

How do increases to the Police Pension and State Pension Schemes work?

Background

In April 1978, the Government started the State Earnings Related Pension Scheme (SERPS). Employees who paid full rate National Insurance contributions, (NICs), began to build up rights to an Additional Pension, (AP), from the State based on earnings during their working life. This was on top of the flat rate Basic State Pension and any Graduated Pension entitlement, all to be paid at state pension age.

However, many employers also run pension schemes. An employer who has an occupational scheme, which satisfies certain requirements, may contract its employees out of SERPS. The Police Pension Scheme has chosen to do this.

Between April 1978 and March 1997, employers who wanted to contract out had to agree to provide a Guaranteed Minimum Pension, (GMP), paid at the state pension age, which was broadly equivalent to the AP which the employee would otherwise have earned had they not been contracted out of SERPS. Such contracted out employees pay lower NICs because they are not going to receive a SERPS benefit from the State. The GMP forms part of the occupational pension and is not in addition to it. In many cases the full occupational pension payable is higher than the GMP.

What happens at state pension age?

At state pension age, a notional AP is calculated as though the person had not been contracted Out of SERPS. The GMP is then deducted from this figure. As a general rule the GMP and AP amounts should be exactly the same. Occasionally, however, a small balance may appear due to the different calculation process used in the two systems. The balance, if any, is paid as an AP by the state with the basic flat rate state pension.

Future increases on the GMP part of your company pension after state pension age

The responsibility for future increases of GMP is shared between the company and the state. Increases on any excess company pension over and above the

GMP remain the responsibility of the company.

In summary then:

- GMP built up between 1978 and 1988 is increased in line with the retail price index, (RPI), by the state.
- GMP built up between 1988 and 1997 is increased by up to 3%, (or RPI if less), by the company. The state funds any increases in the GMP over 3% if necessary.

The following is a typical example of the calculations involved to increase your company pension this year. The RPI rate up to the last September is normally used. This was 3.3%.

The state has now fulfilled its responsibility for up-rating its share of the GMP. The payable balance has increased by £102.18pa, (£362.18 minus the original £260), or £1.96 pw. (£6.96 minus the original £5).

Effect of early retirement on AP

Many people now take the opportunity of early retirement and this can have an effect on their AP.

This is because some years ago during a period of high inflation and in order to protect the GMP of early leavers, company pension providers were required to revalue the GMP part of the company pension each year. The revaluation rate chosen is often much greater than the rate at which the notional AP is increased from the early retirement date up to state pension age. The notional AP amount is revalued each year in line with the rise in average national earnings. If this rate is less than the GMP revaluation rate chosen, then the AP balance payable will progressively reduce each year between early retirement and the state pension age. Given long enough the AP is wiped out completely by the time state pension age is reached, regardless of whether an earlier pension forecast from the state had shown some entitlement.

So, for instance, in the example above, at state pension age, there is a balance of £5 owing, due to the GMP being less than the notional AP. If early retirement had been taken and the company had chosen to re-value the GMP at a greater rate than the rise in average national earnings (by which the AP figure would have been increased), then there may well have been no balance owing at 65 as it

could have been wiped out. It can then take some years after state pension age for the top line AP figure to catch up and a balance become payable again.

It has been recognized that this system had weaknesses and the Pensions Act 1995 effectively broke the links between SERPS and contracting out. Since April 1997, pension schemes are required to protect pensions earned after that date in line with inflation up to 5%.

What happens when someone dies?

At present, when someone dies, their spouse will inherit all of the notional additional pension less half of the GMP figure.

However, from 6th October 2002, a new rule will apply that may affect any entitlement to the state additional pension (SERPS). Changes are being introduced which will reduce the maximum amount of (SERPS) that a widow/er may inherit from their husband or wife from 100% to 50%.

Nobody who is widowed before 6th October 2002 will be affected by this new rule.

If your husband or wife is due to reach state pension age before 6th October 2002, you will receive up to 100% of their SERPS when they die (less half their GMP entitlement).

If your husband or wife is due to reach state pension age after 5 October 2002 but before 6th October 2010, when they die you will receive a maximum of between 90% and 60% of their SERPS (less half their GMP). The exact amount will depend on when, in this period, they reach state pension age.

To calculate the **company pension** increase, the GMP is subtracted from the pension **before** applying the 3.3% increase. Note all the calculations below assume a 52 week year.

	Per annum	Per week
31/3/01 current company pension per annum	£15,600.00	£300.00
Less pre-1988 GMP	£2,600.00	£50.00
Less post-1988 GMP	£2,600.00	£50.00
Excess pension over the GMP	£10,400.00	£200.00

The increases:

	Per annum	Per week]
Increase excess pension of £10,400 fully by 3.3%	£343.20	£6.60
Increase on post 1988 GMP of £2,600.00 by 3%	£78.00	£1.50

The final result:

	Per annum	Per week
Pension as at 31/3/01	£15,600.00	£300.00
Add increase on excess of GMP as above	£343.20	£6.60
Add increase on post 1988 GNU' as above	£78.00	£1.50
New pension rate as at 1 April 2001	£16021.20	£308.10

The above shows how the company increases the pension.

How does the state cover the increase in the pension that is not covered by the company?

When a member attains state pension age the Benefits Agency does two calculations:

1. Calculates an entitlement to a state AP as though the retiree had not been contracted out of SERPS and stayed in the state scheme. This is called the ***notional additional pension***. See example below.
2. Calculates the entitlement to a GMP actually earned through being contracted out.

	Per annum	Per week
Notional additional pension, (approx. the same as GMP but can be slightly more as in this example)	£5,460.00	£105.00
Less GMP, pre-88	£2,600.00	£50.00
Less GNU', post-88	£2,600.00	£50.00
Payable balance	£260.00	£5.00

What then happens at the following April state benefit up-rating time?

The RPI rate used for the April state benefit up-rating this year is 3.3%.

1. The notional AP will be fully up-rated by the RPI.

Then the up-rated GMP already paid by the company is deducted.

Applying this to the example above we get the following:

Notional additional pension of £5460 plus 3.3%	£5,640.18	£108.46
Less GMP pre-1988 (unchanged)	£2,600.00	£50.00
Less post-1988 GMP (up-rated by 3%)	£2,678.00	£51.50
Payable balance of the state AP	£362.18	£6.96

If your husband or wife is due to reach state pension age on or after 6th October 2010, you will receive up to 50⁰/a of their SERPS (less half their GMP) when they die.