ASSOCIATION OF
ACA
CONSULTING ACTUARIES

St Clement's House, 27-28 Clement's Lane. London EC4N 7AE
Tel: +44 (0)20 3207 9380 Fax: +44 (0)20 3207 9134 EMail: acahelp@aca.org.uk
Web: www.aca.org.uk

11 February 2013

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

Dear Sirs

ACA response to the further consultation on Fair Deal: published November 2012

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the Consultation on the Fair Deal Policy issued in November 2012.

Members of the Association are all qualified actuaries and are subject to the Actuaries' Code of the Institute and Faculty of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes. Our members also provide advice to sponsors and trustees of thousands of arrangements, both defined benefit and defined contribution schemes of all sizes, and to organisations involved in public sector outsourcing contracts under which those organisations take on employees who are members of, or entitled to membership of, statutory public sector pension schemes.

The ACA is the representative body for consulting actuaries in the UK, whilst the Institute and Faculty of Actuaries is the professional body.

General Comments

We welcome the draft guidance issued. We are also pleased to see a further consultation on future transfers of those staff transferred under the existing Fair Deal, as the Government has rightly identified that there are additional issues that make application of a new Fair Deal more complicated for these employees.

However, we still await the key information of how the employer rate will be set for contractors.

These details determine the key point of how much pension risk a contractor would be bearing through participating in a public sector scheme. If this risk is too great, even though it may be less than in a broadly comparable scheme, contractors may still be put off tendering. Therefore the aim of aiding the plurality of provision would not be met.

In responding to the guidance and the further consultation, we therefore have to give some responses that refer to this uncertainty, and therefore how attractive participation in a public sector scheme will be.

Find attached our comments on the questions posed. If you would like to follow up any matters, please contact me at clare.hobro@aonhewitt.com

Yours faithfully,

Clare Hobro
Chair, ACA Public Sector Outsourcing Committee

Responses from Association of Consulting Actuaries (ACA) to Fair Deal consultation (November 2012)

Box 4.C: Question 1

The Government welcomes views on the proposed application of the Fair Deal policy to staff previously transferred under the existing Fair Deal. In particular, the government would welcome views on:

a) whether organisations employing these staff should be able to continue to offer a broadly comparable pension scheme to staff already transferred out under Fair Deal or;

b) whether access to the relevant public service pension scheme should be a term of business for potential bidders for retendered contracts (including incumbent providers) and;

c) at what stage in the contracting process employers should be required to set out how they will offer pension provision for transferred staff – through access to the public service scheme or through offering a broadly comparable scheme.

To answer a) to c) we first need to set out the context, exploring three issues:

- The first looks at how the employer contribution rate will be set.
- The second looks at how this might be taken into account in a contract's financial agreement

Together these two affect the level of financial risks that would arise from participating in a public sector scheme. This affects the relative attractiveness of a broadly comparable alternative.

- The third looks at bulk transfer payments at the end of contracts. This affects incumbent's choices since continued broadly comparable provision delays the requirement for a bulk transfer..

First context point: How will the employer contribution rate be set?

A.12 of the draft guidance says that this will be decided on a scheme-specific basis, subject to HM Treasury consent. Once decided it will be set out in the final version of the guidance. However, how these are set will crucially affect the risk transfer. This sets the context for the questions in this consultation. The most appropriate answer to those questions therefore depends on how the employer rate will be set

The guidance A.14 says the rate payable by contractors "will, generally, reflect the employer contribution rate paid by the public service employers whose staff are members of the scheme."

It is not clear what "generally reflect" will mean in this context. For example:

- Will it be a flat rate (percentage of pay) applicable to all participating employers or will it take account of the specific details of each contract (eg characteristics of membership – age, benefit category, pay levels, gender and financial strength of contractor)

- What costs will be payable in addition? (eg indemnities, early retirement costs – due to redundancy or ill health)

- Will contractors be responsible for additional costs that are judged to be within their control, for example, above average increases in pensionable pay?

- How often will the contribution rate be reviewed? Presumably at the four yearly valuations.

- Will there be any termination payment, eg if a notional "deficit/surplus" has arisen during the contract?

- Will contractors bear any responsibility for costs arising from the pre-2015 schemes?

- Would the rate for transferring staff allow for any existing surplus/deficit, and any surplus or deficit that arises during the course of the contract, in relation to liabilities for any or all of:

  - Service prior to the contract, iro the transferring staff;

  - Service for other employees;

  - benefits of deferred, current and dependant pensioner members whose deficit/surplus is allowed for in the public service employer's rate?

Deficits or surpluses in respect of these items would affect the public service employer's rate. Furthermore, the effect of deferred, current and dependent liabilities in the pre-2015 schemes would sit outside of the employer cost cap, as set out in HM Treasury's document "Establishing an employer cost cap in public service pension schemes". In addition, other items such as effect of change in discount rate also sit outside the cap.

They could therefore cause the actual rate paid to be higher than the employer cost cap.

If this variability is to be reflected in full in a contractor's rate, then they would be exposed to the risk of pension costs exceeding the cap.

These details will affect how the cost of participation compares to a broadly comparable scheme. This would be particularly important if there is a choice between these two when re-letting a contract that was originally let under the existing Fair Deal.

The last point also crucially affects how much pension risk the contractor would be taking on by participating in the public sector scheme.

The ACA Response to Q1 depends to a great extent on the terms under which contractors would be able to join the public sector scheme, how their pension costs would vary over the contract duration, and whether and to what extent additional costs could be levied on contractors during and at the end of the contract. Our response to Q1 is therefore mostly predicated on the assumption that New Fair Deal includes sufficient certainty for contractors to feel that access to the relevant public service schemes would be an economically viable option, without undue uncertainty regarding future pension costs.

Second context point: How might the pension contributions be dealt with in a contract?
Another key point is how the employer pension contributions would be dealt with in a contract. This affects whether the risk inherent in a contractor's employer pension contribution is taken

on entirely by the contractor, or if some or all is shared back to the outsourcing authority. If the employer contribution rate contains significant elements of risk (such as any need to pay a deficit at the end of the contract, or significant exposure to prior liabilities) then such risk sharing may be the only way to encourage a wider group of companies to bid.

An analogy is the current situation where contractors can be admitted bodies (i.e. participate) in the Local Government Pension scheme. In that case, they are subject to employer contribution rates that could change during the contract, for example due to changes in market conditions. They are also liable to pay any deficit that exists at the end of the contract. In this context, there are various options (although not every contract will be open to any option) At the two extremes:

- the contractor could allow for anticipated pension costs in its bid, and be liable to meet the actual costs, whatever they are

- there could be a straight pass-through of pension costs, which are reimbursed by the contracting i.e. contractors quote for the underlying services and the pension costs are met directly by the contacting authority).

The latter approach reflects the fact that many of the costs of running a scheme are outside the control of individual contractors, for example: longevity, inflation and investment performance

However, full pass-through would not reflect the actions that are within the control of the contractor. This could either fail to recognize the value of bids from contractors who are good at controlling costs arising from those actions, or indeed encourage contractors to use these actions as a cost-free way to achieve their aims where possible.

A modification may therefore be necessary, so that some additional costs that are based on the actions of a contractor are to be met by that contractor. Examples are ill health costs (to the extent that these exceed those allowed for in the calculation of the contribution rate), redundancy costs, augmentations and pay rises above those assumed in the contribution rate. Under the modified approach, contractors would not be able, without incurring costs, to encourage members to retire early with augmented or on ill-health pensions and to replace them with employees with less generous pension terms.

In other cases, it is too complex to allocate the precise cause of risk and so a cap and collar approach is used as a broad proxy in recognition of a decision that each party should bear some of the risk.

Many current contracts with Local Government Pension scheme admitted body pensions use some form of risk-sharing such as modified pass-through arrangements. Indeed the DCLG issued guidance (see http://timeline.lge.gov.uk/Statutory%20Guidance%20and%20circulars/CLG_AdmittedBody_guidance_Dec09.pdf) on appropriate risk-sharing, with a table on page 17 setting out which risks might be attributed to the contractor and which to the outsourcing body.

The way pension contributions and additional costs are set will affect whether risk sharing is something that needs to be considered. If it does warrant consideration, then the optimal treatment of pension contributions in a contact is likely to depend on the particular contract, and indeed what would be optimal may also vary depending on who wins the contract.

Third context point: difficulties with transfers out at end of contract

It should also be noted that whereas under the current Fair Deal commercial contracts **should** include clear provisions regarding the onward bulk transfer requirements at the end of a contract, our experience is that the contract provisions are often unclear in practice. Hence, the views of the awarding body or relevant public service scheme regarding acceptable terms may not be consistent with those understood by the incumbent contractor.

Furthermore, typically the bulk transfer terms for the original transfer out from the unfunded public service scheme will have been set as a margin above yields on index-linked Gilts as at the date the staff originally transferred to the contractor. Private sector schemes cannot be certain their assets will perform to meet a no-less-favourable bulk transfer out on those terms because:

- If the scheme were invested 100% in index-linked gilts, this would lead to certain underperformance, due to not receiving a margin over index-linked gilt yields;

- In any case, private sector schemes are almost universally invested in a mixture of assets which will include no or few index-linked Gilts. Hence there is a mismatch between the investment strategy of contractors' pension schemes and the assets notionally underlying the original bulk transfer terms. Therefore even a well-funded pension scheme of a contractor could have a funding level that is insufficient as at the date the staff transfer back into the public service scheme. The company would then need to pay money to top up the amount their scheme pays out, to meet a contractual requirement for no-less-favourable terms.

In response to the specific questions:

(a) Should organisations employing these staff be able to continue to offer a broadly comparable pension scheme to staff already transferred out under Fair Deal?

The ACA feels that this must remain an option for an incumbent contractor.

While it is recognised that the opportunity to access the public service schemes for previously transferred staff will in many cases be an attractive option for contractors, there will be circumstances where an incumbent contractor would be able to offer better value if it can continue to use its own broadly comparable pension scheme.

There will be numerous reasons why an incumbent contractor may wish to continue with this option, but a few key possibilities include:

- If there is insufficient clarity regarding the financial risks associated with allowing access to the relevant public service schemes, some contractors may be unwilling to bid or may include significant additional margins in their contract prices to reflect their view of the risks they would be taking on. This would reduce the value for money benefits to the public sector of making this option available.

- To pay the public service scheme the required transfer value in full may require the incumbent contractor to pay a top-up to the amount their broadly comparable pension scheme will pay out (possibly because of temporarily low investment asset values in the scheme as the particular measurement date). The incumbent may therefore be able to provide a more attractive bid if on winning they would be able at each future contract to continue to spread any deficit in a Recovery Plan, instead of assuming they would need to pay it out all in one go.

- For some contractors, transferring all active members out of the broadly comparable pension scheme could trigger a "Section 75" debt requirement in relation to the deferred and pensioner liabilities. This typically involves the deferred and pension liabilities being valued at a greater amount than on the triennial valuation's Technical Provisions basis. This would result either in substantial funds being diverted to the broadly comparable pension scheme or in the contractor having to divert substantial management time and resource to negotiating with the scheme trustees;

- Regardless of the above, use of a broadly comparable pension scheme offers contractors enormous flexibility with their employees. For example, an employer might agree with scheme members that they would be allowed to remain in the broadly comparable pension scheme whilst working in another and unconnected part of the business. We understand that under the access arrangements of the public service schemes this option would not be open to the contractor or any affected employees. It can be time-consuming to monitor hours history on the contract to assess who is deemed still connected with the contract. Removing the broadly comparable option for existing contracts could reduce the contractor's flexibility and stifle innovation, as well as potentially harming career prospects for transferred public sector staff;

- The loss of employment flexibility from closing off the broadly comparable option referred to above will also reduce the flexibility of contractors to make efficiency savings on a given contract without having to make staff redundant. This is likely to be detrimental both to the transferred staff and to the contracting authority which will not be able to benefit from associated cost savings.

Hence, overall, we believe the best interests of all parties are served by allowing the incumbent contractor to continue to offer membership of its broadly comparable pension scheme.

b) Should access to the relevant public service pension scheme be a term of business for potential bidders for retendered contracts (including incumbent providers)?

Again, the ACA feels that broadly comparable provision should be an option for all bidders including incumbent contractors. Hence, we do not believe that contracting authorities should be allowed to make access to the public service scheme a condition of bidding.

Points I, IV and V above apply to potential new contractors just as much as they do to incumbent contractors. Hence, while we believe this option will generally be viewed very positively by the majority of contractors, there are compelling reasons why contractors should retain the option to offer membership of a broadly comparable pension scheme to staff who have already been transferred out of the public sector.

c) At what stage in the contracting process employers should be required to set out how they will offer pension provision for transferred staff – through access to the public service scheme or through offering a broadly comparable scheme?

It would be inappropriate to require bidders to state their final position before BAFO stage. Before BAFO, contractors are still exploring their options in general, including pensions. Some contractors may have a clear preference for one form of pension provision, However, others explore both options so they may need that time, and dialogue opportunities, to properly analyse the implications of the two options.

Ideally, full pension information should be available before BAFO. However, from past experience we expect there to be many instances where this is not the case. Hence we recommend there should be flexibility after BAFO stage for contractors to be able to change their preferred pension position if, for example, the financial implications of the bulk transfer requirements (from an incumbent or to another bidder) became clear after (or very shortly before) BAFO.

We recognise that changing the preferred position from (say) offering access to the relevant public service pension scheme (say, at BAFO stage) to offering continued membership of a broadly comparable pension scheme (possibly as a result of additional financial information becoming available during or as a result of contract negotiations) may have implications for determining which bidder is offering the best value bid. However, we assume there will be ways in which the bidding and negotiation processes can accommodate this.

Overall, we believe that transparency (of costs and risks) and flexibility are most likely to ensure the maximum number of quality contractors bidding and that this enhanced competition will help ensure best value is achieved for the public sector.

Box 4.D: Question 2

The Government welcomes views on whether there are any other situations that may arise when contracts covered by Fair Deal are retendered.

We believe that in future there may be some situations where it is not wholly clear whether an employer taking on a contract is an independent provider or part of the public sector, particularly in light of various government initiatives to encourage innovative ways of providing public services, eg mutuals (such as MyCSP) and alternative providers of medical services (APMS).

On a slightly different tack, we believe there may be situations that could arise, other than contract retenders, where it would be helpful if employees previously transferred out of a public service scheme under the Fair Deal could be offered the opportunity of returning to an appropriate public service scheme. Such situations might include:

- Employees being TUPE-transferred to a sub-contractor organisation which doesn't have a suitable broadly comparable scheme

- The contracting business being acquired by another organisation, with the result that the employees are no longer able to participate in the broadly comparable scheme of the previous owner of that business

- The contracting organisation going insolvent, and the business being transferred without a retender to another organisation which doesn't have a suitable broadly comparable scheme.

More generally, we believe it may be helpful to allow contractors with employees in a broadly comparable scheme who previously transferred out of a public service scheme under the Fair Deal to negotiate with the contracting authority and a suitable public service scheme terms under which those employees could be offered the opportunity of returning to that public service scheme, even where this is not at the end of the contract or under any of the circumstances described above. Depending on the how the employer contributions are to be set, as well as the management and other costs of the exercise, this may lead to a reduction in anticipated pensions cost and risk for the contractor, mid contract. If so, this would enable a lower contract cost to be negotiated by the contracting authority .It should also mean that at the next contract re-tender the pensions issues would already have been resolved, so simplifying the retender process.

Box 4.E: Question 3

The Government welcomes views on which scheme employees returning before 2015 should be able to access. This could be the one they originally left, the contracting authority's currently open scheme, or the scheme most broadly comparable to the one they originally left.

We believe the fairest and most practical approach will be to offer returning employees access to the current version of the section of the public service scheme they were members of (or eligible for) at the time they transferred out of public sector employment. So for example if the employee was a member of the Classic section of the PCSPS when originally transferred out of public sector employment and they return to the public sector before 2015, they should be offered membership of the Classic section of the PCSPS in its current form (i.e. with CPI increases and with the member contribution structure in force at the time of the transfer).

This would put them in the same position as if they had continued in public service employment throughout. This is also in line with the suggested approach for post-2015 transfers, whereby employees would join the same scheme to which current Classic members will transfer in 2015.

One result of adopting this approach would, however, be that some employees will need to pay higher contributions to the current public service scheme than they were paying to the broadly comparable scheme they are currently in – as a result of the increases in member contribution rates to the public service schemes which have been implemented in recent years. Such an increase may cause employment law issues unless consulted on properly with the relevant employees, or if a compensatory salary increase is provided. Such a consultation may be more practically carried out prior to the termination of the contract than at the point of TUPE-transfer, so as to avoid the need to provide a compensatory salary increase. This would support the suggestion above under Question 2 that it may be appropriate to allow contractors to negotiate with contracting authorities terms for employees to return to an appropriate public service scheme prior to the end of a contract.

However, if contractors are allowed to offer broadly comparable benefits instead, then care needs to be taken to ensure both a level playing field, and fair outcomes for employees, between bids with public sector scheme participation and bids with broadly comparable provision. This means the broad comparability needs to be tested against the current scheme.

If an incumbent contractor retains the contract after the rebid, it may seem simpler for the employer and scheme members if their benefit accrual is unchanged. This may be more generous than a structure broadly comparable to the current public sector scheme. The incumbent should therefore have the option to remove this over-generosity, for example through an increase in member contributions. Again, to avoid may cause employment law issues, this may require consultation prior to the end of the contract.

In some cases the incumbent may not wish to rebid, and for this or another reason may thus be unwilling to initiate consultation and changes to benefits. Consideration is needed on how best to deal with this: an option for lower member contributions within the public sector scheme (complicating the public sector schemes) or away to ensure the salary uplift is only temporary.

Note these TUPE issues also apply to scheme employees returning to public sector schemes after 2015.

Box 4.F: Question 4

The Government welcomes views on how bulk transfers for employees covered by the existing Fair Deal will work when those contracts are retendered under the new policy.

Under A.19, there is the ability for these members to be admitted to a new broadly comparable scheme, or admitted to a relevant public sector scheme.

If members transfer to a broadly comparable scheme, we would expect future service to be dealt with as per response to question 3.

If members move to a relevant public sector scheme, then the future service benefits should be provided on the same terms as would apply if it was a new contract, as per our response to question 3..

In relation to the bulk transfer terms to the public sector scheme or to a broadly comparable schem, there are two categories of members that need to be considered.

For contracts entered into since the 2004 changes, the terms of the ongoing transfer value should have been agreed at the time the contract transferred. As set out in A.26, the difference between transfer value based on these terms and the value that the public sector scheme places on the transferring benefits, will fall on the contracting authority. We recommend that similarly any shortfall to meet the transfer value required by a receiving broadly comparable scheme should continue to be met by the contracting authority as under current Fair Deal. This means the contracting authority will need to ensure that bids make clear the terms required for broadly comparable schemes, and that the public sector scheme's required terms are also known, which in turn relies on the ITT and bidding process providing sufficient pensions information. Also, the contracting authority should have a robust method of assessing the possible shortfalls that could therefore arise, and allowing for that in a considered manner when assessing bids..

The other category is in relation to contracts entered into under the original 1999 terms,including those entered into after 2004 but where exit terms were not dealt with appropriately nevertheless. In these cases, it would appear unreasonable for contractors to have to pay transfer values higher than those that they would offer to the schemes of other contractors. As such, it would be appropriate for the transfer terms set by the Trustees of the transferring scheme to be set in the same manner as they would for a transfer to another broadly comparable scheme.

In our experience, existing contracts include a variety of provisions for end of contract transfers. As noted in A.25, contracts entered into after the 2004 Fair Deal guidance was issued are required to include a provision for an onward transfer on “no less favourable” terms than the initial bulk transfer to the contractor’s scheme.

Ensuring that an appropriate onward transfer payment is agreed might not be straightforward because:

- Pre-2004 contracts are much less likely to contain a provision on how the onward transfer should be calculated, and as noted above, some post-2004 contracts also do not contain onward transfer provisions.

- Even though post-2004 contracts usually contain the “no less favourable” provision, this provision can be subject to differences in interpretations in terms of the calculation approach to be used – it could be judged to be an absolute or relative measure, for example should the calculation basis be updated for changes in life expectancy or financial conditions since the contract started? Also it is not always clear whether it applies only to the service originally transferred to the contactor, or also to service built up while employed by that contractor.

- Post-2004 contracts usually only provide for the bulk transfer to be calculated on a no less favourable basis when employment is transferring to a new contractor, and do not anticipate a transfer back to a public sector scheme.

We note that remaining in the private sector pension scheme with an RPI-linked deferred pension might be attractive for members with low salary expectations, relative to moving back to a final salary arrangement in the public sector. However, this would need to be considered against the arguably greater security offered under public sector schemes, where the risk of “default” is substantially less than for private sector schemes.

In addition, it will be necessary to determine the service credits that will be provided under the public sector scheme, as our experience is that most broadly comparable schemes do not replicate the public sector arrangements exactly. The determination of the service credits, to provide benefits of equivalent value, will therefore involve detailed calculations in some cases. The service credit should be agreed between the contractor and the public sector pension arrangement, based on appropriate actuarial advice. Similarly service credits would need to be determined in the case of a transfer to another broadly comparable scheme, as currently.

Box 4.G: Question 5

The Government welcomes views on whether the proposed approach to the Fair Deal policy for employees that have already been transferred out of the public sector will have differential impacts on people with protected characteristics.

We have no reason to believe that the proposed approach to the Fair Deal policy for employees that have already been transferred out of the public sector will have differential impacts on people with protected characteristics. However, as we similarly do not hold data on the protected characteristics of those people that have been transferred out of the public sector under the Fair Deal, we are not able to carry out any analysis on this issue.

Box 4.H: Question 6

The Government welcomes views on this draft guidance and suggestions for further areas that need to be covered.

As stated in our initial comments before answers to specific questions, we believe that the key to success for the new policy is to minimise uncertainty in pension costs for contractors both at outset and during the term of the contract. In this regard, the following areas need clarification:

How the employer contribution rate will be assessed.
As noted in our answer to question 1, A.12 of the draft guidance says that this will be decided on a scheme-specific basis, subject to HM Treasury consent. Once decided it will be set out in the final version of the guidance.

However, this information is needed before the guidance is finalised. This is because it needs to be taken into account when making decisions on other parts of the guidance, including decisions on the treatment of future transfers of existing transferred members. If this information is simply slotted in at the last moment, it could radically change the impact of the new Fair Deal, perhaps in a way not intended.

Therefore

- it is crucial that the proposed approach is consulted on and agreed before final guidance is published,

- the answer to how employer contribution rate will be assessed is intricately linked with other aspects of this consultation

Timescales
- When will the new policy be effective?

- As noted in question 2 above, we recommend that the Treasury consider allowing contractors and contracting authorities to agree to apply the new Fair Deal terms prior to the end of an existing contract – we are aware of some contracts with very long terms (up to 25 years) and it would seem reasonable to allow the new pension provisions (both benefits and transfer back to the public sector scheme) to be implemented by mutual consent as soon as the new Fair Deal policy is implemented. For contracts which have recently started, an earlier transfer of pension rights would enable employees to re-link to final pay their deferred benefits in the public sector arrangements.

Enhanced early retirement and redundancy
To what extent will enhanced early retirement terms on redundancy be included within the new Fair Deal policy, if at all (noting the current uncertainty over the TUPE requirements in this area)? For example, will contractors be required to provide identical benefits on redundancy to the NHS Pension Scheme?

Existing deferred and pensioner members of schemes
Will it be possible to transfer back members who had previously transferred out of the public sector schemes, but have subsequently left the contractors and so are deferred or current pensioners within their arrangements. Transferring active members, but not deferred and current pensioners could leave these members with less protection in the event of a future insolvency of a contractor.

Clarity of the parties involved and their roles, for bulk transfers
We recommend that sections A23 to A26 should be re-written for two reasons, first to avoid the misleading implication that in most cases the actuaries to two schemes will agree on a transfer value, and secondly to correct and clarify the parties involved and their roles.

First point:

A24 implies that there is a single value to be placed on liabilities that we would expect actuaries to the two different schemes to agree on. In fact, a value placed reflects the context and purpose for which it is calculated, for example whether it is

- designed to follow the scheme's Trust Dead and Rules and be fair between transferring and non-transferring members, or whether it is

- designed to represent the expected cost within the public sector scheme, with an appropriate likelihood of being sufficient to enable fairness between current and future taxpayers, and to represent an appropriate level of risk of deficit arising in future, taking account of the risk to be borne by the employer and that to be borne by the employee through impact of the cost ceiling.

Although A26 explains there may be a shortfall between the two amounts, the initial view that the actuaries will be able to agree will have lodged into readers' minds (similar to anchoring in behavioural finance theory). As we find contracting authorities typically do not understand that pension liabilities can have different values attached to them for different purposes, reinforcing this misconception in A24 before rebutting this in A26 can be particularly confusing.

Second point:

As currently drafted, there is confusion over the roles of the various parties.

In fact, typically there will be input from different actuaries, each appointed to advise one of: the outsourcing body, the public sector fund, the outgoing contractor, the outgoing contractor's pension scheme, the incoming contractor, and the incoming contractor's pension scheme. Note that each party typically may have a corporate actuary (advising the organization) and a fund/scheme actuary (advising the pension fund). Indeed, in some cases potential conflicts of interest will require the appointments to be different individuals

Meanwhile, monies might flow from pension scheme to pension scheme but also top-ups be paid into pension schemes from other sources, and/or additional monies paid for a contractor to set aside against the risk of future deficits.

Each amount of money will be determined according to different documents. These could be: the original or new contract; a scheme's Trust Deed and Rules; a public sector pension fund's guidance on transfer in amounts.

As an example, perhaps the employees of CurrentCo will have their broadly comparable CurrentCo Pension Scheme benefits transferred into the NHSPS, under a contract for the XYZ Primary Care Trust. The process may be as follows:

- CurrentCo's pension scheme Trustees ascertains the amount to pay out. This is governed by the scheme's Trust Deed and Rules, general duties of Trustees under Trust Law and relevant pension legislation, and on advice of their Scheme Actuary. Say this is £10M. This will be paid directly into the NHSPS.

- Let's assume the original contract set out required bulk transfer terms on exit. The actuary to CurrentCo and the actuary to XYZ PCT ascertain this amount is, say, £10.5M. This means that CurrentCo is obliged to pay the additional £0.5M. Whether this is paid into the NHSPS depends on whether £10M covers the amount they require.

- The NHSPS's fund actuary will have advised on the general requirements for transfers in. They will then calculate the specific amount for this transfer. Let's say it is £11.5M in that case. The additional £0.5M from CurrentCo would therefore go into the NHSPS. Also, the XYZ PCT would need to pay in the further £1M to top-up the £10.5M to £11.5M

- During the bidding process, the £1.0M will not yet be known. The actual amount will depend on how many members choose to transfer their past service pension rights and the differential impact of market conditions on the two calculations. The assessment of the range of values this could take should be available as information during the bidding process. This will enable the bidder to compare to the position if it is considering a broadly comparable offer, and the public sector body to plan finances.

Following current practice for outgoing transfers from public sector schemes, we would expect the fund actuary to the public sector scheme to set the transfer terms, and we would expect the actuary advising the contracting authority to advise on range of the likely shortfall.

Clarity is needed over whether the NHSPS (in this case) would commit to fixing the terms for the incoming transfer during the bidding process (even if in the meantime the NHSPS updates its approach for bids newly tendered). .

Where benefits will be transferred into a new contractor's broadly comparable scheme,that typically involves the new contractor's corporate actuary advising during the bidding process, with input from the scheme. When the actual transfer takes place, the scheme's Trustees and scheme actuary would determine the transfer-in required, and this may differ from any indications given during the bidding process, as their duties are not overridden by having given any such indications.

As can be seen from the detail above, the interaction of the various parties is different in many ways from the current draft guidance. Therefore considerable new text will be required. In doing so, it will be important to remove the current scene-setting of A24, which has the misleading implication that issues is largely a process of agreement between the actuaries to the two schemes.

How pension contributions are dealt with in the contract, and risk sharing
Depending on the detailed rules for setting their employer contribution rate, the contractor may be taking on some pension risk. If so, we recommend that guidance is added to cover this topic. For example, the Department of Communities and Local Government issued guidance on this topic, which has helped contracting authorities to appreciate the rationale for risk-sharing and the various methods available.

Submission from:

Association of Consulting Actuaries
St Clement's House
27/28 Clement's Lane
London EC4N 7AE
020 3207 9380
Contact: clare.hobro@aonhewitt.com

11 February 2013