

Pension Provision for Public Sector Outsourcing Contracts

LGPS passports cancelled

May 2007

The Government Actuary's Department (GAD) has announced that it has withdrawn all the Local Government passports issued before 26 April 2007. Contractors will need to agree new terms to obtain a new passport.

Background

Contractors bidding for local authority contracts must either provide a pension scheme that is broadly comparable to the Local Government Pension Scheme (LGPS), or become a participating employer in the LGPS (known as an admitted body in LGPS parlance).

If a contractor chooses the broad comparability route, it can obtain a certificate of broad comparability from the Government Actuary's Department (GAD) – these are commonly called passports.

The benefits within the LGPS are due to be radically changed from April 2008, and these changes will affect current local government employees as well as new entrants. GAD is withdrawing all old passports because broad comparability will not be satisfied once the LGPS changes have been made. To obtain a new passport benefits must be broadly comparable for current LGPS benefits until 31 March 2008, and the new LGPS terms thereafter.

What are the key issues?

- **New design** - Most contractors' passport pension schemes will need to have new benefits in place from April next year, as the current benefits are unlikely to meet the test.

For example, LGPS pensions will in future be based on an accrual rate of 1/60 with commutation, and also members' contribution rates will depend on their pay level. If the contractor's scheme already has 1/60 accrual, it may still need changes if it is less valuable than the new look LGPS in other areas.

- **Timescales** – GAD has not indicated how long it will take to obtain a new passport, but given the volume of LGPS passports needing renewal, delays may be inevitable.

The information in this document is based on UK legislation and practice. The Watson Wyatt commentary in this document is not intended to be comprehensive, nor to provide professional advice. It should not be treated as a substitute for professional advice on individual circumstances.

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- **Current contract negotiations** – the lack of a passport is likely to be a problem in current negotiations. Contractors will need to agree a delay in the process with the local authority, or perhaps that the passport will be provided after the contract is signed with benefits backdated.

Contractors may be under pressure to become an admitted body of the LGPS instead. However there are significant financial risks associated with this, relating to future company pension contributions and contract termination liabilities. Contractors should understand the issues before agreeing to be an admitted body, so they can negotiate suitable protections in the contract or price the risk into their contract accordingly.

- **Existing employees** - if local government employees have already transferred employment to the contractor, there is no requirement to change their benefits for service from April 2008.

The only exception is if the local authority required a contractual commitment to maintain broad comparability for the existing employees throughout the life of the contract. In these cases, contractors should discuss with the local authority what changes are required, bearing in mind that the changes may increase their pension costs.

- **Second generation contracts and sub contracts** often require broad comparability. Strictly speaking this should be against the terms of the LGPS when the employees left the LGPS, but in practice it is likely that the new terms will apply to these employees as well.

GAD has also stated that they may be withdrawing NHS and Civil Service passports in the near future, as their benefits are currently under review.

How can we help?

Watson Wyatt can assist in modeling the financial pension costs and risks. We can help you when negotiating with GAD and the local authority to manage the costs and risks of your contractual employee benefit commitments.

To find out more about managing pension provision in public sector contracts, please contact your Watson Wyatt consultant or call Steven Dicker on 0161 839 1600 or Andrew Reid on 020 7222 8033.