ANNEXE 10

PENSIONS INCREASE

Public service pensions, including the FPS, are increased each April to take account of increases in prices. This is called “Pensions Increase” (sometimes shortened to “PI”).

The main Pensions Increase legislation is separate from the FPS legislation. It is the responsibility of HM Treasury.

This Annexe, which is based in part on notes of guidance issued by HM Treasury, gives a simple outline of how Pensions Increase legislation works to help maintain the purchasing power of your FPS benefits.

What is Pensions Increase?

Pensions Increase is the system by which pensions are increased from time to time to maintain their purchasing power, taking account of movements in the general Retail Prices Index (RPI) after they are awarded. This is sometimes referred to as “inflation-proofing” or “index-linking”.

Background to Pensions Increase

Before 1971 there was an ad hoc system of Pensions Increase in the public services, under which smaller pensions were increased at irregular intervals, mainly with the object of relieving hardship. Means-testing featured in early assessments.

The Pensions (Increase) Act 1971 gave public service pensioners (including FPS pensioners) a statutory entitlement to Pensions Increase every 2 years once the RPI had risen by at least 4% during the review period, if certain basic conditions relating to age and circumstances were met.

It also made good the deficiencies of previous Acts by a complicated formula which ensured that the purchasing power of a pension already in payment was at least restored to its original level. In 1972 the Act was amended to provide for annual reviews and increases once the RPI had risen by a certain level.

Private sector pension schemes, too, must index the benefits they provide but they are not required to offer the high level required of public service schemes (although some may do so voluntarily).

Who can receive Pensions Increase?

Along with other members of public service pension schemes, firefighters and their widows, widowers and dependants have benefits covered by the Pensions Increase rules.

The rules cover personal and dependants’ benefits, injury awards, allocated pensions and pension credit pensions (i.e. the pension paid to an ex-spouse of a firefighter under a pension sharing order issued by a court on divorce or annulment of marriage).

Does the increase apply to all of the pension?

The increase is usually applied to the pension actually due, i.e. after, where appropriate, any reduction, for example, for commutation, allocation or National Insurance modification.

Where the pension includes a Guaranteed Minimum Pension (see below) part of the increase may be paid by the Department for Work and Pensions.

What are the qualifying conditions for the payment of increases?

The conditions are set out in section 3 of the 1971 Act. Pensions Increase would be payable on dependants' awards regardless of their age. It would also be payable in respect of a firefighter's injury award. In the case of other awards payable to the firefighter, however, increases will not be paid until and unless –

(a) he/she has attained the age of 55 years, or

(b) he/she has retired on account of a physical or mental infirmity from the office or employment in respect of which, or on retirement from which, the pension is payable, or

(c) he/she has at least one dependant*, or

(d) the pension authority are satisfied that the pensioner is disabled by physical or mental infirmity (this means permanently incapacitated by the infirmity from engaging in any regular full-time employment).

* For this purpose a dependant is normally someone who is wholly or mainly supported by the pensioner and who is either under 17 or is in full-time education or training. However, in the case of a woman only the fraction of her pension earned by service before 1 January 1993 will be increased and in the case of a man only that fraction of his pension earned by service between 17 May 1990 and 31 December 1992 will be increased.

What about deferred pensions and lump sums?

Deferred or "preserved" pensions and lump sums are those earned by people who are no longer active members of their pension scheme, for example because they have since left employment or opted out of the scheme, but who are not yet old enough, or otherwise entitled, to receive pension benefits.

Deferred pensions are increased to reflect the successive increases between the date the benefits were "preserved" and the date they become payable. However, if you have left the fire service and your deferred pension is paid early on health grounds and you are below age 55, Pensions Increase will not be paid immediately unless you are permanently incapacitated by your infirmity from engaging in any regular full-time employment (see Qualifying Condition (d) above). If you are an optant-out with a deferred pension and you have to leave the fire service on grounds of permanent disablement, your deferred pension would be put into payment on leaving and Pensions Increase **would** be paid immediately because you satisfy Qualifying Condition (b).

Deferred lump sums are also increased but the increases on the lump sums are not paid until a qualifying condition is met, irrespective of whether the lump sum has been paid.

What about pension credit members?

Pension credit members who have entitlement to benefits under a pension sharing order issued by a court on divorce or annulment of marriage will receive Pensions Increase when their pensions become payable (at age 60 or from the date of the order if later).

What about pension credit members? (continued)

Pension sharing was introduced by the Welfare Reform and Pensions Act 1999. Section 39 of the Act amended the Pensions (Increase) Act 1991 to include pension credit pensions and set the beginning date for this type of pension (see later in this Annexe "When does a pension or lump sum begin?") in section 8(2A) of the 1971 Act –

"A pension which is attributable to a pension credit shall be deemed for the purposes of this Act to begin on the day on which the order or provision on which the credit depends takes effect."

How will the increases be paid?

Where part of a pension represents a Guaranteed Minimum Pension (GMP), this part will be uprated by the Department for Work and Pensions from State pension age, on the basis set out below.

If your pension is based wholly or in part on service after 4 April 1978 and before 6 April 1997, for which you were contracted-out of the State Earnings Related Pension Scheme (SERPS), you will have earned a GMP.

The GMP is an amount broadly equivalent to what you would have received if you had been in SERPS (i.e. not contracted out) for that period of service. If you have a GMP, then at State pension age – assuming that is when you claim your State retirement pension – or following your spouse's death in the case of a widow's or widower's pension, the DWP will calculate and inform you of your GMP.

Subsequent annual Pensions Increase will then normally be calculated and paid in two parts from two sources –

(a) with your State widow's benefit, widower's invalidity pension, or your State retirement pension (the "old age pension") the DWP will pay any increase related to your GMP earned before 6 April 1988 and any increase above 3% a year on any GMP earned from 6 April 1988 until 5 April 1997, and

(b) with your FPS pension, the fire authority will pay any increase up to 3% a year due on any GMP earned from 6 April 1988 until 5 April 1997, together with any balance due on your FPS pension. The increase on the balance will be calculated on your FPS pension less your GMP.

Where you do not have entitlement to a GMP, e.g. because your pension is based entirely on service before 6 April 1978 or after 5 April 1997, the whole increase will be paid with your FPS pension.

How do the DWP calculate the increases they pay?

See page Annexe 10-Example 1

Do I receive my full entitlement when the DWP pay part of the increase?

If you receive increases in two parts as outlined in "How will the increases be paid?" above, then the total amount of increase you receive in these two ways will be at least as great as the amount you would have received if the whole increase had been paid with your FPS pension. This will be the case even where the increase is not paid by the DWP. This may occur where you –

(a) are resident in a country overseas with which the UK does not have a reciprocal arrangement for uprating social security pensions, or

(b) are deferring your State retirement after reaching State pension age and therefore do not receive State retirement pension, for example if you continue to receive Incapacity Benefit after reaching State pension age, or

(c) are temporarily disqualified from receiving State retirement benefits because you are in prison, or your State pension is reduced to pocket-money pension rate because you have been in hospital for at least 52 weeks, or

(d) have an additional pension from the State scheme which is less than the total GMP to which you are entitled (you will receive from the DWP a notice of entitlement which tells you what these amounts are), or

(e) are entitled to a widower's GMP in respect of your late wife's FPS pension entitlement, are under age 65 or your late wife was under 60 when she died, and you do not receive a State retirement pension by virtue of your late wife's National Insurance contributions.

In such cases increases will be applied to your FPS pension to take account of the fact that the DWP is not uprating your GMP. If your circumstances change and the DWP begins to pay increases on the GMP again, the FPS pension will be reduced accordingly.

Can my pension be adjusted?

At the time the fire authority first calculate the increase on your FPS pension they may not have been notified of the amount of GMP to which you are entitled or whether the increase on your GMP will be paid by the DWP. In these cases, the fire authority will not know your GMP entitlement and some overpayment or underpayment may result. When the fire authority receive the appropriate notification, they will adjust payments accordingly.

In some cases where an individual has been on Incapacity Benefit and begins to receive State retirement pension instead, the reduction in the FPS (on account of the fire authority being notified of DWP inflation proofing of the GMP) will not be matched by an equivalent increase in the payments from the DWP.

This is because individuals will have already been receiving some inflation proofing of their GMP from the DWP as part of their Incapacity Benefit.

What are the percentage increases that are received?

Increases to the FPS pension are based on the rise in retail prices as measured by the all items Retail Prices Index. The increases take effect in April each year and are based on the increase in the index in the 12 months up to the end of September in the preceding year.

If the pension began on or before the date of the last increase, it will receive the full amount of the next increase. However, public service pensions which began after the last Pensions Increase date will receive a proportion of the next increase based on the number of months between the date when the pension began (see the explanation of "When does a pension or lump sum begin?" below) and the date when the next increase takes place. In this calculation, a part month of more than 15 days is rounded up to a complete month. So if the pension begins 7 months before the next increase, it will get 7/12th of that increase.

How are increases in individual pensions calculated?

See page Annexe 10-Example 2

When will the increase be paid?

If the qualifying conditions are met, for pensions already in payment, the increase takes effect from the same date in April as the increase in State social security benefits (except that any increase paid by the pension scheme on a GMP earned from 6 April 1988 onwards is paid on 6 April even when the main increases are paid on a different date).

If the qualifying conditions are not met, the cumulative effect of increases will be paid from the date the conditions are met.

Normally, when a pension first comes into payment no increase is due until the following Pensions Increase date (assuming qualifying conditions are met at that time). However, if the pension was based on pay averaged over a period before the final year of service, Pensions Increase may be due on the pension as soon as it is paid (again assuming qualifying conditions are met). Also if the pension being put into payment is a deferred pension (at age 60) Pensions Increase will be due when it is brought into payment.

There may be a considerable period between the date your pension begins (as explained below) and the date you receive an increase for the first time. Where this happens the increase will take account of all the increases since your pension began. However, this higher rate of pension applies only from the date you qualified for Pensions Increase; there are no arrears due from before that date. For example, assume a pension of £10,000 a year began on 1 August 1995 but the pensioner did not qualify for Pensions Increase until 20 April 1999. The cumulative increases over that period are 12%. Until 20 April 1999 the gross pension payable would be £10,000 a year and from 20 April 1999 it would be £11,200 a year.

When does a pension or lump sum "begin"?

A pension or lump sum usually begins for Pensions Increase purposes on the day after the last day of the service in respect of which it is payable. This is not necessarily the same day as the pension becomes payable. However, there is no entitlement to the increased rate of lump sum until the lump sum actually becomes payable or to the increased rate of pension until the pension is actually payable and a qualifying condition for receiving Pensions Increase is satisfied (see above).

Where the member's pension and lump sum are based on pay received in a period ending before the last day of service, they are deemed to begin on the day following the end of that period.

For example, if a pension is based on pay up to 31 January 1999 but the last day of service is 31 January 2000, the pension would be deemed to begin for Pensions Increase purposes on 1 February 1999 even though the pension was not due to be paid until 1 February 2000.

In other words, the "beginning date" for Pensions Increase purposes is the first day after the end of the "averaging period" for working out the average pensionable pay used in the pension calculation.

Dependants' benefits payable when a former firefighter dies are generally treated as having begun on the same date as the firefighter's pension "began" for Pensions Increase purposes.

A pension credit member's pension is deemed to "begin" on the date on which a pension sharing order takes effect – see "What about pension credit members?" earlier in this Annexe.

An allocated pension is deemed to begin on the same day as the firefighter's own pension or, if earlier, on the day from which the surrender of the original pension takes effect.

What is the effect of National Insurance modification?

When the National Insurance modification system was introduced in the 1940s it was decided that public service employees should have their pensions reduced or "modified" to take account of the then new flat rate State retirement pension. This generally took effect for employees who joined after 1948. There were matching reductions in pension contributions for most public service employees. Such adjustments to public service pensions are known as National Insurance modification.

The modification of FPS pensions applies in respect of service before 1 April 1980 only. Where it applies, it takes effect from State pension age whether or not you decide to defer your State retirement pension. If a person's FPS pension begins at State pension age, National Insurance modification would be applied before the FPS pension is brought into payment. Pensions Increase would subsequently be applied to that modified pension.

What is the effect of National Insurance modification? (continued)

Where the FPS pension begins to be paid before State pension age, the increases are calculated at first on the basis of the unmodified pension. Once, however, the member has reached State pension age, the increases will be recalculated on the basis of the modified pension from the date the pension began. This means that at State pension age, the FPS pension will see the effect of being reduced by not only the National Insurance modification but also the Pensions Increase which has accrued on that pension. (See Example C on page Annexe 10-Example 2.) Pension payments already received before State pension age are unaffected.

Flat rate pensions

The flat rate pensions payable to dependants under the FPS used not to be eligible to increased, like other FPS pensions, under Pensions (Increase) Review Orders. An increase along the lines of the standard increase would be assessed and added to the various levels of flat rate pension, then notified to fire authorities by the Home Office (which then had responsibility for fire pensions) as the new level of flat rate pension. This practice ceased in 1978. The flat rate pensions as revalued at that time were written into Firemen's Pension Scheme Orders with an instruction that fire authorities were, in future, to assess and apply Pensions Increase to these "fixed" figures on the assumption and basis that –

- these flat rate pensions were official pensions which could be increased under the Pensions (Increase) Act 1971, and
- the "beginning date" for these pensions was 30 June 1978
- the first Pensions (Increase) Review Order which would apply would be the first to be made under section 59 of the Social Security Pensions Act 1975, i.e. the Pensions Increase (Review) Order 1979.

Example of how the DWP and fire authority calculate the increases they pay

Example A

A firefighter reaches State pension age at April 2000 with a FPS pension of £10,000 a year. This pension includes a Guaranteed Minimum Pension of £2,000, £1,000 of which was earned before 6 April 1988 and £1,000 between 6 April 1988 and 5 April 1997. Assume the increase from April 2000 is 4%.

The fire authority would increase the £10,000 pension by paying –

- 4% on the £8,000 which exceeds the GMP, and
- 3% on the £1,000 GMP earned between 6 April 1988 and 5 April 1997.

4% x £8,000 =	£320.00
3% x £1,000 =	£ 30.00
Total	£350.00

When this is added to the existing £10,000 it would give a new annual rate of FPS pension of £10,350.00

The DWP would pay –

- 4% on the £1,000 of GMP earned before 6 April 1988, and
- 1% on the £1,000 of GMP earned from 6 April 1988

4% x £1,000 =	£ 40.00
1% x £1,000 =	£ 10.00
Total	£ 50.00

The DWP would pay this £50.00 as an additional pension with the State retirement pension.

This means that the total Pensions Increase paid to the former firefighter, in part by the fire authority and in part by the DWP, is £350.00 + £50.00 = £400.00.

This equals the amount of Pensions Increase which would be paid by the fire authority had there been no element of GMP, i.e. –

4% x £10,000 = £400.00

Example of increase in individual pensions

Example A

A male firefighter retires at age 60 with a FPS pension of £10,000 a year payable from 1 April 1999. Assume the increase in the Retail Prices Index (RPI) to be applied to State benefits from 10 April 2000 is 2% and the RPI increase from 9 April 2001 is 2% again. No GMP is taken into account at this point because the firefighter has not attained State pension age (65).

The pension payable will be updated –

- from 10 April 2000 by 2% giving a new annual pension of £10,000 + 2% = £10,200.00
- from 9 April 2001 by a further 2% giving a new annual pension of £10,200 + 2% = £10,404.00

Example B

A male firefighter retires at age 60 with a FPS pension of £10,000 a year payable from 6 October 1999. Assume the increase in the Retail Prices Index (RPI) to be applied to State benefits from 10 April 2000 is 2% and the RPI increase from 9 April 2001 is 2% again. No GMP is taken into account at this point because the firefighter has not attained State pension age (65).

Because in this example, the pension began in October, i.e. 6 months through the 12 month period from April 1999 to March 2000, a pro rata increase of 6/12 x 2% = 1% is applied from 10 April 2000 giving a new annual rate of £10,000 + 1% = £10,100.00

From 9 April 2001 the annual rate of pension would rise to £10,100 + 2% = £10,302.00

Example C

A male firefighter retired on health grounds aged 40 in 1977. He attains State pensionable age in 2002 at which time his annual FPS must be reduced by National Insurance modification of £34. (Because he retired before 1978 no adjustment for a GMP is necessary.) His pension at retirement was £3,000 a year. Assume the cumulative effect of Pensions Increase from 1977 to 2002 has increased that pension to £13,800 a year (the Pensions Increase multiplier being 4.6000).

At age 65, his basic pension before Pensions Increase must be reduced by National Insurance modification:

£3,000.00 - £34.00 = £2,966.00 a year

Pensions Increase is then added to the reduced pension:

£2,966.00 x 4.6000 = £13,643.60 a year from age 65