

Abolition of DB contracting-out: statutory modification power

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Introduction

As a result of the introduction of the new single-tier state pension, DB contracting-out will be abolished with effect from 6 April 2016. Due to consequential changes to legislation in relation to the abolition of DB contracting-out, open, contracted-out schemes which operate fixed rate revaluation of GMPs are likely to need a rule amendment.

On 1 March 2016, the Occupational and Personal Pension Schemes (Modification of Schemes – Miscellaneous Amendments) Regulations 2016 (“the Regulations”) were published. These will provide trustees with a statutory modification power to assist with the change.

Key points

- Schemes which operate fixed rate revaluation of GMPs are likely to need a rule amendment to allow such revaluation to be triggered when a member leaves pensionable service (in line with changes to the legislation) rather than, as is currently the case, cessation of contracted-out employment.
- The Regulations, which will come into force on 6 April 2016, will provide trustees with a statutory modification power to make the necessary change to their rules.
- The resolution may only take effect on or after 6 April 2016, but may be passed retrospectively.
- Trustees will have to pass the resolution before 6 April 2017.
- The Regulations make clear that a change to the timing of fixed rate revaluation will not trigger the consultation requirements, whether it is made using the statutory modification power or the scheme’s amendment power.
- The Regulations only apply to England and Wales but equivalent legislation is expected for Northern Ireland.

What is a GMP?

The Social Security Act 1975 (which came into effect on 6 April 1978) provided for the State scheme retirement pension to be related to earnings on which NI contributions are paid. It consists of:

- the basic state pension (“BSP”) and
- an additional (earnings-related) state pension (“ASP”).

Where a person is “contracted-in” the additional pension is paid by the State. Where the person is contracted-out both they and their employer pay reduced NI and, instead of an additional pension from the State, the occupational pension scheme is required to pay a prescribed minimum pension, broadly equivalent to the additional pension which would have been received from the State. Those who were contracted-out between 6 April 1978 and 6 April 1997 accrued an entitlement to a GMP.

Scheme members are entitled to their GMP from age 60 (women) and age 65 (men). These dates are not affected by the [increases being made to SPA](#).

GMP revaluation: on or before 5 April 2016

To provide protection against inflation, a member’s GMP must be increased using one of two methods:

- Section 148 orders – revaluation is calculated using a percentage prescribed under the relevant s148 order by reference to earnings in the final tax year of the earner’s working life
- Fixed-rate revaluation – the GMP is increased each year by a fixed rate which is determined by the date the member leaves contracted-out employment.

The “default” under the contracting-out legislation is to use section 148 orders. A key difference between the two methods is that, currently, fixed rate revaluation is triggered by a member ceasing to be in contracted-out employment.

GMP revaluation: on and from 6 April 2016

As the abolition of contracting-out is a result of Government policy rather than an employer decision, on and from 6 April 2016, legislation permits schemes to provide for fixed rate revaluation to be triggered by a member ceasing to be in pensionable service.

To make use of this change to the legislation, most schemes will require a rule amendment.

Statutory modification power

Following concerns that schemes with restrictive amendment powers would not be able to amend their rules to allow for a change to the timing of fixed rate revaluation, the DWP decided to introduce a statutory modification power.

The Regulations, which will come into force on 6 April 2016, will provide a power for trustees to modify their scheme rules to enable them to provide for fixed rate revaluation of GMPs when pensionable service ends. The power may be used by any scheme wishing to make this change, not just those which have restrictive amendment powers.

Next steps

The Regulations provide trustees with some breathing space in respect of the above change. However, it is still advisable to deal with the issue as soon as practicable.

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