

EXECUTIVE COUNCIL

PUBLIC

Title:	Falkland Islands Pension Scheme (“FIPS”) – Increase to Trivial Pension Threshold
Paper Number:	53/18
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Responsible Director:	Financial Secretary
Report Author:	Financial Secretary
Portfolio Holder:	MLA Roger Spink & MLA Roger Edwards
Reason for paper:	This paper is submitted to Executive Council: For policy decision (including budgetary policy)
Publication:	Yes
Previous papers:	206/13 Proposed Amendments to the Falkland Islands pension Scheme Ordinance
List of Documents:	Extract from s28 of Falkland Islands Pension Scheme Ordinance 1997

1. Recommendations

Honourable Members are recommended to:

- (a) Approve the increase of the trivial threshold to the sum of £40,000, based upon the accrued pension fund value of the FIPS member and to instruct drafting of the necessary legislation (option 3 (para 5.3)).
- (b) Note the further work that will be undertaken to develop a cost neutral mechanism to enable existing small monthly payments for existing FIPS pensioners to be converted into a capital sum equivalent to £40,000.

2. Additional Financial Implications

- 2.1 There are no immediate additional financial implications to Falkland Islands Government (“FIG”).

2.2 There may be an administration benefit to FIG Treasury, who administer FIPS, with a reduced number of low value pensions paid out each month. This does not represent a cashable saving.

3. Executive Summary

3.1 The Falkland Islands Pensions Scheme Ordinance 1997 (“the Ordinance”) was enacted to establish FIPS and to make provision for the payment of retirement pensions and other benefits to or in respect of members of the scheme, and for connected matters.

3.2 The current trivial pension threshold for FIPS is an annuity of £750 per annum (Falkland Islands Pensions Scheme Islands Pension Scheme Ordinance s28(3a)).

3.3 Currently, there are members of FIPS with pension accounts that will deliver a pension annuity of more than £750 per year, but in some cases not significantly more¹. Individuals will have different pension annuities depending upon their age at retirement.

3.4 The last change to the trivial threshold was made in 2015, when the amount was increased from £500 to £750.

3.5 The FIPS Board meets quarterly and at the meeting of 14 February 2018 an amendment to the current trivial pension threshold was discussed and the sum of £40,000 recommended.

4. Background

4.1 Movements in Retail Price Index (“RPI”)

4.2 The last change to the trivial threshold was made in 2015, when the amount was increased from £500 to £750. An RPI adjustment to £750 would increase it to approximately £755.

4.3 Trivial pension to be based on a lump sum

4.4 FIPS members have ready access to information about the value of their pension fund. It is easier to understand a pension fund value, rather than the potential annuity value that will change through time. In addition, there is an administrative overhead in obtaining actuarial information to identify whether the trivial threshold has been met.

4.5 There is still a choice to the Pension Scheme member to take a monthly pension if they so wish, funded by an annuity.

4.6 Choice for FIPS Members at Retirement

4.7 The Falkland Islands does not currently have a facility whereby members of approved pension schemes can withdraw their entire pension pot (of whatever value) taxed at the

¹ In March 2018 there were 42 pensions in payment below £100 a month.

appropriate marginal rate.

4.8 Having the trivial pension threshold based upon a lump sum value, and at a higher value than the capitalised cost of the existing trivial pension limit is a small step towards FIPS members having greater choice about how they use their pension savings.

4.9 Impact on FIPS Members with Pension Savings above £40,000

4.10 The FIPS rules are that up to 25% of the pension fund value may be taken as a lump sum that is tax free, and the rest must be taken as an annuity.

4.11 A FIPS member that is just over the trivial threshold does not currently have the opportunity to take 100% of the fund value out as a cash lump sum.

4.12 It is proposed that the existing s28(a) be retained. This means that a person with a pension fund value of £41,000, for example, would only be able to take 25% as a lump sum.

4.13 Impact on Economic Behaviour of Individuals

4.14 It is not possible to predict what the impact on the changes to the trivial threshold would be. However, in the UK the Financial Conduct Authority (“FCA”) published interim findings of the Retirement Outcomes Review in July 2017. This was the first major comprehensive study into how the UK retirement income market started to change since the pension freedoms².

4.15 The main findings were:

- Accessing pension pots early has become ‘the new norm’. Almost three quarters (72%) of pots that have been accessed were by under 65’s.
- Most are choosing to take lump sums rather than a regular income.
- Over half (53%) of pots accessed have been fully withdrawn. However the fully withdrawn pots are mostly small with 90% below £30,000.
- 94% of consumers making full withdrawals had other sources of retirement income in addition to the state pension.
- Drawdown has become much more popular. Twice as many pots are moving into drawdown than annuities.

4.16 The change to the limit that is recommended in this paper is not considered to have a material impact upon social and economic planning in the Falkland Islands. However, the changes can make a positive difference to individuals in terms of choices and flexibilities about how they access and use cash that they have saved up.

4.17 Currently, UK personal pensions can be accessed from the age of 55. FIPS members can access their pension (an annuity and a cash lump sum, or just an annuity) from the age of 50.

² The full report is available here - <https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review>

4.18 Existing FIPS monthly pensions of a Low Value

- 4.19 It is acknowledged that there are a number of existing pensions that are of a lower value³. Some of those individuals may wish to convert their annuity back into a trivial lump sum.
- 4.20 FIG Treasury plan to investigate further the mechanics of providing a means to convert a trivial annuity into a lump sum. In effect this is buying out future pension rights for trivial pensions, if the pension so chooses.
- 4.21 FIG Treasury need to ensure that any proposed calculation or transaction is cost neutral, based upon the actuarial assumptions to hand.
- 4.22 The Pensions (Old Scheme) Fund is the annuity provider (i.e. pays the monthly pensions) for FIPS pensions that are being drawn. There would be a transfer out of a cash lump sum, but a cessation of future pension payments.
- 4.23 Further work will be undertaken in this area to cover actuarial, financial and legal matters.

5. Options and Reasons for Recommending Relevant Option

- 5.1 Option 1: Do nothing. Although this would be straightforward, there is little benefit to FIPS members. This option is not recommended as there will be individuals having to have a small monthly annuity whereas they might wish to have the cash lump sum.
- 5.2 Option 2: To uplift the £750 trivial threshold limit in line with RPI. Not recommended because the uplift would be minor and would not give greater individual choice to FIPS members.
- 5.3 Option 3: To change the trivial threshold to £40,000 fund value. This is the recommended option because there is greater flexibility and choice offered to FIPS members and also administrative processes will be simplified.
- 5.4 Honourable Members are recommended to approve Option 3.

6. Resource Implications

6.1 Financial Implications

- 6.2 The economic behaviour of individuals cannot easily be predicted. However, there are not thought to be any indirect financial consequences to FIG.

³ Lower defined as being an annuity value that if purchased today would cost £40,000 or less to purchase.

6.6 Human Resource Implications

None

6.7 Other Resource Implications

None

7. Legal Implications

7.1 S28 of the FIPS Ordinance 1997 will need to be rewritten, and this has been drafted.

8. Environmental & Sustainability Implications

8.1 No direct environmental and sustainability implications: this is a financial matter.

9. Significant Risks

9.1 There are no significant risks to FIG.

10. Consultation

10.1 A paper was approved at the FIPS Board on 14 February 2018.

11. Communication

11.1 FIG Treasury will be able to update information on the FIG website and inform FIPS members over the age of 50 when they start to ask for estimates.

Extract from Falkland Islands Pension Scheme Ordinance 1997 – with proposed amendments

28 Benefits which must be provided under the Scheme

(1) Subject to the provisions of this Ordinance, a member of the Scheme on his retirement shall be entitled-

(a) if he so elects, to receive a sum of such amount as may be specified in the election, which may not exceed one-quarter of the accrued value of his account as at the date of his retirement; and

(b) to enter into a qualifying annuity contract with an approved pension provider for an annuity payable on his retirement in consideration of the payment of a sum equal to that value, or to the remainder if he elects to take part as a lump sum under paragraph (a); and

(c) [to] such benefits.

(2) The member may choose any approved pension provider he wishes to provide the annuity but if he does not, the Board shall choose an approved pension provider for him.

(3) For purposes of this section a person retires and is entitled to any of the benefits mentioned under subsection (1)-

(a) when the person reaches normal retirement age; or

(b) on the person's elected retirement age (that is at any age within the eligible retirement age when the person elects to retire).

(3A) A member may elect to receive, in place of any benefit under subsection (1)(a) or (b), a sum equal to the accrued value of the member's individual account if that value is ~~insufficient to fund the purchase of an annuity the annual value of which, on the assumption that no lump sum is payable under subsection (1)(a), would not exceed £750~~ less than £40,000.

(4) A member may elect to defer the payment of the lump sum or the purchase of the annuity, or both, for such period, ending on or before his 75th birthday, as he may specify in the election.

(4A) An election by a member under subsection (1)(a) or (4) shall be made not later than one year after the date of the member's retirement.

(5) An election under subsection (4) may be withdrawn or amended, by notice to the Board, at any time before the date of deferment specified in the election; and any such election shall have effect as so amended, or as the case may require, cease to have effect, from such date as may be specified in the notice, not being earlier than 3 months after the date the notice is given to the Board.

(6) Where a member elects under subsection (4) to defer payment of the lump sum and purchase of the annuity, for the reference in subsection (1)(a) to the date of that member's retirement there shall be substituted a reference to the date specified in the election as the date to which the payment and purchase is to be deferred ("the deferral date").

(7) Where a member elects under subsection (4) to defer payment of the lump sum but not the purchase of the annuity, the amount deferred and the amount available for purchase of the annuity shall be calculated in accordance with subsection (1) as at the date of that member's retirement, but-

(a) the member's individual account shall continue (after purchase of the annuity) until the deferral date, and

(b) the amount payable as a lump sum on the deferral date shall be an amount equal to the accrued value of the member's account at that date.

(8) Where a member elects under subsection (4) to defer the purchase of the annuity but not payment of the lump sum, the amount of the lump sum shall be calculated in accordance with subsection (1) as at the date of that member's retirement, but-

(a) the member's individual account shall continue (after payment of the lump sum) until the deferral date, and

(b) the amount available for purchase of an annuity on the deferral date shall be an amount equal to the accrued value of the member's account at that date;

and the member may, within 6 months of the deferral date, elect to receive, in place of any benefit under subsection (1)(b), a sum equal to the accrued value of the member's account at that date if that value is ~~insufficient to fund the purchase of an annuity the annual value of which does not exceed £500.~~ **less than £40,000.**

(9) Where a member has elected to defer both the purchase of an annuity and the payment of a lump sum, the member may, within 6 months of the deferral date, elect to receive, in place of any benefit under subsection (1)(a) or (b), a sum equal to the accrued value of the member's individual account if that value is ~~insufficient to fund the purchase of an annuity the annual value of which, on the assumption that no lump sum is payable under subsection (1)(a), would not exceed £500.~~ **less than £40,000.**

(10) The Board shall ensure that any member is provided with sufficient information to allow the member to determine whether or not to make an election under subsection (3A), (8) or (9).

(11) Where an election is withdrawn under subsection (5) any reference in subsections (6) to (9) to the deferral date shall be read as a reference to the date on which the election ceases to have effect.

(12) An election and any notice under this section shall be made in writing and shall include such information as the Board may require.