



Summary of the changes.

- April 2016 sees the dawn of a new state pension.
- New pensioners will receive a 'flat rate' pension instead of the basic state pension and a SERPS/S2P addition.
- The ability to contract out will cease and all contracting out certificates will be automatically cancelled.
- National Insurance costs will increase for employers operating contracted out DB schemes with ongoing accrual.
- Regulations are in place allowing employers to offset costs by making certain scheme changes without trustee consent.
- The DWP will no longer be responsible for tracking contracted out benefits.
- In 2018 the DWP will be mailing an estimated 18 million people who have, at some point, been contracted out.
- It is important that schemes' GMP records agree with the DWP's before the 2018 mailing.

The End of Contracting Out

A New State Pension

For many years employers running pension schemes meeting certain criteria have received a subsidy from the government in the form of reduced National Insurance (NI) costs. Members too have benefitted from lower NI.

The trade-off for this would be that the member would not accrue additional state pension (SERPS/S2P). Members were 'contracted out' and would only receive a basic state pension at retirement (or a 'contracted out deduction' from any additional pension earned).

From 6th April 2016 the current 2 tier state pension will be replaced with a new "flat rate" system. The lower NI currently enjoyed by employers with open contracted out defined benefit (DB) schemes will increase.

Although permitted to offset costs,

unless they take action, employers' payroll expenses will increase.

Contracting out for defined contribution schemes ended in 2012 so these schemes are not impacted.

How Much Will People Receive?

As with SERPS/S2P, the new state pension will be dependent on an individual's NI record.

To receive the full amount (around £155 per week) a person will need 35 qualifying years. As with SERPS/S2P, years where a person has been contracted out (prior to April 2016) will not qualify. However, NI paid through self-employment will result in a qualifying year.

Subject to a minimum of 10 years, anyone with fewer than 35 qualifying years will receive a reduced income.

If, at April 2016, an individual has already accrued pension under the current scheme worth more than the new state pension, this will be protected.

Increased Costs

Where an employer currently operates a contracted out DB scheme that is still open to accrual, their payroll costs will increase by around 2-3%, dependent on salaries. Based on an individual earning £35,000 per annum (gross), employer and employee NI will increase by approximately £1,000 and £400 per annum respectively.

Employers have a number of options to offset costs including reducing scheme benefit accrual rates or increasing member contributions. Regulations are in place to enable employers to do this without trustee consent although the requirement to undertake a 60 day member consultation remains.

The regulations permit employers to make changes on more than one occasion but the aggregate cost savings cannot be more than the increase in their NI costs.

Although the regulations only allow employers to make changes with saving up to the value of their increase costs, it is anticipated that some schemes will take this opportunity to make more fundamental changes with many considering ceasing accrual.

What Happens to GMP?

Although, on 6th April 2016, all contracting out certificates will be cancelled, GMP will remain in schemes and will continue to enjoy the same protections as now. The DWP will no longer track contracted out benefits and, after 2018, plan to significantly wind down their services to pension schemes. The existing

resource will be replaced with a self-service approach.

Before April 2018, schemes should reconcile all figures held with the DWP.

Recognising this to be a mammoth task, they have established a Scheme Reconciliation Service (SRS) allowing trustees to start this process for all non-active members.

Active members will automatically cease to be contracted out in April 2016, at which point they too should be reconciled with DWP.

The DWP will no longer track contracted out rights and will no longer be contacting members when they retire confirming their contracted out deduction.

However, scheduled for December 2018, they will begin issuing pension statements to all individuals who have ever been contracted out. This will generate a large volume of enquiries from scheme members and it is essential that trustees are prepared.

Although a limited service will continue to be operated enabling schemes to check GMP liability beyond 2018, this will not include a reconciliation service. As many scheme administrators know, cessation exercises will always generate unexpected issues, some of which can involve exhaustive investigation and go on for many years. It is wise to consider early reconciliation of scheme data to that held by the DWP.

Knowing that a scheme's records match information held by the DWP:

- Brings certainty of funding obligations,
- Provides assurance that the scheme is meeting its legal obligation regarding GMP,
- Avoids overpayment of GMP,

- Will reduce contact from members.

Next Steps

Trustees of open schemes should liaise with the sponsoring employer to establish if any changes are to be made to the benefit structure. This is a complex area and, along with information regarding the increase in employees' NI deductions from salary, will need to be communicated to all affected members.

The Pensions Regulator and the DWP regularly remind schemes of the importance of maintaining accurate data and that it is each scheme's responsibility to maintain accurate records in respect of GMP liability. This is particularly important given the likely number of enquiries that will be generated by the pension statements that the DWP will issue from December 2018.

Even if a scheme is not open to accrual, unless GMPs have already been reconciled with the DWP, trustees should consider doing this now to avoid difficulties later on. The DWP have lost almost 30% of their workforce in the last 5 years and are under continued pressure to reduce costs. There is no commitment that they will have resources to deal with GMP enquiries after 2018.

Scheme rules, booklets and other communications will need to be reviewed. Even if no changes will be made to member contributions or benefits, it is likely that alterations will be necessary to reflect the end of contracting out.

If you would like to discuss how your scheme is affected, please get in touch with your usual Quattro contact.

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