NON-DEPARTMENTAL PUBLIC BODIES: PENSION AND COMPENSATION GUIDANCE NOTES

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CONTENTS

1. **PENSIONS FOR NDPBs**
Introduction
Availability of this document
Government policy on occupational pensions
Injury and redundancy
Personal pensions
Some fundamental principles of public service pensions

2. **POWERS TO PAY PENSIONS**
Status of Body and powers
What powers should provide
Ministerial consent
Annex: Example 1 an extract from schedule 1 of the Access to Justice Act 1999
Example 2 an extract from schedule 2 of the Utilities Act 2000

3. **CHOOSING THE PENSION ARRANGEMENTS**
Occupational pension schemes
Admission to an existing public service scheme
A funded trust-based scheme
Contracted-Out Salary Related (COSR) arrangements
Contracted-Out Money Purchase (COMP) arrangements
By-analogy pension arrangements
Schemes marketed by insurance companies and other pension practitioners
No occupational scheme
Stakeholder and other personal pensions
Addresses

4. **CONTRACTING OUT**
Contracting-out reference scheme test
Guaranteed Minimum Pensions (GMPs)
National Insurance
Government policy on contracting-out for occupational schemes
Personal pensions and contracting out

5. **INLAND REVENUE APPROVAL AND LIMITS**
Revenue Practice Notes
Limits as ceilings, not targets
Funded schemes
Employee contributions
Employer contributions
Pensionable earnings cap
Pensions for high earners
Retirement age
1989 and other regimes
Pension
Lump sums
Final remuneration
Leaving early (transferring out)
Early retirement
Death-in-Service

Death after Retirement
New Pensions Tax Regime

6. **MANDATORY REQUIREMENTS**
AVC provision
Contracting-Out
Disclosure
Equal Treatment
Internal Dispute Resolution (IDR)
Investment Advice
Leaving Early (Transferring Out)
Minimum Funding Requirement (MFR)
Pensions Scheme Registration
Pension sharing on divorce
Professional advisors and financial services authorisation
Stakeholder access
Tax approval
Trustees

7. **ACCOUNTING AND FINANCIAL ARRANGEMENTS**
SSAP 24
FRS17
Unfunded by-analogy schemes
Multi-employer schemes
Funded schemes
References

8. **PENSIONS INCREASE**
Increases awarded to public service pensions since 1988

9. **EARLY RETIREMENT, SEVERANCE AND REDUNDANCY**
Linked compensation arrangements
Early retirement
Severance
Proposals

10. **GUARANTEES AND INDEMNITIES**
Indemnities
Guarantees

11. **TRANSFERRING STAFF**
Basic principles
Future service
Past service
Further details
Movement within the public service
Transfer of Undertaking (Protecting of Employment) Regulations
Annex A: Staff transfers from Central Government: a fair deal for staff pensions

12. **PENSION ASPECTS OF MERGING AND WINDING UP NDPBs**
Machinery of Government changes
Closed and frozen schemes

Winding up a scheme
Issues on wind up or merger
Disclosure
Discharging the liability
Giving up the Contracting-out certificate
Informing other parties
Redundancy and severance
Residual pension liabilities
Successor bodies
Bulk transfers without consent: GN16 certificate
Bulk transfers with consent
Transferring into the PCSPS (from a by-analogy arrangement)
Primary legislation
Secondary legislation
Financial considerations
Bulk transfer payments

CHAPTER 1: PENSIONS FOR NDPBs

Introduction

1.1 This Guidance Note is intended to assist all bodies involved in the management of Non-Departmental Public Bodies (NDPBs), including NDPBs themselves. It complements the Cabinet Office guidance '*Non-Departmental Public Bodies: A Guide for Departments*', and is also related to the Treasury guidance '*Board Members' Pensions and Compensation: Guidance Notes*' that deals with the pension arrangements for Chairmen and Board Member of NDPBs.

1.2 Questions that NDPBs have about the application of this guidance should firstly be addressed to their sponsor departments.

Availability of this document

1.3 This document is an open document and freely available to view on the Treasury website (www.hm-treasury.gov.uk).

Government policy on occupational pensions

1.4 In the United Kingdom, a well-developed framework of occupational pension schemes complements the State retirement pension system, with just under half of the workforce belonging to occupational pension schemes. Occupational pension scheme benefits are valuable and are often worth the equivalent of a fifth or more of pay.

1.5 The Government encourages the provision of occupational pensions on top of the basic State Retirement Pension to provide support for individuals after working age and for their dependants. Government employers should aim to provide a remuneration package that includes access to an occupational pension and employer financing towards the accruing costs of those pensions. Employment with an NDPB should therefore normally provide access to an occupational pension scheme. This has generally involved providing defined benefit (salary related) occupational schemes, but defined contribution (money purchase) arrangements may be provided alongside, or instead, where this is considered to represent value for money.

1.6 Occupational pension schemes usually fulfil three main tasks:

- At retirement, access to a tax-free lump sum and a regular retirement income, (retirement will include early retirement on grounds such as incapacity/ill health);
- Life assurance, by providing for a tax-free lump sum in the event of death before retirement;
- An income for the bereaved dependants of the members.

1.7 Any scheme provided for NDPB staff would be expected to cover these basics, either by a pension scheme or a pension combined with separate ill-health and death cover.

Injury and redundancy

1.8 Compensation for injury attributable to the duties of the employment and for redundancy, over and above the early payment of accrued retirement pension benefits, should be provided for separately from the pension scheme. Inland Revenue rules do not permit approved pension schemes to include such additional compensation benefits as they are not directed at provision for age retirement or for death or ill-heath "insurance" cover.

Personal pensions

1.9 NDPB staff are not obliged to become, or remain, members of the occupational scheme that the NDPB ultimately chooses. Staff have the option to opt out and make individual arrangements through a personal pension. This includes a stakeholder pension (for further information see paragraph 3.41).

1.10 Staff may opt for personal pensions (delivered as a money purchase or defined contribution scheme) instead of membership of the occupational pension scheme provided by the NDPB. However, where this occurs the employer is not obliged to contribute to the same extent to a personal pension as they do to the occupational pension scheme.

1.11 Contributions to defined contribution (DC) schemes, like those for defined benefit (DB), need to be set at a level that is cost effective for recruitment, retention and motivational purposes. However, comparison with DB arrangements is not straightforward and departments should take professional actuarial advice. The Government Actuary's Department (GAD) is available to offer such advice. Their address is at the end of the chapter.

1.12 Where staff opt for a personal pension, either as an alternative to a DB scheme or a DC scheme, it is for the employer to decide whether the employer contribution rate should aim to match those for the occupational pension scheme.

Some fundamental principles of public service pensions

1.13 There are also a number of fundamental principles about how pension provision should be designed and taken into account in the overall remuneration package. For example, pension arrangements would normally be designed taking account of likely full working lifetimes of the membership. Therefore, when determining the level of provision for retirement, it is necessary to take account of opportunities for pension provision, both before and after the particular employment as well as during it. The employer's pension arrangements should provide an income, after the normal retirement

age for the scheme, that relates to the length of service given by the individual and provides incapacity benefits and protection for dependants.

1.14 The pension arrangements should also be designed to provide benefits valued by employees and the incentives should be geared towards the recruitment, retention and motivation needs of the particular employment. Scheme design should aim at providing the most cost-effective mechanisms for supporting the employer's career structures. Pensions should therefore encourage desirable behaviours, such as retaining people while they are particularly needed by that employment.

1.15 Likewise, the Government wishes to remove unnecessary and undesirable incentives for individuals to leave public service employment early, including inappropriate use of ill health retirement. Pensions also need to be linked to levels of pensionable remuneration to maintain the link between the pensions element of the remuneration package and pay for responsibility and performance.

Cost of Pensions

1.16 In order to obtain the best possible value for money, pension options should be compared with other incentives, such as pay, when considering changes in the remuneration package and assessing the relative recruitment, retention and motivational benefits. The value of any pension provided by the employer, by way of the employer's own scheme or employer contributions to a pension provided by another body, should be taken into account.

Contributions

1.17 Arrangements under which staff contribute towards pensions vary between employers and pension schemes. Some are explicitly contributory, where employees make contributions out of their gross pay. In other arrangements the pay levels may be lower in lieu of a contribution, or there may be a combination of explicit contribution and this element taken into account in pay, as in the civil service.

1.18 Like the rest of the remuneration package, pensions also have to be affordable by the taxpayer. In determining what is cost effective and affordable for recruitment, retention and motivation purposes, it is necessary to look across the public services in general as well as at what private sector employers provide.

The true cost of providing a pension

1.19 The cost of the pension liabilities needs to be properly taken into account in terms of the accruing as well as immediate cash costs to the employer. The actuarially assessed cost to the employer over the employees' lifetimes should be taken into account when determining the appropriate level of the overall remuneration package and the contribution made by the employer and employee. The full accruing cost of providing for pensions should be made

explicit in the accounts of those controlling the pension arrangements and in employers' budgets.

Funded or unfunded

1.20 It is usually unnecessary to set up an alienated pension fund to provide an adequate financing regime for pension benefits where the benefits are guaranteed by statute and funded by the taxpayer, and there is an adequate budgetary regime that makes clear the full accruing cost.

Compliance with pensions legislation

1.21 Public service schemes' rules should conform to UK and European law, including legislation on pensions and equal treatment. Changes to pension provisions should similarly accord with Inland Revenue tax rules. Pension provisions should also be consistent with a range of other policies, for example on labour market participation and mobility.

1.22 Employers will also need to be aware of forthcoming legislation on age discrimination, civil partnerships etc. when drawing up new schemes.

No retrospection

1.23 It has been a long standing policy of successive Governments, of whatever political persuasion, that there should not be retrospective improvements to pension schemes. Public service occupational pension entitlements are essentially determined by the terms of the remuneration package during the individual's employment. Reopening those arrangements after the person leaves employment is generally very complex, does not offer benefits in terms of recruitment, retention and motivation of employees and can be prohibitively expensive (bearing in mind, for example, that public service pensions cost over £23 billion a year gross[1] in resource terms).

1.24 The presumption is therefore against making retrospective improvements, particularly to preserved pensions or pensions in payment. This means that improvements to a pension scheme *are for serving staff only and for future service* and are not backdated to individuals who may have left many years ago, or to their dependants.

1.25 Improvements to pension schemes should also be costed carefully and treated with more caution than most other claims for increases in spending on remuneration. Whilst changes in other terms and conditions, like pay, can be adjusted in the short- or long-term, once pension terms change the effects on spending can last for up to 100 years or more.

Benefit improvements

[1] Source: Resource accounts 2002-03

1.26 The Government has made it clear that it is prepared to consider changes in pension scheme rules to provide for benefit improvements if the members want such changes and are prepared to meet the full cost of the improvement. For example, the Green Paper "*A new contract for welfare: partnership in pensions*" Cm 4179 December 1998, stated that the Government had no objection in principle to the extension of survivor's pensions to unmarried partners, provided that the employees were prepared to meet the additional costs. Also, in the light of the Green Paper of December 2002 (see paragraph 1.27 below) many schemes are looking at the scope for redirecting resources in the context of increasing pension ages.

Normal Pension Age of 65

1.27 In the Green Papers "*Simplicity, Security and Choice: Working and saving for Retirement*" Cm 5677, December 2002 and "*Action on Occupational pensions*" Cm 5835, June 2003, the Government proposed that public service pension schemes should increase their pension ages. So, for example, for new members in 2006 an unreduced pension should generally be available from age 65. Such increases in pension age would help the financial sustainability of schemes and help offset the cost of increased longevity.

1.28 With the changes in the pension ages and the Inland Revenue Regime, and the need to address issues about contractual retirement ages in the light of EU legislation on age discrimination which will be implemented by 2007, this is an opportunity for employers to identify the scope for greater flexibility, particularly in the transition from work to retirement, and improvements in benefits.

Consultation with HMT

1.29 If there is doubt about the compatibility of a particular aspect of a pension arrangement within public service policy you should contact the PSP team of the Treasury.

Useful addresses

Gerard Foley
Public Service Pensions team
HM Treasury
Room 3/23, 1 Horse Guards Road
London SW1A 2HQ
Tel (020) 7270 4525

Andrew Johnston
Government Actuary's Department
Occupational Pension Schemes
Finlaison House
15-17 Furnival Street
London EC4A 1AB
Tel (020) 7211 2647

CHAPTER 2: POWERS TO PAY PENSIONS

2.1 Legislation is normally required to establish an NDPB that has ongoing executive or regulatory functions, particularly where it is expected to require continuing Government funding. Further details can be found in the Cabinet Office guidance, Non-departmental Public Bodies: A Guide for Departments.

Status of Body and powers

2.2 The constitutional arrangements for NDPBs vary, according to their functions and the degree of independence from Ministerial and Parliamentary control.

2.3 NDPBs generally fall into four main categories:

- Advisory NDPBs
- Royal Commissions
- Tribunals
- Executive NDPBs

2.4 Traditionally civil servants on secondment staff Advisory NDPBs, Tribunals and Royal Commissions. They usually remain in their Civil Service pension scheme. This guidance is therefore almost exclusively about Executive NDPBs.

2.5 Specific authority is generally required for new and continuing services that are not de minimis. The current threshold is £900,000 a year (see Government Accounting and DAO (GEN) 8/99).

2.6 Most Executive NDPBs are legally incorporated, usually by legislation providing for the NDPB to be a body corporate. This provides for the body to have a separate legal identity.

2.7 Such a NDPB usually has to be given powers to provide for staff remuneration. It is important that any Bill establishing the NDPB includes sufficient powers to pay pensions, allowances and gratuities for both the staff and any management board.

What the powers should provide

2.8 The body requires the power to pay pensions, allowances, gratuities and compensation to staff members or to make provision for their payment by others. The formulation needs to be expressed in very general terms, so it is broad enough to cope with all foreseeable pension requirements. These include making contributions to a funded occupational pension scheme or a personal pension arrangement; setting up an unfunded pension scheme for the body; payments made on account of early retirement (which might be because of ill-health or inefficiency but also arise from voluntary early retirement); paying death benefits; and benefits to dependants. It should also cover compensation for redundancy and for injury.

2.9 In some circumstances the pension arrangements will have already been decided but provision in the Bill may be required to bring this arrangement into effect. This frequently arises where an NDPB is added to schedule 1 of The Superannuation Act 1972, which allows the body to participate in the Principal Civil Service Pension Scheme (PCSPS). Further details of this option are set out in chapter 3 of this guide.

2.10 Examples of Acts giving the power to pension, both general and specifically within the PCSPS, are set out in the annex to this chapter. However, specific legal advice should be sought on every occasion and consultation with the Cabinet Office and/or HM Treasury occur in good time before a Bill is drafted.

Ministerial consent

2.11 Older NDPBs may have been established under legislation that requires pension arrangements to be established "…with the consent of the Minister and the consent of the Treasury". Nowadays a requirement for Treasury consent is no longer included in legislation, but the consent of the departmental Minister is still required.

2.12 However, departments and NDPBs are reminded that, although Treasury consent is no longer required, this does not mean that they have a completely free hand to determine pension arrangements. NDPBs and Departmental Ministers are expected to apply Government policy on public service pensions in line with this guidance. For example on matters such as compliance with Inland Revenue rules and the extent to which staff should pay for any increases in the overall value of staff pension arrangements (see, for example, chapter 1 on Some Fundamental Principles).

ANNEX TO CHAPTER 2

EXAMPLE 1: GENERAL POWER TO PROVIDE PENSIONS

EXTRACT FROM SCHEDULE 1 OF THE ACCESS TO JUSTICE ACT 1999

Staff

10. – (1) The Commission shall make, in respect of such of its employees as, with the approval of the Lord Chancellor, it may determine such arrangements for providing pensions, allowances, or gratuities, including pensions, allowances or gratuities by way of compensation for loss of employment, as it may determine.

(2) Arrangements under sub-paragraph (1) may include the establishment and administration by the Commission or otherwise, of one or more pension schemes.

EXAMPLE 2: ADMITTANCE TO PCSPS VIA PRIMARY LEGISLATION

EXTRACT FROM SCHEDULE 2 of the UTILITIES ACT 2000

Staff

5.-(1) The Council shall, with the approval of the Secretary of State, appoint a principal officer on such terms and conditions as it may, with that approval, determine.

(2) The Council may, with the approval of the Secretary of State as to numbers and terms of employment, appoint such other employees as it may determine.

(3) The persons to whom section 1 of the Superannuation Act 1972 (persons to or in respect of whom benefits may be provided by schemes under that section) applies shall include employees of the Council.

(4) The Council shall pay to the Minister of the Civil Services at such times as he may direct, such sums as he may determine in respect of any increase attributable to sub-paragraph (3) in the sums payable out of money provided by Parliament under the Superannuation Act 1972.

CHAPTER 3: CHOOSING THE PENSION ARRANGEMENTS

3.1 Chapter 2 identified some of the different kinds of NDPBs. The nature of the NDPB and how it is staffed plays a big part in determining what the pension arrangements should be.

3.2 Key factors might be:

- The status and functions of the body;
- The contractual status of the staff (e.g. secondees, fixed-term contracts, ex-civil service or local government staff etc);
- What the long-term future of the body is likely to be (e.g. is it intended to move into the private sector shortly?)

3.3 In light of the assessment of the above factors, the most appropriate pension arrangement can be decided.

Occupational pension schemes

3.4 The models most generally available are:

- A defined benefit (DB) scheme
- A defined contributions (DC) scheme
- A possible hybrid of DC/DB

3.5 Most NDPBs offer an occupational scheme. There are several ways of providing an occupational pension scheme for the staff of an NDPB:

a) Admission to an existing public service scheme;
b) Admission to an existing trust-based funded scheme (either final/average salary or money purchase), perhaps by setting up a new section of the scheme; or
c) Setting up a new trust-based funded scheme;
d) Setting up an unfunded scheme that is by-analogy to a major public service scheme; or
e) Buying an off-the-shelf scheme from an insurance company.

3.6 Group Personal Pensions (GPP) are an alternative, although this is not really an occupational scheme but an arrangement under which an employer facilitates the selling of a particular personal pension product to its employees. The employer is not part of the contractual arrangement, which is between the employee and the pension provider (see paragraphs 3.41-3.42 below).

Admission to an existing public service scheme

3.7 This option keeps administrative work for an NDPB to a minimum. The administrators of the existing scheme usually handle admission on the body's behalf. Most ongoing administration can usually be handled under the scheme's existing arrangements, which may include a choice of who provides pension record keeping and awarding services (that is calculating the pension award and arranging for it to be put into payment).

3.8 However, the NDPB still has important responsibilities to ensure that information about the scheme and individual entitlements is circulated to staff, pay administrative fees for the normal day-to-day running of the scheme, and ensure that those responsible for its payroll deduct employer and employee pension contributions on a timely basis. Employers will also normally be responsible for meeting the cost of early retirements (e.g. on grounds of voluntary or compulsory redundancy or inefficiency) and injury benefits.

3.9 Admittance is usually only allowed where the body is sufficiently akin to the other employments already admitted to the scheme. The Inland Revenue restricts the ability of employers to join another employer's pension scheme. However, most NDPBs undertake functions that are directly comparable to functions provided by employments covered by one or more of the main public service schemes.

3.10 The great majority of executive/regulatory NDPBs participate in the Principal Civil Service Pension Scheme (PCSPS) and a significant number have been admitted to the Local Government Pension Scheme (LGPS).

3.11 Departments must consult Civil Service Pensions (CSP) division of the Cabinet Office (and forward a copy of the letter to the Public Service Pensions (PSP) team of the Treasury) about adding an NDPB to schedule 1 of the Superannuation Act 1972 and thereby allowing it to participate in the PCSPS.

3.12 If an NDPB has a close affinity to Local Government then the appropriate contact is the Local Government Pensions Unit (LGPU) of the Office of the Deputy Prime Minister (ODPM). Addresses for CSP and LGPU can be found at the end of this chapter.

3.13 The NHS and Teachers schemes also admit some staff of some employments with which they have strong links (e.g., in the case of the NHS, medical staff in hospices and staff in General Practices) but it would be unusual to admit all staff of an NDPB to either scheme.

A funded trust-based scheme

3.14 In Britain, a framework of largely funded, trust-based schemes supplements the state pension system. The existing legal framework surrounding pension schemes is complicated but essentially private sector employers set up pensions schemes under trust with alienated funds. They would normally be established under an irrevocable trust and the assets of an approved occupational pension scheme must only be used to provide for benefits for scheme members. Trusts are used because the separation of the fund from the

employer's assets provides security and is a requirement of Revenue approval. Trustees are governed by trust Law as well as law on occupational pensions.

3.15 Funded occupational pension schemes need exempt approved status from the Inland Revenue (see chapter 5 for further details). Among other things, exempt approval enables trustees of funded schemes to invest money without any liability for income or capital gains tax.

3.16 Details of the Inland Revenue's approval of conditions for occupational pensions schemes can be found in *Occupational Pension Scheme Practice Notes IR12 (2001)*. It may be viewed on the Inland Revenue website (www.inlandrevenue.gov.uk). But also see paragraphs 5.29-5.30 of chapter 5 for new developments.

3.17 Funded trust-based schemes are relatively uncommon in the public service and can be relatively expensive to establish and run. They have generally been considered appropriate where bodies, such as public corporations, are performing functions of a commercial nature and/or may in future be transferred to the private sector. Before a new funded scheme is proposed or it is suggested that an NDPB's employees should join an existing one, there should be consultation between the sponsor department and the Treasury. Trustees of an existing scheme will have to obtain investment, legal and actuarial advice, and advice from actuaries and lawyers will be needed before a new funded scheme can be established.

3.18 The trust deed needs to be carefully constructed. It needs to deal for example with possible changes in the status of the body (including winding up or merger) and to ensure that the trustees and employer (or the Secretary of State if the employer no longer exists) are able to transfer assets to another public service pension provider and return surplus assets to the employer/Secretary of State and members.

Contracted Out Salary Related (COSR) arrangements

3.19 Most occupational pension schemes are salary related (known as defined benefit - DB), including most existing funded NDPB schemes. Final salary arrangements are particularly suited to organisations with a large proportion of long serving staff and/or where it is desired to use the pension scheme as a retention device.

3.20 Career average earnings arrangements, where the final pension is based on each year's uprated earnings, may be more suitable in some circumstances. For example, they may provide more valuable benefits for those whose earnings peak before the last decade or so of their careers and, depending on the earnings uprating factors used, can reduce the effects (and costs) of significant real increases in earnings during a career.

3.21 DB schemes also provide considerable certainty of benefit level for scheme members, particularly where they are underwritten by the State. However, the employer bears the risk of having to provide whatever financing is required (e.g. given changes in longevity or earnings).

Contracted Out Money Purchase (COMP) arrangements

3.22 An alternative to final salary pension provision is money purchase (MP), also known as defined contribution (DC) arrangements. Under this system a member's benefits are determined by contributions made into the scheme and the return those contributions make on their investment, after deducting charges for running the scheme (including the cost of administering the investments).

3.23 The pot of money that has accumulated is used at retirement to buy an annuity, with the ability to take a 25 per cent of the benefits as a tax-free lump sum if required. The value of the pension bought with an annuity therefore depends on annuity rates when individuals come to retire. Annuity rates vary with interest rates. Contracted Out Money Purchase (COMP) schemes are subject to the contribution and benefit limits set by the Inland Revenue (see Chapter 5 for details).

3.24 This option would normally require an external pension provider to provide the expertise to run the scheme, and provide actuarial and legal advice. The pension scheme may be set up as a stakeholder arrangement (see below).

3.25 The contribution rate for DC schemes can be of the flat-rate variety, where the employer makes the same contribution regardless of age or grade, or a more complex arrangement, structured by age or service. However, a more complex contribution makes issues of communication and budgeting more complicated.

3.26 The value of the total contributions, both employer and employee, will be a key factor in determining the value of the scheme. The more paid in contributions, the more valuable the eventual pension benefits are likely to be. However, investment returns and annuity rates will also be major determinants of the eventual pension.

3.27 Account should also be taken of additional related costs that a DC option will bring: e.g. life assurance cover, permanent health insurance (PHI), administrative charges etc.

By-analogy pension arrangements

3.28 An unfunded by-analogy scheme is one where a body bases its rules on those of an existing major public service scheme, subject to some possible minor adaptation to comply with current Inland Revenue requirements.

3.29 By-analogy schemes deliver broadly the same pension benefits as the scheme being used as the model. These arrangements have been relatively simple to maintain, as there has been little need to worry about scheme development or most communications with members: whatever happens in the parent scheme usually flows through automatically to the by-analogy scheme.

3.30 However the NDPB has little or no ability to influence changes in pension benefits under the parent scheme, but still needs to maintain or contract for enough pensions expertise to understand the implications of certain pension developments for current and former staff.

3.31 Under the *Finance Act 1989* the Revenue restricts the amount of benefits provided by occupational pension schemes. As noted above, some of the provisions of the parent scheme may be excluded in order to comply with the IR tax regime for occupational pension schemes created after 14 March 1989, known as the post-1989 regime.

3.32 Most NDPBs with by analogy schemes use the PCSPS as their model. As the PCSPS pre-dates the 1989 tax regime it requires some amendment to make it acceptable to the Revenue. The Treasury has prepared standard model documentation for:

- a by-analogy pension arrangement;
- a by-analogy compensation scheme;
- a by-analogy additional voluntary contribution (AVC) arrangement.

3.33 By-analogy schemes are unfunded and mainly work on a pure pay-as-you-go (PAYG) basis. This means that there is generally no system of employer contributions paid for from budgets and no money is put aside for the future pensions liabilities: they are simply paid when they emerge. Employee contributions are collected from staff, but they are used to offset expenditure on pensions within the financial year.

3.34 Also any money received as a transfer payment (i.e. the sum that buys reckonable service in the pension scheme from someone who is transferring in service from another pension scheme) can also be used to offset pensions expenditure in-year, including transfer values paid out that year in respect of people leaving the scheme. But where there are no offsetting transfers out the money from transfers in should be remitted back to the sponsor department for surrender as Consolidated Fund Extra Receipts (CFERs).

3.35 NDPBs will in future be required to account for the accruing liabilities of their scheme (see Chapter 7). Also, the NDPB can face increasing difficulties in financing its own PAYG scheme. A PAYG arrangement can seem cheap in the beginning, but over time pensions will form an increasing part of the running costs of an organisation and costs will be greater than contributions that would be paid if the scheme were actually funded, or were notionally funded with a system of employer contributions paid from annual budgets and liabilities for pension payments resting with the Exchequer/department managing the scheme centrally.

3.36 Also, PCSPS by-analogies have from October 2002 operated the full range of PCSPS arrangements:

a old PCSPS ("Classic")
b new PCSPS ("Premium")
c combined old and new ("Classic Plus") and
d the DC scheme.

They also gave existing staff an informed choice between a, b and c (after having ensured their employees' pensions data is completely accurate).

3.37 Departments thinking about an unfunded by-analogy scheme are asked to approach the Treasury before committing themselves to this form of pension.

Schemes marketed by insurance companies and other pension practitioners

3.38 Pension practitioners can be found amongst insurance companies, actuaries, and lawyer firms. The Occupational Pension Schemes Joint Working Group can be found at

Mr J Mortimer
Occupational Pension Schemes Joint Working Group
C/o Society of Pension Consultants
St Bartholomew House
LONDON EC4Y 1DG

The JWG is an umbrella organisation for the following representative bodies: the Association of British Insurers, the Association of Consulting Actuaries, the Association of Pension Lawyers, The National Association of Pension Funds, the Society of Pensions Consultants.

3.39 Some older NDPBs may have schemes devised from the 1970s by insurance companies that cover the basic pension and dependant's benefits, with the sponsoring department meeting the cost of index linking. Insurance companies did not offer index linking in the 1970s but pension practitioners now provide limited price indexation (LPI), which is a legal requirement, and will generally be able to offer full RPI (see chapter 8 about increasing pensions in payment).

No occupational scheme

3.40 In a few cases no pension provision may be made. This is only likely to occur where a body is expected to have a very limited life as a public service organisation. Staff will be, by default, in the state second tier pension arrangement: the state earnings related pension scheme (SERPS) for those employed pre-April 2002 and the new state second pension (S2P) for those employed post-March 2002. In such circumstances staff must also be given access to a stakeholder pension arrangement, as required by *the Welfare Reform and Pensions Act 1999*.

Stakeholder and other personal pensions

3.41 *The Welfare Reform and Pensions Act 1999* requires employers to stipulate a stakeholder pension arrangement for staff who are ineligible for membership of an occupational pension scheme. Public service employers are therefore required to nominate a stakeholder provider unless they fit one of the exempted categories listed in regulation 22 of the *Stakeholder Pension Schemes Regulations 2000* (SI 2000/1403).

3.42 Also a member of an occupational pension scheme with an income below a certain level (currently £30,000) is also allowed to have a stakeholder pension (known as concurrent membership or concurrency). Public service employers may therefore also nominate stakeholder providers for those public service pension scheme members who are entitled to "concurrency".

Addresses

Local Government Pensions Unit
Office of the Deputy Prime Minister (ODPM)
Ashdown House
123 Victoria Street
LONDON SW1E 6DE
Email: lgpensions@odpm.gov.uk
Enquiries: Telephone 020 7944 6015

Civil Service Pensions
Cabinet Office
8th floor Grosvenor House
Basing View
BASINGSTOKE
Hampshire RG21 4HG
Email: employerhelpdesk@cabinet.office.x.gsi.gov.uk
Telephone: 01256 846564

Public Service Pensions
HM Treasury
Room 3/23
1 Horse Guards Road
LONDON SW1A 2HQ
Email: Gerard.Foley@hm-treasury.x.gsi.gov.uk
Telephone: 020 7270 4525

CHAPTER 4: CONTRACTING-OUT OF THE STATE ARRANGEMENTS

4.1 Since 6 April 1978 it has been compulsory for employers and employees to contribute towards the state's second-tier pension so as to augment the basic state pension. That is achieved either by contracting in to the State Second Tier Pension (S2P) from 6 April 2002, or by providing a contracted out occupational pension scheme. Prior to April 2002 the State Earnings Related Pension Scheme (SERPS) was the vehicle for the second tier state pensions.

4.2 The Government encourages employers to provide their own second tier pensions. In practice, the great majority of public service employees are contracted-out, mainly via their employers' scheme but in some cases through personal pension plans.

Contracting –out reference scheme test

4.3 Since 6 April 1997 in order to contract out a scheme has to pass a Reference Scheme Test (RST). Under this test at least 90 per cent of the scheme members must receive benefits no lower than those provided under the 'reference scheme'. That sets a basic standard (for pensions accrual, pensionable earnings, years of service, age that pension is payable and spouses pension) which employers' pensions schemes must match to a significant extent. The scheme actuary must sign a certificate every three years to confirm that a scheme meets the reference scheme test.

Guaranteed Minimum pensions (GMPs)

4.4 Prior to 6 April 1997 schemes had to guarantee to provide a minimum amount of pension at retirement: a guaranteed minimum pension (GMP). The GMP was a broad equivalent to the amount of pension that would have accrued in SERPS. From 6 April 1997 existing GMPs ceased to accrue further GMP benefits and there are no new GMPs for workers beginning work after that date. However, schemes are still required to honour and update past GMP rights earned between 1978 and 1997 (see Pensions Increase chapter 8).

National Insurance

4.5 If an employer contracts out a pension scheme from S2P both the employees who are members of the occupational pension scheme and the employer (in respect of those employees) pay lower National Insurance Contributions on those earnings subject to NICs. The reduction in National Insurance Contributions for salary-related contracted-out schemes since 6 April 2002 has been 5.1 per cent, split 1.6 per cent to employees and 3.5 per cent to the employer.

Government policy on contracting-out for occupational schemes

4.6 The Government's policy is for public service pension schemes to be contracted-out of S2P. If different treatment is proposed for an NDPB departments are asked to contact the Public Service Pensions (PSP) team of HM Treasury at the earliest possible opportunity with details and justification for adopting a different course.

4.7 Briefly, to meet the conditions for contracting-out employers must:

- Give notice of the intention to contract out to any independent trade union;
- Obtain a reference scheme test certificate from an actuary;
- Apply for a contracting-out certificate from the National Insurance Services to the Pensions Industry (NISPI);
- Provide a triennial re-assurance statement on the contracted-out status.

4.8 Further details can be obtained from the following Inland Revenue publications:

CA14C Contracted-Out Guidance for COSR Schemes and Salary Related Overseas Schemes.

CA14D Contracted-Out Guidance for COMP Schemes and Money Purchase Overseas Schemes

These booklets and other information can be obtained from:

National Insurance Services to the Pensions Industry (NISPI)
Inland Revenue
Longbenton
Newcastle upon Tyne
NE98 1YX

Personal pensions and contracting out

4.9 Where an employee has taken out an individual personal pension arrangement, it is for the employee to decide whether that personal pension should be contracted in or out. This applies whether or not the employer makes a contribution (for example, under PCSPS DC arrangements or PCSPS by-analogy equivalents).

CHAPTER 5: INLAND REVENUE APPROVAL AND LIMITS

Warning: this chapter is subject to revision once the full details of the Inland Revenue's tax simplification review are known. A revised chapter will be issued in due course. See paragraphs 5.29-5.30 for further details.

5.1 For an occupational pension scheme to receive favourable tax treatment, it must apply for and obtain Inland Revenue exempt approval. Alternatively it can be a "relevant statutory scheme". A statutory scheme is, broadly, a scheme established under a public general Act. A "relevant statutory scheme" must have been established before 14 March 1989 or be registered by the Board of the Inland Revenue as a scheme the provisions of which correspond with those of an approved scheme. This means that any new public service schemes must comply with Inland Revenue rules.

5.2 However, it is Government policy that public service employers should ensure that any changes to relevant statutory schemes established before 14 March 1989 should also be compatible with Inland Revenue rules.

5.3 An exempt approved scheme (such as a funded trust based scheme) qualifies for the following tax reliefs:

- Employee contributions are not taxable
- Employer contributions are not taxable on the employee as a benefit in kind
- Retirement lump sums are not taxable if they are within the Inland Revenue maximum
- Employer contributions are not taxable on the employer
- The investment income arising from scheme assets is not taxable
- Chargeable gains realised on the disposal of scheme assets are not taxable.

A relevant statutory scheme only qualifies for the tax relief under the first 3 bullet points. The second 3 bullet points do not apply to unfunded schemes. A funded relevant statutory scheme will need to apply to the Inland Revenue for exempt approval to obtain other tax reliefs.

5.4 New public service schemes will generally be statutory schemes (that is established under the provisions of a particular statute governing the body and its functions). They still in effect require Inland Revenue approval (as registered statutory schemes) under Section 611A of the *Income and Corporation Taxes Act 1988*). A few may not be established under a specific statute, but would also require approval/registration.

Revenue Practice Notes

5.5 The full Revenue requirements are set out in *Occupational Pension Scheme Practice Notes IR12 (2001)*, but we have set out below a broad overview of the current tax regime.

Limits as Ceilings, not Targets

5.6 Please note that the existence of a Revenue limit does not imply that any new scheme should provide benefits at the maximum level permitted by the Inland Revenue. Departments, when considering the possibility of establishing an occupational scheme, should at an early stage consult actuarial advisers (for example to assess the possible cost and value of different pension packages) and the PSP team of the Treasury (e.g. to identify what might be acceptable given current public service pension policy).

Funded Schemes

5.7 Funded schemes must normally be established under a trust deed. The rules should be drawn up as soon as possible as the Inland Revenue will not normally approve a scheme if the application for exempt approval is not accompanied by full definitive documentation of the scheme's provisions. Exempt approval cannot be backdated beyond the beginning of the tax year in which it is given.

Employee contributions

5.8 The employee receives tax relief on pension contributions at his or her marginal rate of tax, as employee contributions are made from gross salary before the deduction of income tax (although the gross salary is subject to National Insurance Contributions). The Revenue also allows a retirement pension lump sum to be paid tax-free. However, the pension is treated as taxable income at the point of payment.

5.9 The maximum employee contribution on which tax relief is allowed in any one tax year is 15 per cent of gross pay earned in that year from the employment being pensioned. In addition the pensionable earnings cap imposes a cash limit on employee earnings which can be pensioned. This therefore means that tax relief on an employee's contribution is limited to 15 per cent of the pensionable earnings cap (see paragraph 5.11 below).

Employer contributions

5.10 One of the key conditions of approval for an occupational pension scheme is that the employer must contribute towards the scheme. In defined benefit schemes the employer usually pays the contributions needed to meet the balance of cost, as determined by the scheme actuary. When first setting up a scheme, contributions have often been split 1/3rd employee, 2/3rds employer.

However, where the scheme rules allow, in funded schemes there may be occasions when the state of the fund is healthy enough for the employer to pay a reduced rate of contributions or to stop paying contributions altogether (taking a contributions holiday) for a period of time.

Pensionable earnings cap

5.11 *The Finance Act 1989* introduced a statutory maximum on the amount of earnings that could be pensioned under an approved occupational pension scheme. The earnings cap applies to scheme members who are not regarded as having continuous membership of the scheme since before April 1989. The amount is uprated in line with the RPI each year in the Budget but rounded to the nearest multiple of £ 600. The historical cap is set out in the table below.

TAX YEAR	EARNINGS LIMIT
1989-90	£ 60,000
1990-91	£ 64,800
1991-92	£ 71,400
1992-93	£ 75,000
1993-94	£ 75,000
1994-95	£ 76,800
1995-96	£ 78,600
1996-97	£ 82,200
1997-98	£ 84,000
1998-99	£ 87,600
1999-00	£ 90,600
2000-01	£ 91,800
2001-02	£ 95,400
2002-03	£ 97,200
2003-04	£ 99,000

Pensions for high earners

5.12 The existence of the earnings cap has led some employers to provide additional salary or some other benefit pension benefits. However, some have provided pension benefits in excess of the pensionable earnings cap, where this is considered necessary to recruit, retain or motivate and pension offers better value for money than pay.

5.13 In the wider pensions world the provision of benefits on earnings above the cap can be addressed in four main ways:

- from the main approved scheme (perhaps under a separate section of the main scheme). Benefits would still be based upon capped pay but could also be based on an accrual rate up to the Inland Revenue's maximum pension accrual rate (before any commutation to provide a tax-free lump sum) of 1/30th for each year of service up to a maximum of 20 years, assuming this accrual rate for earnings above the cap is greater than the main scheme's accrual rate;

- from a separate approved scheme for senior executives, again by providing benefits based upon capped pay and an enhanced accrual rate up to the Inland Revenue's maximum accrual rate (before any commutation to provide a tax-free lump sum) of 1/30th for each year of service up to a maximum of 20 years;

- an unfunded unapproved retirement benefit scheme (UURBS);

- a funded unapproved retirement benefit scheme (FURBS).

5.14 The majority of benefits above the earnings cap are provided by top-up arrangements (third and fourth bullet points above). Under this scenario senior staff are still members of the main staff scheme with rights to the standard package, but also are allowed to be members of a top-up supplementary scheme. Contributions to such schemes and benefits paid from them are not tax exempt.

5.15 The Civil Service top-up scheme is called the Supplementary (Earnings Cap) Scheme. The scheme provides pension benefits on pay in excess of the cap broadly corresponding to that which the PCSPS would have provided if no cap existed. As an unapproved scheme no tax relief is available on the contributions of 1½% (or 3½%) of pay in excess of the cap. The lump sum benefit is paid net of tax with no grossing up to take account of the tax liability. The Government Actuary will calculate the accruing superannuation liability charge (ASLC) rate for pay above the cap. For more on ASLCs see chapter 13.

Retirement Age

5.16 Normally the scheme rules must designate a normal retirement date (NRD), the point at which members normally begin to receive their pension. The NRD normally falls between the ages of 60-75. Very exceptionally, and only with the Inland Revenue's prior agreement, a person's NRD can be earlier than 60 if the nature of his or her employment means that it is not physically possible to continue working in the employment concerned beyond the earlier NRD.

1989 and Other Regimes

5.17 Occupational pensions currently operate under what is known as the 1989 tax regime. This refers to the benefit limits introduced by the Finance Act 1989 for members joining schemes from 1 June 1989 (i.e. an individual joining an established scheme now) and all members of new schemes established on or after 14 March 1989 (i.e. any scheme set up now).

5.18 In some schemes members may be subject to other tax regimes: "Pre-1987 limits" (for members who joined before 17 March 1987) and the "1987 limits" (for members of schemes established before 14 March 1989 who joined between 17 March 1987 and 31 May 1989 inclusive). However, such members may opt to be subject to the 1989 Regime.

Pension

5.19 The 1989 regime allows the build up ("accrual") of pension benefits to provide a pension of a maximum of 2/3rds of final remuneration, as limited by the current level of the pensionable earnings cap. This can be achieved after a minimum of 20 years service. The maximum accrual rate is 1/30th of final remuneration for each year of service. However, in most occupational pension schemes pensions accrue over 40 years. Pensions that accrue over shorter periods of time are usually very expensive and no NDPB provides a full pension after only 20 years service.

Lump sums

5.20 The various tax regimes allow for the payment of a tax-free lump sum. Under the 1989 regime this may be the greater of 3/80th of final remuneration for each year of service up to a maximum of 40 years or 2.25 x the initial rate of pension before any commutation, to provide a tax-free lump sum or any allocation of a member's pension to provide for dependants' benefits. Where the scheme rules provide for a pension and a separate lump sum rather than a commutable pension, the maximum lump sum is an amount equal to 3 x the initial rate of the separate pension.

5.21 Under the pre-1987 limits there is no ceiling on the amount of a tax-free lump sum, but the maximum earnings used on the lump sum calculation are limited to £ 100,000 and included in the 1987 regime and the earnings under cap under the 1989 regime.

Final remuneration

5.22 The Inland Revenue designates what may be included in final remuneration. Generally, it is either:

(i) basic pay, plus any fluctuating pay averaged over the previous 3 or more years, for any year in the 5 years before leaving the scheme (e.g. on retirement); or
(ii) the average of total pay over any 3 or more consecutive years ending not more than 10 years before leaving the scheme.

Pay received in the years before the year ending with the date of leaving service may be increased in proportion to any increases in the Retail Prices Index (RPI) in the intervening period.

Leaving early (transferring out)

5.23 Members who have earned the right to a preserved pension and who leave at least one year before normal pension age have the right under occupational pensions legislation to a cash equivalent transfer value. This may be taken to:

- a subsequent employer's approved pension scheme
- an approved deferred annuity contract
- an approved personal pension
- a subsequent employer's relevant statutory scheme.

Early retirement

5.24 The Inland Revenue permits an employee to take an immediate pension and lump sum if their employment is terminated early. The pension can usually be taken from age 50 onwards.

5.25 The maximum pension benefits payable for early retirement on ill-health grounds are those that could have been payable at normal retirement date, but based on the level of final remuneration at the date of early retirement. Under the 1989 regime the maximum lump sum is 2¼ x initial pension, or 3/80 x potential total service (up to 40 years) x final remuneration.

Death-in-Service

5.26 The Inland Revenue allows a death lump sum of up to 4 x final remuneration to be paid to a beneficiary. In addition a refund of the employee's contributions is allowed, with interest, but it is not a requirement. Schemes can also provide a pension to survivors (a widow, widower or other dependant). The dependant's pension may not exceed 2/3rds of the maximum pension that would have been payable to the member at their normal retirement date, but based on their final remuneration at death. If more than one dependant's pension is payable, for example if children's pensions are also payable, the aggregate of all the survivor's pensions must not exceed the maximum pension that would have been payable at the NRD to the member.

Death after Retirement

5.27 When a scheme member dies after retirement the Revenue allows the payment of a dependant's pension of up to 2/3 of the maximum pension that could have been provided for the member at retirement, increased in line with the RPI. If more than one dependant's pension is payable the aggregate must not exceed the maximum pension payable at NRD to the member.

5.28 The Inland Revenue allows schemes to provide a guarantee to pay the retirement pension for a minimum period after retirement. The guarantee can be for up to 10 years, but if it is more than 5 years no widows', widowers' or other dependant's pension can start until the period has ended as this would conflict with the National Insurance Contributions Office's contracting-out requirements. As a result the most common guarantee period is five years. So if a member dies before receiving five years' pension payments, the balance can be paid to a spouse or dependant, including pension increases.

New Pensions Tax Regime

5.29 In December 2002 the Government published a consultation document '*Simplifying the taxation of pensions*" which proposes replacing the present tax regime with a new single regime. The main features are:

a) a single lifetime limit on how much someone can save in a tax-privileged pension. £ 1.4 million has been proposed as the starting level;

b) an annual limit for the increase in value to an individual's aggregate tax relieved pension savings (or individual pension fund), set initially at £ 200,000. This would allow most people to contribute sums equivalent to their annual earnings if they wished;

c) up to 25% of the value of the tax privileged pension benefits taken at a particular time can be in the form of a tax free lump sum;

d) by 2010 the minimum age at which someone can draw a pension would increase from age 50 to age 55; and

e) tax approved schemes will be permitted to offer arrangements which would enable employees to draw pensions while still working, for example to supplement income when stepping down to less onerous and lower paid jobs , or moving to part-time working.

5.30 The Government will be publishing more detailed proposals during 2003. The new regime, like the old regimes, does not imply that all new and existing public service pensions should provide benefits up to maximum levels permissible. The benefit design will be determined by factors such as value for money, in terms of recruitment and retention needs, cost and affordability.

CHAPTER 6: MANDATORY DEPARTMENT OF WORK AND PENSIONS (DWP) REQUIREMENTS

Warning: this chapter is subject to revision as DWP will bring forward a Pensions Bill to change some of the requirements on schemes. A revised chapter will be issued in due course.

6.1 In addition to Inland Revenue limits, pension schemes need to meet the occupational pension scheme requirements set out in the Pension Schemes Act 1993, the Pensions Act 1995 and regulations made under those Acts.

6.2 The following paragraphs give a flavour of some of the mandatory requirements with which pension schemes must comply. However, they are no substitute for consulting professional advisors.

AVC provision

6.3 Schemes are obliged to offer to members the ability to augment their pensions via Additional Voluntary Contributions (AVCs).

Contracting-Out

6.4 There is a complicated set of rules surrounding the contracting-out of pension schemes. This enables lower National Insurance Contributions to be paid by both the employer and employee in return for opting out of the state second pension (S2P). See Chapter 4 for fuller details.

Disclosure

6.5 Section 41 of the Pensions Act 1995 governs the provision of documents to members. Essentially employees are entitled to detailed information about their pension scheme. Further details are set out in Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (SI 1996/1655) as amended[2] which cover, amongst other things, the constitution of the scheme, basic information, information that must be made available to members, the availability and content of annual reports, the availability of the actuarial valuation, schedule of contributions, payment schedule and statement of investment principles.

Equal Treatment

6.6 It is axiomatic that pension schemes must provide for equal treatment of members. There have been many cases before the courts about the lack of equal treatment. As a result of the European Court of Justice's decision in the Barber case (Barber v Guardian Royal Exchange Assurance Group, Case

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[2] Amended by SIs 1997/786, SI 1997/819 and 1997/3038.

262/88 [1991] QB 344), and the Maastricht Protocol all accrued pensionable service after 17 May 1990 must be equalised (see section 62 of the Pensions Act 1995).

6.7 In the Preston judgement (Preston & Others v Wolverhampton NHS Trust & Others [2001] 3 All ER 947) the House of Lords held that in some circumstances the right to equal treatment may be claimed from 1976 onwards, as this was the year the European Court of Justice decided Article 119 of the EC Treaty had direct effect.

Internal Dispute Resolution (IDR)

6.8 Schemes are expected to have a two-stage Internal Dispute Resolution (IDR) procedure for members and other beneficiaries who are unhappy with their treatment by the scheme. See Occupational Pension Schemes (Internal Dispute Resolution Procedures) Regulations 1996, SI 1996/1270).

Investment Advice

6.9 When providing guidance on pension choices that may be available schemes and employers must be careful not to give specific investment advice. Investment advice can only be given by those authorised to do so under the financial services legislation. However, a person's pension rights under an occupational scheme are not investments within the meaning of the financial services legislation. Scheme administrators and trustees can give scheme members and new employees eligible to join the scheme advice about the scheme, including its AVC arrangements.

Leaving Early (Transferring Out)

6.10 As noted in the previous Chapter, employees leaving the scheme with preserved benefits have a right to take a Contributions Equivalent Transfer Value (CETV). This can be taken at any time until a year before Normal Pension Age.

Minimum Funding Requirement (MFR)

6.11 The MFR is an attempt to ensure that schemes have sufficient assets to reach a minimum standard. The regulations are contained in Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996, SI 1996/1536[3]. They require a scheme's trustees to obtain a special valuation whereby the scheme's actuary sets out the MFR funding level calculated against a specified method and set of assumptions.

6.12 In his Budget statement of 7 March 2001 the Chancellor of the Exchequer announced that the Government intends to abolish the MFR and replace it with a scheme specific standard, but the MFR continues in place until legislation comes forward to amend sections 56-61 of the Pensions Act 1995.

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[3] As amended by SIs 1996/3127, 1997/786, 1997/3038, 1999/3198, 2000/679, 2000/2691

Pensions Scheme Registration

6.13 Schemes must be listed with the Registrar of Occupational and Personal Pension Schemes. The Registry can be found at

The Pensions Scheme Registry, PO Box 1NN, Newcastle Upon Tyne, NE99 1NN. The website is www.opra.gov.uk/registry.

Pension sharing on divorce

6.14 Since December 2000 schemes must provide for pension sharing on divorce. A court may order that a pension must be split and the scheme rules must provide for either a CETV or the creation of a new category of “former spouse member”.

6.15 The Inland Revenue publication Occupational Pensions Scheme Practice Notes IR12 (2001) provides detailed guidance on how scheme rules should provide for pension sharing on divorce. If no provision is made then the Inland Revenue will not grant exempt approval to a trust based scheme or register a statutory scheme (see chapter 5).

Professional advisors and Financial Services authorisation

6.16 Trustee scheme managers must employ certain professionals to advise them on pensions: lawyers, actuaries, accountants, investment fund managers etc. However, the responsibility ultimately lies with the Trustee or, for unfunded schemes, the employer (e.g. the Secretary of State or NDPB Board). Employers, schemes and advisors are subject to the requirements of the Financial Services and Markets Act 2000, which requires advice about investing in pensions to be provided only by authorised advisers (as well as requiring trustees and managers to be authorised if they manage, deal or arrange deals in investments).

Stakeholder access

6.17 Under the Welfare Reform and Pensions Act 1999 employers have an obligation to provide access to a stakeholder scheme, unless they are exempt.

Tax approval

6.18 Pensions schemes need tax approval to attract tax relief. See Chapter 5 for fuller details.

Trustees

6.19 Trustees of a funded pension scheme have to operate within certain parameters set out in Trust Law. Trustees should therefore arrange training to ensure that they know what the job entails and the limits of their powers. The trust deed will be one of the main sources to determine what can and cannot be done.

CHAPTER 7: ACCOUNTING AND FINANCIAL ARRANGEMENTS

SSAP24

7.1 Statement of Standard Accounting Practice (SSAP) 24 "*Accounting for Pension Costs*" was introduced in May 1988. Its aim is to ensure that the cost of providing occupational pensions is recognised in employers' accounts. It requires employers to score the accruing costs of pension provision in respect of current employees rather than, for example, only the contributions. Thus a cost would need to be recognised even if the employer made no contribution to the scheme (e.g. if there was a contribution holiday).

7.2 However, guidance issued by HM Treasury in 1990 on the implications of SSAP 24 concluded that, where an organisation paid pensions directly from its own resources rather than contributing to a pension scheme, it would be sufficient to account simply for pensions in payment and that the accruing pension liability need not be recognised. Although this approach has been questioned, the replacement of SSAP 24 with FRS17 has made further discussion pointless.

FRS17

7.3 A new accounting standard, FRS17, which replaces SSAP24, was introduced in November 2000. It has a phased implementation period, with application in full from accounting periods ending on or after 22 June 2003. As most NDPBs have financial year ending on 31 March, FRS17 will come fully into effect for 2003-04 onwards. However it also requires disclosures (e.g. of the assumptions used in calculating liabilities) in accounts from 2001-02 and much of the information needed for full compliance has to be provided in accounts from 2002-03.

7.4 Although the Accounting Standards Board (ASB) subsequently permitted a longer implementation period (i.e. until 1 January 2005 to allow for discussion on the implications of convergence with the equivalent international standard) Central Government has decided to require full implementation in line with the original timescale, i.e. by 2003-04.

7.5 NDPBs will need to reflect the accruing cost of pension schemes as they provide benefits to staff. There are alternative arrangements for organisations contributing to multi-employer schemes like the Principal Civil Service Pension Scheme (see paragraph 7.12). The scheme will need to be able to disaggregate the movement in assets and liabilities into current service costs, past service costs, actuarial gains and losses, curtailments and settlements, returns on assets (relevant only for funded schemes) and interest costs.

7.6 All of these costs are recognised in the statement of financial performance (usually the Income & Expenditure account), although actuarial gains and losses are shown in the statement of total recognised gains and losses (STRGL).

7.7 Further information on FRS17 may be found in the ASB publication Financial Reporting Standard 17 Retirement Benefits, November 2000 ISBN 1 85712 099 X.

Unfunded by-analogy schemes

7.8 Some NDPBs operate schemes that provide by-analogy benefits, but which are provided on a pay-as-you-go (PAYG) basis from the NDPB's own resources. Following the full introduction of FRS 17, employers of the small, unfunded public service schemes will have to switch to accounting for pensions in a similar way to larger schemes.

7.9 Bodies subject to the full requirements of FRS17 will take provisions in their balance sheet in respect of the accruing liability to pay pensions to current staff and, if appropriate, board members. Actuarial advice will provide the amount of the liability. Changes to the valuation will be reflected in further charges, or credits, to the Income & Expenditure (I& E) account. NDPBs with unfunded by-analogy schemes can get assistance from the Government Actuary's Department (GAD) in valuing their liabilities under FRS17. DAO (GEN)18/02 informed organisations of the availability of a spreadsheet for valuing their liabilities. Larger schemes, i.e. a membership of over 1,000, should contact GAD for an alternative assessment of their liabilities

7.10 The accrued unfunded liability, i.e. the balance sheet liability, is set up as a provision. The accruing costs (i.e. the cost of staff each year) should be recorded in the Income & Expenditure account, and this will usually add to the provision shown on the balance sheet. Actual pensions paid reduce the provision, but do not score in the I & E account.

Multi-employer schemes

7.11 FRS17 requires the accounts of employers to reflect changes in the pension liability between the beginning of the year and the year-end. However, it recognises that there may be arrangements in which several employers contribute to a single scheme and that an individual employer may be unable to identify his share of the pension liability and so account for the changes during the year.

7.12 FRS 17 notes that where more than one employer contributes to a defined benefit (DB) scheme, the employer should account for the changes in the pension liability as described in paragraphs 7.3-7.7 above unless:

(a) the employer's contributions are set in relation to the current service period only (i.e. are not affected by any surplus or deficit in the scheme relating to past service of its own employees or other members of the scheme). If this is the case, the employer should account for the contributions to the scheme as if it were a defined contribution (DC) scheme; and

(b) the employer's contributions are affected by a surplus or deficit in the scheme, but the employer is unable to identify its share of the

underlying assets and liabilities on a consistent and reasonable basis. If this is the case, the employer should account for the contributions to the scheme as if it were a DC scheme but, in addition, disclose

(i) the fact that the scheme is a DB scheme but the employer is unable to identify its share of the underlying assets and liabilities; and

(ii) any available information about the existence of the surplus or deficit in the scheme and the implications of that surplus or deficit for the employer.

7.13 If these conditions are met, the employer may account only for the contributions made to the scheme.

7.14 Where NDPBs are in a multi-employer arrangement (e.g. the PCSPS or LGPS) the NDPB should record only the contributions paid.

Funded schemes

7.15 NDPBs that operate funded schemes will need to apply FRS17 in full and should consult their own actuaries for advice.

References

7.16 Further material can be found in the following publications:

- Resource Accounting Manual (HM Treasury) ISBN 0-11-56009-X. To access the Resource Accounting Manual on the internet visit http://resource-accounting.gov.uk.

- PES (2003) 11, dated 8 August 2003, entitled *Unfunded By-analogy and Funded Pension Schemes: Recording Under FRS17*. To access PES papers electronically visit http://www.hm-treasury/psd/pes_guidance/spending_guidance_home.htm

CHAPTER 8: PENSIONS INCREASE

8.1 Movements in the all-items Retail Prices Index (RPI) are used to increase public service pensions. The movement from September to September the previous year is used to uprate pensions from the following April. This follows the practice used by the Department of Work and Pensions (DWP) in uprating the State Earnings Related Pension and some other Social Security benefits.

8.2 The Pensions (Increase) Act 1971, as amended, governs increases in most of the major public service schemes. Almost all other public service pension schemes apply increases to their pensions by analogy to the 1971 Act.

8.3 In March each year HM Treasury lays an order before Parliament to increase official pensions from the first Monday in the new tax year. The historic increases since 1988 are set out in the table below. Pensions which start part way through the preceding year receive pro rata increases.

8.4 Funded schemes are also required by legislation to uprate pensions in payment and preserved pensions. Sections 51-54 of The Pensions Act 1995 require any pension accruing since 6 April 1997 to be increased at least in line with the RPI, subject to a ceiling of five per cent a year (known as Limited Price Indexation, or LPI). However, funded public service schemes may increase pensions in line with the Pensions (Increase) Act provisions.

INCREASES AWARDED TO PUBLIC SERVICE PENSIONS SINCE 1988

Effective date	Percentage increases
11 April 1988	4.2 %
10 April 1989	5.9 %
9 April 1990	7.6 %
8 April 1991	10.9 %
6 April 1992	4.1 %
12 April 1993	3.6 %
11 April 1994	1.8 %
10 April 1995	2.2 %
8 April 1996	3.9 %
7 April 1997	2.1 %
6 April 1998	3.6 %
12 April 1999	3.2 %
10 April 2000	1.1 %
9 April 2001	3.3 %
8 April 2002	1.7 %
7 April 2003	1.7%
12 April 2004	2.8%

CHAPTER 9: EARLY RETIREMENT, SEVERANCE AND REDUNDANCY

9.1 Once bodies have decided what the pension arrangements they are going to adopt they will also need to consider the compensation arrangements for early retirement, severance and redundancy.

Linked compensation arrangements

9.2 Bodies that have chosen to join one of the major public service pensions scheme like the Principal Civil Service Pension Scheme (PCSPS), or the Local Government Pension Scheme (LGPS), will be expected to take the associated compensation arrangements. This is because they are so inextricably linked that to do anything else would involve considerable amounts of work to disentangle them and set up free-standing arrangements. Also the pensions and compensation arrangements are part of a package and should not normally be decoupled.

9.3 Bodies with by-analogy pensions schemes will also be expected to adopt by-analogy compensation arrangements. Chapter 3 contains guidance for by-analogy schemes.

9.4 Bodies with their own funded scheme may also wish to establish early retirement compensation arrangements. These may be modelled on one of those of the main public services.

Early retirement

9.5 The general rule is that early retirement, as dictated by Revenue rules, can only take place at the earliest within ten years of the normal retirement age. This usually means that the earliest that individuals can begin collecting a pension after taking early retirement is age 50.

Severance

9.6 Leaving employment before the age of 50 (other than on ill-health grounds) is usually referred to as “severance”. An accrued pension is usually preserved for payment at the normal retirement age (NRD). Compensation therefore normally takes the form of a lump sum payment.

Proposals

9.7 Bodies should contact the PSP team, HM Treasury to discuss any proposals for compensation arrangements that are not simply part of a linked pensions and compensation package, wholly derived from one of the major public services.

CHAPTER 10: GUARANTEES AND INDEMNITIES

10.1 Guarantees and indemnities in regard to NDPBs usually arise in relation to funded schemes.

Indemnities

10.2 The Treasury Officer of Accounts (TOA) issued guidance to Accounting Officers under cover of two DAO letters – DAO (GEN) 2/99 and DAO (GEN) 1/2002 of January 1999 and January 2002 respectively (DAO letters can be seen at www.hm-treasury.gsi.gov.uk/psd/accounting/dao/dao.htm) which sets out the policy on indemnities for NDPB board members and for members of bodies which, although public sector, have not been formally classified as NDPBs by the Cabinet Office.

10.3 Any new indemnities given to trustees of pension funds subsequent to DAO (GEN) 1/02 are likely to need reporting to Parliament through the Minute procedure provided for in Government Accounting Chapter 26. In cases of doubt please consult the Treasury's Officer of Accounts (TOA) team who have the lead on such indemnities.

10.4 The standard indemnity offered in such cases is in the following terms:

> *The Government has indicated that an individual board member who has acted honestly and in good faith will not have to meet out of his personal resources any personal civil liability which is incurred in the execution or purported execution of his board function, save where the person has acted recklessly.*

10.5 Any indemnity which conforms to, and offers no greater cover than, the above text is likely to be acceptable to HM Treasury, who should see and approve new proposals for indemnities of any kind.

10.6 The trustees of a pension scheme usually seek indemnities in relation to the winding-up of a pension scheme. NDPB Board Members are in much the same position as Pension scheme trustees with regard to the need for indemnification.

Guarantees

10.7 Funded schemes sometimes ask about guarantees from departments, usually in relation to the minimum funding requirement (MFR). Funded schemes are generally subject to the MFR, but pension schemes that have a Government guarantee are exempt from the MFR (section 56(2)(b) of the *Pensions Act 1995*).

10.8 However, it has been Government policy that where bodies have funded pension schemes they should generally be subject to the same regime as private sector schemes. It is therefore general Government policy not to give guarantees to NDPBs in relation to their pension funds.

10.9 Departments seeking guarantees should approach their spending team contact in the Treasury who will consult with TOA and, where necessary, PSP about the issue of guarantees.

CHAPTER 11: TRANSFERRING STAFF

11.1 Where staff are transferred from a non-departmental public body (NDPB) to a private sector employer as part of a business transfer special considerations apply to pensions.

Basic principles

11.2 Pensions are an important element in the remuneration of staff. Special arrangements have to be made to ensure that staff are treated fairly, openly and transparently. Staff and their representatives need to be consulted throughout the process.

11.3 There are two strands to the treatment of pensions in a business transfer:

- future service, where staff should continue to have access to a good quality occupational scheme; and
- past service rights, or accrued benefits that they have already earned.

Future service

11.4 Where a function is transferred to the private sector, staff generally cannot remain in the public service scheme because they usually cease to be eligible for membership. The ability to earn further pension will therefore generally be in their new employer's arrangements.

11.5 New employer's schemes are, however, unlikely to replicate some of the features found in a public service scheme. To ensure that no material detriment overall is involved the transfer should specifically protect staff pensions. The guiding principle is that the new pension arrangements should be 'broadly comparable' to the scheme employees have just left. An actuary will have to assess the benefits on offer with those currently available and provide a certificate of broad comparability (known as a GN16 certificate).

Past service

11.6 Staff who leave occupational schemes early, for whatever reason, have the option of preserving their benefits in the scheme, or transferring them to another pension arrangement. If they preserve their benefits they become deferred pensioners of the public service scheme. Their benefits will be increased in line with prices until they come into payment at the normal retirement age.

11.7 Where benefits are transferred a transfer payment is paid to cover the increased liability of the new scheme. It usually discharges all liability for pensions on the part of the sending scheme/body. The service that the transfer value buys in a new arrangement will depend upon an actuarial valuation. On occasion a bulk transfer agreement can be made whereby the importing scheme agrees that individual transfer values can be bundled together and

special terms are applied, which can mean the transferor pays more but generally means the receiving scheme provides better benefits.

11.8 Where staff are compelled to leave a public service scheme because they now work for a private sector employer due to the transfer of a function, it is Government policy to negotiate a bulk transfer arrangement.

Further details

11.9 For fuller details about transfers see '*Staff Transfers From Central Government: A Fair Deal For Staff Pensions'* (HM Treasury June 1999). A copy is attached at Annex A. During 2003 HM Treasury will be issuing some additional guidance on bulk transfers. A draft document "*Fair Deal for Staff Pensions and Related Issues: Procurement of Bulk Transfer Agreements*" has been circulated to public service employers and unions.

11.10.1The Cabinet Office have also produced a document '*Staff Transfers In The Public Sector: Statement Of Practice*' (Cabinet Office, July 1999) that covers other aspects. Copies are available from the Cabinet Office or can be viewed at www.cabinet-office.gov.uk.

Movement within the public service

11.11 Movements within the public service can, in many ways, be more complex as the options are not so stark. Sometimes staff can remain with their existing pension arrangements, or move to another public service scheme.

Transfer of Undertaking (Protection of Employment) Regulations

11.12 Departments will need to consider the impact of moving NDPBs into different sectors of the public service. The Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) [4] SI 1981/1794, may apply where there is a change of employer.

11.13 TUPE is generally not held to cover pensions and there is no requirement to offer comparable pension provision. The Government's Law Officers have advised however that employees might be able to sue their former employer if the new employer does not offer a broadly comparable scheme.

11.14 Moves within the public service should be guided by the general principles set out in Staff Transfers From Central Government: A Fair Deal For Staff Pensions (HM Treasury, June 1999. See Annex A). These include:

- Treating staff fairly;
- Doing so openly and transparently
- Involving staff and their representatives fully in consultation about the process and results; and

[4] At the time of writing the TUPE regulations, including their coverage of pensions, were under review. For an up to date position see the DTI website: www.dti.gov.uk.

- Clear accountability within Government for the results.

11.15 Each case must be considered on its merits. There is no ‘one size fits all’ approach and transfer arrangements will vary from case to case.

11.16 Departments should consult PSP team at an early stage where pension provision looks like it will have to change due to public sector restructuring. (contact: Bill Guy on 020 7270 4906).

ANNEX A to chapter 11

STAFF TRANSFERS FROM CENTRAL GOVERNMENT: A FAIR DEAL FOR STAFF PENSIONS

Guidance to Departments and Agencies
June 1999

Introduction

This paper sets out in general terms how pensions issue are to be handled in future when staff from central government Departments and Agencies are transferred to a new employer as part of a business transfer. The new approach set out here builds upon earlier guidance, and extends and strengthens its application in order to ensure that staff are treated fairly. It is mainly concerned with transfers between the Government and the private sector when contracts are awarded under public-private partnership (PPP) deals.

2. Better Quality Services gives guidance on the treatment of staff pensions in PFI and PPP deals, and there are also policy statements and guidance issued by the Treasury Task Force covering, for instance, the Government's continuing commitment to dialogue with staff and other interested parties about the way PPP projects are managed.

3. This new guidance should be reflected in procurement practice as soon as is practicable without disruption to projects which are already at an advanced stage. Detailed guidance will be issued to contracting authorities later this year.

Background

4. Pensions are often an important element in the overall remuneration of staff, particularly within the public services where there are occupational schemes offering a high quality of benefits. Sometimes public service schemes require very low employee contributions to earn pensions benefits, such as in the Principal Civil Service Pension Scheme (PCSPS) where employee contributions are only 1½%[5] of pay, and in these cases employee pay is somewhat lower than it would otherwise be, to reflect the value of the pension scheme.

5. If appropriate arrangements were not made for staff pensions as part of business transfers, the result could be disadvantageous to public service staff who were transferring to the new employer. Not only are the pension arrangements an important subject, but they are complex and likely to cause confusion and apprehension if not handled openly and consistently by the contracting authority. It is not in the interests of the contracting authority, or the new employer, or the taxpayer, for staff to be alarmed about the prospects for their pensions in a business transfer which depends upon staff motivation for delivery of good quality public services.

6. Occupational pensions are not covered by the Transfer of Undertakings (Protection of Employment) Regulations 1981 (the TUPE regulations). The new EU Acquired

[5] The rate is 3.5% in the Premium section post-October 2002.

Rights Directive gives Member States the option of including occupational pensions within the terms which are protected by national legislation when an undertaking transfers between employers, and the Government is reviewing whether and if so how, to include pensions within new TUPE regulations.

7. Independently of the TUPE review, and without prejudice to its conclusions, this paper sets out the standard practices that the Government will follow when its own staff are transferred to other employers. Contracting authorities in other parts of the public sector will continue to make their own arrangements consistent with the law and good employment practice. It would be welcome if they adopted approaches comparable to those set out here. Separate consideration is being given to staff transfers from local government.

8. The principles which Government will apply as a contracting authority in relation to the pensions of transferring staff are:-

- to treat staff fairly;

- to do so openly and transparently;

- to involve staff and their representatives fully in consultation about the processes and its results; and

- to have clear accountability within Government for the results.

9. There are two separate but related aspects to treatment of pensions in a business transfer:-

- first, staff should continue to have access after the transfer to good quality occupational pension schemes under which they can continue to earn pension benefits through their **future service**:

- second, staff should be given options for the handling of the **accrued benefits** which they have already earned.

Each of these aspects is discussed, in turn, in the following sections.

FUTURE SERVICE

10. The focus of this guidance is upon those cases, likely to be in the majority, where a business transfer means that staff have to be 'early leavers' of the occupational pension scheme associated from their former employment. The Government has no plans to seek amendment to the Superannuation Act 1972 to broaden the categories of employees eligible for membership of the PCSPS. Where civil servants transfer to private sector employment they will therefore cease to be eligible for PCSPS membership, and their ability to earn further occupational pension service through future service will depend upon the occupational pension arrangements offered by the new employer.

11. Not all private sector employers offer occupational pension schemes which are as valuable to employees as the public service pension schemes, and where good quality pension schemes are offered they typically differ in major respects: for instance, the

age of normal retirement, the rate of accrual of pension entitlements, provision of a lump sum on retirement, the degree of indexation of pensions increases, and so on. If care were not taken over staff pensions, the unintended upshot of a business transfer might be a detriment to staff pension benefits.

12. The terms of the business transfer should specifically protect staff pensions. The arrangements made to achieve this need to be considered within the overall context of the business transfer negotiations between the conducting authority and prospective private sector partners and should not be so cumbersome or expensive to administer as to militate against finding a justifiable business solution.

13. To require that the new employer should offer transferring staff access to a pension scheme which is in all respects identical to the public service scheme that they are leaving would be unduly restrictive. It would add to administrative costs and it could hamper harmonisation of terms and conditions. In the case of the PCSPS it would be an unrealistic requirement, because a non-statutory scheme that was identical to the PCSPS would not qualify for tax exemption. A requirement for an identical scheme would also prevent employers from offering different benefit packages, more in line with private sector standards, which might overall be of greater value to many transferring employees.

14. The guiding principle should be that the new employer offers transferring staff membership of a pension scheme which, though not identical, is **'broadly comparable'** to the public service pension scheme they are leaving. To satisfy the criteria for broad comparability there must be a rigorous scrutiny of the alternative pension arrangements by a professionally qualified actuary, which compares the alternative scheme with the public service scheme in detail. A broadly comparable scheme will be one which, in the professional opinion of the actuary, satisfies the condition that there are no identifiable employees who will suffer material detriment overall in terms of their future accrual of pension benefits under the alternative scheme. The PCSPS takes actuarial advice from the Government Actuary's Department, as do a number of other public service pension schemes.

15. There may be cases where although there are no identifiable classes of employee who would be materially worse off overall, transfer to a new scheme might be materially detrimental to a few individuals. In such cases it will be a matter of judgement whether the new scheme should be adjusted, or whether it would be better simply to make appropriate compensation arrangements to protect the disadvantaged individual(s).

16. Each case should be considered on its merits. There may be exceptional circumstances where there are special reasons for not providing a broadly comparable pension scheme. The strength of those reasons should be tested rigorously and it would be necessary for the terms of the business transfer to ensure appropriate compensation for the staff. Actuarial advice should be taken by the contracting authority on the calculation of any compensation in these exceptional circumstances if a broadly comparable scheme is not to be provided, or if there are identified individuals who would be materially worse off overall in the new scheme. In all cases the preference should be for the new employer to offer transferring staff membership of a broadly comparable scheme, and this should be a contract condition in the procurement. Only in exceptional circumstances should the combination of pension

arrangements which are less than broadly comparable plus appropriate compensation for employees be accepted.

17. This principle is already being followed by the Government. Its practical application will now be strengthened, extended and made more open:-

(i) for transfers of staff from Government Departments and Agencies it will continue to be a requirement for the Government Actuary's Department (GAD) to certify the broad comparability of specified alternative pension arrangements before any contractual commitment is made;

(ii) if for exceptional reasons the requirement for broad comparability is to be waived, GAD advice on appropriate compensation must be followed;

(iii) GAD will follow a published Statement of Practice in certifying broad comparability. This sets out clearly the principles which are being followed. Publishing these principles in the form of this Statement for the first time will increase transparency and accountability;

(iv) GAD will provide to the contracting authority an analysis of the key differences between the alternative pension scheme and the public service scheme, and the ways in which the differences balance out overall to satisfy the condition of no material detriment overall, by reference to the different groups of employees identified in the staff to be transferred;

(v) the full GAD analysis will be made available to trades unions and staff representatives, and GAD will respond to any queries or observations which staff representatives have. A reasonable period will be allowed by the contracting authority for discussion, if requested, of any points arising from the GAD analysis;

(vi) at the conclusion of this period, if any points of concern about the suitability of the proposed alternative pension arrangements remain which cannot be settled by discussion between staff representatives and the contracting authority, staff representatives may raise their concerns directly with a nominated Minister responsible for the affairs of the Department or Agency;

(vii) no contractual commitments will be made whilst this process of review and consultation is underway, but a reasonable time limit may be set by the contracting authority;

(viii) the contract for the business transfer must specifically require the implementation of the alternative pension arrangements which have been accepted.

18. In practice this will mean that in order to avoid delay or having to retrace steps, contracting authorities will need to be satisfied about the broad comparability of alternative pension arrangements well in advance of moving a procurement to selection of short-listed bidders or a preferred bidder. Bidders will need to provide GAD with detailed specifications of their proposed pension arrangements in good time to allow the analysis required and, if necessary, subsequent discussion of it with

staff representatives. Contracting authorities will have to reflect this in their procurement logistics. There can be no proper evaluation of options for public-private partnership without a full analysis of the future staff pension arrangements.

19. Ministers will not authorise a procurement contract, and contractual commitments should not have been made under delegated powers, if the conditions set out in paragraph 17 (above) have not been satisfied. This provides a guarantee to staff that the process of identifying acceptable alternative pension arrangements will be fair and open and carried out in full consultation with their representatives.

Subsequent transfers of staff

20. Current practice restricts the contracting authority's concern about broad comparability to transfers from Government to another employer. Once staff have transferred to a new employer, they may be involved in subsequent business transfers. As a contracting authority, the Government will usually not be involved directly as a party to those arrangements. A contracting authority cannot take responsibility for the treatment of its former staff throughout the remainder of their working lives. But a contracting authority does take an interest in the conduct of business transfers which occur as the direct consequence of actions which it takes as a contracting authority.

21. Therefore:-

(i) where a contract for services is terminated and the work is given to another contractor, the contracting authority will require that pension arrangements are made for staff transferring from the first contractor to the second contactor which would at least be broadly comparable with the public service pension scheme which those staff were in originally. The requirement will be limited to staff originally transferred from the contracting authority, although employers may find it convenient to harmonise terms and conditions in the workforce; and

(ii) where a primary contractor under a Government contract transfers staff whose work is integral to performance of a contract to a sub-contractor in consequence of the terms of the primary contractor's obligations to the Government, it should be a condition of that sub-contracting that broadly comparable pension arrangements are made for the transferring staff who were originally in the employ of the contracting authority.

ACCRUED BENEFITS

22. The treatment in procurement practice of the accrued pension benefits of transferring staff is more complex, but raises issues of equal importance. Regulations applicable to pension schemes require 'early leavers' to be given the option of preserving their accrued benefits in the pension scheme which they are leaving, or transferring them to another pension arrangement. In the former case (preservation), the early leavers become deferred pensioners of the scheme which they are leaving. The value of their benefits in that scheme will be uprated by price inflation until they come into payment at normal retirement age. This option may often be preferred by staff, especially those who are closer to retirement and do not expect significant future real earnings growth. In the latter case, where accrued benefits are transferred, the transferor scheme makes a transfer payment to the transferee scheme which extinguishes its liability to the early leaver; in return the new employer's scheme

awards a past service credit to the individual. (If the transfer were made to a personal pension plan instead, it would be invested in the normal way.)

23. Regulations stipulate a basis for calculating a minimum transfer value where accrued credits are transferred. Typically this will not result individuals securing full credits in the new employer's scheme in relation to the credits they are surrendering in the transferor scheme, unless there is a specific agreement between the two pension schemes that they should do so. Typically there is then a different basis for calculation of the transfer value involving the transferor scheme in making higher transfer payments. Such agreements between pension schemes are called **bulk transfer agreements** (although they may in fact cover only a few members of staff, or just one). A bulk transfer agreement specifies the basis for calculating the transfer payment and the size of the transfer credits it will secure.

24. It is desirable where staff are obliged by a transfer of undertaking to be early leavers of a public service pension scheme for there to be bulk transfer arrangements covering the award of past service credits by the new employer's pension scheme. Current practice, as set out in *Better Quality Services* is to treat the absence of a bulk transfer agreement as a significant disadvantage of a bid. In practice this means that bids should be unlikely to succeed unless there is a very good prospect of a bulk transfer agreement being concluded to cover transferring staff. But it is still possible for the business transfer to become dissociated from negotiation of the bulk transfer agreement between the two pension schemes, leaving staff uncertain about the arrangements that will eventually be made.

25. The existing approach will therefore now be strengthened by making it a condition for the business transfer that there will be a bulk transfer agreement under which the pension scheme of the new employer will provide day for day past service credits (or an equivalent recommended by the Government Actuary's Department as a suitable reflection of differences in benefit structures between the schemes) to staff choosing to transfer their accrued credits.

26. It will therefore be essential in future that negotiations between the public service pension scheme and the new employer's pension scheme are settled at a sufficiently early stage in the procurement. The contracting authority should then be able to explain to staff and their representatives what the terms for award of past service credits will be. Staff representatives will be able to discuss this with the contracting authority and GAD, and they will have a reasonable period in which to make any observations and, if necessary, to make representations directly to the Minister nominated as responsible for the project.

27. Only in exceptional circumstances should staff transfers be contemplated where the contract terms will not ensure appropriate bulk transfer terms. If there are exceptional circumstances justifying a waiver of this contract requirement, these should be explained and discussed with staff representatives at an early stage.

28. As in current practice, staff should normally be given a three-month period following the issue to them of the pension option forms in which to elect whether to preserve their accrued benefits or transfer them. Pension option forms should be issued as soon as practicable following the staff transfer.

29. Further guidance will be issued to contracting authorities concerning the mechanics of bulk transfer negotiations.

Subsequent transfers

30. Where a public service pension scheme associated with the public contracting authority is not a party to a bulk transfer agreement involving a further transfer of former public servants, the position is substantially more complicated. But appropriate bulk transfer terms should be sought for staff in transfers arising from second-round and subsequent contracting, and sub-contracting. Further guidance will be issued to contracting authorities concerning appropriate contractual safeguards covering availability of bulk transfer terms in subsequent TUPE transfers involving staff who in initial transfers from the Government were the subject of bulk transfer payments by a public service pension scheme.

31. Making these reforms to procurement arrangements will ensure fair treatment of staff pensions in public-private partnerships. It will continue to be important to look at each case on its merits, and to allow contractual mechanisms to continue to evolve towards better practice. The new approaches described above will guide current practice and new developments to ensure that staff are treated consistently on terms which are fair and predictable, and that there is in every case an opportunity for staff to understand fully the implications for their pensions and to make any representations they wish to the responsible Minister well before a Government contracting authority makes a final arrangements for a business transfer involving the transfer of staff.

32. The Government will be ready to consider any further reforms which may be needed to cope with developments. In addition, for the longer term, it will review with representatives of employer and employees the scope for simplifying the administration of public-private partnerships, for instance, by developing 'model schemes' or industry-wide multi-employer schemes which are broadly comparable with public service schemes and can facilitate transfers of staff between employers more easily as public-private partnership arrangements become more important to the delivery of public services.

CHAPTER 12: PENSION ASPECTS OF MERGING AND WINDING UP NDPBs

12.1 On occasion Ministers may decide to merge (or close down) non-departmental public bodies (NDPBs). Pensions will be one of the main personnel issues when bodies disappear or merge and may take some considerable time to resolve. It is therefore important to focus early on the pensions issues once the option of winding up an NDPB and/or merging it with another is floated.

12.2 There may be advantages in rationalising the NDPBs' pension provisions. For example, there may be cost savings in not doubling up on advisers; mobility may be eased if membership is shared in a multi-employer scheme and administration will be easier and lower costs per head may be achieved.

Machinery of Government changes

12.3 In cases of re-organisations of the public sector there may be cases where members of one public service pension scheme find that they have been moved from one category of employer to another, but stay within the same public service scheme. Such cases are usually confined to the Civil Service, NHS and Local Government, although other public sector employers can be involved. This will have implications for future employees who will be expected to be offered pension terms which accord with the norm for the category of public service employers that the body finds itself in, but there may be issues about the pension arrangements for existing staff.

12.4 To deal with these re-organisations it may be possible to set up separate membership sections in the receiving scheme, although it can be problematical to accommodate the various merged benefit structures within large statutory public service schemes.

12.5 Up until recently the practice has not been to be unnecessarily concerned about the detailed differences amongst public service schemes when dealing with internal public sector transfers. The approach had been to treat each scheme as broadly comparable and arrange for bulk transfer terms which staff could use if they wanted to.

12.6 However, the development of PCSPS Premium - with a very different benefit structure from other public service schemes - means that an actuary can no longer provide a certificate of broad comparability in most cases of transfers from another public service scheme. As an interim measure, probably until the other schemes have updated their pension terms, a solution to compulsory transfers under machinery of government auspices has been sought.

12.7 It has been agreed between the major schemes that each case would be judged on its merits. The outcomes could include:

- Continue to provide access to a scheme with the differing benefits, where possible;

- The greater use of admission agreements, allowing bodies that were not natural members of a scheme to remain within its membership;
- The use of secondments;
- As a last resort, compensatory pay adjustments

Closed and frozen schemes

12.8 If a scheme cannot yet be wound up, it can be closed. The scheme is closed to new members, it will therefore still collect contributions from existing active members as they accrue further service, but no new employees are admitted. If however the active members have moved elsewhere the membership may consist only of deferred pensioners and pensioners. This is sometimes known as a frozen scheme.

Winding up a scheme

12.9 Winding up is a process whereby an occupational pension scheme is discontinued. This may be because of:

- Harmonisation across employments – the employer wants to harmonise pension provisions where there are several schemes in operation
- Merger of employers – the new employer may want a common pension provision for all employees
- Discontinuance – the employer may simply cease to exist.

Issues on wind-up or merger

12.10 There are various issues that departments will need to consider on the merger or winding up of an NDPB. These include:

- What are the pensions arrangements to be for any new body?
- What options are there for the accrued benefits of staff in the organisation that is disappearing?
- What are the implications for overall remuneration packages across the organisation?

12.11 Special rules apply when work is contracted out, privatised, subject to a Public Private Partnership (PPP) or Private Finance Initiative (PFI) deal. See chapter 11 for more details.

Winding up a scheme

12.12 There are conditions attached to the wind-up of a pension scheme. The full detail is contained in the *Occupational Pension Schemes (Winding Up) Regulations 1996* (SI 1996/3126) [6] as amended. Some of the main features include

<u>Disclosure</u>: all members and beneficiaries must be kept informed;
<u>Discharge of pension liabilities</u>: arrangements must be made regarding the accrued pension liabilities.

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[6] Amended by SI's 1997/786, 1999/3198,and 2000/2691

Disclosure

12.13 It is important to keep all members and beneficiaries appraised of the decision to wind up the scheme. The information should be provided as soon as possible and should detail the options, if any, that staff have with regard to their pensions. Bodies should provide a contact name, address and number for further queries.

Discharging the liability

12.14 The former administrators have a duty to discharge the liabilities for accrued benefits. This is usually done in two ways:

- transfer the accrued rights to another scheme; or
- buy out the rights with insurance policies, specifically with immediate and deferred annuities.

12.15 The most common option for unfunded schemes is to join the parent scheme on which it is based, i.e. unfunded by-analogy schemes to join the PCSPS. An actuarially assessed bulk transfer value would be used to transfer the accrued liabilities.

Giving up the Contracting-out certificate

12.16 Once all the liabilities have been dealt with the scheme is free to give up its contracting-out certificate. Employers should obtain leaflet CA14 *Termination of Contracted-out Employment-Manual for Salary Related Pensions Schemes* from the Contributions Agency, Longbenton, Newcastle Upon Tyne, NE98 1YX. The leaflet details how to surrender the certificate.

Informing other parties

12.17 The administrators of the scheme may also need to contact the AVC providers to inform them where members with AVC contracts have gone. The AVC provider may decide to relocate funds, e.g. where an unfunded by-analogy scheme joins the PCSPS.

12.18 The employer should also tell the Pension Scheme Registry, PO Box 1NN, Newcastle Upon Tyne NE99 1NN (www.opra.gov.uk/registry) and the Inland Revenue, Yorke House, PO Box 62, Castle Meadow Road, Nottingham NG2 1BG.

Redundancy and severance

12.19 Staff who are made redundant will normally be entitled to benefits due under their contracts (see chapter 9).

Residual pension liabilities

12.20 Where an NDPB is abolished, the sponsor department should establish that adequate powers exist to meet residual pension liabilities. Inadequacies should be addressed in any legislation to abolish the body.

12.21 The source of finance to meet the residual liabilities should be carefully determined, particularly if the body was only part grant-aided. For wholly grant-aided bodies the financial source may well be the Estimate from which the grant was paid. Advice should be sought from the relevant Treasury spending team.

12.22 In the case of a funded scheme a major part, if not all, of the residual liabilities may be covered by the alienated fund which will fall to be dealt with in accordance with the Trust Deed or, failing that, the winding-up provisions of the occupational pension scheme regulations.

12.23 It will need to be clear who will have responsibility for paying benefits in the future (e.g. if there is a contractual commitment to RPI pension increases and the arrangements are not covered by the pension scheme).

Successor bodies

12.24 Where there is a successor body the liabilities may be transferred to the successor body, or the pension rights transferred to a suitable other public service scheme.

12.25 Where a merger takes place consideration will have to be given to what terms and conditions will apply to future new entrants, including the pension arrangements. One of the existing pension arrangements may be chosen as the scheme for the future merged body.

12.26 Departments should discuss with their sponsored bodies at an early stage any proposals to harmonise terms and conditions that may impact on pension provision. For example, elements of the pay package related to the pension e.g. a non-pensionable pay addition to cover the employee contribution, may need to be handled carefully (e.g. in this case to prevent them becoming pensionable). An unnecessary and gratuitous windfall gain should not result simply because of a change of pension scheme.

12.27 The same considerations that are set out in chapter 11 regarding transferring staff will apply to a merged body, namely

- treating staff fairly;
- doing so openly and transparently;
- involving staff and their representatives fully in consultation about the process and results; and
- clear accountability within Government for the results.

Bulk transfers without consent: GN 16 certificate

12.28 Transfer of pension liabilities can take place without individuals' consent. *The Occupational Pension Schemes (Preservation of Benefit) Regulations 1991* (SI 1991/167) allow for the transfer of member's accrued rights without their

consent in certain circumstances. For example, this can occur where both schemes relate to employment with the same employer. However, the actuary for the transferring scheme must follow the guidance note issued by the Faculty and Institute of Actuaries, GN16.

12.29 GN 16 does not require the actuary to give an opinion on the reasonableness of a bulk transfer value, nor to consider the future benefits. Neither does the receiving scheme have to mirror the benefits of the receiving scheme. But the actuary, amongst other things, has to be satisfied that, whilst the new scheme does not have to mirror the existing scheme, no member, beneficiary or even contingent beneficiary is to be given materially inferior benefits.

12.30 It should be noted that transfers cannot be made without consent from contracted-out money purchase (COMP) schemes, or from an occupational pension to a personal pension. Also transfers from a defined benefit to a defined contribution scheme, or vice versa, represent such a major change that a GN 16 certificate is unlikely to be given.

Bulk transfers with consent

12.31 With consensual transfers individuals can of course remain in their existing scheme. The existing scheme may therefore need to continue and the scheme will be unable to be wound up until the remaining liabilities are moved elsewhere.

Transferring into the PCSPS (from a by-analogy arrangement)

12.32 Unless employment is regarded as being in the "civil service" of the State, it generally requires legislation to admit a by-analogy scheme into the Principal Civil Service Pension Scheme (PCSPS). There are two methods of admitting bodies to schedule 1 of the Superannuation Act 1972, which lists the non-civil service employers allowed to participate in the PCSPS.

Primary legislation

12.33 Firstly, primary legislation can be used to add a body to schedule 1 of the 1972 Act. There is no restriction on the type of organisation or its financing arrangements, other than that the body must clearly be part of the public service. Private sector bodies cannot be admitted.

12.34 NDPBs are usually added to the PCSPS under the legislation setting up the body. Before instructions are given to Parliamentary Counsel to draft a Bill, departments should contact Civil Service Pensions (CSP) division of the Cabinet Office and the Public Service Pensions (PSP) team of the Treasury to discuss the acceptability of a new organisation for PCSPS membership.

Secondary legislation

12.35 Alternatively, secondary legislation also allows a body to be added to schedule 1 of the Superannuation Act 1972, but the requirements for entry via this method are more stringent. Departments should contact CSP division of the Cabinet Office for up to date information on what is required.

Civil Service Pensions
Cabinet Office
8th floor Grosvenor House
Basing View
BASINGSTOKE
Hampshire RG21 4HG

12.36 The Superannuation Act 1972 requires that organisations joining via this route must be financed out of money Voted by Parliament, or funded out of the Consolidated Fund or other fund established under an Act of Parliament. (N.B. Organisations that receive money out of National Lottery funds are therefore included).

12.37 With admission by Order, the Civil Service Pensions division of the Cabinet Office will arrange for the drafting of the statutory instrument which adds the NDPB to schedule 1 of the Superannuation Act 1972. CSP and their legal advisors will check that organisations are eligible for admission. Once the Minister for the Civil Service has granted approval the order will be laid before the House.

Financial considerations

12.38 When a body becomes a PCSPS employer it will have to pay Accruing Superannuation Liability Charges (ASLCs). These employer contributions vary according to the pensionable earnings of the staff of the body.

12.39 New bodies admitted to the PCSPS, whether the NDPB is a new creation or an existing one transferring in, need to budget on the basis of the ASLC regime. The current scale of ASLCs (wef 1 April 2004) is set out below.

Salary Band	ASLC wef 1/4/2004
Up to £ 17,500	12 %
£ 17,501 – 36,000	13.5 %
£ 36,001 – 62,000	16.5 %
£ 62,001 and over	18.5 %
Pre-Fresh Start Prison Officers	20.5 %

12.40 Please note that ASLC rates will alter considerably, probably from April 2005 or 2006, due to a technical re-adjustment of the way in which they are calculated.

Bulk transfer payments

12.41 As the PCSPS is taking on the accrued liabilities of the members transferring to it, the Civil Superannuation Vote needs to receive a bulk transfer value to reflect its acceptance of those liabilities.

12.42 Where this is a movement between unfunded pension schemes (for example, a PCSPS by-analogy scheme and the PCSPS), it is simply transferring liabilities from one part of the public sector to another. It therefore has no impact on Total Managed Expenditure (TME).

12.43 Accordingly, the Treasury will provide for a non-scoring Annually Managed Expenditure (AME) grant to the body's sponsor department to facilitate the movement of the pensions liability. PES paper 1998(34) contains the full details.