The Pensions Bill 2013

David Everett – 21 March 2013

All change – from ~~April 2017~~ ~~“at the earliest”~~ April 2016

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Agenda

The new State Pension

The end of contracting out

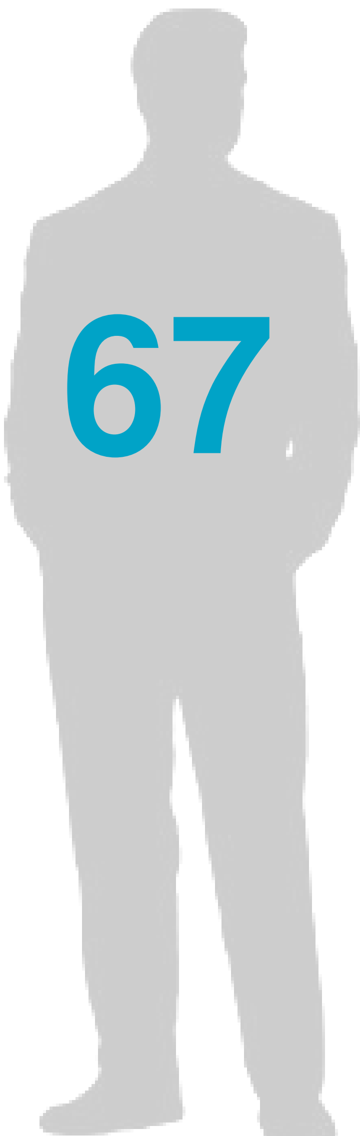
Bits and pieces

Bits and pieces

… in brief

Bits and pieces

In the Bill now



- Increase in State Pension Age
  - will gradually rise from 66 to **67** between 2026 and 2028
  - review every five years (first by May 2017)
- Prohibition of incentives to transfer benefits from a salary-related scheme – regulation making power
- Suspension and prohibition of trustees – tidying up
- Scheme Returns – easement for micro-schemes

Bits and pieces

Going in the Bill later?

- Power to issue guidance on GMP conversion
- Fixes to auto-enrolment (March consultation…)?
- Any more?

The new State Pension

… an overdue reform, but who wins and who loses?

Winners and Losers

Due to an early commencement

✓ Winners	× Losers
▪ The Treasury (extra NICs but..) ▪ Those reaching SPA between 6 April 2016 and 5 April 2017 who are self-employed or otherwise have not accrued much SERPS / S2P	▪ Public sector employers ▪ Contracted out employees ▪ Private sector employers if they don't move fast enough

The new “State Pension”

If no NI record at commencement date

State Pension = QY/35 x “Full rate”

- “Full rate” will be set above the guarantee credit element of the Pension Credit (£142.70pw in 12/13)
    - say £144pw compared to the Basic State Pension of £107.45pw

- Qualifying Years (QY) are over working life (16 to SPA)
    - but need to have a minimum number of years (7 to 10) for any accrual and accrual ceases after 35 years

- Payable from State Pension Age (SPA)
- Increases in payment by not less than the increase in national average earnings

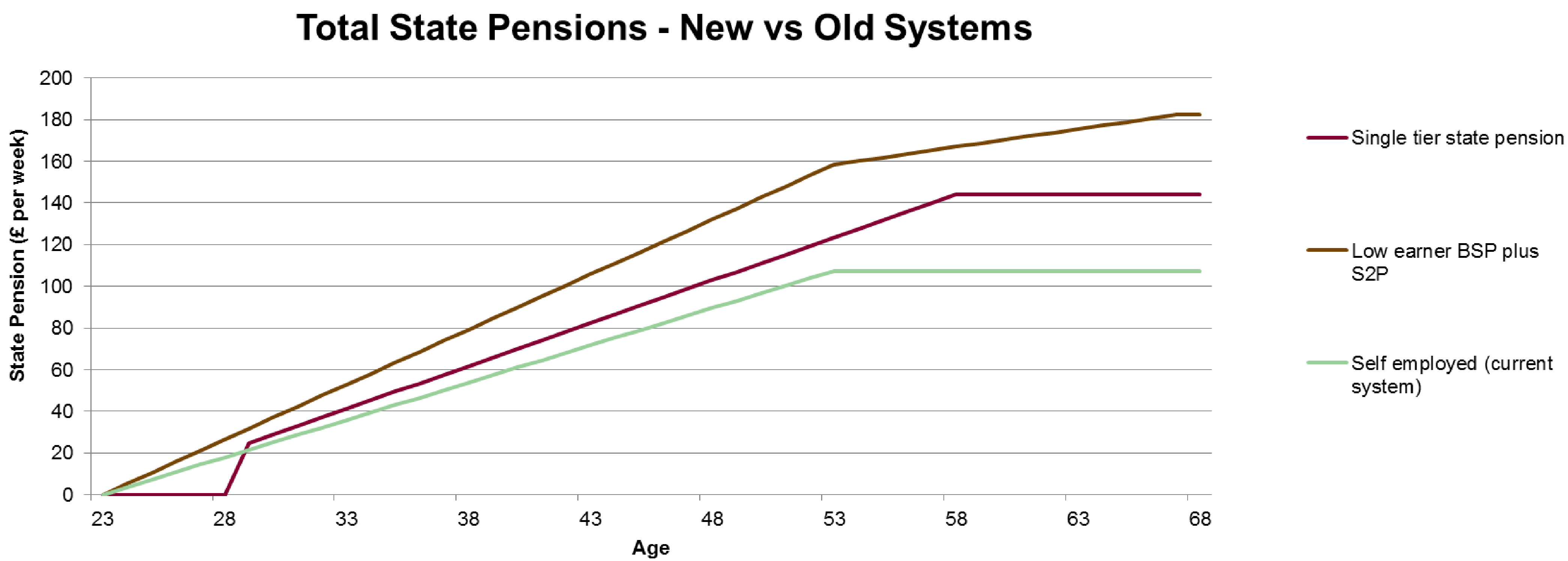
Winners and Losers

If no NI record at commencement date

✓ Winners	× Losers
▪ The self-employed	▪ The employed
But may have to pay increased NICs	The system is less generous than the one it replaces

Winners and Losers

Modelling a 23 year old's build up of state pension



Winners and Losers

Much of the earnings-related state pension has gone now

The transitional new "State Pension"

If NI record at commencement date

Transitional State Pension:

Lesser of

"Full rate" (say £144 pa)	AND	The sum of the Amount for pre-commencement qualifying years (the "Foundation amount")	+	The Amount for post-commencement qualifying years

But if Full rate < Foundation amount then pay the Foundation amount divided into the Full rate and the excess (the "protected payment")

(and the protected payment increases in payment by the increase in prices)

A pre-commencement qualifying year is one between 6 April 1978 and the commencement date

The transitional new "State Pension"

If NI record at the commencement date

Pre-commencement amount	Post-commencement amount
Higher of: **(a)** Accrued old state pension ie accrued BSP + GRB/SERPS/S2P (net of deductions for contracting out) **(b)** Notionally accrued new state pension less a contracting out reduction ie Pre Comm QY/35 x "Full rate" – "C-out reduction"	Normal new State Pension accrual - ie: Post Comm QY/35 x "Full rate"

In both new state pension calculations the minimum number of years accrual requirements is ignored but the 35 year maximum applies.

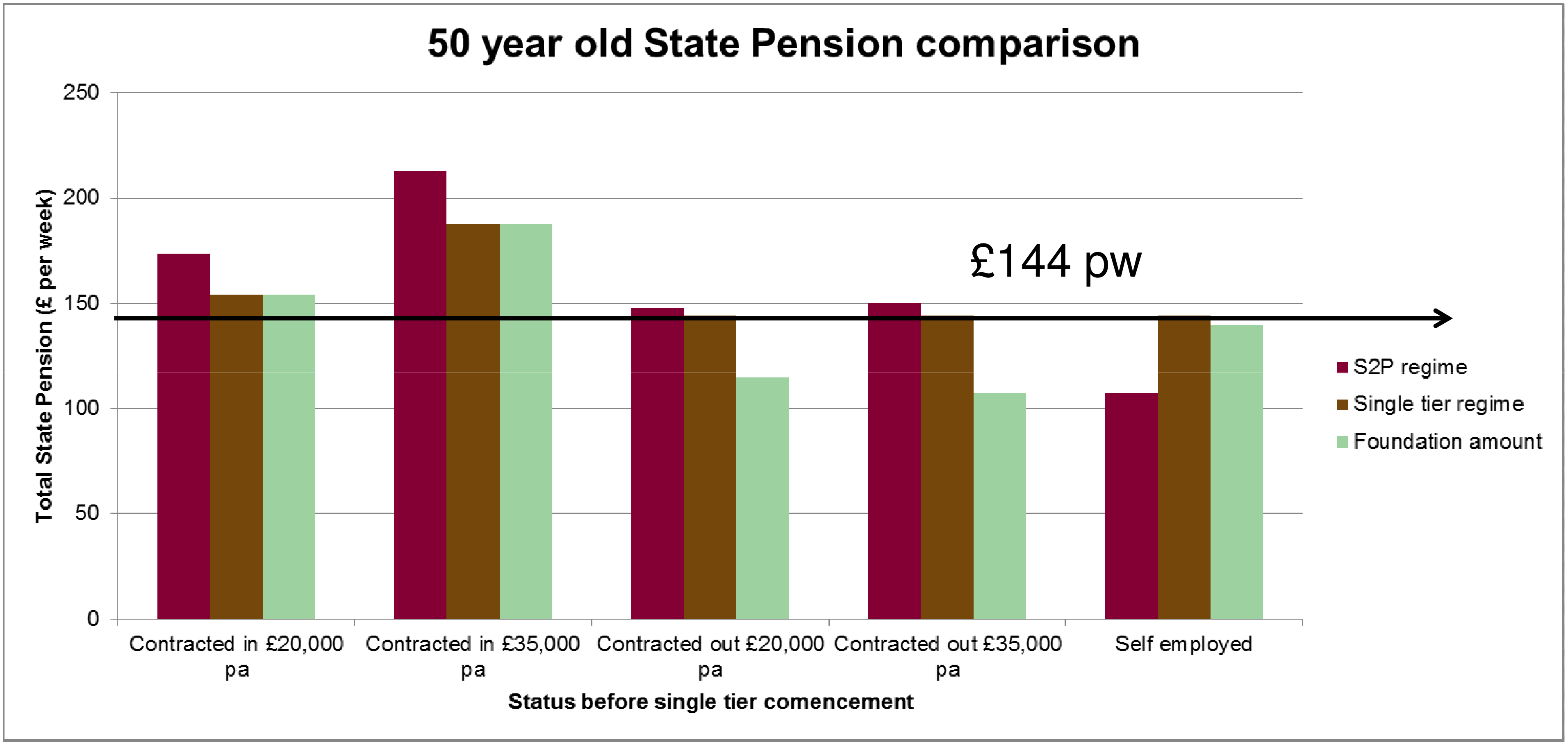
Winners and Losers

If NI record at commencement date

✓ Winners	× Losers
▪ The self-employed ▪ The contracted out (as past service elsewhere and get some credit for future NICs)	▪ The contracted in (as little credit for future NICs)

Winners and Losers

Modelling the pension at SPA of a 50 year old at commencement date



The new State Pension

… what might it do to scheme design?

Schemes with state pension in their design

Anything could happen!

Design type	Possible impact
▪ A deductible in defining pensionable earnings for contribution purposes ▪ A deductible in defining final pensionable earnings for benefit purposes ▪ Bridging pensions (pre-SPA uplift / post-SPA "clawback")	▪ Jump to the new state pension ▪ Not be affected at all (eg because the LEL is referenced as a proxy for the State benefit) ▪ Remain locked to the old state pension benefit (if the Rules definition unambiguously points this way) ▪ Become indeterminate (because a term is used which loses its unique understanding)

Schemes with state pension in their design

Wording used in some real schemes

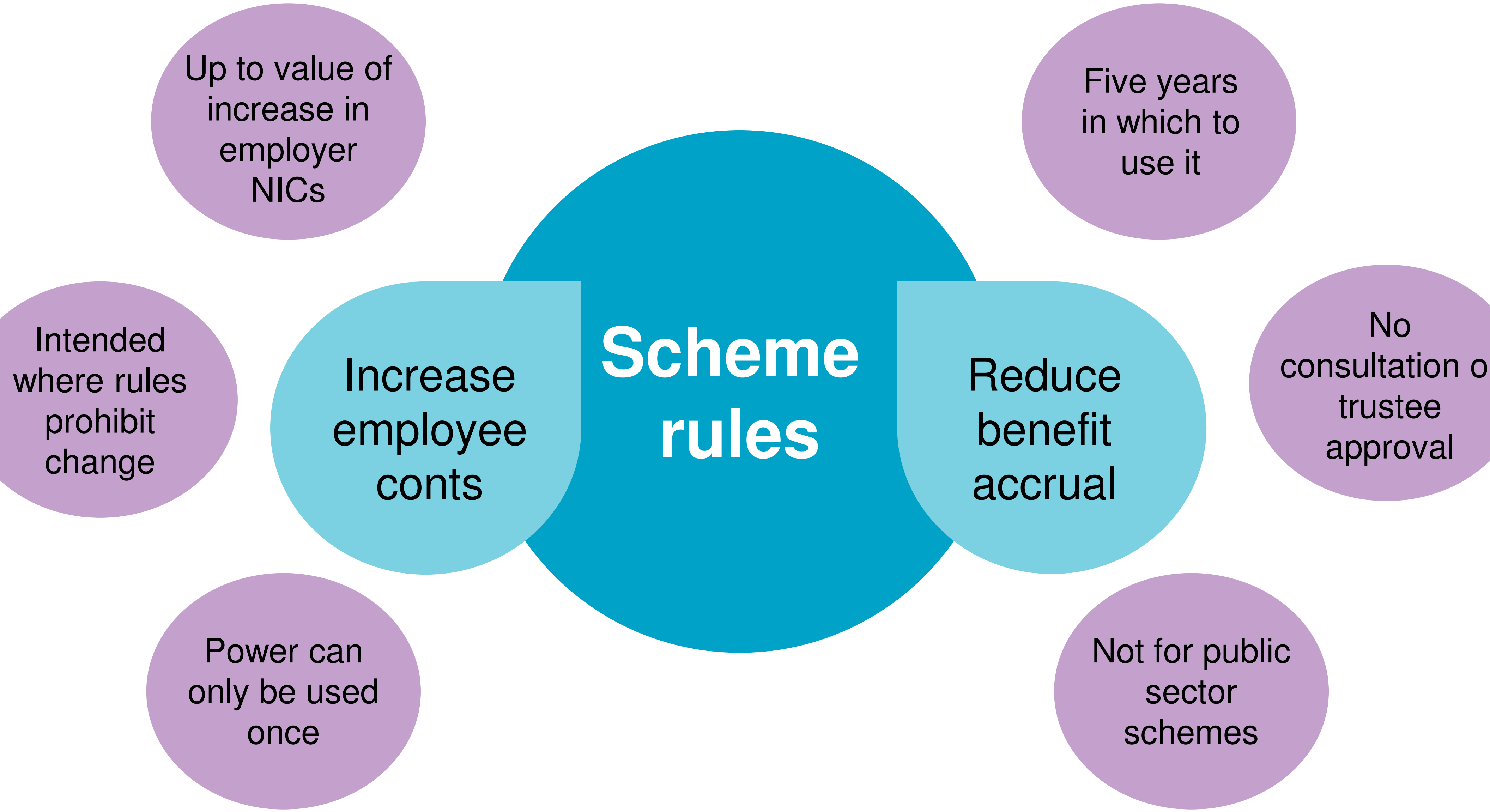
- "Annual equivalent of the flat state retirement pension payable to a single person"
- "The average basic state pension during a member's last 12 months of service"
- "The pension that would have been payable to the member under the State scheme at the date he or she ceased to be an active member" *("State scheme" not defined)*
- "The State pension payable to the member after State Pension Age" *("State pension" not defined)*
- "….annual average of the State flat rate pension payable to an unmarried person…"
- "The basic Category A retirement pension payable to a single person in accordance with s.44(4) of the Social Security Contributions and Benefits Act 1992…"

The end of contracting out

…… consequences of the new State Pension…..

Employer override

To claw back the NIC increase



Employer override

To claw back the NIC increase

The deal

- One off and 5-year time limited opportunity for employer to
  - increase "total annual employee contributions"; and/or
  - reduce the "amount of the scheme's liabilities in respect of the benefits that accrue annually"
- So long as not more than "annual increase" in employer NICs

Some issues

- No checks and balances
- Not clear how to avoid significant targeting or cross-subsidy between groups of employees
- What exactly is the actuary certifying?
- Which actuary?
- What method and what assumptions are to be used?
- How do the margins for practicality work?
- What if get it wrong?
- When will it be available to use?

Regulatory house-keeping

Repeal, repoint and retain

Repeal as not needed	▪ Certification requirements ▪ State scheme premium facility
Repoint to a new test	▪ Auto-enrolment quality requirement for DB schemes
Retain existing protections	▪ GMP rules ▪ Anti-franking ▪ The Protection Rule for schemes ceasing to contract out ▪ Section 9(2B) rights scheme rule change check ▪ Section 9(2B) transfer out restrictions

Keeping the GMP rules

Unsurprising but with surprises

- GMPs remain – no Protected Rights style abolition
- GMP revaluation funnies will occur
    - If active – future revaluation in service switches to whatever trustees had decided for early leavers (typically fixed)
    - Trustee revaluation policy – is fixed for all future deferred pensioners (typically fixed – at whatever the fixed rate will be from commencement)

Keeping the Protection Rule?

A little known aspect of ceasing to contract out

The Rule

The total amount of the benefits under the scheme for each member at NPA and the member's widow, widower or surviving civil partner at the day following the date of death of the member, must not be less than the sum of:

- Section 9(2B) rights and GMPs
- Any other benefits due in respect of rights accrued in relation to service in employment which was contracted-out before 6 April 1997; and
- Any benefits due in respect of rights accrued in relation to service in employment which was not contracted-out

Issues

- Little understood
- Separate to anti-franking and revaluation requirements
- Not clear whether revaluation requirements are part of this Rule
- Seems that schemes must explicitly add to Scheme Rules

Is it really needed? Isn't Section 67 and Trust Law good enough?

Regulation 45 of the Occupational Pension Schemes (Contracting-out) Regulations 1996

Keeping the Section 9(2B) rights scheme rule change check

An unnecessary new requirement

Changes to accrued "section 9(2B) rights" not usually allowed unless:

- the post 1997 contracted out benefits provided to members and survivors' considered separately are at least as good as those provided via the reference scheme; or
- Section 67 of the Pensions Act 1995 does not apply; or
- the alterations are neither "detrimental" nor "protected" modifications, or if they are "detrimental" the Section 67 actuarial equivalence test is met, and in either case the actual or contingent survivors' post-1997 contracted-out pension must be "at least as generous" as before the change.

Is this new rule really needed?
Isn't Section 67 and Trust Law good enough?

Introduced by the Occupational and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2013

Keeping the anti-franking rules

But the cessation date is triggered on the commencement date. So.....

- Retirements from active will be subject to anti-franking for the first time
  - and all four components of the “relevant aggregate” will apply
  - so you don’t just check whether the GMP is covered
- Actives who become deferred pensioners after the commencement date will be subject to all four components of the relevant aggregate measured from the commencement date
  - which will need to be compared against their normal anti-franking practices measured from their later date left pensionable service

Confused?

Where benefits accrue after cessation date

Theory

Relevant Aggregate

Relevant Sum + GMP Uplift + Appropriate Addition + Later Earnings Addition

Further possible components

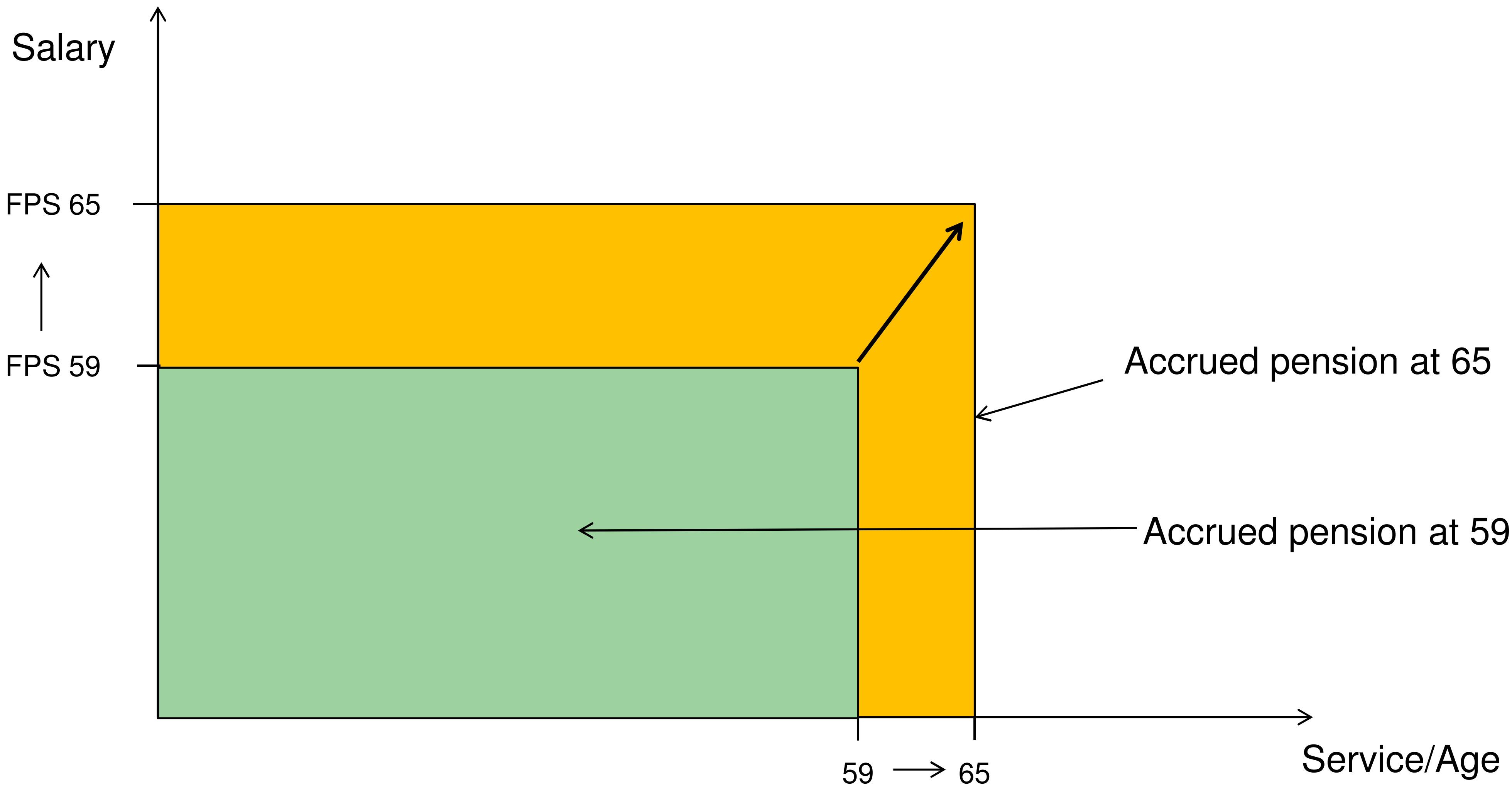
Statutory revaluation on excess + Statutory increases in payment on Post-97 pension

The overall pension must not be less than total of all six of these

If the sum of these is more than the member's pension at the date payment of GMP commences an uplift may be required

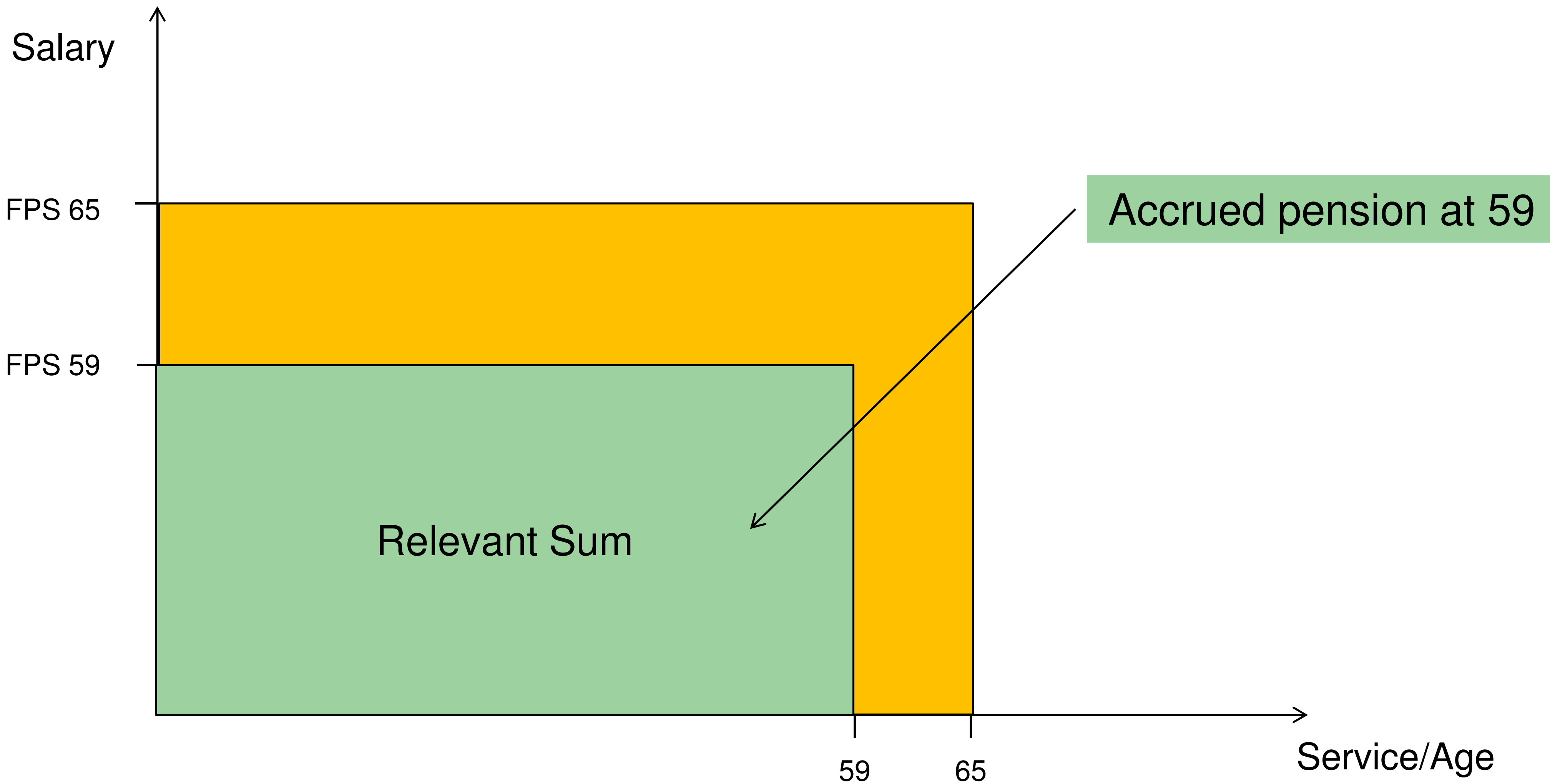
Retirement from service

Member retires at 65 but scheme ceased to contract out when member was 59



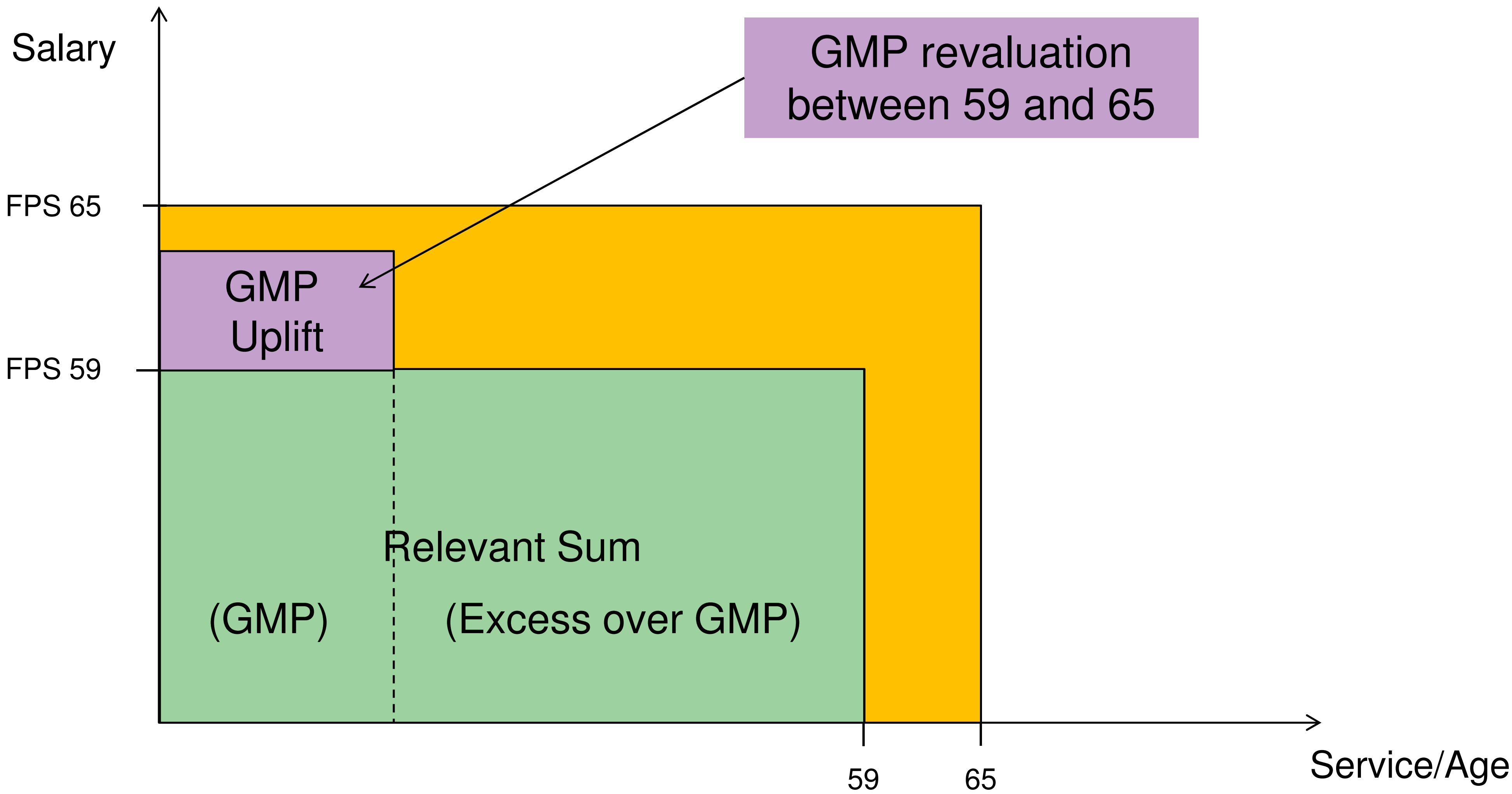
Retirement from service

Relevant Sum



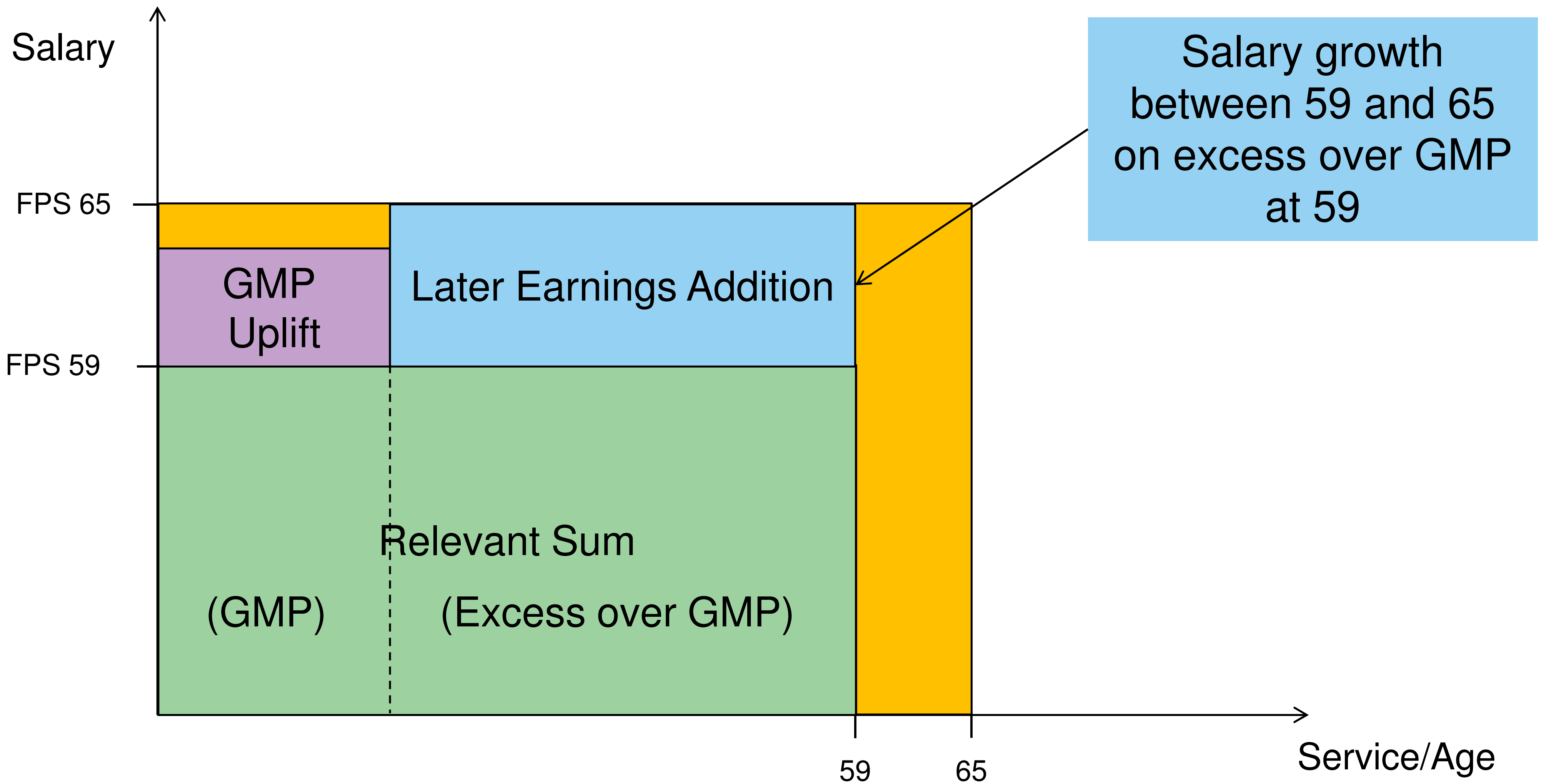
Retirement from service

Relevant Sum + GMP uplift



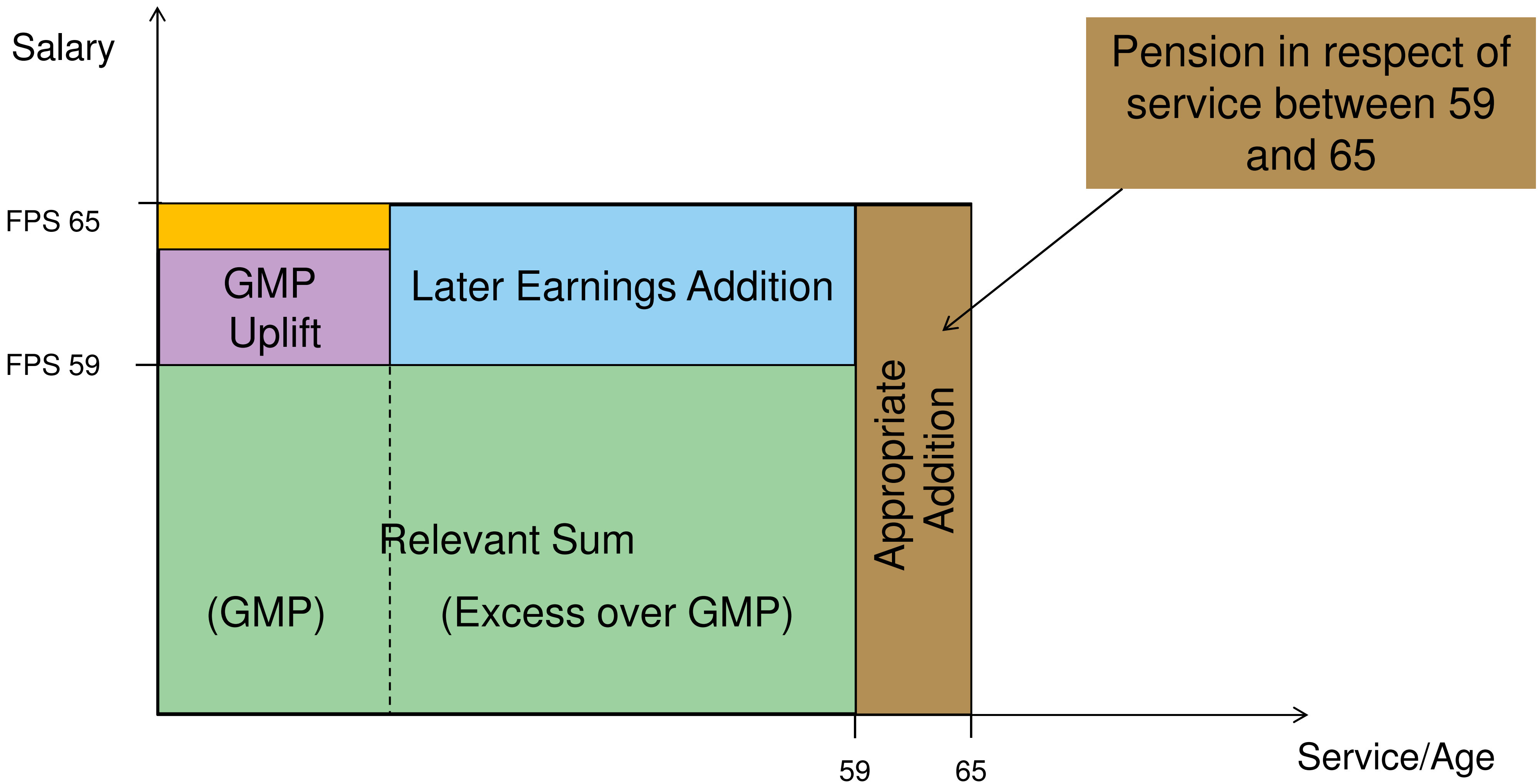
Retirement from service

Relevant Sum + GMP uplift + Later Earnings Addition



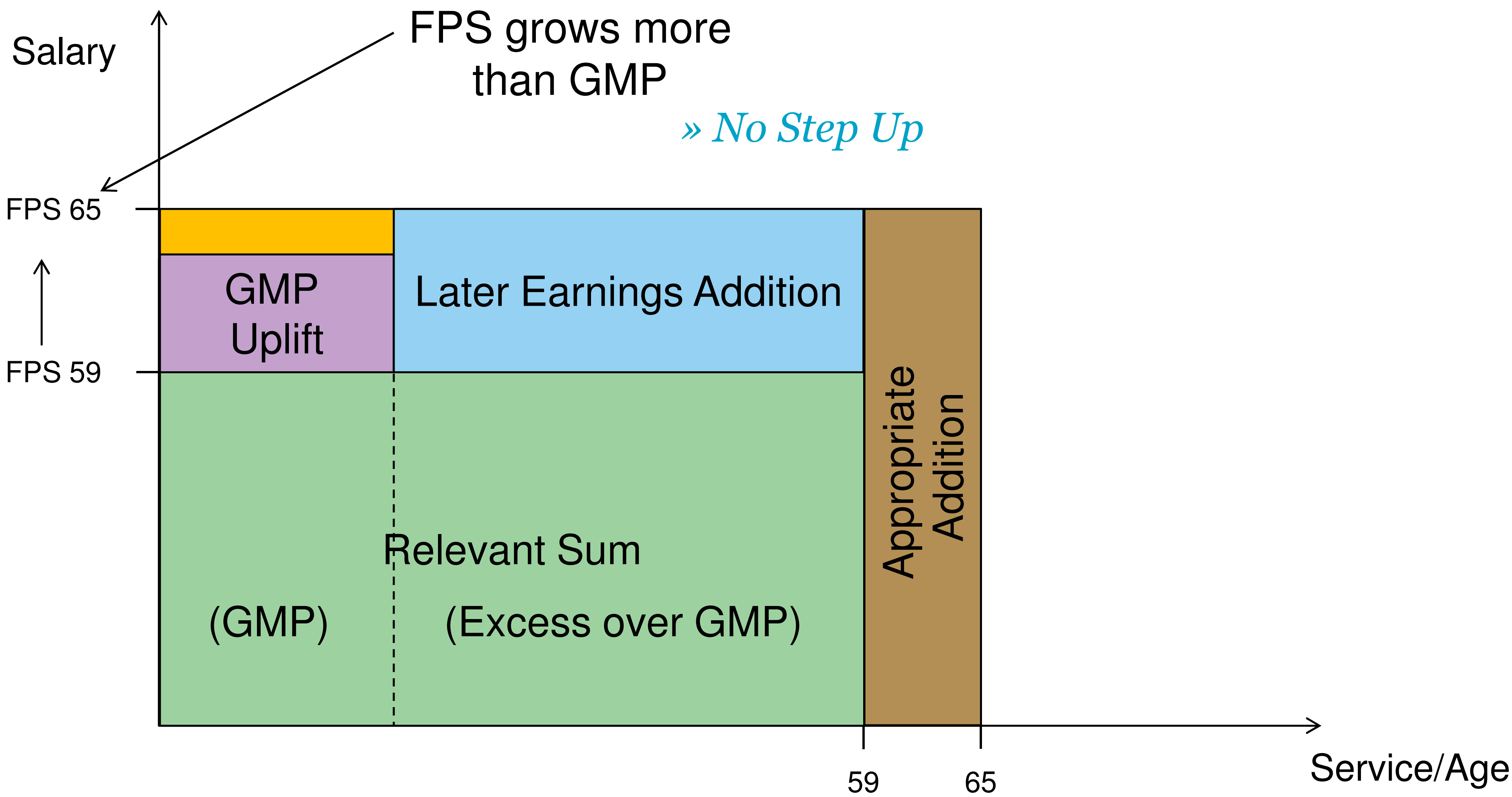
Retirement from service

Relevant Sum + GMP uplift + Later Earnings Addition + Appropriate Addition



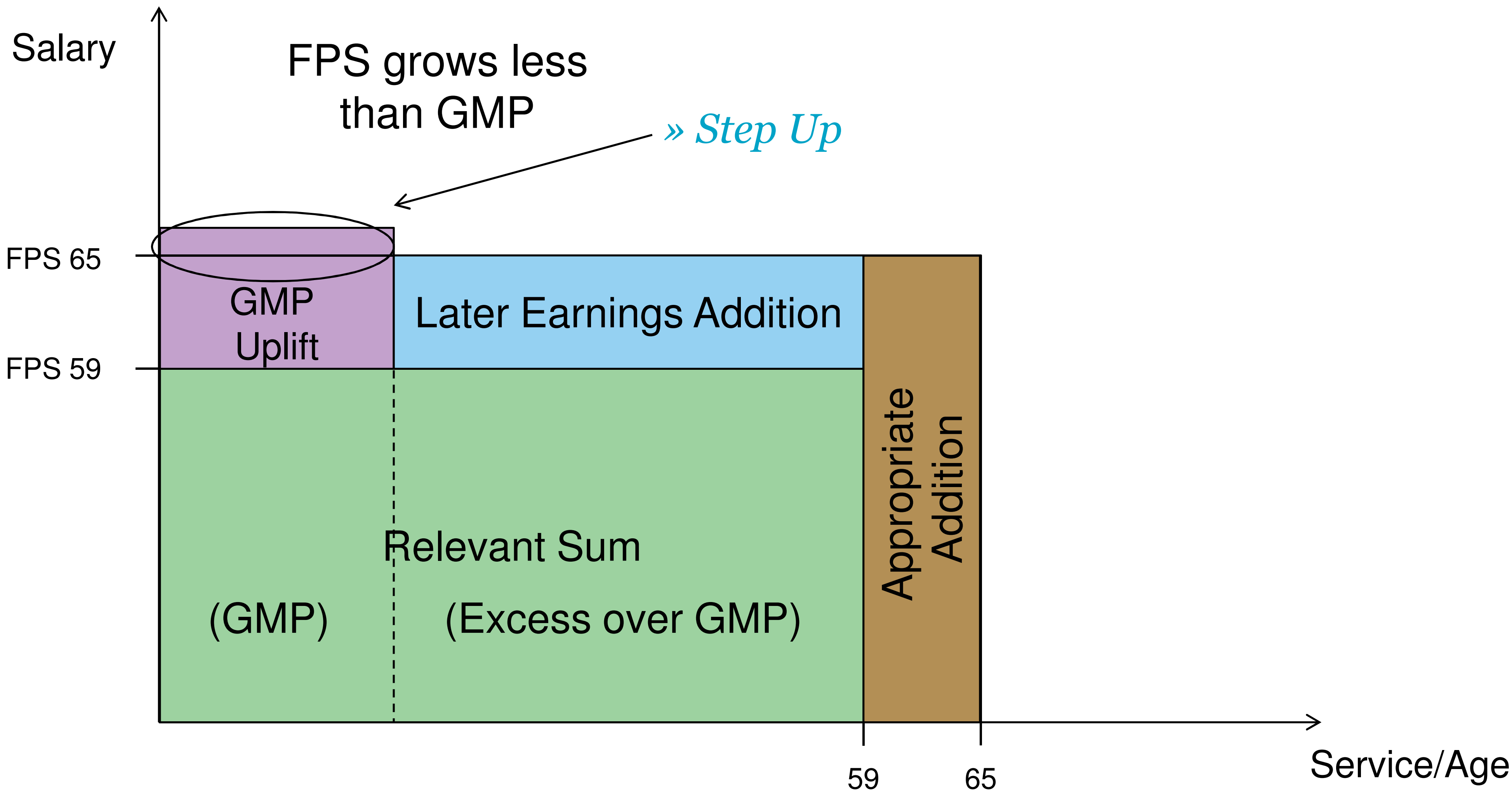
Retirement from service

Significant salary growth since 59



Retirement from service

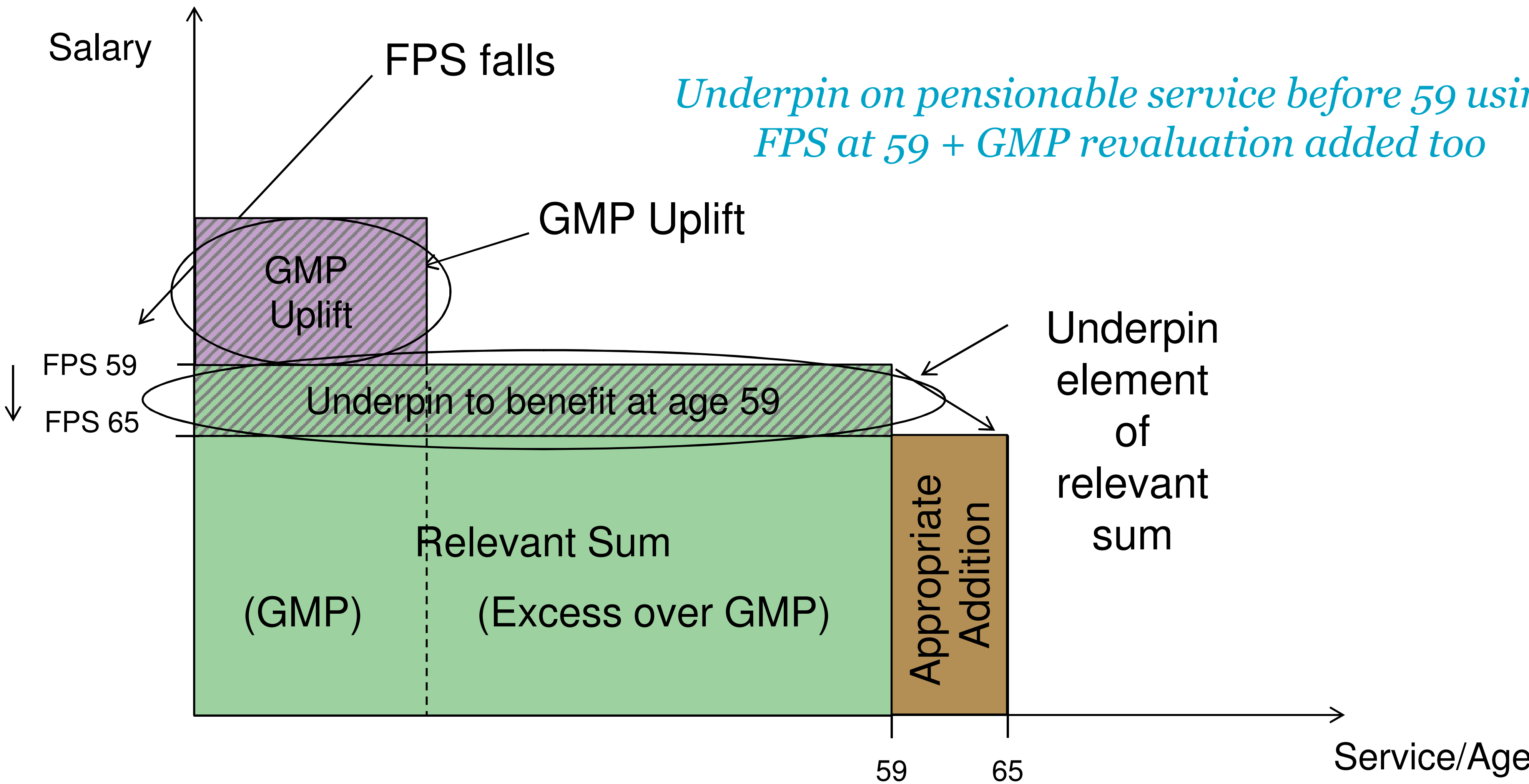
Low salary growth from 59



Retirement from service

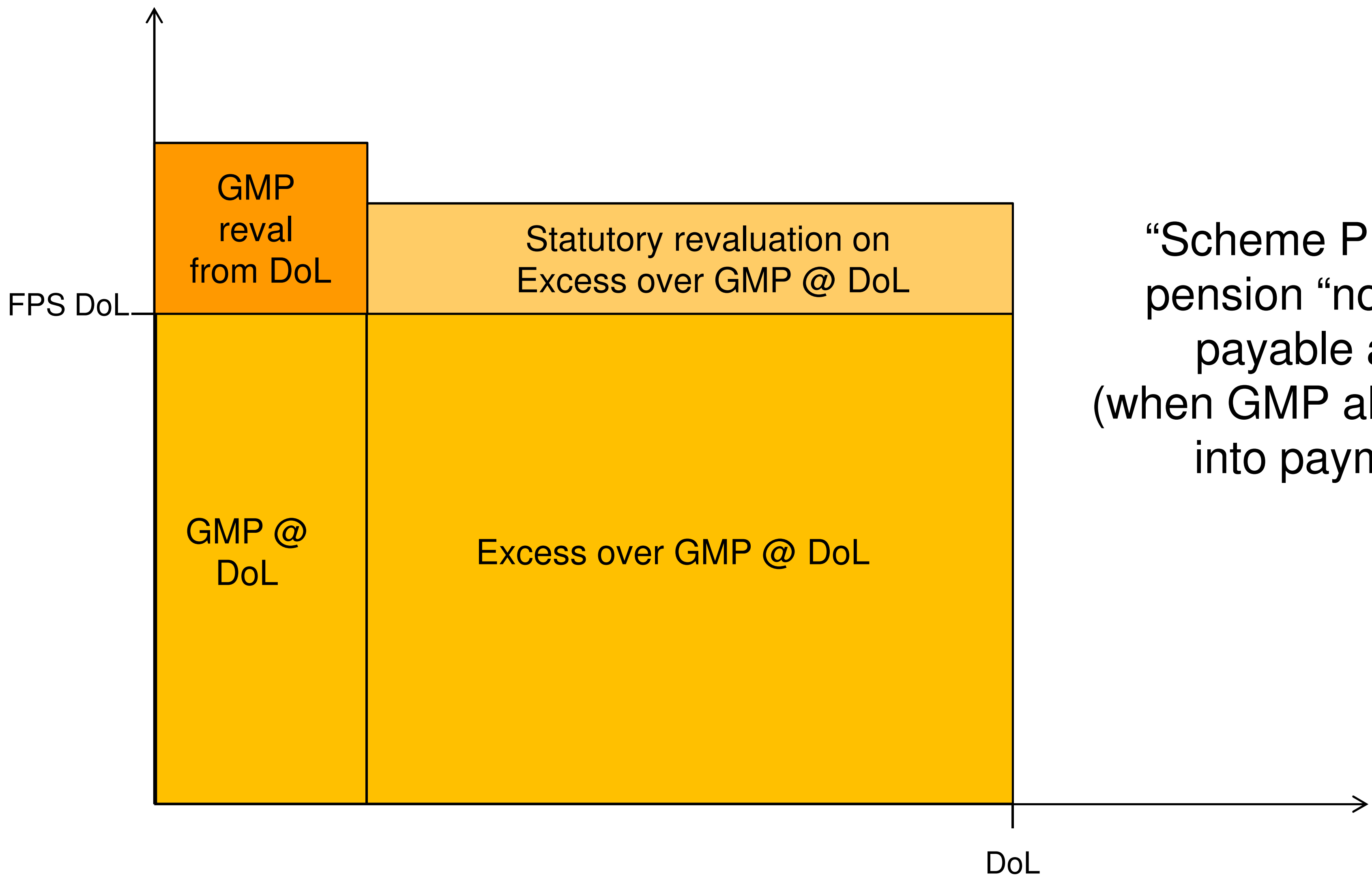
Salary fallen since 59

Underpin on pensionable service before 59 using FPS at 59 + GMP revaluation added too



Deferred pensioner

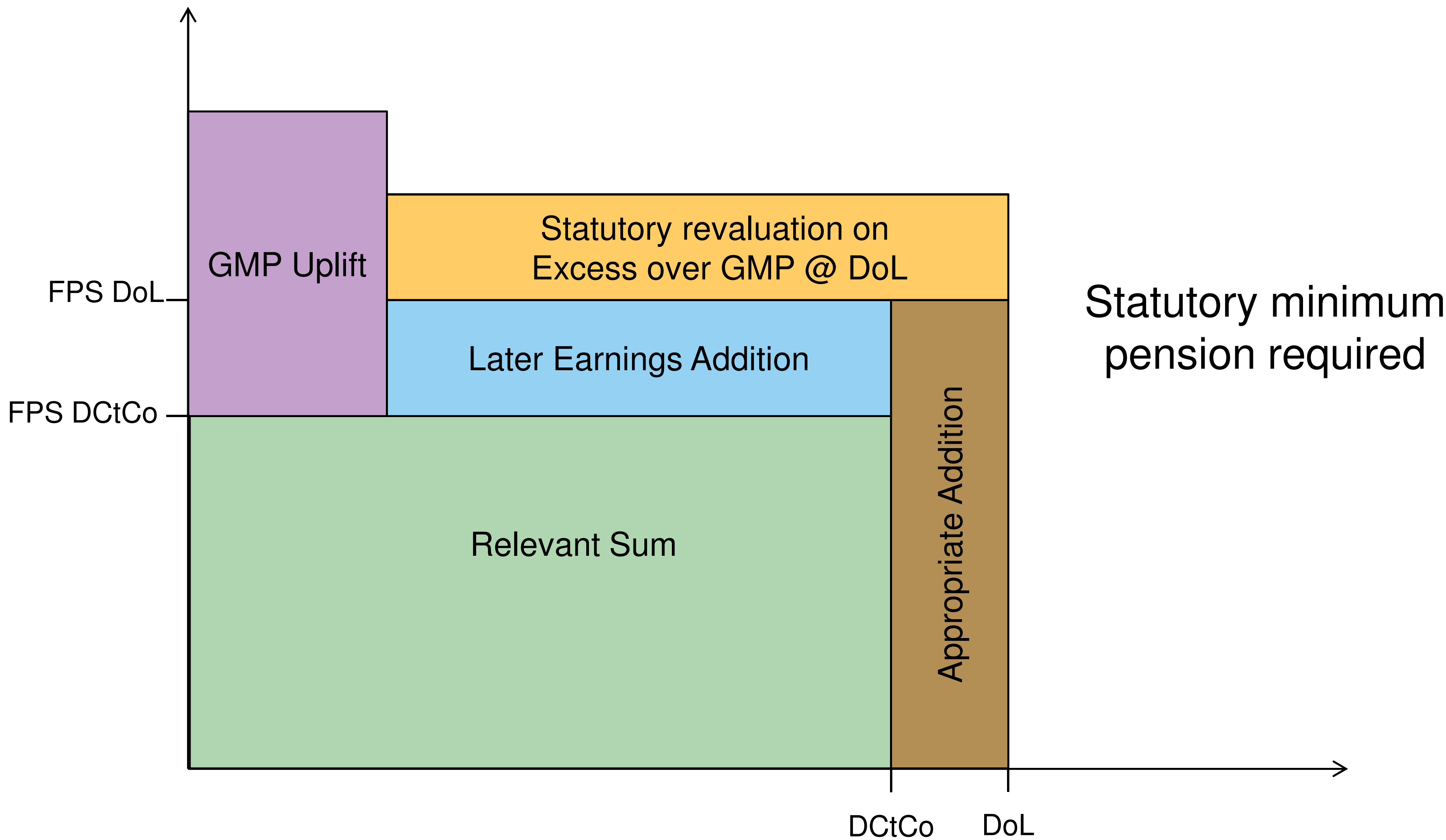
Current scheme practice



"Scheme Practice" pension "normally" payable at 65 (when GMP also comes into payment)

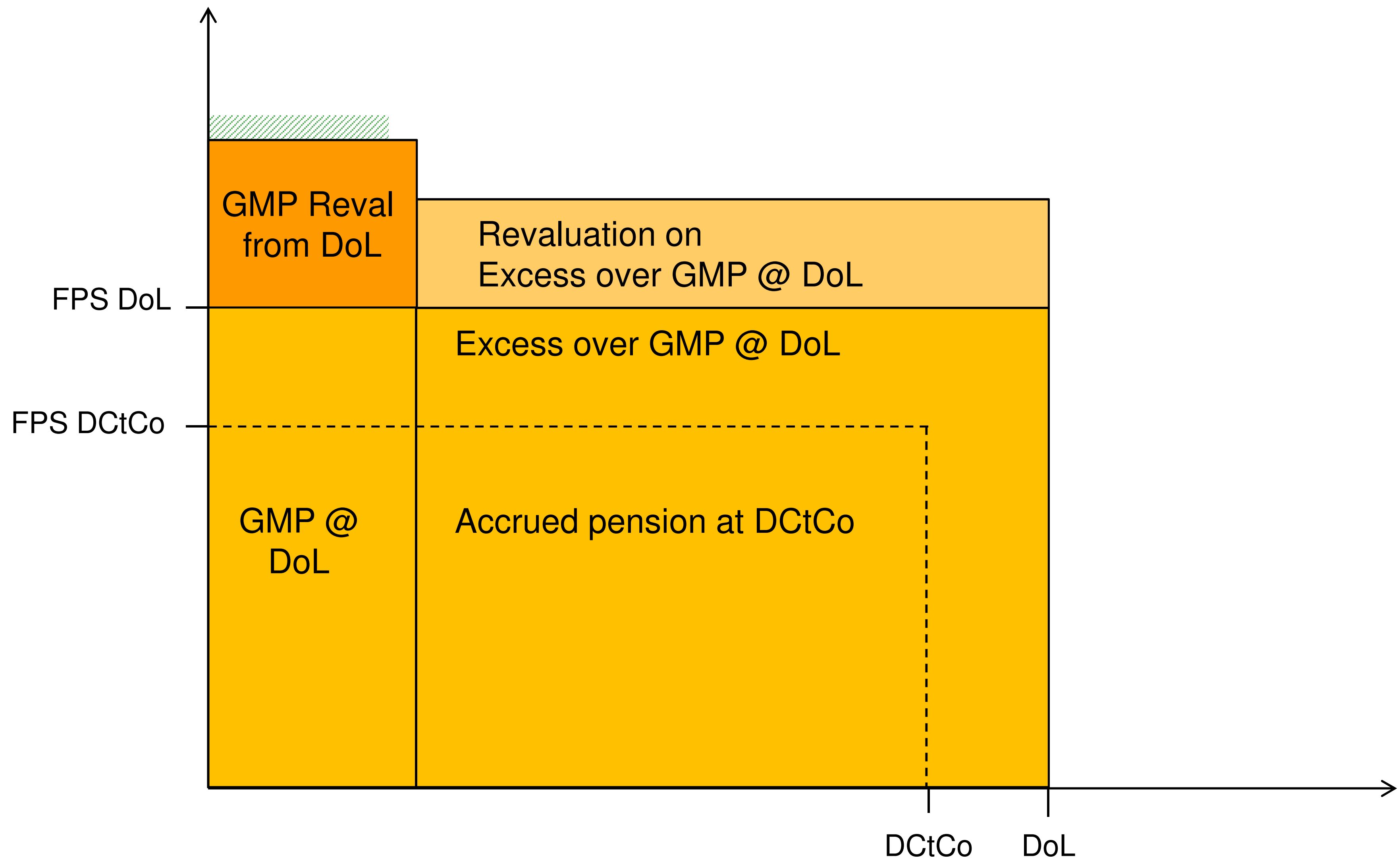
Deferred pensioner

New anti-franking test



Deferred pensioner

Current scheme practice with anti-franking overlaid



Two solutions to this

The Government changes the legislation so that these new tests are not introduced as a result of schemes being forced to contract back in

OR

Employers stop future accrual in any schemes with GMPs and start up another scheme to comply with auto-enrolment

Conclusion

- **State Pension Policy now clear – the new system should start on 6 April 2016**
  - DWP needs to facilitate schemes with state pension in their design
- **Contracting out should end on the same date**
  - Employers need early certainty on how they can claw back the NIC increase
  - DWP needs to ensure that its regulatory house-keeping does not add to scheme costs and complexity
  - DWP ought to also see whether it can deregulate too
- **And the bits and pieces**

It is now all very tight. Everything, including regulations needs to be in place before the General Election – and the employer override needs to be finalised by the end of 2013.