PENSIONS NEWS LETTER

Autumn 2010

# Introduction

Welcome to the latest issue of the Pension News we hope that you find it useful and informative. This is your publication and we would be more than happy to cover any issues of specific interest to scheme members in future issues. If you would like us to cover a specific issue in future news letters please let us know and we will do our best to cover it.

## The Transfer of Previous Local Government Service In England and Wales – This is important!

Where a person has previous LGPS service with another local authority in England or Wales and wishes to transfer this to count for the purposes of their current local authority job they must elect to transfer such rights within **12 months** of starting the new employment. Transfer is never automatic and you must formerly request that the transfer takes place. This involves the following process:-

- You must complete a form requesting that we provide information about your transfer options and give details of your earlier service.
- We will request transfer information from your previous employer or pension fund and provide you with details of the options available.
- You must then request that the transfer goes ahead, if that is what you want.

Simply indicating on the new starter form that you are interested in transfer is not enough you must respond to the formal transfer offer confirming that you want it to go ahead.

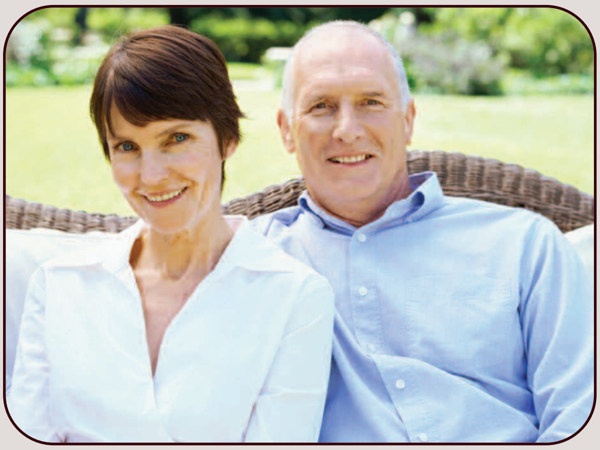
The 12 month time limit during which transfers must be affected has been missed by a number of employees, largely because they did not fill in the "new starter" form we sent them which allowed them to initiate the transfer process.

The scheme regulations have recently been temporarily relaxed and they allow any person who has missed the 12 month deadline one further **final** option to transfer earlier (English or Welsh) local authority service. An election under this rule **must be made before 1st October 2011**

If you are not sure of your own position please check the annual benefits statement sent to you earlier this year. That statement had details of the service we hold for you. If you are still in doubt contact the pension team.

This will be the final chance to resolve this issue. Failure to transfer service can be costly where say a person gets the opportunity to retire early because we will not include such service and the former employer is highly unlikely to meet the cost of paying the pension early which you have deferred with them.

Please note that this option only relates to previous pension rights retained in the LGPS in England and Wales. It does not relate to the Scottish LGPS as that is now a separate scheme and it does not extend to pension rights held in another scheme in the public or private sector.



# Lump Sum Death Benefits and Nominations

Where a scheme member dies in service a lump sum of 3 times annual pensionable pay is due. For example a scheme member has pensionable earnings of £40,000 in this case a lump sum of £120,000 would be due on death in service. Where earnings are reduced because of sickness absence the lump sum would be based upon the pay the person would have earned if they had been working normally (i.e. the reduction to pay is ignored).

For pensioners (who left after 31st March 2008) the scheme now contains a 10 years pension guarantee. Where a pensioner dies a lump sum is due of 10 times their pension **less** the total amount of pension paid to them up to the date of death. Therefore once a pension has been in payment for 10 years or more no lump sum would be due.

The LGPS allows a member to nominate who they would wish to receive any lump sum due in the event of their death. If you have not made a lump sum nomination, please consider doing so. If you have made a nomination please consider whether or not it still reflects your wishes. On more than one occasion we have had to deal with a situation where, in the past, a person had nominated their spouse to receive the lump sum due but had divorced them by the time they died.

It is particularly important to consider this if you are not married and live with a partner. Common law spouses, as they are often referred to, have very few rights regarding inheritance.  If you have a partner and you wish them to benefit from any lump sum due on your death please consider making a lump sum nomination.

If you are married you can still make a nomination in favour of your spouse. It is also possible to nominate children, although if the child is a minor you should give some consideration as to how you would wish the money to be managed.

## Survivor Pensions

When a scheme member dies, in service, on pension, or whilst entitled to a deferred pension a survivor pension can be paid to:

- their spouse, including a civil registered same sex partner,
- an unmarried partner, who has been nominated to receive a pension upon the death of the scheme member, who meets the qualifying conditions,
- a dependant child of the deceased, who is aged less than 18 or who has not attained age 23 and has remained continuously in full-time education.

With regard to unmarried partners, a formal nomination in favour of the partner must be in place, if it is not then **in no circumstances** will a pension be awarded to your unmarried partner. Please don't get confused with the provision which allows a member to nominate a person to receive any lump sum due on their death. These are two entirely different things. If you live with an unmarried partner and you want them to receive a pension on your death you must make a partners pension nomination in their favour. If you also want them to receive any lump sum due on your death you must complete an additional lump sum nomination i.e. you will need to make **two separate nominations.**

## Civil Registered Partners – Improved Survivor Pensions

When the law changed to allow same sex couples to enter into civil registered partnerships the terms of the LGPS were amended to provide an automatic survivor pension to be paid to the surviving partner, in much the same way as to a widow or widower (i.e.  no nomination is needed).

However, survivor pensions for civil registered partners were only provided in respect of service in the scheme which had accrued from April 1988. Pensionable service prior to this date did not count in the assessment of the survivor pension. This situation has now been changed and all pensionable service is included in the assessment of a survivor pension in the case of same sex civil registered partners.

## Unmarried Nominated Partner Pensions

As outlined earlier, the scheme allows a scheme member to nominate an **unmarried** partner to qualify for a survivor pension in the event of their death provided, for a period of 2 or more years:-

- They have lived together as if they were husband and wife (or as civil registered partners in the case of a same sex couple).
- They have been free to marry each other (or become civil registered partners in the case of a same sex couple).
- The partner has been financially dependant upon the scheme member or they are inter-dependant upon each other.

If a nomination is **not** in place **we cannot pay a pension.** There can be no exceptions to this. It is therefore your responsibility to make sure that you put a nomination in place. Partner Pension Nomination forms are available from the Pension Section (see contact details on the back page).

## An option to improve the pension due to a nominated partner

Where a scheme member dies and their nominated unmarried partner qualifies for a pension, such a pension is only based upon pensionable service from April 1988. It is however now possible to pay additional scheme contributions to purchase additional unmarried partner's survivor pension for service **prior to April 1988.** If you have nominated your unmarried partner to receive a pension in the event of your death **and** have service prior to April 1988 which you wish to consider "upgrading" for survivor pension purposes please contact the pension section (see contact details on the back page) and they will provide you with details of the costs and additional partners pension available.

**Please note that this only applies to people who have a <u>nominated unmarried partner</u>. If you are married or have entered into a civil registered same sex partnership your spouse/partner is automatically entitled to a pension on your death.**

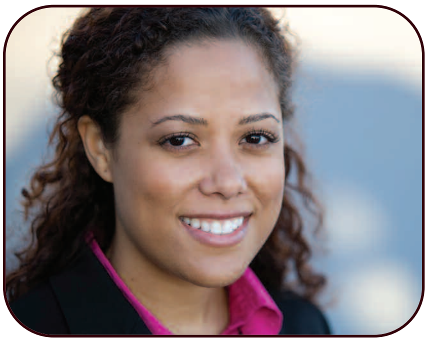
## Earliest Retirement Age

We reported in earlier news letters that with effect from the 1st April 2010 the earliest age from which early retirement could be granted (other than early retirement on the grounds of permanent ill-health) would increase from age 50 to 55. Therefore from 1st April 2010 an employee had to be aged 55 or over before the employer could grant early retirement on grounds of:-

- Redundancy.
- Efficiency of the service.
- At the employees request (previously referred to as the rule of 85).
- Flexible Retirement

In all cases early retirement before age 60 can only be taken with the consent of the employer.

There seem to have been some confusion with regard to what this change actually means e.g. we have had people volunteering for redundancy at the age of say 53 who assumed that they would have a right to the payment of their pension at age 55. **This is not the case.** Where a person is aged less than 55 on the date their employment terminates on redundancy grounds, they would qualify for a deferred pension which would be payable at retirement age. The earliest age at which the person could access their pension as a right is age 60 and even then the pension and lump sum may be subject to an actuarial reduction because it is being taken before age 65. Therefore in some cases the person may not be able to access their full accrued pension benefits until age 65 (i.e. if they take their pension at 60 it would be reduced).



It is still possible to qualify for ill-health retirement before age 55. This however requires the Council's medical advisor to confirm that the person is permanently incapable of doing their local authority job and has a reduced likelihood of obtaining any gainful employment.

# Changes to the Tax Relief Arrangements which apply to Pension Schemes

Until April 2006 the tax regime capped scheme member contributions to a pension fund at a maximum of 15% of pay and limited the maximum pension at age 60 to one based upon no more than 40 years service.

From April 2006 the tax regimes changed and both the maximum limit on contributions of 15% and the maximum pension based on 40 years were replaced by limits stipulating the maximum amount by which a person's pension fund could grow in any one year (the annual allowance - £255,000 for 2010/11) and the total amount a person could have invested in a pension fund or funds at retirement (the lifetime allowance - £1,800,000 for 2010/11). Where these limits were breached a penal rate of tax was applied to the excess. Clearly within the LGPS few people ever breached these limits.

However in a scheme like the LGPS which operates on a final salary basis we do not allocate a fund value to individuals, either annually or at retirement. Therefore for a scheme like ours these limits were imposed by applying multipliers to a person's pension. For example a person who qualifies for a pension of £40,000 a year and a lump sum of £100,000 would be deemed to have a pension fund at retirement of:-

**£40,000 x 20 (lifetime allowance multiplier) = £800,000 + £100,000 lump sum = £900,000. As this is less than £1.8M no additional tax would be due**

Changes will however be made to these limits. From April 2012 the lifetime allowance will reduce from £1.8M to £1.5M.The annual allowance will reduce from £255,000 a year to £50,000 from April 2011. The reduction to the annual allowance is likely to be the most problematic and the following example illustrates how this will work. To keep the example simple it assumes that all the person's service counts at a 1/60th rate for pension.

If we take a member who is earning £60,000 and has 34 years of scheme membership. In the 35th year of service his pay increases to £72,000. His tax position is as follows:-

**Opening position = Earnings £60,000 ÷ 60 x 34 years = £34,000 accrued pension.**

If this pension had been in payment it would have increased in year 35 by 2.5% (based upon assumed CPI Inflation) the notional pension would therefore have increased to £34,000 x 1.025 = £34,850 a year revised pension.

His actual accrued pension at the end of year 35 is as follows:

**Closing position = £ 72,000 pay ÷ 60 x 35 years = £42,000 accrued pension.**

The increase in pension therefore is:-

**£42,000 - £34,850 = £7,150 increase in annual accrued pension.**

The value placed on this increase for the purposes of the annual allowance is the increase in pension multiplied by 16 (a flat rate multiplier of 16 is always used for the purposes of the annual allowance). Therefore in year 35 his pension fund is taken to have increased by:-

**£7,150 x 16 = £114,400. This exceeds the annual allowance of £50,000 by £114,400 - £50,000 = £64,400 excess.**

This person can however carry forward any unused annual allowances for the 3 previous tax years. Let us assume that the person's pension fund had increased by £30,000 in each of those 3 years and therefore he can carry forward the £20,000 unused annual allowance for each of those years - £60,000 unused allowances in total. This person would therefore be facing the following tax bill:-

**Excess £64,400 - £60,000 unused allowance = £4,400 taxable x 40% = £1,760 additional tax due.**

People paying AVC's will also need to give greater thought to the revised annual allowance from April 2011. A person can pay up to 50% of their pay into the in-house AVC scheme, however the contributions paid in a year would be added to the value of the increase in the fund due to an increase in salary and service.



*continued overleaf*

In the above example the person's pension fund was deemed to have increased by £7,150 x 16 = £114,400 in a year. If they had also paid £25,000 in AVC's the fund would have increased by £114,400 + £25,000 AVC's = £139,400 less £50,000 annual allowance = £89,400 less £60,000 unused allowances for earlier years = £29,400 taxable x 40% = £11,760 tax due.

It is our understanding that individuals will need to calculate and pay any tax due via the self assessment tax system. Pension administrators will be required annually to provide information where the annual allowance is clearly breached or where the person requests it.

The reduction in the annual allowance could clearly cause problems where a person is promoted either internally or on changing employer and receives an increase in salary.

One further change which could impact upon LGPS members is, at present changes which occur in the last year of service are not taken into account when determining any tax liability in relation to the annual allowance e.g. if a persons accrued pension increases because they have been given added years as part of an ill-health pension package the value of those added years would not be taken into account to determine if a person had breached the annual allowance limit. Under the proposed changes to the annual allowance rules benefits awarded in the last year may be assessable so the award of added years in an ill-health or any other case could result in a tax charge.

## Changes To The Way LGPS Pensions Are "Index-linked"

As you may be aware from the budget, the Government announced a change in the way in which public service pensions are increased. Currently both pensions in payment and deferred pensions are subject to an annual increase. Until the budget, that increase was based upon increases in the Retail Prices Index (RPI).

In the budget the Government announced that the measure used to determine increases in public service pensions and certain State benefits would change from RPI to the Consumer Prices Index (CPI).

Commentators on this change have remarked that the CPI measure of inflation is usually lower than RPI by about 0.5%, although this does vary from year to year and at times CPI runs ahead of RPI. Commentators have remarked that the exclusion of mortgage interest and certain housing costs from the CPI measure is one reason why it is often lower than RPI. This is indeed one reason, although there are others, principally the way in which the CPI measure is calculated.

Again at this stage full details of the change are not available and we will be issuing further information on this topic in due course.

# The Hutton Commission Report Into Public Service Pensions

There has been much in the media concerning the publication of Lord Hutton's report on the future of public service pensions. He has published his interim findings. The report looks at the pension schemes which apply across the whole of the public service i.e. Civil Service, NHS, Teaching, Police, Fire, Local Government, the Armed Forces as well as some of the smaller schemes e.g. those which apply in atomic energy sector.

This interim report looks at issues across all of these schemes and suggests a number of ways in which these pension arrangements could be reformed. The terms and benefits of these schemes are however very often quite different and the local government scheme is markedly different from the majority of the other public service schemes in that it is funded i.e. it is backed by actual invested assets. The report does not prescribe how changes should be applied to individual schemes, rather it looks at a range of issues which are common to most schemes and presents a number of options for reform. At this stage therefore it is not possible to say what changes are likely to be made to the LGPS.

The report looks at a range of short-term options for reform and a range of more fundamental changes in the longer-term. Of the short-term options it would seem at this stage that the most likely outcome could be an increase in the employee contributions. The report does however stress that even here care would need to be exercised e.g. they are concerned that lower paid employees could opt out of these schemes if faced with higher contribution costs. If this happened and these persons then retired with no occupational pension or a much reduced pension they could then fall back on means tested State Benefits which could have the opposite of the desired effect on public expenditure and cause it to increase.

Of the longer-term options the report suggests a number of ways in which the calculation of pensions paid by these scheme could be changed. The report seems to suggest that the current final salary structures of these schemes are unlikely to be sustainable in their present form and retirement ages may need to be later. The report does however state that for the most part they are not in favour of defined contribution plans as a replacement for these schemes, as has largely been the case in the private sector. The report suggests possible alternatives to the current final salary structures as:

- A pension based upon a person's career average earnings i.e. the pension is based upon an average of what the person has earned over their working life with earlier years earnings being revalued to reflect inflation.
- A scheme in which the maximum amount of final salary is capped i.e. pay beyond a certain level would not count in the calculation of a person's pension.
- A hybrid scheme where part of the pension is based upon a capped final salary with a top up pension for those earning above the cap being based on defined contributions (defined contributions works on the basis that money is invested and the final pension is determined by how well or badly those investments perform rather than the person's level of pay).

It is perhaps worth stating that the report clarifies that pensions already accrued would be protected and any changes would only impact upon future service.

This is an initial view of what is a complex 176 page document. As more detail becomes available on this topic we will provide further information. At this stage however it looks like we will need to await the final report of the Commission before we will know what the likely implications are for the LGPS.

## Contacting The Pensions Team

The Pensions Team are there to help you with any matter relating to your pension entitlement. You can contact them by phone, letter and online. Contact details are as follows: -

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County Hall, Morpeth, Northumberland. NE61 2EF

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