

The Government's long awaited [paper on state pension reform](#) has attracted much press attention. While the Government's desire for simplification is to be applauded, such widespread reform will not be straightforward to achieve. There are clearly implications for all workers in the UK, however, in this article we focus on the considerations for sponsoring employers and trustees of occupational pension plans.

Background

In brief, the Government proposes to abolish the state second pension (which is an earnings related top up to the basic state pension). The state pension will become a single tier for those who become pensioners from the date of introduction, which will be April 2017 at the earliest. Individuals with sufficient National Insurance contributions (or credits) will receive approximately £144 per week, an amount which is designed to lift the majority of pensioners above means tested support, and sits comfortably with the Government's desire to encourage lower earners to save for retirement. Safeguards will be put in place to protect entitlements already built up by individuals at the date of the change.

As trailed in the Budget 2012 and earlier consultations, the Government has confirmed the increase in state pension age to 67 from 2028 and a more structured approach for considering future changes. It is proposing that the state pension age will be reviewed every five years to take account of movements in life expectancy projections.

The end of contracting out

Once the single tier state pension is introduced, employers will no longer be able to operate occupational pension plans on a contracted out basis, and employers and employees will be required to pay full rate NI contributions.

Private sector

The Government proposes to introduce a new power, for a five year period, to allow private sector employers to amend their pension plans without trustee consent to offset the increase in NI contributions, by increasing the contributions of the relevant members and/or reducing accrual of future benefits. Actuarial certification will be required. This will be the first time that such a modification power has been placed in the hands of employers and not trustees. It is proposed that this overriding power can be exercised only once in respect of each relevant member. It is therefore vital that the regulations that will follow are clear so that employers can get this right first time.

Public sector

The statutory power to modify plans to reduce the value of pension benefits or increase employee contribution rates will not be extended to public service employers. This is due to the Government's commitment that reforms to public service pensions that are currently being put in place should endure for 25 years.

Protected persons

Employers in some former nationalised industries are restricted in their ability to make contribution and benefit changes to their pension plans for members covered by 'protected persons' legislation (which broadly requires pre-privatisation terms to be maintained for those who were members when the industry was privatised). The draft Bill contains a provision which would appear to override that. The Government is sensitive to the potential for strong feelings as to whether that is fair and appropriate. Without an override, employers will have limited options for recouping NI costs, and may find it difficult from an industrial relations perspective to introduce different contribution or benefit structures for employees who are not protected persons. However, employees with protected person status may consider that a statutory override compromises the protection promised to them.

Guaranteed Minimum Pensions

The Government has stated that it does not believe that it is possible to make any significant simplifications to GMPs as part of this reform. In spite of the Government's aim to "close all open periods of contracted-out employment and update National Insurance records with minimum cost and administrative burden to both HMRC and schemes", it is acknowledged that the processes used for reconciling GMP information were not designed for mass closure. This represents a major challenge for HMRC. Without a streamlined solution the reconciliation process that will naturally follow from the abolition of contracting out could grind to a halt.



Employee consultation

Employers will be required to consult with affected members if planning any change to accrual rates, or an increase to the level of employee pension contributions, stemming from the abolition of contracting out. The Government has said that it will remove the requirement to consult on the end of contracting-out itself - we await further details on this.

The Government has also said that it will work with employers and the pensions industry to produce standard employee communications. Assistance and publicity from the Government will be useful but specific tailored communications will still be necessary to explain any changes to contribution or benefit structures.

Review of state pension age

The Government's view is that the state pension age should be adjusted in line with life expectancy, so that each generation of adults is expected to spend broadly the same proportion of their life in receipt of a state pension.

A review of the state pension age is proposed every five years (ie in each parliament) with the outcome of the first review being published by 7 May 2017. The Government believes that a five yearly review strikes the right balance between providing clarity for individuals and also allowing state pension age to take account of changes in life expectancy in a timely manner (thus avoiding large adjustments at each review). It is intended that individuals will be given ten years' notice of any change to state pension age.

At first sight, this might appear irrelevant for occupational pension plans. However, many pension plans contain design features for which this is important, for example, a state pension offset. Employers and trustees will need to review the provisions of their pension plans to make sure that the consequences of a change to the state pension age are understood.

Further considerations

Automatic enrolment

The legislation currently provides that defined benefit pension plans can satisfy the quality requirement in relation to a jobholder by virtue of being contracted out. Unless the Government amends the legislation the abolition of contracting out could mean that this relatively simple route will be lost and defined benefit plans will need to satisfy the theoretical benchmark applicable to contracted-in pension plans, which will often require actuarial certification.

Salary sacrifice

The Government's paper does not consider the effect on employers who operate salary sacrifice arrangements, whereby an employee agrees to give up part of his remuneration in return for the employer paying extra contributions to his pension plan - this reduces his salary and therefore the amount of NI contributions payable. Salary sacrifice may become even more attractive for employers and employees who face increases in NI contributions as a consequence of the abolition of contracting out.

Action

This is a major area of reform and employers and trustees need to keep a watching brief on developments. When the Pensions Bill 2013 is enacted, employers with contracted out pension plans should assess the cost effects of the NI increase and consider what changes, if any, should be made to the pension plan. Legal advice will almost certainly be needed.

For further information please contact any of the partners listed or your usual contact in the pensions team.

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