Cabinet Office

Civil Service Pension Scheme

Consultation response about proposed changes to Defined Contribution arrangements

January 2015

Civil Service Pension – Defined Contribution arrangements

Background

1. On 28th August 2014, Cabinet Office issued the document "Consultation on proposed changes to Defined Contribution arrangements effective from April 2015." The consultation closed on 3rd November 2014 and can be found at http://www.civilservicepensionscheme.org.uk/news/consultation-on-proposed-changes-to-defined-contribution-arrangements-effective-from-april-2015/

2. This consultation response document sets out a summary of the responses received and the Cabinet Office's decisions about the changes detailed in the consultation.

Consultation Recommendations and Questions

3. The consultation document set out a number of recommendations, listed in the section later in this document entitled "*Summary of Recommendations set out in consultation document and Cabinet Office decisions following consultation*"

4. The consultation document also set out eight questions which Cabinet Office believe are of primary interest, although also invited responses about all aspects of the consultation:

Q1: Are there any compelling reasons to not tier employer contributions?

Q2: Should matching of voluntary member contributions up to 3% be retained?

Q3: Are there desirable alternative options which ensure all members contribute at least the statutory minimum after 2018 which meet the principle of simplicity?

Q4: Is there any reason not to expand eligibility to pre 2002 joiners not in the protected groups?

Q5: Do you agree with the rationale and proposed changes to death benefits?

Q6: Is there any reason to retain an earnings cap?

Q7: Is there any reason to retain the annuity guarantee, particularly given the changes announced in Budget 2014?

Q8: Are there any additional changes not discussed in this document which should be considered?

Consultation responses

5. Cabinet Office is grateful to those who responded to this consultation.

6. A total of 12 individuals responded along with 4 responses from Trades Unions and a small number of responses from scheme employers and payroll providers.

7. Most of the individual responses were from existing members of Partnership or members who are considering moving to Partnership in the future.

8. Most responses covered all questions, but some responses were limited to a single or small number of questions.

9. The following section sets out the key decisions Cabinet Office has made in response to the consultation. A detailed analysis of the issues covered by the consultation responses and Cabinet Office responses is set out in the table later in this document.

Summary of Recommendations set out in consultation document and Cabinet Office decisions following consultation

Timing of changes

10. Cabinet Office received a number of responses from scheme employers and payroll providers stating that it would be much more preferable to separate the implementation date of the DC reforms from the implementation date of the 2015 changes to the main scheme. Delivering the main scheme reforms is a very large undertaking, and Cabinet Office recognises that the focus should be on successfully implementing reforms which affect the vast majority of scheme members.

Decision: The date of implementation, including the change to contribution rates, will be put back to 1 October 2015. Eligibility will also be expanded to pre 2002 joiners eligible to participate in *alpha* on 1 October 2015.

New death and ill-health benefit schemes must take effect from 1 April 2015 as the existing schemes close, so these changes will be taken forward with effect from 1 April 2015. These changes will make very little difference to members as the replacement schemes will be very similar to the existing schemes, although it does mean the annuity guarantee will be removed with effect from 1 April 2015.

The AVC scheme will also be amended so that from 1 April 2015 members can take advantage of the flexibilities to access their DC pension announced in Budget 2014

Partnership, including ill-health and death benefit schemes

1. Recommendation from consultation: Increase employer contribution rates to reflect the value of post 2015 Defined Benefit scheme, retaining most of the existing age tiers.

Decision: The consultation revealed a general preference for contribution rates to be tiered by age. Cabinet Office intends to retain the existing age tiers with some consolidation, and change employer

contributions to broadly reflect the value of the post 2015 Defined Benefit scheme, *alpha*, except for the youngest and oldest members.

2. Recommendation: Introduce a minimum employee contribution rate of around 2.5% (the same rate applying to all members) set at a level to ensure that all members pay at least 8% of their pensionable pay into their pension as a result of employee contributions, employer contributions and basic rate tax relief. The increase to be phased in over 2 years to mitigate the impact on existing scheme members. All of the extra contributions will go into individual's pension pots and lead to a larger pension pot at retirement – the Exchequer will not receive any of this additional contribution.

Decision: The consultation did not favour mandatory employee contributions. Cabinet Office will change the initial recommendation and instead introduce a minimum employer contribution rate of 8% for all members, the cost of this being offset by a reduction to the proposed employer contribution rate for the oldest members, although the employer contribution rate for the oldest members will still increase compared to the current contribution structure.

3. Recommendation: Extend eligibility to employees recruited prior to 2002 who are eligible to participate in alpha (the main section of the post 2015 Civil Service pension scheme), but not until a future date (probably April 2016). Members with Transitional Protection who remain in existing schemes and who joined prior to 2002 will remain ineligible to join Partnership.

Decision: The consultation showed a clear preference for as few restrictions as possible, and for any expansion to be implemented as soon as possible. However, given the importance of the introduction of alpha in April 2015, Cabinet Office believes that it is not appropriate to introduce a further burden to employers by expanding eligibility at that time.

Eligibility to participate in Partnership will remain unchanged in April 2015, with only those who joined employment after 1st October 2002 being eligible to participate. However, in recognition of the clear

preference to expand eligibility as soon as possible, Cabinet Office will commit to expanding eligibility to all those eligible to participate in *alpha* from 1st October 2015.

4. Recommendation: Death-in-service benefits to be reduced from 3 times salary to 2 times salary

Decision: Consultation responses argued strongly for the current benefit of 3 times salary to be retained. Although the death benefits in *alpha* will be 2 times salary, in other public service pension schemes (for example, the LGPS) they will be higher. Given the strong desire to retain 3 times salary in Partnership, Cabinet Office will retain the 3 times salary calculation, the cost of this being offset by a reduction to the proposed employer contribution rate for the oldest members, although the employer contribution rate for the oldest members will still increase compared to the current contribution structure.

5. Recommendation: Earnings cap to be removed.

Decision: The consultation showed widespread support of abolishing the earnings cap, which will be removed as proposed.

6. Recommendation: No significant change to ill health benefits, although some amendments required, for example to change age references from 60/65 to State Pension age.

Decision: Although there were varied responses to the consultation regarding ill-health, there is no evidence that the ill-health provision in Partnership needs reform so Cabinet Office is not minded to review this aspect of the Partnership arrangements at this time.

AVC Scheme

1. Recommendation: Amend rules of AVC scheme to be consistent with new pension decumulation regime which will apply from April 2015.

Decision: The consultation showed wide support to implement the new pension flexibilities. Cabinet Office will amend the rules of AVC scheme to be consistent with new pension decumulation regime from April 2015.

2. Recommendation: Remove annuity guarantee offer from AVC scheme (members who are currently eligible will be protected)

Decision: There were no new arguments advanced to support the need for the guarantee to remain. Cabinet Office therefore intends to remove the guarantee from April 2015, and will honour the guarantee for any annuities taken out prior to 1 April 2015.

Employer and employee contribution rates

11. The table below details the contribution rates (as a percentage of pensionable salary) which will apply in Partnership from October 2015.

Table 1: Employer and employee contribution rates from 1st October 2015

Age Band	Current employer contribution (with no mandatory employee contributions)	Employer contribution proposed in consultation (with mandatory employee contribution of 2.5%)	Employer contribution following consultation and which will apply from October 2015 (with no mandatory employee contributions)	Voluntary employee contributions (matched by employer)
20 and under	3.0%	5.5%	8.0%	Unlimited, up to 3.0% matched by employer
21-25	4.5%	5.5%	8.0%	Unlimited, up to 3.0% matched by employer
26-30	6.5%	7.0%	8.0%	Unlimited, up to 3.0% matched by employer
31-35	8.0%	9.0%	9.0%	Unlimited, up to 3.0% matched by employer
36-40	10.0%	11.0%	11.0%	Unlimited, up to 3.0% matched by employer
41-45	11.5%	13.5%	13.5%	Unlimited, up to 3.0% matched by employer
46 and over	12.5%	16.0%	14.75%	Unlimited, up to 3.0% matched by employer

Detailed consultation response to specific issues raised

Questions/issues/comments, by consultation questions	Cabinet Office response and decision
Q1: Are there any compelling reasons to not tier employer contributions? (i) Yes - people should not be treated differently by age (ii) No - some members have contributed under the existing tiered structure, and it would be unfair to these members (who are now on average older) to change to a different structure.	A variety of views both for and against tiering of contributions were put forward. No clear consensus emerged. From the responses, **Cabinet Office cannot identify any compelling reason not to continue with the existing tiering arrangement.**
Q2: Should matching of voluntary member contributions up to 3% be retained? (i) Yes - Members should be rewarded for demonstrating seriousness to saving by making voluntary contributions (ii) Yes - Removal could be viewed as a cut to pension benefit (iii) Yes – those who make voluntary contributions get a higher employer contribution in all age tiers than if the same employer contribution rate was paid to all members (iv) No – employer pension contributions are more tax efficient, so a higher base employer contribution is preferable (v) No – for members choosing Partnership due to tax considerations having either compulsory or incentivized member contributions is not desirable, as they may well be incurring tax charges on the additional contributions. (vi) The employer contribution rates (without matching) suggest a redistribution from younger members to older members, reflecting higher voluntary contributions from older members – this is difficult to justify.	There was some confusion about exactly which member contributions would be eligible for matching. The proposal set out in the consultation document has mandatory member contributions which would **not** be eligible for matching. The first 3% of voluntary member contributions in addition to the mandatory contributions would be eligible for employer matching. Hence if the mandatory employee contribution was 2.5% a member would need to contribute a total of 5.5% to get the full 3% employer matched contributions. There were a variety of opinions put forward for and against retaining matched contributions, with the balance of opinion favouring retaining matched contributions. **The consultation proposed retaining matched contributions as the default approach, and the consultation found the balance of opinion favoured this approach.**

Q3: Are there desirable alternative options which ensure all members contribute at least the statutory minimum after 2018 which meet the principle of simplicity? (i) Mandatory contributions should only to members who would not otherwise meet statutory minimum (ii) Agree with single mandatory member rate to make administration simpler (iii) Further consolidation of age groups may reduce the level of mandatory member contribution required. (iv) There is no need to make Partnership automatic enrolment compliant as it is appropriate that members review their decision every 3 years (as they would if they had simply opted out of them main scheme and were re-enrolled) and hence there is no need to have minimum member contributions. (v) Automatic enrolment contribution increases are phased in. The increase in National Insurance contributions in April 2016 from contracting-out should also be considered to ensure members are not hit all at once. (vi) Mandatory contributions are undesirable as members choosing Partnership due to Annual Allowance issues may well be disadvantaged by having to make employee contributions (vii) Mandatory contributions are undesirable as members choosing to leave the main scheme due to not being able to afford contributions may also not join Partnership, leaving them with no pension. (viii) Introducing mandatory contributions is not undesirable at a time when there is pay restraint.	Although opinion was divided, there was a clear preference to either not have mandatory member contributions, or to limit them as much as possible. Cabinet Office believes that Partnership should be automatic enrolment complaint for existing members, particularly around minimum contribution levels to ensure members have adequate retirement provision. Making Partnership automatic enrolment compliant will make administration simpler and also be more convenient for members. Cabinet Office has reviewed the proposed rates and **will change the proposed contribution rates so that the scheme meets automatic enrolment contribution standards for all members from the employer contribution alone. This means that mandatory employee contributions will not be required.** The cost of this will be offset by a reduction to the proposed employer contribution rate for the oldest members, although the employer contribution rate for the oldest members will still increase compared to the current contribution structure.
Q4: Is there any reason not to expand eligibility to pre 2002	The responses to this consultation question resulted in a

joiners not in the protected groups?	strong consensus that there should be no membership restrictions for Partnership, and that existing restrictions should be lifted as soon as possible - although it was noted that April 2015 will be the 4th year of pension contribution increases for *classic* members and so thought should be given to offering a non-contributory/low contribution scheme to that group as it may result poorly considered and hasty member decisions. A particular issue was identified for those eligible for tapered protection, which enables members to remain in existing schemes after April 2015. If eligibility is expanded to all those eligible for *alpha* (the post 2015 scheme) then those being offered tapered protection who wish to join Partnership may need to choose to move to *alpha* in April 2015, then move to Partnership when eligibility is expanded. This will lead to some members having very short periods of *alpha* service and 3 different pension arrangements. If eligibility was extended to all, those members who are currently in *classic* and who remain in *classic* after April 2015 would have their pension arrangements enhanced by being given an option they do not have currently. Cabinet Office does not believe it is appropriate to enhance the pension arrangements of those who are already full protected. The issues around employers dealing with multiple changes at the same time in April 2015 is still relevant, and there will be much work for employers to complete
(i) All members should be eligible to join Partnership as soon as possible (ii) For those who commenced employment prior to 2002 and who have tapered protection, if they wish to join Partnership it will be necessary for them to choose to move to *alpha* in April 2015, and then move to Partnership when entry conditions are expanded in the future. Would it be possible to stay in *classic/premium/nuvos* until the entry conditions are expanded and move at that point? (iii) If eligibility is expanded to pre 2002 joiners who are eligible to participate in *alpha* the only group not eligible for Partnership will be protected members of *classic*. Is this not age discrimination? (iv) Both pre and post 2002 members will move to *alpha* in 2015 – both groups should have the same options in April 2015, whereas the pre 2002 group will have to wait until at least April 2016 to be eligible to move to Partnership. The numbers of pre 2002 joiners moving to *alpha* in April 2015 will be small, as many of the pre 2002 joiners will have transitional protection, and only a small proportion of the group would want to move to Partnership. (v) Given the length of time the introduction of *alpha* has been known about there should be no operational reason not to be able to expand access in April 2015. Alternatively, expansion could happen shortly after April 2015, there is no need to wait a full year. (vi) Would expansion have any consequence on the cost cap in the main schemes?	

	after *alpha* is introduced in April 2015. However, given the strong preference for eligibility to be expanded as soon as possible, **Cabinet Office will commit to expanding eligibility to Partnership to all those eligible to participate in *alpha* from 1 October 2015,** regardless of whether an individual joined before 2002.
Q5: Do you agree with the rationale and proposed changes to death benefits? (i) Unfair to change rules for existing members (ii) Reducing death benefits to be in line with *alpha* is equitable (iii) Change would erode terms and conditions (iv) Death benefits are not expensive, so why change from 3 times salary, or why not increase *alpha* to 3 times salary? (v) Death benefits are not changing to 2 times salary for all members – those eligible to stay in *premium* after April 2015 will still have 3 times salary (vi) 2 times salary is less than the norm in the City – 3 times salary is the usual the minimum, with 4 times salary for management. (vii) The main scheme provides survivor benefits, which the Partnership scheme does not. This justifies higher death benefits.	The changes to death benefits produced a near-consensus against the change. However, the only strong argument put forward against the change was that Partnership does not provide survivor benefits, whereas the main scheme does provide such benefits and this may justify the higher death benefits. Whilst this is accurate, beneficiaries of members of Partnership will receive the pension pot the member accrued instead of the survivor benefits. **Given the clear preference to retain the existing level of death benefits, there will be no change from the current level of 3 times salary**. The cost of this will be offset by a reduction to the proposed employer contribution rate for the oldest members, although the employer contribution rate for the oldest members will still increase compared to the current contribution structure.
Q6: Is there any reason to retain an earnings cap? (i) No, there is no reason to have one and removal would be equitable	**There was uniform support to remove the earnings cap, in line with the consultation proposal.**
Q7: Is there any reason to retain the annuity guarantee, particularly given the changes announced in Budget 2014?	There was a mixed response to this question, with several arguing that the guarantee should remain whilst

(i) Financial crisis showed benefit of guarantee (ii) Can lead to poor member outcomes and is only of value in very unusual circumstances – would be better to remove guarantee (iii) The guarantee makes members take an active decision, and Equitable Life shows there is a risk of provider failure. (iv) Would the change be retrospective? (v) There is no evidence that anything has changed nor is there any evidence the guarantee is leading to poor member decisions. Hence the need for change is not clear. (vi) It may be prudent to wait to see how the new pension flexibilities develop, and remove the annuity guarantee at a later time if the flexibilities are successful.	others suggested the guarantee was no longer necessary. There were no new arguments advanced to support the need for the guarantee to remain. **Cabinet Office therefore intends to remove the guarantee from April 2015, and will honour the guarantee for any annuities taken out prior to 1 April 2015.**
Q8: Are there any additional changes not discussed in this document which should be considered? (i) Basing employer contribution on age at 6 April leads to a cliff-edge, particularly for those with birthdays close to that date. Basing the rate solely on age would be fairer. (ii) Will staff be able to access AVCs without retiring? (iii) The values of the employer contribution should not only reflect *alpha,* but also include an allowance for the proportion of members eligible to participate in *premium* and *nuvos*. (iv) Is any allowance made for the abolition of contracting-out in April 2016? (v) There should be further actuarial analysis of the ill health benefits available in Partnership compared to the main scheme. (vi) Further consideration of proposals to enhance flexibility of remuneration packages should be undertaken, for	It was pointed out that those eligible to remain in *premium* and *nuvos* can join Partnership, and so it would be appropriate to incorporate within the contribution rates an allowance to reflect the value of the *premium* and *nuvos* benefits, not just *alpha.* There is merit to this argument, but implementing this suggestion would lead either to multiple sets of contribution rates, with separate rate depending on which main scheme a member was eligible to participate in, or a single set of rates which does not accurately reflect the value of the main scheme benefits for any single member. Given that the number of members in the existing schemes will constantly decline (as they are closed to new members) **Cabinet Office believes it is appropriate to only base the employer contribution rates on the *alpha* scheme.**

example offering additional death benefits at cost price on a voluntary basis. Similar trading/purchasing of annual leave and non-core workplace benefits should be considered. (vii) Redundancy protection should not be linked to membership of the Defined Benefit scheme. In particular, a member with continuous service should be eligible to benefit from their employer buying-out the actuarial reduction for early payment even if they are a deferred member of the scheme. (viii) It would be far preferable to separate the timing of changes to the DC schemes from the changes to the main scheme, given the extent of change which employers and payroll providers already have to deal with.	The changes to the AVC scheme will mean that members can access them in full without retiring. As Partnership is a contracted-in scheme already, the abolition of contracting-out does not have any impact on Partnership. The actuarial modelling was all based on *alpha* being a contracted-in scheme (ie based on the post 2016 environment). There is no evidence that the ill-health provision in Partnership needs reform, so Cabinet Office is not minded to review this aspect of the Partnership arrangements at this time. Cabinet Office recognises the efforts required to deliver the 2015 reforms to the main pension schemes, and it is necessary to prioritise getting those reforms delivered in April 2015. **Cabinet Office is therefore going to slightly delay the DC reforms to be implemented from October 2015.** Other comments were not directly relevant to Partnership but will be noted and considered as part of other policy decisions.