-schemes

Contracted-in schemes with more than one benefit scale need only be "broadly equivalent" to the test scheme looking at the overall benefits provided by the scheme (and not by reference to each separate benefit scale). So the benefits of more than 10% of members on one benefit scale can fail the test so long as the benefits of more than 90% of the overall membership pass the test.

There is more detail in the revised guidance about how different types of hybrid scheme should be certified.

DB/hybrid guidance for actuaries
Corrections have been made to errors in the guidance on the requirements for revaluation of active members' benefits under career average schemes.

Guidance:
https://www.gov.uk/government/publications/automatic-enrolment-guidance-for-actuaries-on-certifying-defined-benefits-and-hybrid-pension-schemes

The guidance is now clear that lump sum retirement benefits should be included (ie, for schemes where there is a separate lump sum rather than commutation of pension).

The guidance includes the same changes as noted above for schemes with different benefit scales.

Ban on consultancy charging implemented
Regulations came into force on 14 September 2013 prohibiting the use of consultancy charges in DC automatic enrolment schemes. The prohibition applies to personal pensions and DC occupational pension schemes which make provision for third party consultancy charges to be deducted from a member's benefits.

Regulations:
http://www.legislation.gov.uk/uksi/2013/2328/contents/made

There is an exception for schemes where there was a legally enforceable agreement in place between the employer and the third party before 10 May 2013 (which is when this proposal was first announced) under which the employer is bound to make the payments. A consultation expected shortly will ask whether this exception should be removed.

As noted in **WHiP Issue 40**, a consultation is also expected on whether the Government should use the proposed power in the Pensions Bill (see **WHiP Issue 39**) to prohibit consultancy charges under all qualifying schemes (ie, schemes used to satisfy the employer duties for existing members, including where contractual enrolment is used).

DC Pensions

Pensions Regulator publications
The Pensions Regulator has published:

- its strategy for regulating DC pension schemes;
- a draft compliance and enforcement policy for DC occupational pension schemes; and
- updated codes of practice on late payment of DC contributions.

Regulation strategy
The Regulator intends to promote good member outcomes by:

Strategy document:
http://www.thepensionsregulator.gov.uk/docs/dc-strategy-2013.pdf

- asking schemes (voluntarily) to produce a governance statement showing the extent to which the scheme has the 31 DC "quality features" set out in its DC code of practice and making this available to members and employers (for example in the annual report or on a website). The Regulator will shortly publish an example template and an assessment template for use in preparing the governance statement.

- enabling master trusts to provide assurance – by producing (as above) a governance statement and obtaining independent assurance to demonstrate the presence of governance and administration standards that meet the DC code of practice and forthcoming guidance (see **WHiP Issue 37**). The Regulator has worked with the Institute of Chartered Accountants to produce an independent assurance framework, a draft of which has been published.
- enabling employers to choose a good scheme – through communications directly to employers and via accountants and independent financial advisers (IFAs), and by encouraging employer management committees where the employer has chosen a group personal pension or master trust.

Draft framework for master trusts:
http://www.thepensionsregulator.gov.uk/press/pn13-36.aspx

<u>Compliance and enforcement policy</u>
The draft compliance and enforcement policy applies to trustees of any trust-based scheme that provides any DC benefits (including those with DB underpins) and to their advisers. Most of the content is not new or surprising.

Draft policy:
http://www.thepensionsregulator.gov.uk/doc-library/dc-compliance-enforcement-policy.aspx

Governance standards, investment governance and decision-making, administration practices and fraud are identified as core risk areas.

The Regulator will conduct "thematic reviews" on particular activities or types of scheme, to which it expects trustees to contribute when asked. If they do not, action may be taken under the Regulator's information gathering powers. These reviews may also result in enforcement action against particular schemes.

The short consultation on the draft policy closes on 31 October 2013.

<u>Codes of practice on payment of contributions</u>
The following Pensions Regulator updated codes of practice came into force on 20 September 2013:

Codes of Practice:
http://www.thepensionsregulator.gov.uk/codes/code-reporting-late-payment-contributions-mp.aspx

http://www.thepensionsregulator.gov.uk/codes/code-reporting-late-payment-contributions-pp.aspx

- Code of practice no.5: Reporting late payment of contributions to occupational pension schemes (NB This applies to DC occupational pension schemes only)
- Code of practice no.6: Reporting late payment of contributions to personal pension schemes

The Regulator has produced accompanying guidance and a quick guide for employers.

These aim to ensure that money purchase contributions are paid correctly and on time by employers and that trustees and pension providers adequately monitor the payment of contributions and report failures when appropriate. The Regulator expects occupational pension scheme trustees and personal pension providers to monitor incoming contributions. This may include obtaining sufficient information from employers to demonstrate that amounts paid reconcile with amounts due. The code says that trustees should report to the Regulator if they request information from an employer and the employer does not provide it within 14 days.

The codes spell out when the Regulator expects (and does not expect) trustees and managers to report unpaid contributions to it and to members. A proposal requiring nil returns was dropped. If contributions have not been paid, the Regulator expects (in the guidance, not the code) three attempts to contact the employer within 90 days after the contribution due date, after which reporting of unpaid contributions is required. At least one of these attempts should normally be made by telephone.

There should be an online reporting system in place by March 2015.

Office of Fair Trading report on DC charges
The Office of Fair Trading (OFT) has completed its market study of DC pensions, focusing on charges. This has led to the following actions.

Press release:
http://www.oft.gov.uk/news-and-updates/press/2013/63-13

- To address the OFT's concerns about small trust-based schemes, the Regulator has agreed to take rapid action to assess which smaller trust based schemes are not delivering value for money. The Government has agreed to consider whether the Regulator needs new enforcement powers to tackle the problem.
- The Association of British Insurers (ABI) and its members have agreed to an immediate audit of older contract and bundled trust schemes which are considered more likely to contain unfair charging structures. The audit is intended to give a full understanding of the charges and any benefits associated with these schemes and ensure savers are getting value for money. This will be overseen by an independent project board.

- The ABI has agreed that its members will establish independent governance committees to oversee their contract-based schemes. Committees should recommend changes to providers and escalate issues to regulators where they see risks of poor outcomes for savers.

In addition, the OFT identified a number of practices that may lead to savers losing out without action by the Government. As a result, it recommends that:

- the Government consults on improving the transparency and comparability of information about the cost and quality of schemes in order to make employers' initial choice of scheme easier; and
- the Government consults on preventing schemes being used for automatic enrolment from operating in-built adviser commissions or applying higher charges for members who have stopped contributing into their pensions. (The Pensions Minister had already proposed to do this.)

The OFT decided against recommending a cap on annual management charges, fearing that a low cap might reduce standards and a higher cap might lead low-charging providers to increase their charges.

Age-related DC contributions

In *HK Danmark (for Glennie Kristensen) v Experian A/S*, the European Court ruled that an age-related DC contribution scale can, in appropriate circumstances, be justified under European law – if this is a proportionate way of achieving a legitimate aim.

Case report:
http://www.bailii.org/eu/cases/EUECJ/2013/C47611.html

Ms Kristensen was a member of the Experian DC pension scheme in Denmark. Its contribution scale was:

- under age 35: 3% member; 6% employer
- age 35 to 44: 4% member; 8% employer
- age 45 and over: 5% member; 10% employer

She resigned, aged under 35, and filed an age discrimination claim against Experian, claiming that she had been unlawfully discriminated against on grounds of age compared to an employee aged 45 or over.

The Danish court asked the European Court whether this discrimination was permitted under exemptions in Article 6 of the 2000 Equal Treatment Directive (2000/78). The exemptions provide that:

> *"1. Notwithstanding Article 2(2), Member States may provide that differences of treatment on grounds of age shall not constitute discrimination, if, within the context of national law, they are objectively and reasonably justified by a legitimate aim, including legitimate employment policy, labour market and vocational training objectives, and if the means of achieving that aim are appropriate and necessary.*
>
> *...*
>
> *2. Notwithstanding Article 2(2), Member States may provide that the fixing for occupational social security schemes of ages for admission or entitlement to retirement or invalidity benefits, including the fixing under those schemes of different ages for employees or groups or categories of employees, and the use, in the context of such schemes, of age criteria in actuarial calculations, does not constitute discrimination on the grounds of age, provided this does not result in discrimination on the grounds of sex."*

Danish age discrimination legislation reflects Article 6(2) of the directive by saying that it *"does not preclude the fixing of ages for admission to occupational social security schemes or the use, in the context of such schemes, of age criteria in actuarial calculations"*.

The European Court held as follows.

- Although directives are aimed at member states, rather than private individuals, the Court has acknowledged the existence of a principle of non-discrimination on grounds of age which must be regarded as a general principle of European law. The prohibition is also set out in the Charter of Fundamental Rights of the European Union which has the same overriding legal status as EU treaties.
- The pension contributions were pay and there was age discrimination.
- Article 6(2) of the directive does not expressly allow the fixing of ages for different DC contribution entitlements.
- The submitted aims of:

- enabling older workers, who enter the service of Experian later in their working life, to build up reasonable retirement savings over a relatively short period;
- including young workers in the same scheme at an early stage, while making it possible to have at their disposal a larger proportion of their wages; and
- providing risk benefits, which are more expensive for older employees

were legitimate aims within Article 6(1) of the directive.

- The means of achieving those aims are proportionate if they genuinely reflect a concern to attain the aims in a consistent and systematic manner and do not go beyond what is necessary to do so. It is for the national court to determine whether or not this is the case.

Note that under UK law there is an express exemption for DC age-related contribution bands if the aim is to equalise, or make more nearly equal, the amount of the resulting benefit. It has never been clear how many bands this requires.

It is also interesting to note that the European Court seems to have taken the view that individuals can bring claims directly by reference to general principles of European law, regardless of whether there is a claim under national legislation.

Accounting for DB pensions

FRC press release:
http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/October/Findings-of-the-FRC-in-respect-of-the-accounts-of.aspx

WH Smith restates its accounts

Following intervention by the Financial Reporting Council, WH Smith Plc has agreed to amend its 2012 accounts to recognise pension contributions due under a schedule of contributions as a liability.

The WH Smith pension scheme was in surplus by £108 million on an IAS 19 basis but in deficit by £75 million on a technical provisions basis. The company decided not to recognise any surplus or deficit in its accounts. It took the view that a schedule of contributions was not a "minimum funding requirement" that has to be accounted for under IFRIC 14 and IAS 19. Under pressure from the FRC, it agreed to recognise the liability and has restated its accounts for the year ended 31 August 2012, resulting in a £4 million profit reduction.

Accountants are likely to raise this development with other affected companies.

IASB announcement:
http://media.ifrs.org/2013/IASB/September/IASB-Update-September-2013.html

IASB proceeds with amendments to IAS 19

The International Accounting Standards Board (IASB) has decided to go ahead with its proposed (see **WHiP Issue 39**) amendments to IAS 19, with some minor modifications. The original proposal described the changes as follows.

> *"The IASB is responding to concerns that were raised about the complexity of applying certain requirements of IAS 19. Specifically the concerns related to the accounting for contributions from employees and third parties to defined benefit plans. The objective of the proposed amendments is to provide a more straight-forward alternative for this accounting when the contributions payable in a particular period are linked solely to the employee's service rendered in that period. The proposed guidance would be applicable, for example, to accounting for employee contributions that are calculated according to a fixed percentage of salary."*

The amended IAS 19 is expected to be published in November 2013. The changes will take effect from 1 July 2014 but earlier adoption will be permitted.

Pensions Ombudsman determination: insufficient enquiries about potential beneficiaries

Determination:
http://www.pensions-ombudsman.org.uk/determinations/docs/2013/aug/po-1758.doc

The case of *Mr J Young* is a good example of a trustee getting into trouble over the apparently straightforward exercise of a death benefit lump sum discretion.

Miss Parkes had her marriage to Mr Young dissolved in September 2010. The following month, she took out an Essential SIPP policy. On the application form she gave her marital status as "engaged" and nominated her fiancé, Mr W, for the lump sum death benefit. Shortly afterwards, she reverted by deed poll to her maiden name, Parkes, and told the SIPP trustee.

In June 2012, she died intestate. Two young children from her former marriage lived with her and Mr W. Mr W reported her death to the SIPP trustee and named himself as next of kin. The death certificate, which he provided, was blank where it said "maiden name".

The SIPP trustee paid the lump sum death benefit to Mr W. It made no enquiries about the existence of a will, children, or any other dependants. Mr Young claimed that the

SIPP trustee should have paid the lump sum to Miss Parkes' estate for the benefit of their children.

The Pensions Ombudsman found that there had been maladministration in that there was no evidence that the trustee had asked any questions, including as to the existence of a will or any dependent children. Although it would have appeared to the trustee that Miss Parkes had never been married, it was *"baffling in current times"* to assume from this that she would not have any children. He directed the SIPP trustee to consider its discretion again and make a wholly fresh decision, ignoring the fact that it had already paid the benefit out to Mr W. There was no award for distress or inconvenience.

Inflation figures

ONS website: **http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/september-2013/stb---consumer-price-indices---september-2013.html**

The September 2013 CPI and RPI figures have been announced. The September annual increase figures are used for increases to state pensions and other benefits, and for minimum revaluation and indexation requirements. Scheme rules also often specify September as the month for measuring annual inflation.

The annual September CPI increase is 2.7% and the RPI increase is 3.2%. For September 2012, the respective rates were 2.2% and 2.6%.

Public sector outsourcing: "Fair Deal"

Consultation response: **https://www.gov.uk/government/consultations/further-consultation-on-the-fair-deal-policy**

Fair Deal guidance: **https://www.gov.uk/government/publications/fair-deal-guidance**

HM Treasury has issued its response to its latest "Fair Deal" consultation (see **WHiP Issue 37**) and has published final, new "Fair Deal for staff pensions" guidance with radical changes.

Fair Deal is the policy designed to protect the pension rights of central government employees when their function is outsourced to private sector contractors. Previously, it required central government departments to ensure that contractors (and their successors) to which employees are compulsorily transferred offer employees membership of a "broadly comparable" pension scheme for future service (as certified by the Government Actuary's Department) and day-for-day past service benefits for employees who agree to participate in a bulk transfer.

The policy applies to central government departments, agencies and other centrally governed bodies such as the NHS and schools/academies ("contracting authorities"). Contracting authorities are expected to raise these requirements at an early stage of the procurement process. The onus is on them to ensure that the requirements are implemented. This is done by including terms in the outsourcing contract.

The new requirements are broadly as follows.

- Employees transferred from central government will continue to participate in their public sector pension scheme while they continue to work in the outsourced function. Eligible employees will continue to be eligible. The transferred employees' contracts of employment with the contractor should incorporate these rights.
- When a transferred employee ceases work in the outsourced function (even if remaining in the contractor's employment), he/she will cease to be eligible for membership of the public sector scheme.
- As at present, the same requirements apply on "second generation" staff transfers, ie, when a contract is retendered and another contractor is successful and takes over the function and the employees. It will apply in the same way in the event of any subcontracting.
- Contractors must be required to enter into a participation agreement where required by the relevant public sector scheme. This must be agreed before the staff transfer takes place.
- Employees and employers will pay the same contribution rates to the public sector scheme as apply to their public sector equivalents unless the scheme authorities decide that additional funding is necessary to cover new risks arising from the contractor's participation. The contracting authority and the contractor may agree to pricing adjustments if the employer contribution rates change.
- Scheme regulations or directions may include a provision to charge employers an "exit payment" (plus the actuary's calculation expenses) if contributions paid have not been enough to fund the liabilities in full (NB the basis for determining this is not specified) or there has been any breach of the participation agreement. (The normal employer debt regime under section 75 of the Pensions Act 1995 does not apply to these schemes.) They may also provide for additional funding requirements for any benefit enhancements (eg, due to redundancy or the exercise of an employer discretion) and pensionable pay increases above a specified level.

- Contractors may be required to provide indemnities, guarantees or bonds to protect the public sector scheme against failure to recover costs arising from their participation in the scheme.
- Enforcement provisions should be included in the outsourcing contract. In particular, the contract should provide that a breach of the participation agreement entitles the contracting authority to terminate the outsourcing contract.
- In rigorously-examined exceptional circumstances, a contracting authority may agree – after workplace consultation – to apply the old Fair Deal requirements (ie, broadly comparable scheme and bulk transfer) or to provide alternative compensation to employees.

There are similar requirements when an existing contract is retendered, including provisions for bulk transfers back to the relevant public sector scheme. There is, however, scope for different approaches where these are required in order to ensure that incumbent contractors with broadly comparable schemes who bid in the retender contest are not at a competitive disadvantage. Under public procurement laws, all bidders should be on an equal footing.

Note also the following:

- There are different "Best Value" requirements for local government outsourcings, which continue unaffected for now. The Department for Communities and Local Government will consider how to implement Fair Deal in the local government context.
- Pension provision for any other employees of the contractor, including those recruited to work alongside the transferred employees in the outsourced function, is outside the scope of the guidance. (The old "Two Tier" code of practice, which required central government bodies that were outsourcing functions to the private sector to ensure that new recruits working in that function were given the same employment benefits, was withdrawn in late 2010. It was replaced by "Principles of Good Employment Practice". These are voluntary principles that are not enforced as part of the procurement process. Principle 3 says: *"Where a supplier employs new entrants that sit alongside former public sector workers, new entrants should have fair and reasonable pay, terms and conditions. Suppliers should consult with their recognised trade unions on the terms and conditions to be offered to new entrants."* (See **WHiP Issue 24**.))

The guidance takes effect immediately but some amendments to scheme regulations are required before the policy can be fully implemented. Negotiations for outsourcings that are "*already at an advanced stage*" need not comply with the new policy.

This and previous issues of WHiP can be found on our website **here**.

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If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Paul Stannard, Peter Esam, Philip Stear, Susie Daykin and Daniel Gerring.

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