



**Isle of Man
Government**

Reiltys Ellan Vannin

A Consultation Response Document



Ending Contracting-Out of the State Second Pension

Issued by:

Income Tax Division
The Treasury
Government Offices
Bucks Road
Douglas
IM1 3TX

8 March 2018

Index

Page

1. Introduction.....2

2. Executive Summary.....2

3. Summary of Responses2

4. Conclusion..... 13

Ending Contracting-Out of the State Second Pension

Consultation Response Document

1. Introduction

In March 2015 the Treasury published a consultation document entitled "Proposed Changes to the Manx Social Security and National Insurance Systems".

Following this consultation Treasury presented to Tynwald a set of proposals that would form the foundation of the proposed new Manx Pension to replace the existing Basic State Pension, Additional State Pension and (ultimately) the Manx Pension Supplement. These were approved by Tynwald in July 2015. One of the proposals was that the current contracting-out arrangements should cease.

In July 2016 further proposals were agreed by Tynwald including that Treasury would issue a further consultation on the impact of ending the current contracting-out arrangements following the introduction of the new Manx Pension from 6 April 2019.

The additional consultation exercise was begun in July 2017 and sought the views of employers and scheme trustees who operate contracted-out schemes and employees who are members of such schemes as to how Treasury could minimise any adverse impact that the ending of the current contracted-out arrangements may have.

2. Executive Summary

The consultation was open for eight weeks, from 7 July 2017 to 1 September 2017, and generated a good deal of interest. A total of 33 responses were received. Of these, one was received a number of weeks after the timescale allowed but it has been included in the responses. Treasury would like to take this opportunity to thank all respondents for taking the time to reply to the consultation.

This document provides a summary of the responses made to each question raised in the consultation, together with a sample of the comments and suggestions made by respondents.

3. Summary of Responses

Twenty of the 33 responses were made by individuals and, of these, half responded to the questions raised in the consultation document while the other half commented more generally on the consultation.

The 13 remaining responses were received from local authorities, employers, employee representatives and a political body (hereinafter collectively referred to as "non-individuals"). Two of these responses advised that they would make no comment and therefore only the 11

remaining responses will be included in any comments below. Of these 11 submissions, nine responded to the questions raised in the consultation while two commented more generally.

A summary of the responses made to each question raised in the consultation is set out below. In each case sample comments are also included to illustrate the nature of the responses. Where the response is short, a comment may represent the full response. However, where the response is lengthier or consists partly of views that are also expressed in other responses, then a comment shown may be an extract. Names, places, etc, mentioned in responses have been removed. A reference to "GMP" that appears in some of the comments means Guaranteed Minimum Pension, a term used in the consultation document.

Question 1

Do you think that it is appropriate for schemes to be able to reduce future pension benefits or increase member contributions as a result of contracting-out ending?

Of the 10 individuals who directly responded to this question, the overwhelming majority considered that it was not appropriate.

Of the nine non-individuals who responded to this question, two considered the proposal to be inappropriate, three considered it to be appropriate, one had no issue with it, one had no comment to make, one acknowledged and noted relevant comments in the document, while the remaining response said that it may be appropriate for employers who have real cost pressures to manage as a result of the ending of contracting-out but that it should be the result of consultation and negotiation.

Sample of comments received:

Not in favour

- Not appropriate, and unfair - particularly for the members of the scheme who retire after 6th April 2019.
- I do not think that the pensions should be affected for existing members. We have not received a pay increase in line with inflation for some time. Contributions are being increased in every way possible but there are no increases in wages.
- No, it's completely unfair that I should be penalised for the actions of the government when I have paid in for a long time and believed from a young age that in my old age I would be financially okay.
- No – I feel that to penalise people to the extent that they will be hit is immoral at this stage. The amount being talked about is far in excess of the benefit that will have been received by being contracted out. Employers have received the greatest benefit of the arrangement and will feel no effect whatsoever – this cannot be right.

- This is unbelievable that you propose imposing decreased benefits or increased contributions in private sector pension schemes to cover employers, whilst using taxpayers money to protect the majority of contracted out workers, **immoral** is being kind.
- are of the opinion that it is not appropriate for any workplace pension scheme to be able to reduce pension benefits or increase member contributions as a result of contracting out ending to offset the increase of 3.7% employer NI contributions.
- Understandably employers may be unhappy about having to manage this extra cost but this does not mean they do not have an ability to do so by making a change in their pension scheme. It is we believe inappropriate for the Government to encourage employers to make a change in their pension schemes when costs can be managed in other ways.

In favour

- appreciates the impact that losing the contracted-out rebate could have on employers and has no issue with the proposals to follow the UK in this regard and to allow adjustments to pension scheme designs in this regard.
- Further costs for sponsors of defined benefit pension schemes could lead employers to make changes that may be detrimental to employees. Therefore, we consider it appropriate for schemes to be able to reduce future pension benefits or increase member contributions to adjust for the additional cost that will result from contracting out ending. In particular we would support the treasury's proposal to give employers powers to make proportionate changes to pension scheme rules for this purpose without Trustee consent.
- Yes – Otherwise the whole cost of these changes will fall on employers. Although this may encourage members of the scheme to opt out.

Question 2

Do you think Treasury's proposed approach to dealing with previous periods of contracted-out scheme membership in the transition to the new Manx Pension is fair?

The majority of the responses from individuals to this question were not supportive of the proposal to reduce the new Manx pension as a result of previous periods of contracted-out employment. However, the majority of non-individuals were supportive.

Sample of comments received:

Not in favour

- Absolutely not.
- No this is really unfair.
- No. Many people in workplace pension schemes were unaware that they are, or have been contracted-out, and consequently, they and their employer, are or have been, paying reduced

rates of National Insurance contributions, and this would result in a state pension reduced by an amount determined by the number of years they have been contracted-out. Government schemes should be transparent, and many would have opted to pay full NI contributions if they knew that their state pension would be reduced.

- Consideration of how to make this fair must take place. I have no issue with increasing contributions in the future as this has to happen for a scheme to stay viable but feel very strongly that dealing with past issues in the manner proposed is wrong.

In favour

- Yes - The new Manx Pension is underpinned by the existing State Pension with access to a defined benefit pension which should cover any shortfall in state pension.
- Yes, but in order to defray the costs that will be incurred by both employer and employee, we would suggest the Government staggers the impact over a maximum 3 year period.
- This adjustment is driven by the Treasury's wish to limit the cost of the reform to state pension and in that context it would be unfair if employers who had paid, and whose employees had paid in respect of them, lower NI contributions should get the same benefit as those who had paid higher rates of NI.

However, the challenge of communicating this to employees who have been contracted-out should not be under-estimated.

- feels that Treasury's proposed approach is fair, as it will ensure that all in the scheme will be treated equally in that they are subject to the same terms and conditions and will be responsible for the same rates of National Insurance contributions from 6th April 2019, whilst ensuring that those who have been engaged in contracted-out pension schemes are not penalised when it comes to calculating actual pension entitlement.
- This approach appears to be reasonable. However it is important that the approach also has the confidence of all pension scheme members and taxpayers. Currently there is not enough information for scheme members to assess the impact of the arrangements on their state pension entitlement. Further examples and individual illustrations must be provided to help members understand the impact of these proposals.
- believes this is a fair way of dealing with individuals' state pension expectations.

Other

- Only if the level of entitlement to the pension supplement as a percentage of the new flat rate pension is locked in on the date of change over.
- I think if it needs to be changed then that is acceptable but I think that it is unfair to penalise people for government mistakes and/or lack of foresight.

Question 3

How could the ending of contracting-out be best managed so as to minimise the administrative burden on schemes and Treasury?

Six of the 10 responses to this question from individuals said they did not want any change to be made. Of the remaining four responses from individuals, one suggested it should be phased out, one did not comment on this question, one suggested a calculation that could be used, while the remaining response said that an increase in contributions going forward leads to very little administrative burden but that the approach to retrospective savings is badly flawed and needs to be reconsidered.

Of the nine non-individual responses to this question, seven made comments regarding what they thought should be done. Of the remaining two responses, one said that contracting out should not end while the other said "No comment" to this particular question.

Sample of comments received:

Suggestions

- Communication will be important in keeping the administrative burden to a minimum. The number of incompatible records will determine how much extra work will be required. How quickly these are sorted will depend on the Treasury's approach and the resources available to the pension schemes. Additional funds to cover the additional cost of administration would be helpful.
- supports the idea of studying the approach taken in the UK.
- We would suggest that Treasury ensure it has sufficient experienced resource available in order to manage through the "GMP" reconciliation process over a matter of months, rather than years.
- urges Treasury to work closely with Scheme Administrators to ensure that the administrative burden from these proposed changes is as minimal as possible and supports the Treasury's position in this regard.
- Many employers with UK operations will have already dealt with the abolition of contracting out in the UK. Such employers will often have pension schemes administered by the same provider (whether in house or through a third party). Therefore the best way to minimise the administrative burden is by ending contracting out in a manner that is as similar as possible to the approach taken in the UK. This would seem logical because Isle of Man contracting out is very similar to contracting out in the UK prior to April 2016.
- Whilst the administrative impact that the ending of contracting-out will have upon The Treasury has been recognised, the feels that Treasury should progress the changes as quickly as possible without compromising accuracy.

- In terms of minimising this burden, the would seek to agree with Treasury an automated method timetable for the transfer of final GMP details for each individual contracted out scheme membership. Furthermore, the data sent to the would need to include an identifier to match the employment and scheme membership to which the GMP relates. Alternatively, for the's schemes if contracting out were to cease, the Treasury could maintain liability for the NI returns and continue to calculate and confirm GMP's for the future (potentially up to 40-45 years).
- It is clear that the least administrative impact would be no change. As this is unrealistic it is not unreasonable to make a simple calculation for each employee of contracted out years made, and how many additional years would be required to take this total to 35 with full contributions and award a full pension (or pro-rata if not full) on this basis.

Other comments

- I feel the reason for this is to generate more money to bail government out so leave things as they are.
- Don't do it, leave things alone.
- It shouldn't be done.
- Leave things alone. Government should not be hitting the very people who have kept them afloat.
- We strongly believe that contracting out should not end. This is the best way to reduce the administrative burden.

Question 4

Do you think it is appropriate to develop an alternative to contracting-out when the new Manx Pension is introduced?

Of the ten responses from individuals, five thought it appropriate to develop an alternative to contracting-out when the new Manx Pension is introduced, one was in favour if it is an answer to the problem being faced by contracted-out workers who do not work in the public sector, one thought that it should be avoided like the plague, one did not think it appropriate in this manner, one made no comment, one did not comment on whether they thought it appropriate while the remaining response said that it may be appropriate to introduce a different but equivalent scheme if it had the same outcome for pensions and reduced the impact on employer contributions.

Of the nine responses from non-individuals, six did not think it appropriate to develop an alternative to contracting-out. Of the remaining three, one did support the development of an alternative, one did not have strong views but said that its preference would lead it to lean towards no new contracting out options while also welcoming Treasury's interest in exploring the option, and one thought the question was outside the scope of the consultation agreed to by Tynwald in July 2016.

Sample of comments received:

Not in favour

- As contracting out appears to have been ill thought through and causing such a huge impact to people affected by this after 2019 I would think that any alternative should be avoided like the plague.
- This notion is completely at variance with the whole purpose of the state pension reform which is to produce a simpler system and clarify the incentive to save in company/private pension schemes.

It would be seen as equivocation on the part of the Government as it would be contrary to the declared policy that the extra NI cost, in respect of the 'vast majority' would be absorbed rather than passed on.

- does not feel it would be appropriate to develop alternatives to contracting-out. To do so would involve a lengthy process being undertaken, that would delay progress whilst potentially failing to yield any viable alternatives that would prove to be both cost effective and fair.
- The compliance and administrative burden of operating defined benefit pension schemes has increased significantly in recent years. Pensions have also become more complex for employees to understand so simplification through ending contracting out is welcome provided it can be done without increasing the cost burden. Therefore we don't think it is either helpful or appropriate to develop an alternative to contracting out under the new Manx state pension.
- The proposed new system has been modelled by the UK's Government Actuary's Department and would agree that the proposal appears to be the best way forward for the Island.
- No, as we believe any alternative would simply add to the complexities.

In favour

- Yes. There should be an alternative. There should be an incentive for both employer and employee to arrange a workplace / private pension, thereby reducing the burden on the state. i.e. the original purpose of contracting out.
- YES employer provided pension scheme takes burden off tax payer.
- If it is an answer to the problem highlighted concerning the minority of contracted-out workers who do not work in the public sector and who stand to lose out disproportionately by having to cover both their own and their employers increased contributions.
- An alternative to contracting out, yes. An employer provided pension scheme could well be a sensible idea.

Other

- does not have a strong view on new alternatives to contracting out, although's preference would be for the new Manx Pension to be as simple and straightforward as possible which would naturally lean towards there being no new contracting out options. However, does appreciate that contracting out can be beneficial in some circumstances and welcomes Treasury's interest in exploring this option further whilst also seeking to protect the Manx National Insurance Fund.
- If any impact is to be felt then this needs to be shared by employers who clearly preferred this type of scheme for the savings that they received. Employees cannot be the only ones to carry the effects of this change!!!!

Question 5

What form should this alternative to contracting-out take and how would it interact with the new Manx Pension?

Of the responses from individuals, five who were in favour of an alternative thought it should interact in the same way that it does now, one thought that a number of alternatives should be offered and a referendum held, two provided a joint answer to questions 4 and 5 which has been included under question 4 only, one did not answer this question, and one thought it is acceptable to be in line with other employers but that it needs to be phased in.

Of the nine responses from non-individuals, one said that the alternative should not interact with the new Manx pension, four respondents provided a joint answer to questions 4 and 5 which has been included under question 4 only, three who were not in favour of question 4 said, in relation to question 5, that it was not applicable or that they were providing no response, and one thought the question was outside the scope of the consultation agreed to by Tynwald in July 2016, as per their reply to question 4.

Sample of comments received:

- I think that it is acceptable to be in line with other employers but I think that it needs to be phased in. By making sure that all new employees are signed up to an alternative will eventually sort out the problem. Until then I think that the government should deal with the situation that they have created and keep the agreements that have been made with both the employers and the employees when they entered into the pension.
- Take an island wide consensus – offer a selection of alternatives and hold a referendum.
- It should work in the same way that it does now - people need an incentive to work!
- It should not interact with the new Manx pension and operate completely separately. However, there should be some incentive for the employer and the employee to arrange a workplace pension, and, as stated above, reduce the burden on the state.

Other comments and suggestions

A number of respondents to the consultation did not answer the questions raised in the document but instead made general comments regarding the proposals. Ten individuals responded in this manner together with two non-individuals. Their responses are reproduced below. Those responses which were lengthier or which expressed similar sentiment to others are reproduced in part while the remainder are reproduced in full. Names, places, etc, mentioned in responses have been removed.

Comments received:

- I would love to tell you my views on the proposals. I am actually furious with the proposed changes to be honest. I am 23 and therefore have over 40 years left of work. These changes seek to increase my national insurance contributions, in order for me to benefit from them in 40 years' time. I know I must sound a little selfish on the older generation, however, the pension contributions themselves are set to rise in April and I genuinely cannot afford another increase when wages are not following the same pattern.

As someone from a younger generation, it is much more difficult and expensive in general, with issues such as, trying to get on the housing ladder and concerns around future childcare costs. I feel as though it is incredibly unfair to levy another charge on an already struggling generation, in order to pay for higher pensions for those who have paid considerably less into their pension over the years than I will have done by the time I reach pensionable age. I hope you do not think I am being unfair on those close to pensionable age as I know those people will have their own issues with these proposals. As I am relatively young, I am also, understandably, lower down in the pay scales than those closer to retirement age; this means that I will struggle massively to afford these changes.

- I would like to express my dissatisfaction with such proposal.
- I would like to express my concern over the plans to reduce my state pension as stated in the "contracting out" example given. I have been in public service for over thirty years and have paid all relevant contributions on the understanding that it was full contributions.

I feel it would be very unfair to penalise myself and others for a system that I had no control over and would be extremely difficult to make up this projected shortfall.

I do appreciate that my contributions will increase moving forward but feel to back date "penalties" is wrong.

- I am writing this letter to raise my concerns over the "contracting out" issue, I have been in public sector employment for over 10 years and was not aware that my contribution level was different to other careers. I am fully aware that money needs to be raised to pay for a fair pension system but do not think I should be penalised as I paid my national insurance at the correct rate at the time.
- I write to strongly oppose the contracting out proposals.

Having been a in for 38 years, I have never been made aware that I am paying reduced NI contributions as a result of having an occupational pension.

If I had of been aware I would have made the extra contribution to ensure full state pension.

It feels wrong that people should be disadvantaged so close to retirement.

- I feel this is unfair because it will affect my old age pension on contributions I have already made.
- Will people who are full time benefit and in effect contributed nothing be punished or will they receive the full pension?

If it is the case that they receive more pension than myself and others who have worked all our lives and paid everything that has been asked of us then the system is fundamentally wrong!

- I am very concerned at the implications this will have for government workers such as myself and I do not at all think these proposals are in any way fair.

I have trusted in the government system for my pension provision and I am bitterly disappointed to realise that I may face a reduced rate of pension when I retire, through no fault of my own, because I completely trust in the Isle of Man Government.

I have not been given a choice of my national insurance contributions since I started work at 9 years ago. I was unaware that I had been paying a reduced rate because the IOM government contracted out my pension. I was also unaware that the IOM government has also been making a more substantial saving on my national insurance contributions by doing this.

- I am concerned about the use of the word "should" highlighted below:

Ending contracting out would affect the vast majority of members in public sector schemes by way of them paying higher rates of National Insurance contributions. In return, Treasury has advised that this **should** also mean an increase in state pension for individuals.

If it is NOT a straight pension benefit and rather to increase revenue to the Government for distribution other than to raise pension payments then you must not frame it that way. People with a contracting-out arrangement may not increase their personal contributions to their private schemes assuming that the government will pay somewhere near an equivalent value. If this is NOT your intention or if it has a reasonable probability then you should make that clear.

It should be honestly written as a whole communication or the sentence should read:

"In return, Treasury has advised that this **will** also mean an increase in state pension for individuals."

(Note: the above comment was made in reference to a staff email bringing the consultation to the attention of all employees and does not relate to the consultation document itself.)

- "In any consultation exercise the responses received do not guarantee that changes will be made to what has been proposed."

A telling final sentence.

So what does the consultation guarantee?

I think there has been couple of crucially important questions missing from all the consultations on our pensions:

- Do you understand any of this?
 - Do you think we are being deliberately obtuse and confusing?
 - Do you think we are treating you fairly?
- noted that Treasury will introduce the new Manx Pension from 6th April, 2019, and that changes to the National Insurance Contributions will have effect the finances of by introducing additional costs equating to approximately a 3.5p rate. felt that the changes will happen and, as their implementation will be compulsory, question to need to consult.

I am instructed to advise that felt the consultation presented a fait accompli which would have an adverse impact on rate payers.

- - has concerns that the increase in employers' contributions of 3.7% has the potential to impact on frontline services either through the reduction in staffing or in resources.
- It would be wholly unacceptable for schools to be disadvantaged due to this proposal, either via a reduction in funding or provision of resources, including teachers.
- There was an increase in Isle of Man inflation, as measured by the RPI, of 29% from July 2010 to July 2017, after the meagre pay uplifts during this period are taken into account. This means that teachers' pay has declined in real terms by 25% during this time.
- The proposed additional 1.6% in National Insurance (NI) contributions will further exacerbate this sharp decline and adds insult to injury.
- would assert that if the Treasury is considering different options, including new forms of contracting out, details of these need to be provided without delay.
- The Treasury should also consider allowing contracted-out provision to continue in certain schemes, such as teaching where specific and unique factors exist.

(Note: the text shown at this bullet point consists of a number of separate comments extracted from the response received.)

4. Conclusion

Treasury believe that the introduction of the single-tier state pension is fundamental in ensuring that the state pension is affordable for future generations. It therefore intends to bring forward legislation in the near future to end contracting-out in April 2019.

Treasury acknowledge that many contracted-out occupational pension schemes in the Island are similar in design to those which operated in the UK before contracting-out ended there in April 2016. Given the financial and administrative impacts the abolition of contracting-out will have on schemes, Treasury propose that the procedures for scheme reconciliation which applied in the UK will be adopted in the Island. This will minimise the cost and administrative burden for both schemes and Treasury.

A number of responses to the consultation were received from individuals who are currently members of contracted-out pension schemes and it was clear that some were not aware of how contracting-out affected their entitlement to the state pension under the existing scheme. Therefore, Treasury will work with schemes to ensure that members are made aware of their contracted-out periods and how this will affect their entitlement to the new Manx pension.



This document can be provided in large print or audio tape on request