Social Security Policy and Legislation Division

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Your reference:
Our reference:
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Dear Sir

Pensions Bill – Letter from Prospect, GMB and Unite unions

Thank you for the opportunity to comment on the concerns raised by Prospect, GMB and Unite unions in their letter of 12 January.

The letter suggests that the pension scheme purchased an annuity in 2000 on the basis of uprating in line with the RPI. As the scheme rules provide for increases in line with the Pensions Increase (Review) Order which uses the CPI (which is currently lower than the RPI), the Unions suggest that the annuity provider is profiting at the expense of the scheme members.

We have been in contact with Mr Scoggins on several occasions to try to fully understand the members' concerns. The precise status and nature of the annuities is not entirely clear. Schemes sometimes buy annuities in the member's name and the insurance company pays the member direct. Our understanding is that in these cases, the annuity normally buys out the scheme's liabilities and the person generally therefore ceases to be a member of the scheme. In this case it doesn't matter what the rules of the scheme provide by way of pension increases – the member is entitled to whatever the annuity provides. So there can never be a mismatch between what the individual is entitled to and the pay-out from the annuity.

Alternatively, a scheme may buy an annuity in its own name, in order to secure a regular income. Here, the annuity is simply a scheme asset where the income is used to pay the member what is due under the scheme rules. Although the scheme will seek to match the benefits exactly, this may be subject to changing circumstances. If there is mismatch, it will be the scheme that bears the consequences as the member will always be entitled to what the rules provide.

In both cases, however, whoever receives the income will benefit from RPI-linked increases agreed under the annuity contract, so it is difficult to see how an insurance company could benefit from the difference between RPI and CPI.

The Department therefore is not aware of a scenario in which an insurance company would be benefiting in the way outlined in the letter, and neither the Department nor the Department for Work and Pensions are aware of representations from any other scheme on this issue.

The general policy is that a scheme must uprate in line with the CPI. However, in mitigation, schemes are free if they wish to uprate by higher than the CPI. The Pensions Act (Northern Ireland) 2012 in effect allowed schemes to continue to use the RPI, if they wish, or to use CPI (or a combination of the two) depending on individual scheme rules. Where schemes continue to increase pensions by the RPI and have done so continuously since January 2011 (or when the pension came into payment, if later), the Act provided that they do not have to carry out an annual comparison of the RPI under the scheme rules and the CPI under the statutory requirements and pay the higher of the two.

Turning to the proposed dispensation, from the information it appears that the scheme is complying with the statutory requirements and its own rules. The proposed dispensation would in effect overturn the scheme rules and force the scheme to pay in excess of the statutory requirements. To do so, would be in conflict with the current policy. We are not able to assess the full implications of such action, for example, schemes may already have made forward funding and planning decisions on the basis of income from annuities and future pension liabilities based on CPI indexation. Additionally, given that many schemes operating in Northern Ireland are in effect UK-wide schemes, if Northern Ireland were to act unilaterally in this matter schemes could have to operate separate uprating regimes for members in Northern Ireland, giving rise to increased administration costs etc. perhaps acting as a disincentive to good quality schemes continuing to be available to members in Northern Ireland.

Yours faithfully

Anne McCleary

ANNE McCLEARY
Signed for the Department for Social Development