

Local Government Pensions Committee
Secretary, Jeff Houston

LGPC Bulletin 140 – February 2016

The ending of contracting out and the new State Pension

This bulletin contains information about the introduction of the new 'single tier' State Pension from 6 April 2016 and the ending of contracting out.

Background

On 18 March 2013 the government announced that the single-tier pension would be introduced on 6 April 2016 and would affect people who reach State Pension age from that date. Individuals reaching State Pension age before the introduction date will receive their State Pension based on the rules in existence before 6 April 2016.

The Government's aim is to introduce a simpler, fairer system where people have a clearer idea about what the state will provide, making it easier to plan their retirement savings.

Integral to the single-tier reforms is the closure of the State Second Pension and, by extension, contracting out of the State Second Pension – the ability to give up State additional pension entitlement in return for the provision of at least a broadly similar occupational pension.

The ending of contracting out has implications for employers, employees and pension schemes. The main implications are:

- increased National Insurance contributions for employees and employers¹ due to the loss of the National Insurance rebate
- the reconciliation of contracted-out records against data held by HMRC, and
- potentially, additional Pensions Increase costs.

This bulletin looks at the implications for each of these groups in more detail and sets out what actions should be taken by employers and pension fund administering authorities. It draws together guidance that has been already been provided by the Department for Work and Pensions (DWP), HM Treasury (HMT), the LGPC secretariat and other sources to assist administering authorities and employers in communicating and incorporating the changes.

¹ Other than where the employee is paying the married woman's or widow's reduced rate of NI or the employee is at or over State Pension Age.

Implications for the employer

Matters for employers to consider:

- 1. Cost implications** - whilst the Pensions Act 2014 permits occupational pension schemes in the private sector to offset the increases in National Insurance contributions by amending the rules of the pension scheme, the same legislation specifically prevents public sector pension schemes from doing so. As a consequence LGPS employers will bear the full cost of the loss of the 3.4% National Insurance rebate between the Lower Earnings Limit (LEL) and the Upper Accruals Point (UAP).

Employers should already have assessed the impact of the increased employer National Insurance contributions and factored the increased costs into their budgets from 2016/17 onwards.

The LGPC issued an employer Q&A in July 2015 about the ending of the National Insurance rebate. This has recently been updated and can be found on the [Communications Resources](#) page of www.lgpsregs.org

- 2. Communicating with employees** – public sector employers should be aware that most employees will also be affected by the changes to National Insurance.

DWP have produced a number of materials to assist employers communicate the changes to National Insurance and the new State Pension to their employees. In December 2015 we understood that DWP had issued a letter (see [appendix 1](#)) to all public service employers, via Directors of Finance, informing them of these products and of the increase to National Insurance. However, it has since come to light that the letter may not have reached all of its intended audience.

The letter confirmed that whilst there is a regulatory requirement for scheme administrators to inform their members that they will no longer be paying into a contracted out pension scheme, there is no requirement for the scheme to go any further i.e. to inform members about the changes to their National Insurance contributions. Although this communications responsibility rests with pension scheme administrators (see item 1 on page 4 of this bulletin) there is a role for employers and DWP recommend that public sector employers co-ordinate their communications with pension scheme administrators in order to provide a joined up message about the ending of contracting out and the loss of the National Insurance rebate.

The communication materials referred to in the letter include emails, articles, posters, videos and images – which employers are free to use in whichever way suits them. These products are available as part of the new [State Pension toolkit](#) Also included was a factsheet specifically for public sector employees (see [appendix 2](#)).

DWP have asked that LGPS administering authorities assist them in reaching all LGPS employers, particularly smaller employers. They would, therefore, be

grateful if you would forward their letter ([appendix 1](#)) and factsheet ([appendix 2](#)) onto all your employers.

3. Implications for payroll – in [bulletin 138](#) (December 2015) we asked you to pass the message below onto employers:

The introduction of the new State Pension will bring with it some changes in what and how you report to HMRC:

- from 6 April 2016: you will not be able to use your Contracted-out Salary Related (COSR) occupational pension scheme to contract employees out of the new State Pension scheme
- there will no longer be a requirement to report the Employers Contracting-out Number (ECON) and Scheme Contracted-out Number (SCON) details on Full Payment Submission (FPS) for tax years commencing 6 April 2016 and onwards
- there will no longer be a requirement to separate the National Insurance (NI) earnings between the Primary Threshold (PT) and Upper Accrual Point (UAP) & UAP to Upper Earnings Limit (UEL)
- there will be a requirement to report NI earnings between the PT to UEL as there was prior to 2009
- there will be one less column to complete on forms P11 and P60. These forms will be updated in due course and will be available on the Basic PAYE Tools or can be ordered from the Employer order line.

All HMRC systems will be amended to reflect these changes and the UAP data field will be removed from the FPS and Earlier Year Update (EYU).

National Insurance Categories from 6 April 2016

Contracted-out National Insurance tables/categories D, E, I, K, L, N, O and V will be replaced by Standard National Insurance tables/categories A, B, J, M, P, Q, R, T, Y and Z (and C or W for those employees over State Pension Age).

National Insurance Categories from April 2015 for employees under age 21

Contracted-out National Insurance categories I, K and V will operate for the 2015-16 tax year **only** for individuals who are aged under 21 and are in contracted-out employment.”

Implications for pension fund administering authorities

- 1. Communication with members** - there is a regulatory requirement (under Schedule 2 Para 12 of the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 [SI 2013/2734]) for pension schemes to inform active members that they will no longer be participating in a contracted out pension scheme from 6 April 2016. The method of notification has to comply with Part 9 of those Regulations (see [appendix 6](#)).

In order to assist administering authorities with this communication the LGPC has produced a sample letter (see [appendix 3](#)) that administering authorities may wish to use, or adapt for their own use. Whilst there is no obligation for schemes to provide any further information e.g. that member's will no longer receive the NI rebate this information was included in the sample letter in order to provide a meaningful communication.

The sample letter links to the member 'new State Pension Q&A' document produced by the LGPC in August 2015 and subsequently updated in February 2016. The Q&A can be found in the [employees' guides section](#) of www.lgpsregs.org. The questions answered in the document are:

1. Why is the State Pension changing?
2. Who will receive the new State Pension?
3. Why will I have to pay more in National Insurance contributions?
4. How much more in National Insurance contributions will I have to pay?
5. Will the benefits provided by the LGPS change because of this?
6. I cannot afford to pay the extra National Insurance contributions. What can I do?
7. Will I qualify for the full amount of the new State Pension?
8. Will the new State Pension provide sufficient income in retirement?
9. Where do I find out more information?

The LGPC secretariat are of the opinion that, in accordance with regulation 8(5) (a) of the Disclosure 2013 regulations, administering authorities are only required to inform active members about the ending of contracting out at the present time.

Regulation 8(5)(a) states that no information has to be provided to "relevant persons, except a recognised trade union, unless it is relevant to the person's rights or prospective rights under the scheme". In our opinion the cessation of contracting-out is not relevant to those who, at 6 April 2016, are deferred or pensioner members as it does not affect their "rights or prospective rights under the Scheme". All their rights under the Scheme in relation to GMPs and s9(2B) rights accrued up to 5th April 2016 continue to apply post that date.

The changes may, however, affect pension increases that are due to be applied to deferred and pensioner members after they attain GMP age (if they attain SPA after 5 April 2016 and have a GMP). It would, therefore, be advisable for administering authorities to inform deferred and pensioner members about the

ending of contracting out when a decision regarding how pensions increases will be applied to GMPs has been made (see the penultimate article in this Bulletin).

Where you make reference to the LGPS being contracted-out in communication materials provided to members and other stakeholders (e.g. letters, guides, factsheets, websites etc.) you will need to amend these communications accordingly. For example amend 'contracted-out schemes' to schemes that were contracted out'

- 2. The reconciliation of GMP records against data held by HMRC and administration changes** – as administering authorities will be aware the option to contract-out of the additional State Pension will come to an end in 2016 when the new single tier State Pension is introduced. Protections for scheme members' existing contracted out rights will be maintained, but HMRC's support services will be scaled down and eventually withdrawn.

This means that HMRC will no longer track contracted out rights and will issue closure schedules to schemes so that they can compare these against the contracted-out date and GMP amounts held on scheme records. This is known as contracted-out reconciliation.

Following this, from December 2018 HMRC is planning to send individuals information about their contracted-out history and potentially their GMP amount (reconciled or not).

Therefore it is important that administering authorities reconcile their data against the data held by HMRC. HMRC provides the Scheme Reconciliation Service (SRS) which is a support service designed to help administrators with the reconciliation process. The timescales for GMP reconciliation are set out below:

- **By 5 April 2016** – funds should sign up to the SRS by this date. It is strongly recommended that funds sign up before this date as they will not be able to sign up thereafter unless by special concession of HMRC. Sign up by 5 April 2016 is required so that HMRC can plan their resources to support the UK reconciliation project. In addition, where funds do not sign up for the SRS they may not be able to obtain their data to perform the reconciliation exercise. .
- **From 5 April 2016**
 - HMRC will no longer track individual's contracted out pension rights. It will be the Scheme's responsibility to keep track of GMP liabilities. Funds will need to consider how they are going to change their procedures to obtain the current value of a member's GMP upon payment (or transfer out). This could be achieved by funds either: -
 - following reconciliation, annually increasing the GMP they hold, using section 148 orders within their own pensions administration system, or

- using the GMP micro service to obtain the current value of the GMP at the relevant date (see bullet point below for further information).
- There will be no requirement for schemes to submit termination/transfer notices (except where the cessation of contracted-out employment occurred prior to 6 April 2016).
- HMRC will no longer provide schemes with statements of liability when members leave service, transfer, reach SPA or die (other than AP <= GMP statements for those attaining SPA prior to 6 April 2016).
- Schemes can obtain GMP data via the GMP micro service - the service is intended to be self-serve so that schemes can input data for either individuals or multiple scheme members and obtain the GMP figure revalued up to the relevant date. If funds intend to use the GMP micro service they will need to ensure that they have procedures in place to record the SCON numbers of any GMPs transferred into their fund (including those from other LGPS funds). This is because, in order to obtain the value of a GMP from the GMP micro service, HMRC require the SCON number of the former scheme(s) from which the individual transferred. Even, if funds are intending to revalue GMPs using their own in-house pensions administration system we believe it would be prudent to retain the SCON number of the former scheme(s) from which the individual transferred in case this may be needed for some reason in the future.
- **January 2017** – data for active members will start to be issued to schemes
- **December 2018** – HMRC support for reconciliation queries ends and individuals will be sent information about their contracting out history.

Please note, it will still be possible to pay a CEP for active members at 5 April 2016 who subsequently leave the scheme without a right to a deferred benefit. [Countdown Bulletin 9](#) indicates that HMRC are expecting to accept CEPs where the period of employment in the scheme, including any transfers, started before 6 April 2016 and ended before 6 April 2019, as long as the total period of membership is less than 2 years.

Administering authorities are advised to commence the process of reconciliation as soon as possible. HMRC's resources are likely be under intense pressure towards the end of 2018 meaning it is vital that you allow adequate time for the necessary reconciliation work to be undertaken.

Is there a legal obligation to reconcile?

Not as such, but administering authorities may consider they are duty bound to do so for the following reasons:

- The fourth data principle under the Data Protection Act requires that ‘Personal data shall be accurate and, where necessary, kept up to date’
- 249B of Pensions Act 2004 - requirement for internal controls: public service pension schemes
 - (1) The scheme manager of a public service pension scheme must establish and operate internal controls which are adequate for the purpose of securing that the scheme is administered and managed-
 - (a) in accordance with the scheme rules, and
 - (b) in accordance with the requirements of the law.
- The Pensions Regulator Code of Practice no.14 states:
 - complete, accurate and up-to-date records are key to effective administration
 - scheme managers must establish and operate controls which are adequate for ensuring the scheme is administered and managed in line with the scheme rules
- There is an obligation to only pay the pension that is correctly due.

Why reconcile?

In [bulletin 131](#) (June 2015) we circulated a call to action from the Pensions Administration Standards Association (PASA).

The call to action also set out the reasons why schemes (or, in the cases of the LGPS, administering authorities) should reconcile their membership and GMP data with HMRC. These are set out below:

1. Trustees have a duty to pay the right benefits at the right time. Accurate records are a fundamental requirement for fulfilling this duty.
2. The Pensions Regulator regards good record keeping as a fundamental part of good scheme governance, falling within the statutory duty to establish and operate adequate internal controls.
3. Trustees are required, as data controllers, to ensure that scheme data is accurate and up to date.
4. Inaccuracies in scheme data (for example, GMP amounts, revaluation rates or service history information) could lead to over or understatement of scheme liabilities, with implications for scheme funding decisions, and could result in incorrect benefits/increases being paid, or even having to pay benefits to people who have never been members of your scheme.
5. Reconciliation can't be put off until the scheme is undertaking GMP equalisation or conversion. It is a necessary precursor to those processes and the opportunity to use SRS is limited.
6. HMRC plans to start sending out individual member statements in December 2018 to members of previously contracted out schemes. These statements will, as a minimum, confirm HMRC's position on where members' contracted out rights are held. If the information is inconsistent with scheme data, schemes risk receiving a significant level of time-consuming member queries at a stage when HMRC's services in this area have been significantly reduced. This may result in reputational risk and complaints having to be

managed through the Internal Disputes Resolution Procedure (IDRP) and, ultimately, via the Pensions Ombudsman.

7. HMRC may record GMP liabilities in respect of members who have already transferred out their benefits, either individually or as part of an historic bulk transfer. Each feedback from HMRC is that its records of scheme membership numbers for a particular scheme may be up to 30% higher than those actually retained by the scheme. Schemes which fail to reconcile data may receive unnecessary queries from former members, and may risk gaining additional liabilities.
8. In the event that no reconciliation is undertaken via SRS, it appears that HMRC's default position will be that data held on its records should be deemed to be correct, particularly, as there will be little or no ability to raise queries with HMRC after 2018. This could increase scheme liabilities due to differences in GMP amounts and membership, potentially affecting funding requirements.
9. Reconciliation will be a time consuming process. Taking action sooner rather than later will help schemes avoid a potential capacity crunch as administrators and HMRC struggle to meet the December deadline.

The next steps

If you haven't already done so you should:

- Register with SRS by 5 April 2016
- Review the data received to make an initial assessment of the work required and decide whether or not you will need to engage an external party to interrogate your system and produce meaningful extracts upon which you can base the following decisions.
- Consider your approach to reconciling data. Do you have capacity to do it in-house or you will you need to engage external administrators to help with the task? Will you reconcile all data? Will you apply a tolerance level? Will you update your records following reconciliation?
- Consider the costs of the whole reconciliation exercise and gain support/additional resources where possible

Reconciliation approach

On 4 February 2016 LGPC secretariat forwarded a letter from HMT (see [appendix 4](#)) outlining the recommended approach to the contracted out reconciliation exercise. This letter was superseded by a revised letter which was issued on 10 February 2016 containing a couple of adjustments to part (i).

The LGPC Secretariat believe the following might be of assistance in clarifying the intention behind some points in the HM Treasury letter.

- i) the following data should be reconciled:

- data for active, deferred² and pensioner members whose records include any contracted-out service between 6th April 1978 and 5th April 1997
 - data for non-members i.e. those who the administering authority believes have never been members of the Scheme
 - data for members who had been members of the Scheme but for whom the administering authority believes it has already discharged its liability i.e. via a transfer out, payment of a CEP or trivial commutation
- ii) data for deceased members should not be reconciled where there is no surviving dependant. The Secretariat has clarified that this means reconciliation is not required if there is no surviving widow, widower or surviving civil partner to whom a pension is being paid at the point of reconciliation. Reconciliation is not required where a pension is being paid to a surviving cohabiting partner or eligible child (if there is no pension being paid to a surviving widow, widower or surviving civil partner). This means that no historic over/underpayment of pension in respect of the deceased member (or of the deceased widow, widower or civil partner) would have to be dealt with via the deceased person's estate. Equally, any over/underpayment of a 5 or 10 year pension guarantee would not have to be dealt with.
- iii) where a person who is within the scope of the reconciliation exercise has been underpaid, the person should be paid the correct level of pension going forward together with the arrears of pension due (with interest in accordance with the Scheme rules).
- iv) the question of how to deal with any overpayments will be discussed at the Technical Group meeting in March and an update will then be provided to administering authorities.

Please note, in particular, the last two sentences of the letter which state:

These guidelines have been agreed across departments via the working group and at MOCOP and I'd welcome your support to this approach to the exercise. Nevertheless, should the LGPS choose not to adopt them, I would be grateful if you could please set out to me the reasons behind this decision and continue to work closely with us to ensure any learning or alternative approaches which may be beneficial to all schemes is effectively shared.

If, after considering the recommendations, your administering authority chooses not to follow one or more of them, please advise the LGPC Secretariat to that effect, confirming:

- the recommendation(s) which will not be followed
- what alternative approach is being taken, and
- the reasons for taking the alternative approach.

Please send all responses to Jayne.wiberg@local.gov.uk

² Deferred member means deferred from an HMRC perspective i.e. members who have not yet attained State Pension Age and are not drawing their State pension (even if they are already drawing a pension from the Local Government Pension Scheme).

Other sources of guidance

Countdown Bulletins

The National Insurance Services to Pensions Industry (NISPI) countdown bulletins provide additional guidance for pension scheme administrators on the ending of contracting out in April 2016. These can be viewed using the link below:

<https://www.gov.uk/government/collections/national-insurance-services-to-pensions-industry-countdown-bulletins>

Contracted Out Pension Equivalent

DWP have introduced a new term intended to assist in the communication of the changes to the state pension for members who at some point will have been contracted-out of additional state benefits. The COPE amount is now being included on State Pension statements and the Q&A document attached (see [appendix 5](#)) has been prepared to help pension scheme administrators explain the COPE amount should they receive queries from members.

Pensions Increases on GMP from April 2016

For those who attain SPA prior to 6 April 2016 the position will remain the same as now i.e. no increase on pre 88 GMP and up to 3% on post 88 GMP (unless $AP < GMP$). HMRC have stated that they will continue to issue $AP < GMP$ notifications (where appropriate) for these cases.

For those who attain SPA after 5 April 2016 - no formal decision has yet been taken. A decision is expected to be made by the end of February 2016 and the Ministerial Direction will be amended accordingly.

Whilst we expect the 2016 Pension Increase Order to be zero, there are a group of individuals for whom an early decision and publication of an updated Ministerial Direction is imperative as they can be immediately affected on or after April 2016 (where they are also in receipt of their public service pension). The group to which we refer are those females who will attain State Pension age on or after 6 April 2016 and prior to 10 April 2017. By default this group will have already reached and passed GMP age (60). This means that the scheme will be treating the person as $AP < GMP$ and will, therefore, be paying full pensions increases (PI) on their GMP. Upon immediately taking payment of their new State Pension, increases on their pre 88 GMP and those in excess of 3% on their Post 88 GMP would cease. In other words, the scheme would then treat the person as $AP \Rightarrow GMP$ and reduce the pension to the level that would have applied had the scheme not been paying PI on the pre-88 GMP and on any excess above 3% on the post-88 GMP. However, depending on what the Ministerial Direction contains, it could be that the scheme would have to continue to treat the person as an $AP < GMP$ case with the outcome that the scheme would, instead of reducing the amount of PI payable at SPA, continue to increase the pre-88 GMP by PI and the post-88 GMP by any excess

above 3%. Given that this could impact on a person attaining SPA from as early as 6 April 2016 an early decision and Ministerial Direction is urgently required.

By way of background information it might be helpful to understand that for those individuals who reached State Pension age prior to 6 April 2016, DWP would increase the gross Additional Pension (AP) by the percentage increase in prices (the percentage growth in prices in the UK as measured by the Consumer Prices Index (CPI)). A Contracted-out Deduction (CoD), which is not increased, is then deducted from the increased gross AP and any surplus amount is paid to the individual through their State Pension. In this way, individuals can see what is, in effect, an uprating of their GMP by way of the old State Pension. The new State Pension is paid to all individuals reaching State Pension age after 5 April 2016 without the supplementary AP less CoD. Accordingly, individuals can be affected from as early as the 6 April 2016 if they take payment of their State Pension on this date. How much individuals will be affected is dependent on the decision taken on how to apply pensions increase to public service pensions from April 2016.

Relevant Legislation

Legislation relevant to the cessation of contracting-out on 6 April 2016 is listed below:

Pensions Act 2014 – introduced the new single tier State Pension

The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations 2015 [SI 2015/118]

The Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2015 [SI 2015/1452] – but these regulations, except for regulation 28, and regulation 32 in so far as it revokes regulation 69B of the Occupational Pension Schemes (Contracting-out) Regulations 1996 [SI 1996/1172], were revoked by The Occupational Pension Schemes (Schemes that were Contracted-out) (No 2) Regulations 2015 [SI 2015/1677].

The Occupational Pension Schemes (Schemes that were Contracted-out) (No 2) Regulations 2015 [SI 2015/1677]

Useful Links

[LGA Pensions page](#)

[LGPS members' website](#)

[LGPS 2014 members' website](#)

[LGPS 2015 members' website](#)

[LGPS Advisory Board website](#)

[LGPS Regulations and Guidance website](#)

[LGPS Discretions](#) lists all the potential discretions available within the LGPS in England and Wales.

[LGPS Discretions](#) lists all the potential discretions available within the LGPS in Scotland.

[Recognised Overseas Pension Schemes](#) approved by HMRC and who agreed to have their details published.

[The Timeline Regulations](#) for Final Salary Scheme

[The Timeline Regulations](#) for Career Average in England and Wales

Pensions Section Contact Details

If you have a technical query, please email query.lgps@local.gov.uk and one of the team's LGPS pensions advisers will get back to you as soon as possible.

Jeff Houston (Head of Pensions)

Telephone: 0207 187 7346

Email: jeff.houston@local.gov.uk

Terry Edwards (Senior Pensions Adviser)

*(NB: Normal working days are Thursday and Friday. Works on pension projects and is **not** a contact for technical enquiries)*

Telephone: 01954 232 834

Email: terry.edwards@local.gov.uk

Tim Hazlewood (Pensions Training & Development Manager)

*(NB: Normal working days are Monday and Tuesday. Works on training events and conferences only and is **not** a contact for technical enquiries)*

Telephone: 01455 824 850

Email: tim.hazlewood@local.gov.uk

Jayne Wiberg (Pensions Adviser)

Telephone: 07979 715825

Email: jayne.wiberg@local.gov.uk

Lorraine Bennett (Pensions Adviser)

Telephone: 0207 187 7374

Email: lorraine.bennett@local.gov.uk

Con Hargrave (Pensions Adviser)

Telephone: 0207 664 3176
Email: cornelius.hargrave@local.gov.uk

Liam Robson (Pensions Analyst)

Telephone: 0207 664 3328
Email: liam.robson@local.gov.uk

Elaine English (LGPS Executive Officer)

Telephone: 0207 187 7344
Email: elaine.english@local.gov.uk

Alison Hazlewood (Part-time Administration Assistant - Training & Development)

Email: alison.hazlewood@local.gov.uk

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LGPC
Local Government Group
Local Government House
Smith Square
London, SW1P 3HZ

or email: [Lorraine Bennett](mailto:Lorraine.Bennett@lgpc.gov.uk)
tel: 020 7187 7374