Blue Light Pensions Newsletter #5

A somewhat belated Happy New Year to you, a year that I suspect will be another busy one for us all.

It is useful at this time of year to look ahead and consider what new challenges lay ahead in the coming twelve months and you do not need a crystal ball to predict that 2016 is set to be another year of change in the world of pensions. Those who thought pension reforms were behind us and that we could look forward to a period of consolidation and stability are sadly mistaken, as it appears that the Government's appetite for change has yet to be satisfied. I thought therefore that it would be helpful to briefly look at 5 changes which are either recently announced, or looming large on the horizon:

New pension tax rules. I briefly discussed the forthcoming changes to pension tax in Newsletter 3 (which I have attached for ease of reference), but to recap, in April the Lifetime Allowance (LTA) reduces to £1million and the Annual Allowance (AA) of £40,000 reduces via a taper to £10,000, with those earning more than £110,000 potentially affected. Any pension savings above these new figures are subject to tax charges and anyone who thinks they are likely to be affected needs to take action now, starting with researching the issue and in some cases applying for Fixed or Individual Protection. As a reminder, to calculate LTA multiply the expected annual pension by a factor of 20 and add any lump sum (LS). Thus a pension of £45,000 plus a 3 x LS results in a LTA of £900,000 + £135,000 = £1,035,000 ie £35,000 over the LTA and liable to charges. For AA calculations multiply the pension growth for the year by a factor of 16. These new limits will see many more public servants drawn into the pensions tax 'net' and it is thus important that schemes communicate these changes to members, some of whom will be very surprised to find themselves receiving tax bills from HMRC. More and more employers have accepted that they now need to provide better information to their employees on what is an extremely complex subject and one which can impact on business effectiveness.

End of contracting out - what does it mean for pension schemes?

Many of you reading this newsletter will doubtless agree that the impending end of 'contracting out' in April this year has not been widely advertised, nor explained. In a nutshell, Defined Benefit pension schemes which offered their members good pension benefits were allowed to contract out of the Second State Pension (2SP) previously known as SERPS (State Earnings Related Pension Scheme). The majority of such schemes (both public and private) took advantage of this offer and as a consequence members have been paying 1.3% less NI contributions and employers 3.4% less. This arrangement ends in April when the new single tier state pension scheme is introduced. Consequently in return for improved state pensions, members of contracted out schemes will see their NI contributions rise by 1.3%.

It is not all bad news as for each year that a member pays the full rate of NI they will receive 1/35th of the difference between the old basic rate of state pension and the new full rate. Needless to say it is complicated and it will be very difficult for individuals to assess the impact it will have on them.

I suspect that most public sector pension scheme members eg police officers and firefighters are probably unaware of this impending change and Pension Boards may wish to seek reassurance from scheme administrators that this message is being disseminated to those affected by the change.

NB did you know that pensions are not subject to NI when they are paid? This is why any suggestion of combining income tax and NI (often discussed by the Treasury) is not good news for pensioners.

Data cleansing and Guaranteed Minimum Pensions (GMP)

As a direct consequence of the above change, HMRC is closing its GMP reconciliation service in December 2018. The so what, is that after this date the records held by HMRC which show how much pensioners are entitled to as GMPs will be considered closed and ahead of this date schemes are required to ensure their own records match those of HMRC. It is estimated that in the public sector this may involve up to 10 million records to be checked. Given the scale and the cost of undertaking this work and the fact that the clock is well and truly ticking on this issue, Pension Boards will want to be reassured that this work is well in hand and that administrators have been allocated sufficient funds to pay for what is a multi-million pound task.

New pension statements. One item tucked away in the 2013 Public Service Pensions Act is a new requirement that all public schemes issue active members with an annual statement of their pension entitlement. I say new as although most (but not all) schemes have issued such statements for years, the requirement was not a legal one as it is in the private sector [Note that the rule does not apply to deferred members]. Although the law states when the statements are to be issued (no later than 17 months after April 2015 ie the date the Act came in to force), it does not dictate what the statement should contain and this is where Pension Boards can add value by ensuring these statements include sufficient detail to enable members to fully understand the value of their pensions savings; so for example, as well as including details of pension entitlements to date, it may also be helpful to provide projections of future pension earnings up to normal retirement date. It may also be helpful to show pension earnings/projections set against the new reduced Lifetime Allowance.

March Budget – back to tax!

Finally, back to the subject of pensions tax, the Chancellor is expected to announce in the March Budget a change to the current tax treatment of pensions. The Government currently spends some £50 billion per year in tax relief on pension contributions of which two thirds is given to those paying income tax at the 40% rate and above. Thus whilst a 20% rate tax payer effectively receives 20p from the Government for every £1 they contribute to their pension, 40% rate taxpayers receive 40p for every £1 spent. The Government also allows up to 25% of an individuals' pension 'pot' to be taken tax free. A consultation exercise is currently underway on the subject and the industry has been speculating on the likely outcome. There have been a number of alternative tax models proposed, but most commentators appear to believe the Chancellor will introduce a standard rate of tax relief probably set at either 25% or 30% saving the Treasury billions per year. Whilst high earners will lose out, there would be a significant financial boost to the pension savings of the majority of taxpayers ie those paying 20%. However, there could be a string in the tail if employees have to pay NI on employer contributions – a distinct possibility. Such a change is not without its complications and will require all pension schemes to re-programme their IT and effectively operate annual allowance calculations for every scheme member. The changes may also result in a scrapping of the annual and lifetime allowances, but this is by no means certain. March is set to be another interesting month!

If you have any questions regarding any of the impending changes described above, or would like to discuss how KPMG might be able to assist your scheme meet the challenges of pension reforms from providing training to pension boards, assistance with GMP reconciliations or providing effective communications, please do not hesitate to contact me.

Kind regards

Ian

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About us:
The KPMG Public Sector pensions advisory team is a specialist group which forms part of KPMG's wider pensions team of over 400 actuaries and professional pension advisers. We specialise in advising employers, scheme managers and pension boards.

Ian is the independent Chair of the Metropolitan Police Pension Board.

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