MILLS & REEVE

briefing

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Hutton report: the findings and the future of public sector pensions

This briefing details the main findings of the Independent Public Service Pensions Commission (better known as the Hutton Review), predicts how public sector pensions might be reformed and analyses what the likely consequences will be for public sector pensions.

Final report

The final report of the Independent Public Service Pensions Commission, or the Hutton Review as it is more often referred to, was published this morning. The review aims to demonstrate how “it is possible for public service employees to continue to have access for the foreseeable future to good quality, sustainable and fairer defined benefit pension schemes” whilst, at the same time, reducing the cost to the taxpayer. The report recognises that, if defined benefit pensions are to be maintained within the public sector, “there will need to be comprehensive reform – reforms that can balance the legitimate concerns of taxpayers about the present and future cost of pension commitments in the public sector as well as the wider need to ensure decent levels of retirement income for millions of people who have devoted their working lives in the service of the public”.

The final report makes a total of 27 recommendations. Some are genuine recommendations for benefit redesign or the protection of accrued rights, others are more general, abstract, comments or statements of intent. The key recommendations are:

- pensions should continue to be an important element of remuneration;
- the Government ought to ensure that public service schemes, along with a full state pension, deliver at least adequate levels of income. Employers should seek to maximise participation in public sector schemes;
- the Government must honour in full the pension promises that have been accrued by scheme members;
- a new career average revalued earnings (CARE) scheme should be adopted for general use in the public service schemes;
- members of the current defined benefit schemes should be moved to the new schemes for future service.;
- a single benefit design should apply across the whole income range, although contributions should be tiered to address the differing characteristics of higher and lower earners;

- members should have greater choice as to when they start to draw their pension. Flexible retirement ought to be encouraged;
- normal retirement ages ought to be increased so that they are in line with the state pension age. This link should be reviewed at regular intervals;
- there ought to be a fixed cost ceiling imposed upon the cost of providing public service schemes, with a default mechanism to bring costs back within that ceiling if it is breached;
- public service schemes should move towards a common framework;
- it is undesirable for future non-public sector workers to have access to public service pension schemes;
- all public service pension schemes should be properly managed, by trained professionals. The schemes ought to ensure a framework is in place for independent oversight and scrutiny; and
- the new public service schemes ought to be introduced before the end of this Parliament.

Hutton himself acknowledges that the key recommendation to come out of the final report is that the Government ought to introduce a new career average defined benefit scheme, often referred to as CARE, for all public sector employees. This would mean that, once established, all existing public sector employees would transfer to the new CARE scheme for future benefit accrual. The proposed changes are not restricted to new employees, as many had assumed would be the case.

However, the report recommends that existing members of public sector schemes maintain the link between their final salary and their accrued benefits. “Ministers have … been clear that the pension promises that have been made must be honoured”. This is significantly better than the deal for many private sector workers who, when their final salary schemes closed to future accrual, had their final pensionable salary capped at the date of the scheme’s closure.

Interestingly, Lord Hutton avoids the subject of inflation and price indexation, commenting that he is “taking as given the new landscape in which the Consumer Prices Index is the measure of inflation”. He also acknowledges that “a rise in employee contributions is imminent”.

Will Fair Deal survive?

Last week the Government published a 28-page consultation paper, under the somewhat long-winded title of *Consultation on the Fair Deal policy: treatment of pensions on compulsory transfer of staff from the public sector*.

Fair Deal is the guidance, published by the previous government, which sets out how public sector workers’ pension benefits ought to be handled when their employment is transferred from one public sector organisation to another or, as is more often the case, from the public sector to the private sector. Whilst Fair Deal is guidance and not law, it is stated as applying directly to government departments, agencies and the NHS and the previous government expected other public sector bodies to follow the guidance also.

Fair Deal requires a new employer, who has received public sector staff under a TUPE transfer, to provide access to a “broadly comparable” pension scheme for future service and also to enable the affected employees to transfer their accrued benefits from their public sector scheme to their new employer’s broadly comparable scheme, so as to maintain the link with final salary.

The Government's consultation will affect public sector workers, their trades union and independent private sector business and third sector organisations competing for work in the public sector space. The Government's justification for the consultation is taken from Lord Hutton's interim report, published in October 2010, which stated that Fair Deal acts as a deterrent to small and medium size companies bidding for public sector contracts, is a "barrier to the plurality of public service provision" and, ultimately, that reduction in competition leads to an increase in the cost of providing public services and the taxpayers who fund them.

The consultation proposes adopting one of three options:

- no change to Fair Deal – it appears that the Government does not consider this to be a genuine option, as it would not address the barriers to the plurality of provision of public services;
- reforming Fair Deal – this offers a broad range of options and is not specific about the scope of potential reform; and
- ending Fair Deal – instead relying on the protections afforded by the TUPE requirements.

If Fair Deal is withdrawn, which seems likely as it appears to be the Government's preferred option, public sector workers would be subject to the same protection as private sector workers under legislation. This would, essentially, require any new employer to match former public sector employees' contributions to a defined contribution stakeholder pension scheme, up to a maximum of 6 per cent of salary. There is little doubt that this would lead to affected employees receiving a significantly lower pension than would be the case under either the existing or proposed public service schemes.

The deadline for responses to the consultation is 15 June 2011.

How does this affect you?

On the whole, one anticipates that Lord Hutton's final report will not be wholly welcomed by public sector workers or taxpayers. Whilst Hutton has tried to strike the balance between maintaining good quality pension provision for public service workers and ensuring long-term affordability of public sector pensions, employees are likely to resent the increased cost of contributions and the potential reduction to workers' ultimate benefits, whilst taxpayers may consider the revised schemes overly generous when compared to private sector pension provision.

However, all parties must recognise some form of compromise will be required. As Hutton notes, "confronting the fundamental challenges posed to our pension system, ensuring productivity in the wider economy and value for money for taxpayers requires us to make difficult choices".

The proposed withdrawal of Fair Deal is likely to have a far greater impact upon public service pensions, particularly from the private sector's perspective. Fair Deal acts as a deterrent to private sector contractors looking to contract with the public sector and its withdrawal will better enable more contractors to bid for a greater variety of contracts.

If the private sector's only obligation is to comply with the protections afforded by the TUPE requirements, the private sector immediately has much greater certainty when pricing bids. This ought to result in lower costs and less risk for the private sector, which in turn leads to better value for the public sector.

However, one can state with relative certainty that the public sector trades union will not adopt this view. One would anticipate that unions will consider the withdrawal of Fair Deal to be a step too far and would certainly undermine Hutton's stated intention of balancing protection for public sector workers and reducing costs for the taxpayer.

Lord Hutton stated that, in seeking to reform public service pensions, "it does not mean we have to give up the idea of designing a pension system that can deliver decent retirement incomes". He also stated that establishing "a relationship of trust and confidence going forward will be very important". If Fair Deal is revoked, I suggest that this will encourage a race to the bottom and will undermine any "relationship of trust and confidence" between public sector workers, their trades union and the Government. If Fair Deal is revoked, thus undermining the balance sought by Lord Hutton in his 27 recommendations, I anticipate that there will be a great deal of unrest within the public sector and resistance to changes to public service pensions. In those circumstances, one cannot rule out a summer of discontent.

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