

# MACFARLANES

## PENSIONS

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### BRIEFING

#### CHANGES TO INDEXATION AND REVALUATION

The law requires pensions in payment to be increased and pensions in deferment to be revalued annually to reflect inflationary changes so that the real value of pension benefits can be maintained. The law provides the minimum levels of increase and revaluation but it is open to schemes to provide a greater level of benefit.

Since the introduction of the indexation of pensions in payment (1997) and the revaluation of pensions in deferment (1986), increases and revaluation to reflect inflationary changes have been based on increases to the Retail Price Index (RPI) over a given 12 month period. In July 2010, the government announced proposals which would allow pensions to be increased and revalued in line with the Consumer Price Index (CPI) as opposed to the RPI. The move to CPI will in most cases result in significant savings for many schemes. This is evidenced by the most recent figures released by the Office for National Statistics which show that CPI inflation in the year to September 2010 was 3.1 per cent while the corresponding figure for RPI inflation was 4.6 per cent.

The DWP commenced consultations on the impact of using CPI in December 2010 and the most recent Statutory Revaluation Order (based on CPI for the first time) came into force on 1 January 2011. The precise effect that the move to CPI will have on schemes is likely to depend on how individual scheme rules provide for pension increases and revaluation.

#### SCHEME RULES

Most scheme rules either expressly provide that indexation and revaluation should be based on RPI or require these to be based on the minimum statutory level of increases as specified annually by the Secretary of State. Certain scheme rules make no reference to the increase and revaluation of pension benefits.

The government has confirmed in its consultation document that schemes which specify increases and revaluation in line with RPI will have to continue to provide these on the same basis unless scheme rules are amended. Contrary to previous statements, the government has confirmed that a statutory power to override scheme rules which expressly provide for RPI will not be provided. Previous proposals to provide a modification power (which would allow schemes to amend specific references in their rules to RPI without falling foul of statutory provisions which protect a member's accrued rights in respect of past service) have also been dropped. Therefore, scheme rules which expressly provide for pension increases and revaluation in line with RPI can only be amended (in a way that

would affect accrued rights) with the consent of the members – which is unlikely to be forthcoming. However, subject to the proposed consultation requirement (see below), scheme rules can be amended so that CPI is used in place of RPI for service following the date of the amendment to the rules.

The position in relation to schemes which provide increases and revaluation in line with the statutory order in force and those which are silent on the level of increase and revaluation is more straightforward. Such schemes can provide future pension increases and revaluation in line with CPI.

#### CPI UNDERPIN

The government envisages that some schemes will continue to provide increases to pensions in payment in line with RPI. If in any year, the rate of increase in RPI is lower than the rate of increase in CPI, those schemes with RPI increases would have to increase by CPI for that year, as CPI would be the statutory minimum. The government proposes to take action which will exempt schemes which continue to provide RPI based increases from having to pay CPI based increases where the rate of increase in CPI is greater than that of RPI.

This has been justified on the basis that RPI is generally expected to exceed CPI and members in schemes which choose to use RPI would be better off over time compared to schemes that would apply the new statutory minimum based on CPI.

#### CONSULTATION OBLIGATIONS

Schemes that decide to change their rules in response to the move to CPI should be aware that draft legislation proposed by the government will require employers to consult with active and prospective members prior to implementing such a change. Failure to consult will not invalidate the rule changes but exposes the employer to a fine from the Pensions Regulator.

#### CONTACT DETAILS

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