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Dear

CONSULTATION DOCUMENT: PROPOSED AMENDMENTS TO ARMED FORCES PENSION PROVISION

1. Thank you for the helpful comments I received in response to my letter of 30 October. I have two more pensions issues about which I would welcome your comments or suggestions. As before, if any member would like to discuss any of the proposals I am happy to field questions by telephone, letter or email.

Issue

2. Amendments are proposed to the Armed Forces Pension Scheme 2005 (AFPS 05), the Armed Forces Pension Scheme 1975 (AFPS 75) and the Reserve Forces Pension Scheme (RFPS). These amendments relate to the treatment for pension purposes of those who go absent without leave and, for RFPS only, the removal of the eligibility rule which limits the member to membership of one occupational pension scheme only in relation to his mobilised service.

Timing

3. The Central Advisory Committee are invited to consider the attached amendments out of committee and to submit comments or observations by 2 February 2009.

Background

4. AFPS 05 was introduced for new entrants to the regular Armed Forces on 6 April 2005. RFPS was introduced on the same date for new mobilised reserves and new entrants to the Full Time Reserve Service (FTRS). AFPS 05 and RFPS are modern, non-contributory, final salary pension schemes. AFPS 75 is a non-contributory, final salary-related pension scheme which closed to new entrants on 6 April 2005 when AFPS 05 and RFPS were

introduced. AFPS 05 is a statutory scheme which relies on the Armed Forces (Pensions and Compensation) Act 2004 as its authority. Amendment is by Statutory Instrument (SI) and subject to negative resolution. AFPS 75 rules are contained in prerogative instruments and amendment is by Royal Prerogative. RFPS relies on the Reserve Forces Act 1996 and amendment is by Regulations approved by the Defence Council.

5. Members of AFPS 75 who were in service on that date and still in service on 6 April 2006 were given the opportunity to transfer to AFPS 05. Members of the FTRS section of AFPS 75 were given the opportunity to transfer to RFPS in the same time frame. In the event about 8% of those eligible opted to transfer to the new schemes.

6. Amendment to RFPS eligibility criteria: When RFPS was introduced Her Majesty's Revenue and Customs (HMRC) rules prevented membership of more than one occupational pension scheme in relation to the same service. Thus RFPS contained a rule which says that a person is not eligible to be a member of RFPS in respect of his service if he belongs to any other occupation pension scheme in respect of that service. On 6 April 2006 Pension Tax Simplification swept away the eight former pension tax regimes and, from that date onwards, pension savings in tax-privileged schemes were to be controlled by two mechanisms – the Annual Allowance (AA) and the Life Time Allowance (LTA).

7. The AA limits the amount by which a pension may grow in any input period and the LTA limits the overall size of the pension pot. If the AA is breached the member is liable for a tax charge which is payable immediately. If the LTA is breached the member or the scheme is liable to a tax charge which may be met by reducing the pension.

8. Currently, when a reservist is mobilised, he or she is given a set of pensions options. They may:

- Remain in their civilian occupational pension scheme;
- Remain with their private pension arrangements;
- Remain or join the Second State Pension arrangement; or
- Join RFPS

The MOD will pay the employer's contributions for whichever of these options they choose. In practice, most individuals choose to remain with their civilian occupational pension scheme with the MOD paying the employer's contributions.

9. Senior Officers visiting mobilised personnel in the Middle East have been lobbied about these options in that, although the MOD rightly limits its contribution to only one scheme, reservists reported that their civilian employers were willing to continue paying the employer's contribution. They felt it was unfair, if their civilian employer was willing to continue paying the employer's contribution to the civilian scheme, that they should be denied RFPS membership as well. As there is now no HMRC barrier to belonging to two schemes, we propose to remove the barrier in RFPS rules - although we doubt that we will see many examples of individuals being members of more than one scheme.

10. This proposal is limited to RFPS membership because mobilised service is not a long term career commitment and we can understand why individuals would wish for continuity in their civilian scheme.

11. AWOL: When individuals go AWOL they are not discharged from the Armed Forces and this causes anomalies regarding pension benefits. There are three issues around AWOL that we seek to address:

- For AFPS 75 only, the treatment of periods of less than seven days AWOL for Army personnel;
- For all schemes, what benefits are payable in the event of the death of an individual while he is AWOL; and
- For AFPS 05 and RFPS only, what benefits are payable following a prolonged period of AWOL.

I will deal with each in turn.

12. AFPS 75 rules are set out in separate prerogative instruments for each. Work is in hand to ensure that the wording of the instruments are identical and this work has highlighted a difference in the way that the Army count periods of AWOL of less than seven days. The Royal Navy and the Royal Air Force provisions do not allow these unauthorised absences to count towards pensions entitlements but the Army provisions do not discount them for pension purposes unless the absence exceeds seven days. The proposal is that all three Services should treat periods of AWOL in the same way (ie. that they do not count towards pension). This anomaly does not exist in AFPS 05 or RFPS because of the way that qualifying and reckonable service are defined in such away as the unauthorised absence does not count for pension benefits.

13. When an individual goes AWOL he is not discharged from his Service and none of the schemes has a provision which makes him other than an 'active member' when he or she is AWOL. For an AFPS 75 member this means that, if he dies while he or she is AWOL (regardless of the duration of the absence), a death in service lump sum will be paid worth three times the representative pay for his rank. For AFPS 05 and RFPS the problem exists but is less severe. This is because these scheme have a rule provides that a lump sum of four times 'final pensionable salary' and 'final pensionable salary' is defined as the best consecutive 365 days in the last three years. Thus, if the AWOL extends beyond three years, nothing is payable by way of a death in service lump sum.

14. Other public sector pension schemes get around this problem by treating the absentee as a deferred pensioner. This means that, if they die whilst on a prolonged period of AWOL, the preserved pension lump sum becomes payable together with any survivors' pensions. The proposal is that, once an individual has been AWOL for a prolonged period, he should be treated for pensions purposes only, as deferred pensioner. I would welcome your views on the proposal itself and what the period which triggers this deferred status should be. We had in mind either three or six months AWOL.

15. AFPS 05 and RFPS contain a formula for the calculation of pension and lump sum which relies on the 'final pensionable salary' as defined in paragraph 13. The formula for pension is (final pensionable salary x reckonable service) divided by 70 with a lump sum of three times the pension. Thus, if someone goes AWOL for more than three years the product of this formula would be zero. My concern here is that, although the individual has been AWOL for some time, not to award a preserved pension representing the benefits accrued until the point of his disappearance, is likely to put us in breach of Human Rights legislation in respect of rights to property. The proposal contained in paragraph 14 would address this issue as, after a specified period, he or she would be treated as a deferred member.

Conclusion

16. These proposed amendments serve to:

- Relax the RFPS eligibility rules to allow an individual to belong to RFPS even if his employer continues to pay for his membership of his civilian occupational pension scheme;
- Ensure that all AFPS 75 members are treated the same for pension purposes for short periods of AWOL;
- Limit eligible for death in service lump sums to those whose period of AWOL is not prolonged; and
- Protect the accrued benefits of AFPS 05 and RFPS members who have been AWOL for more than three years.

If you have any comments on the attached proposals I would be very happy to received them. I should be grateful if you let me have them by 2 February 2009.

Yours sincerely,