

Need to know

Daniel Gerring and Nick White, Travers Smith, consider the implications for trustees of the end of contracting-out in April 2016

In the August 2014 issue of *Pensions World*, Peter Sayers of Xafinity Consulting wrote about the issues for employers with contracted-out defined benefit (DB) schemes to consider before contracting-out ends in April 2016. Here, we look at the same topic from the trustee perspective.

Changes to be made to the scheme?

Peter Sayers described the options open to employers to reduce future service benefits or increase member contribution rates, and the requirements for actuarial certification. Employers can make these changes without trustee consent using the new statutory power. Many will prefer to use the scheme amendment power, where possible, which will normally require trustee agreement.

In either case, trustees will want to know at an early stage what their scheme employer has in mind and to make their active members fully aware of how they will be affected and that their scheme is properly administered in light of the revised benefits.

Keeping members informed

The 2013 Disclosure of Information Regulations require trustees to keep active members informed of the scheme benefits and member contribution rates. If the employer will be reducing future service benefits or increasing member contribution rates, the trustees will need to ensure that members are informed. The employer will have its own obligations here, including an obligation to consult in advance about any changes. Therefore, (once the employer consultation is complete) joint communications between the employer and trustees are a good way to avoid bombarding members with overlapping information.

Another requirement of the disclosure regulations is to tell active members which employments are and are not contracted out. This does not apply where no employments are contracted out. When contracting-out ends, though, it seems that the requirement will fall away. However, note that the requirement is not expressly being repealed, as the draft legislation stands – so the position on this could be clearer. Thankfully, the point should be academic: both trustees and employers will want to ensure that members know that their employment will no longer be contracted out, and the consequences of that.



Statutory protections

This area is very technical and limitations of space mean that the following are very broad summaries. It is also based on draft legislation, which could change.

Restrictions on amendments (GMPs and post-1997 rights)

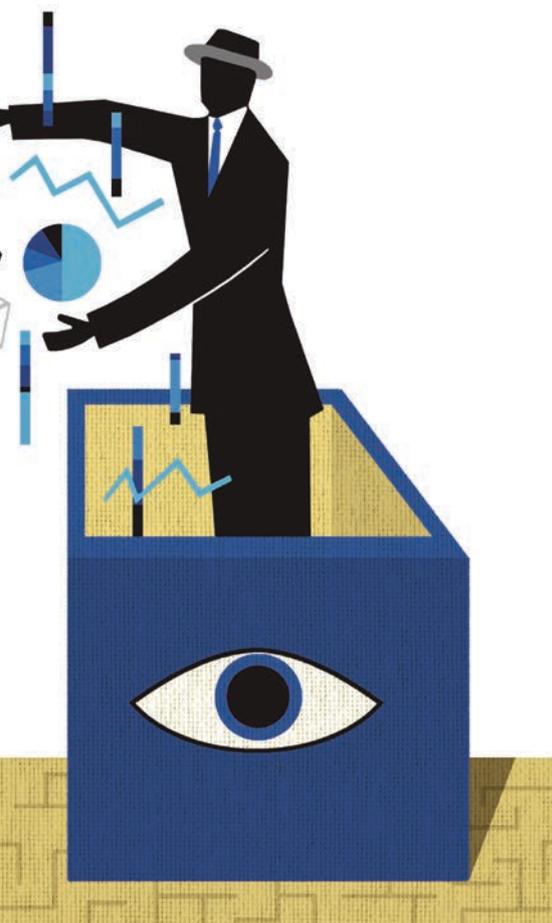
Section 37 of the Pension Schemes Act 1993 and underlying regulations impose restrictions on amending contracted-out rights. There are separate provisions for each of GMPs and post-1997 rights.

- **GMPs** – Unlike protected rights when DC contracting-out was abolished, GMPs are not being abolished and GMP rules continue to apply. So GMPs will have to continue to be preserved and increased pre- and post-retirement. At present, GMPs are revalued in line with national average earnings (NAE) increases while contracted-out employment continues; thereafter, schemes can choose between NAE and fixed rate (currently 4.75% a year) revaluation. When contracting-out is abolished, this will change so that GMPs must be revalued in line with NAE increases until pensionable service in the scheme ends; only thereafter will the choice of NAE and fixed rate revaluation apply.
- **Post-1997 rights** – Currently, when amending future service contracted-out benefits, s 37 of the Pension Schemes Act 1993 requires an actuary's written confirmation to the effect that the scheme will still satisfy the reference scheme test. There are separate provisions concerning the amendment of accrued post-1997 contracted-out rights, requiring the trustees to be satisfied that certain criteria are met.

When contracting-out is abolished, s37 will remain in force, but with the underlying regulations slightly amended. There will still be restrictions on amending any rules related to accrued benefits deriving from contracted-out service. Since, however, the scheme will no longer have any need to satisfy the reference scheme test for future accruals, there will be no restrictions on amending future service benefits.

Anti-franking (GMPs only)

This is most pension lawyers' least favourite topic. Schemes may not "frank" GMP revaluation increases against the benefit in excess of the GMP when the member leaves pensionable service (or its statutory revaluation additions). This rule currently applies



Checking scheme records

HM Revenue & Customs (HMRC) offers a reconciliation service, allowing schemes to check that their records of contracted-out service periods and guaranteed minimum pensions (GMPs) match HMRC's records. To use this service, trustees or administrators need to submit a request before April 2016, preferably sooner rather than later. HMRC will continue to respond to membership and GMP queries until December 2018. This reconciliation service is voluntary. Trustees do not have to make any notifications to HMRC in connection with the abolition of contracting-out.

Protections for accrued contracted-out rights

Various statutory protections apply to GMPs and/or post-1997 contracted-out rights. We consider below whether, and if so then how, they will apply

where there is an interval between the end of contracted-out employment (whether or not pensionable service ends) and the date the GMP is payable (age 60 for women and 65 for men).

When contracting-out is abolished, this will change so that the rule applies where there is an interval between pensionable service ending and the GMP payment date. In practice, this should not normally cause any difficulties, since scheme benefit designs ought to avoid franking GMPs in this way at any time.

The later earnings addition (GMPs only)

This protection currently applies if a member ceases to be in contracted-out service, but continues to accrue benefits in the same scheme. When the protection applies, it requires a complicated earnings-related addition to the member's benefits as if contracted-out employment had ended on the earlier of: (a) GMP payment age (60 for women and 65 for men); and (b) when the member's pensionable service ultimately ends.

When contracting-out ends, it appears that this protection will be amended so that it applies in more limited circumstances than at present. However, it seems questionable whether the amendment really was intended to make these circumstances as limited as they currently appear to be.

Protection rule (GMPs and post-1997 rights)

Very broadly, this protection requires schemes which cease to be contracted out to include a rule such that the total amount of all accrued benefits (not just the contracted-out rights) must be no less than if they had been calculated on an early leaver basis (ie with GMP increases and revaluation of the excess-over-GMP applied by way of an underpin).

It seems that this rule will be abolished in April 2016. If so, schemes will not need to introduce a protection rule when contracting-out ends. Schemes should, however, check carefully to see if they already have one in their trust deed and rules, in which case they may well have to apply the underpin described above.

The commentary on protections described in this section relates to schemes that cease to be contracted out as a result of DB contracting-out being abolished in April 2016. There remains some uncertainty regarding the protection that will apply, after the new legislation takes effect, to accrued contracted-out rights in schemes that ceased to be contracted out before that time.



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to schemes which will cease to be contracted out as a result of DB contracting-out being abolished in April 2016, particularly where the employer wishes to continue DB provision but with benefits reduced to reflect increased employer national insurance liabilities. Bear in mind that after 1997, contracted-out rights represent the whole DB benefit for that period of service (see **Box**).

GMP conversion

The continuing protections for GMPs can, in theory at least, be bypassed by using a mechanism under the Pensions Act 2007 to convert GMPs into standard scheme benefits. This mechanism has, however, only very rarely been used, mostly because of the difficulties in resolving the sex equality issues inherent in GMPs. There are currently hopes that the government may allow GMP conversion as a vehicle for simplified GMP equalisation.

Action points

Most trustees will want to take advantage of the HMRC reconciliation service. All trustees will want to find out from their scheme employer(s) whether they intend to reduce benefits and/or increase member contribution rates. All should check that any required protections will be in place and will be operated by their administrators.

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