



New state pension and abolition of contracting-out

Schemes that are integrated with the state pension system need to respond to the changes from 6 April.

What they need to do depends whether they are integrated through contracting-out or in another way, and whether they will remain open to accrual.

Schemes remaining open to accrual from 6 April 2016

Future service benefits

- Many schemes have already decided what future service benefits will be and how the cost will be met.
- Legislation gives the employer a unilateral power to increase member contributions and/or to reduce future accrual to offset the extra NIC cost. One of several procedural requirements is a certificate from an actuary. The scheme alteration power is also available subject, in most cases, to the trustees' consent. Both powers have their pros and cons for adjusting future benefits.

Contracts of employment

- Employers should consider whether any changes they are considering to future accrual might breach any members' contracts of employment e.g. if, unusually, they have a contractual promise of a particular level of future accrual.

Member communications

- An increase in member contributions or a reduction in accrual will normally require 60 days prior consultation by the employer.
- Depending on what changes are made, the trustees may also have obligations to communicate e.g. as a minimum to tell active members (by 6 July) they are no longer contracted-out.

GMP revaluation: technical point

- Under the *post April legislation*, the method of GMP revaluation for members who remain in *pensionable service* (sic) is s.148 orders. But many *scheme rules* say fixed rate revaluation applies when *contracted-out employment* ends (as it will on 6 April). With legislation and the scheme rules pulling in different directions, the scheme might have to provide the better of the two. Rule amendments may be needed to avoid this. You should check what your rules say.

- Recognising that some amendment powers might be too limited to deal with this, the DWP has created a statutory alteration power. It will allow trustees who face the above dilemma to resolve it by amending their rules. Trustees will be able to exercise the power unilaterally by passing a resolution. This is a helpful development.

Schemes integrated otherwise than by contracting-out

- If your scheme integrates with the State pension in any way, you should check the formula will still work after April. This normally means checking any statutory concepts the scheme relies on (e.g. to define by a deduction from pensionable pay) will remain unchanged and any annual figure will still be published. In one example, the DWP has confirmed figures for the basic state pension will continue to be published.
- Bridging pensions are another example. Here any adjustment needs to ensure the pension will remain an authorised payment for tax purposes and will fall within the dedicated exception in the age equality legislation.

If the scheme is used for auto-enrolment, how it will qualify in future?

- Will the scheme use the test scheme standard or, perhaps more likely, the "cost of future accrual" option?

All schemes that are or were contracted-out

Scheme rules

- We suggest you update your scheme rules to make them consistent with statutory requirements over the protection of contracted-out rights. Light touch, general language can extend the life of the rules as a useful reference point and reduce the need for future amendment.
- Defined terms referring to foundational concepts in contracting-out legislation are among the items to be updated e.g. "Reference Scheme Benefits".

GMP increases

- There is an outside chance a scheme could find itself liable for increases on GMPs that are currently paid by the state. These are increases on pre 1988 GMP and any excess over 3% on post 1988 GMP. For a member reaching SPA on or after 6 April, the state will not pay these amounts. Exceptionally, a quirk of rule drafting could mean liability falls back on the scheme. It is worth checking your rules.

GMP equalisation

- Asked to address GMP equalisation and conversion in the current round of changes, the DWP has replied: "We have considered the responses carefully, but concluded that this issue cannot be addressed in this set of regulations. Conversion and equalisation issues are being explored separately." The waiting continues.

GMP reconciliation

- If you have yet to apply to HMRC's Scheme Reconciliation Service to verify your GMP records, you should do so. Incorrect data could prove expensive. The deadline for applying is 5 April. Understanding the quality of your data is the first step.

Schemes integrated other than through contracting-out

- Schemes integrated other than through contracting-out should update their rules if the benefit formula has been adjusted.

Missing pieces of the jigsaw

The main legislation on abolition is in place. But the DWP is likely to consult on further regulations dealing with outstanding points on:

- whether and, if so, how to give members of previously contracted-out schemes access to DC flexibility,
- the extent to which accrued contracted-out rights can be amended in future as exceptions to the general prohibition on such alterations,

- trivial commutation where, among other issues, the requirements in contracting-out legislation do not sit comfortably with the way trivial commutation and small pot lump sums are defined for tax purposes (though this is not a new issue) and
- a range of technical details in various sets of regulations.

As the legislation stands, bulk transfer of contracted-out rights without consent will only be allowed to another scheme that was previously contracted-out. The DWP has been made aware this is likely to hinder scheme and corporate reorganisations. It has said it will consider this as part of a package of further changes it expects to make in 2017.

More information

If you would like more information, please get in touch with your usual contact in our pensions team or:



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