PAY DELEGATION: GUIDANCE NOTE 35 (2004)
PENSION ISSUES

Introduction

35.1 Pay guidance notes were issued in 1998 when HM Treasury delegated pay arrangements to departments. Whilst some of that guidance may no longer be applicable, the provisions of Guidance Note 35 are still current because they refer to the linkage between pay, which has been delegated to departments, and the policy for the Civil Service Pension arrangements, which has not.

35.2 You should note that some changes to pay structures may involve them in significant pension costs, and that they must refer proposals for particular changes, set out below, to Cabinet Office, Civil Service Pensions Division (CSPD) before proceeding.

35.3 This note explains:

a. how the cost of pension provision, and the cost of improvements to the Principal Civil Service Pension Scheme (PCSPS), should be taken into account within delegated pay bargaining; and

b. the possible implications for pensions of changes in pay and pay related conditions of service.

35.4 The Government's strategy is to encourage people to build up pension rights during their working life. Ministers see good occupational pension provision as contributing significantly towards this objective.

35.5 The PCSPS is the occupational pension scheme for civil servants. It is a statutory scheme made under the provisions of Section 1 of the Superannuation Act 1972. On 1 October 2002, new Civil Service Pension arrangements were introduced via an amendment to the 1972 Act. All civil servants and staff in organisations covered by the PCSPS are normally members of the scheme unless they have opted out or selected a **partnership** pension account. Optants out may make their own arrangements. As a recruitment measure, you may wish to make contributions to a new entrant's own personal pension outside the **partnership** pension account panel. You must take account of the significant administrative consequences, particularly for payroll, of this measure, **and all cases must be reported to CSPD.**

35.6 The Cabinet Office is responsible for Civil Service pensions policy, and departments and agencies are responsible for the administration of the PCSPS

The reward package

35.7 Pension provision forms a significant part of the total reward package for

Civil servants. Annex A sets out a summary of benefits. It is Government policy for Civil Service pay to be set at levels appropriate to recruit, retain and motivate staff, taking account of all relevant factors, including the cost of pension provision.

35.8 Employees bear a share of pension costs by making an explicit contribution from their salary.

35.9 Departments and agencies pay for pensions through employer contributions (also known as accruing superannuation liability charges (ASLCs)). ASLCs are calculated on a salary-banded basis and are designed to meet pension costs as they are accrued by members of the scheme, and not the cost of pensions in payment.

35.10 The reward package of employees therefore includes not only pay but also the employer's pension cost. The ASLC mechanism helps make this pension cost clear to employers.

Pensions costs and pay determination

35.11 Under delegated pay bargaining arrangements, decisions on pay and pensions should continue to be based on the *affordability* of the total reward package. In this way, by bringing the whole package of pay and other conditions into the reckoning, the Government will achieve its aim of ensuring that the total cost represents good value for money.

35.12 The ASLC represents the employer's pension cost and should be taken into account when assessing affordability of any pay proposals.

35.13 The ASLC rates operative from 1 April 2004 are summarised in the table below.

Salary bands	ASLC rate
£17,500 and under	12%
£17,501 to £36,000	13.5%
£36,001 to £62,000	16.5%
£62,001 and over	18.5%
Pre-'Fresh Start' Prison officers	20.5%

35.14 CSPD announce the ASLC rates through an Employer Pension Notice (EPN) each autumn for implementation the following April. The rates relate to the average cost for all members in each of the salary bands. In calculating the rates, the age and marital status of staff across the band are taken into account and assumptions are made about future pay progression and staff turnover. An ASLC rate is therefore an average figure. There may be occasions where a more detailed assessment of the value of pension benefits is required in respect of a smaller group or an individual, e.g. where fast accrual is provided. The Scheme Actuary should then be asked to calculate a special rate taking into account the group or an individual's particular characteristics.

35.15 Every 4 years, CSPD, in consultation with the scheme Actuaries, undertake a fundamental review of ASLC rates. New rates of charge are being introduced over 2 years starting from 1 April 2005. The details were announced in EPN 94.

Effect on pensions of varying pay and pay related terms

35.16 Changes in pay and pay-related terms and conditions of service can affect pensions entitlement in an excessively beneficial or a detrimental way because benefits under the PCSPS (classic, classic plus and premium) are based on final salary. Note that members who have a partnership pension account but who are eligible to join premium, may ‘switch’ schemes once each way, up to age 59.

35.17 Basic pay normally increases each year, and the ASLC mechanism ensures that you pay the increased pension costs associated with such increases. **However, where basic pay is significantly increased or, for example, allowances or bonuses are made pensionable, the payment of ASLCs may not be sufficient.** The value of the extra benefit to the member could be considerable, particularly for those likely to leave the scheme within a couple of years. Likewise, the pension cost to the department or agency could also be high.

35.18 ASLCs assume average pay progression and are not designed for step changes in pensionable earnings. Where such changes take place, the ASLC will cover the future service pension cost, but not the liability arising in respect of earlier reckonable service. For example, for an individual in classic aged 59 with 39 years' service, a £1,000 one-off increase in pensionable earnings will lead to an increase in pension of £1000 x 39/80 **=** £487.50, whereas for an individual with short service the impact on pension would be much less. The capitalised value of the impact on accrued benefits is known as the "past service cost" and, for individuals with long service, can be very significant. In this example, the past service cost of the £487.50 increase in pension is estimated at around **£8,000**. This would not be covered by the ASLC. Where pay restructuring results in large past service costs, CSPD will bill employers for this extra liability.

35.19 Conversely, a proposal to *reduce basic* pay in return for, say, more generous overtime payments would reduce the value of pension benefits that have already accrued, as well as those that could be earned in the future, because overtime is not normally pensionable. The detrimental effect in respect of pension benefits already accrued and the reduction in the value of the reward package for the future service would need to be explained to those affected, and their agreement sought.

35.20 ***Employers must consult CSPD about the pension implications of any proposals to change pay arrangements, which would alter pensionable earnings upwards or downwards as described above, or affect the PCSPS definition of pensionable earnings.***

Non-consolidated pay

35.21 ***Employers should note that non-consolidated pay is normally non-pensionable. You should also note that making it pensionable may lead to significant past service costs***.

35.22 Employers’ pay proposals for non-consolidated pay to be made pensionable in full or in part under the PCSPS must meet certain

Inland Revenue requirements. Only CSPD can exercise discretion on behalf of the Minister under the rules of the scheme. ***You must consult CSPD at an early stage if you are considering making non-consolidated elements of pay pensionable.***

35.23 Under the tax approval rules prescribed by the Inland Revenue, **fluctuating emoluments** - a term defined as any part of an employee's earnings that is not paid on a fixed basis, and includes such things as non-consolidated bonuses - may only be taken into account as pensionable if they are averaged. This is essentially an anti-abuse measure to prevent the deliberate increase of pension entitlement by reference to an emolument paid in the last year of service. Where non-consolidated pay has been made pensionable, the way it is incorporated into a member's benefit calculation will depend on whether they are in ***classic*** or ***premium***/***classic plus***.

35.24 Under ***classic***, two separate calculations are required in order to establish 'pensionable pay'. First, consolidated pensionable pay is calculated in the normal way, using basic salary and pensionable emoluments (excluding any pensionable non-consolidated payments) to establish the best year in the last 3 years. Then, having established the consolidated element of pensionable pay and the pensionable pay year (which might not be the last year of service), pensionable non-consolidated payments over the period of 3 years prior to the last day of the pensionable pay year are averaged and added to the consolidated pensionable pay figure.

35.25 Under **'classic plus'** and **'premium'**, pensions are based on "final pensionable earnings", which is defined as the better of:

- consolidated pensionable earnings in the last 12 months;
- consolidated pensionable earnings in the best of the last 4 complete tax years; or
- consolidated and non-consolidated pensionable earnings averaged over any 3 consecutive tax years in the last 13.

All amounts earlier than the most recent complete tax year are increased in line with inflation before making the comparisons.

See Annex B for examples of how this is applied.

35.26 You will note that it is not always beneficial to members (particularly in classic) for non-consolidated bonuses to be made pensionable, where these are paid outside the period for reckoning pensionable earnings. The employer and the member will pay contributions on the bonuses but they will not increase the final pensionable earnings unless they fall within the pay period(s) for calculation.

35.27 Where non-consolidated pay is made pensionable, care will be needed in implementation. In particular, the payroll operators would need to be informed about the status of the payments. Pensionable non-consolidated pay must be included in the calculation of both ASLCs and employee contributions.

Changes to the PCSPS benefit structure

35.28 Affordability applies as much to pension improvements as to improvements in pay. An approach to pay and pensions that is properly based on the affordability of the total reward package requires both staff and management to consider how any improvement in reward should fall between pay and pensions. There is a balance between the two, and any improvement to the benefit structure of the pension scheme will tilt that balance by increasing the value of the scheme and hence pension costs.

35.29 Different considerations apply to changes in pension entitlements to those that apply in respect of pay and pay-related terms and conditions of service, because of the terms of the Superannuation Act 1972 under which the PCSPS is made. Any changes to the scheme must by made by Order.

35.30 A representative body of employing departments, convened and chaired by CSPD considers any changes in PCSPS benefit structure. Major changes are discussed through Civil Service Management Board. **Only CSPD can seek Parliamentary approval to amend the scheme**. CSPD, as required by the Superannuation Act 1972, consults the Trades Union Side about any changes to the PCSPS benefit structure; where there is a detrimental change; TUS consent must be obtained. These consultations include the question of costs and how they are to be met. Different circumstances could require differing solutions. There are essentially two options:

a) costs to met through an increased employee contribution. ASLCs would be left unchanged.

b) account to be taken in pay negotiations of the value of a pension improvement (to the extent not covered by (a)). Increased costs would be recovered through higher ASLCs.

35.31 If any significant changes were introduced, ASLCs would be changed to meet the cost at the time of introduction. CSPD announces details of changes to the ASLC rates. You will need to consider the implications, as an employment cost, of any change.

35.32 Whilst there is and will be a range of pay settlement dates across the Civil Service, this is not a significant difficulty. Any major changes in pension terms will be agreed and announced by CSPD as far in advance as possible, so as to give maximum prior notice of costs to those responsible for pay negotiations.

Further information

35.33 See the ‘Frequently asked Questions’ at Annex C.

35.34 CSPD produce an Employers’ Pension Guide (EPG) which is updated by Employers Pension Notices (EPNs). If you wish to be added to the circulation list please contact the CSPD employer helpdesk, details below. We also produce a wide range of guidance on pensions issues generally. Scheme Rules, booklets and leaflets together with information for members and employers are on the CSPD website under ‘Leaflets Rules and Forms’:

www.civilservice-pensions.gov.uk

35.35 The Employers and APACs site – linked to the main website - contains the Employers' Pension Guide and all EPNs together with other information for employers. It is password protected:

Username	**employers**
Password	**mc2fxqfy**

35.36 If you want to find out more about the PCSPS – look at your Employers' Pension Guide or contact your Authorised Pensions Administration Centre (APAC).

35.37 If you have any questions about this guidance please contact:

CSPD
Cabinet Office
8th floor, Grosvenor House
Basing View
Basingstoke
Hampshire RG21 4HG

Employer Helpdesk

Tel: GTN 1439 6414
(01256 846414)
Fax: GTN 1439 6594
(01256 6594)

Email: employerhelpdesk@cabinet-office.x.gsi.gov.uk

FREQUENTLY ASKED QUESTIONS

1. What are the pensions implications if we were to:

- ***consolidate an allowance, which is currently non-pensionable into basic pay?***
- ***get rid of overtime and pay everyone a higher "all hours worked" salary?***

Any increase to pensionable pay will increase pension benefits earned prior to the date of the change as well as those to be earned in the future. You must consult CSPD about changes in the pensionable status of any aspect of pay. Where the effect of a change is to increase final pensionable earnings, you will need to assess and usually pay for the past service cost implications.

2. We are thinking about making non-consolidated bonuses pensionable. What issues should we be considering and are there any alternatives?

Such payments can only be pensionable following the formal exercise of a discretion under the PCSPS rules by CSPD. There may also be a past service cost. You must therefore consult CSPD in all cases. Administration and employee understanding are complicated by the Inland Revenue's imposed need for averaging.

One alternative to making bonuses pensionable would be to pay a higher bonus by adding what would have been spent on ASLCs. Recipients could also be encouraged to make their own pension provision by investing their bonus - tax free - in the Civil Service Additional Voluntary Contribution Scheme(CSAVCS).
To benefit from the investment tax-free, you must make the payment directly to the CSAVCS provider for the member's account. The member must have an existing CSAVCS account, or open one to receive the payment.

3. We are moving to a later pay settlement date and would like to make a small one-off payment to compensate staff. Can this be pensionable?

You must consult CSPD but we would normally agree to the payment being pensionable without the complication of it being treated as a "fluctuating emolument".

4. We would like to make a ONE-OFF payment to staff and make it pensionable only for

staff retiring in the next year. Can we do this?

The normal employer (ASLC) and employee (WPS) contributions are not designed to recover the costs of one-off increases in pensionable earnings made immediately prior to retirement. Where modest increases are made pensionable for *all* staff, there is not a problem as this is consistent with the underpinning assumption that pay increases are treated (for pension purposes) in the same way for all staff.

If the employer wishes to give a pensionable increase only to those about to retire, then the Scheme Actuary will need to assess the full past service cost for the staff involved, which you will have to pay. The cost will vary depending on the amount of past service of each employee affected but it would probably be *at least* 4 times the total amount of the increase in pay.

NOTE: If employers do not pay ASLCs that are due, the cost will ultimately fall on all employers participating in the PCSPS. Although the costs in any individual case may appear to be modest in relation to the size of the scheme, the principles underpinning the ASLC mechanism need to be upheld if it is to remain fair to all participating employers.

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CIVIL SERVICE PENSION ARRANGEMENTS – BENEFITS FOR MEMBERS

Final salary schemes **(classic, classic plus or premium)**	**Defined contribution arrangement** **Partnership pension account**
Substantial **employer contributions**	
Comparatively **low cost employee contributions** 1.5% (classic) or 3.5% (premium and classic plus) of pensionable earnings	Employee **choice of contribution level** from £0 to Inland Revenue limit
Retirement pension for the member based on final pensionable earnings and length of service x accrual rate (classic: 1/80 accrual rate classic plus: 1/80 accrual rate for service before October 2002, 1/60 accrual rate for service from October 2002 premium: 1/60 accrual rate)	**Retirement income** from an annuity bought with partnership pension account 'pot'
Pension for : • **husband or wife, and children (classic)** • **husband or wife or partner, and children(premium and classic plus)**	**Member's choice of additional benefits for dependants**
Lump sum –automatic for classic and (for pre-October 2002 service only) classic plus at a 3/80 accrual rate, or by giving up some pension in premium and (for service from October 2002 only) classic plus	**Lump sum possible** from pension pot before buying annuity
Death-in-service benefit lump sum: classic = 2 x pay; classic plus, premium and partnership = 3 x pay	
Death-in-service pension for dependants	**Dependants receive pension pot as a lump sum on death-in-service**
Ill-health retirement pension	**Ill-health retirement lump sum**
Compensation for redundancy under Civil Service Compensation Scheme	
Opportunity to increase pension benefits by buying added years, contributing to the Civil Service Additional Voluntary Contribution Scheme or Stakeholder pension	**Flexibility to increase pension pot and eventual benefits** within Inland Revenue employee contribution limits.

CIVIL SERVICE PENSION ARRANGEMENTS – BENEFITS FOR EMPLOYERS

'Off the shelf' pension arrangements
Valuable benefits highly regarded by staff
Arrangements common across Civil Service – aid to interchange
Majority of benefits funded 'pay as you go'
Flexibilities within scheme to support recruitment, retention, downsizing and departure programmes

NOTE: Civil Service Injury Benefit Scheme applies to all staff, regardless of PCSPS membership

EXAMPLES OF CALCULATIONS

classic 'pensionable pay'

Example 1: a member in ***classic*** retires on 31 October 2003.

The 'normal' pensionable pay history (excluding pensionable non-consolidated payments) is as follows:

Year ending	*amount*
31 October 2001	£21,000
31 October 2002	£22,200
31 October 2003	£23,500

Basic pensionable pay is therefore, <u>£23,500</u>

Over the same pay period, non-consolidated but pensionable performance bonuses were paid follows:

Year ending	*amount*
31 October 2001	£475
31 October 2002	£290
31 October 2003	£530

These bonuses are treated as fluctuating emoluments. They are, therefore, averaged (with the two earlier years increased in line with changes in the RPI to the end of the later year) to provide a pensionable amount:

Year ending	*amount*	*RPI*	*revised amount*
31 October 2001	£475	174.3	£475 x (182.6 / 174.3) = £497.62
31 October 2002	£290	177.9	£290 x (182.6 / 177.9) = £297.66
31 October 2003	£530	182.6	(no revision)

$$\frac{£497.62 + £297.66 + £530}{3} = £441.76$$

Total pensionable pay is therefore:

£23,500 + £441.76 = <u>£23,941.76</u>

premium/classic plus 'final pensionable earnings'

Under ***premium*** and ***classic plus***, 'final pensionable earnings' are calculated as **the best of**:

a) The last 12 months' consolidated pensionable earnings
b) The highest consolidated pensionable earnings in any of the last 4 full tax years
c) The highest average pensionable earnings (consolidated **and** non-consolidated) in any 3 consecutive tax years up to 13 years before retirement date

NOTE: Pay earned earlier than the last complete tax year is increased in line with RPI when making the comparison

Example 2: a member in ***premium*** retires on 30 June 2003, with continuous service from 1 October 1996. In their last 12 months they earned consolidated pay of £25,464. The RPI figure for the last complete month before their last day of service (May 2003) is 181.5.

Their consolidated and non-consolidated pay in each **complete** tax year in the 13 years up to their last day of service (together with the RPI figure at the end of each tax year) is as follows:

Tax year ending	Consolidated pay	Non-consolidated pay	RPI figure
31 March 1998	£15,220	£330	160.8
31 March 1999	£16,384	£300	164.1
31 March 2000	£18,994	nil	168.4
31 March 2001	£20,772	£440	172.2
31 March 2002	£23,955	£300	174.5
31 March 2003	£25,100	£250	179.9

Therefore their final pensionable earnings are the better of:

a) The last 12 months' consolidated pensionable earnings - **£25,464**

b) The highest consolidated pensionable earnings in any of the last 4 full tax years:
£18,994 x 179.9/168.4 = £20,291.10
£20,772 x 179.9/172.2 = £21,700.83
£23,955 x 179.9/174.5 = £24,696.30
£25,100
= **£25,100**

c) The highest average pensionable earnings (consolidated **and** non-consolidated) in any 3 consecutive tax years up to 13 years before retirement date:

	Three year average:
(£15,220 + £330) x 179.9/160.8 = £17,397.05	
(£16,384 + £300) x 179.9/164.1 = £18,290.38	
(£18,994 + nil) x 179.9/168.4 = £20,291.10	£18,659.51
(£20,772 + £440) x 179.9/172.2 = £22,160.50	£20,247.33
(£23,955 + £300) x 179.9/174.5 = £25,005.58	£22,485.73
£25,100 + £250 = £25,350	£24,172.03

= **£24,172.03**

The best of the three calculations is a) - **£25,464**