Cost Management, Benefit Design and Administration Committee

Item 8a Paper D

AMENDMENT TO REFUND OF CONTRIBUTIONS REGULATIONS

Issue

1. The Technical Group has requested that the Scheme Advisory Board should consider making recommendations to MHCLG to address concerns over the requirement in Regulation 18(5) of the 2013 Regulations that refunds of contributions must be made to the entitled person within 5 years of the employment having been terminated.

Background

2. The request from the Technical Group is shown below –

"The National Technical Group recommend to SAB, to change the regulations concerning the payment of a refund to reflect the position prior to 1 April 2014 (i.e. to remove the prescription that requires an administering authority to pay a refund on the expiry of a period of five years beginning with the date the person's active membership ceased if no request is made before then – regulation 18(5) of the LGPS Regulations 2013 [SI 2013/2356]). In making this recommendation the group acknowledged that interest would be added up to the date of payment, as opposed to on the expiry of 5 years.

Brief background

Further to the discussion and recommendations that took place in the meeting of 28 September 2018, the group considered as to whether or not the '5 year rule' set out in regulation 18(5) of the LGPS Regulations 2013 could be removed? After investigation it was discovered that the '5 year rule' had been inserted into the LGPS Regulations 2013 at request from Administering Authorities. It is understood that an equivalent rule is not present in other PSPS. The rule was inserted to avoid building up any further 'frozen refunds, however, this has had unintended consequences.

Detailed background covered in meeting held on 28 September 2018

Members who left active membership of the scheme on and after 1 April 1974 and prior to 1 April 2008

Any refunds being processed 'now' for members who left under the 1974 Regulations, the 1986 Regulations (which were a consolidation of the 1974 Regulations), or the 1995 Regulations (which were merely a consolidation of the 1974 and 1986 Regulations) are paid under regulation 29 of the LGPS

(Transitional Provisions) Regulations 1997. These revoked regulation C21 of the LGPS Regulations 1995 (refunds), as it is one of the "replaced provisions" named in regulation 2(1) of the LGPS (Transitional Provisions) Regulations 1997. Therefore, all refunds that are paid 'now' for members who left active membership of the scheme on and after 1 April 1974 and before 1 April 2008 are paid in accordance with regulations 87 and 88 of the LGPS Regulations 1997. *There is no time limit by when the refund must be paid.*

Members who left active membership of the scheme on and after 1 April 2008 and prior to 1 April 2014

Any refunds paid 'now' for members who left active membership of the scheme on and after 1 April 2008 and before 1 April 2014 are paid in accordance with regulations 46 and 47 of the LGPS (Administration) Regulations 2008. *There is no time limit by when the refund must be paid.*

Members who left active membership of the scheme on or after 1 April 2014

Any refunds paid 'now' for members who left active membership of the scheme on and after 1 April 2014 are paid in accordance with regulations 18 and 19 of the LGPS Regulations 2014 (a small group of members did have transitional protection under regulation 7 of the LGPS (Transitional Provisions, Savings and Amendment) Regulations 2014 though for the purpose of setting a policy approach for the issue to hand this is irrelevant).

Regulation 18(5) of the LGPS Regulations 2013 prescribes that *there is a time limit for payment*:
"*An administering authority shall refund contributions to a person entitled under paragraph (1) when the person requests payment, or on the expiry of a period of five years beginning with the date the person's active membership ceased if no request is made before then or, if the person attains age 75 before then, on the day before attaining age 75.*"

Group discussion

There was overall agreement that the refund could not automatically be paid (i.e. using bank information that may be up to 5 years old) without the necessary up to date mandates and relevant approval/confirmation from the member.

There was also a reluctance to pay refunds to an ESCROW account for a number of reasons:

a) Difficulty in opening ESCROW accounts,

b) If an ESCROW account is opened, payments into the account would need to be tracked causing more work as these members will still not have completed documentation to pay the refund from the ESCROW account. This would impact on those administering authorities with large volumes of refunds who don't reply.
c) This approach is inconsistent with how refunds in respect of members who left prior to 1 April 2014 are processed (albeit the group acknowledges that there are no time constraints regarding payment for those cases).
d) It was recognised that members are reluctant to provide their bank details in order to receive refunds for lower values, for example, those less than £10.
e) The regulations prescribe that a refund should be paid to the 'person entitled' and it's not clear that an ESCROW account meets that criteria.

The group considered the impact of leaving the refund in the pension fund and paying the refund to the member at a date beyond the timescale set down in regulation 18(5)? There are a number of impacts:

1) If the refund were to be paid to the member beyond the expiry of 5 years from leaving active membership and the member had not re-joined the scheme beyond that date, then should the refund be paid this would be a breach of the scheme rules and would need to be recorded as such. These cases would need to be reported to pensions committee, Local Pension Board and included on the breaches register.

   Additionally, the payment could not be treated as a Short Service Refund Lump Sum payment under section 166 and paragraph 5 of the Finance Act 2004 if the member:
   a) Had previously had a BCE in the Scheme, and/or,
   b) Holds deferred benefits in the Scheme, and/or,
   c) Has reached age 75

   If any of the above circumstances have occurred, the payment would be an unauthorised payment, as such would need to be reported on the event report and the payment (excluding both interest which is a scheme administration member payment and any charge by virtue of section 205 of the Finance Act 2004) would be subject to:
   Member tax charges of:
   - 'Unauthorised Payments Charge' (40%)
   - Maybe subject to 'Unauthorised Payments Surcharge' (15%)

   Administering Authority tax charges of:
   - 'Scheme Sanction Charge' (40% though may be reduced to 15% if 'Unauthorised Payments Charge' paid by the member –

administering authorities may wish to consider adopting the mandating procedure set down in PTSM134300).

2) If the refund were to be paid to the member beyond the expiry of 5 years from leaving active membership and the member had re-joined the scheme beyond that date, then should the refund be paid this would be a breach of the scheme rules and would need to be recorded as such. These cases would need to be reported to pensions committee, Local Pension Board and included on the breaches register.

   Additionally, the payment could not be treated as a Short Service Refund Lump Sum payment under section 166 and paragraph 5 of the Finance Act 2004 as the payment would not extinguish the member's benefits under the scheme. The unauthorised payment, would need to be reported on the event report and the payment would be subject to the tax charges as set out in point 1 above.

3) If the refund is not paid to either the member or an ESCROW account these cases should be reported to pensions committee, Local Pensions Board and recorded as a breach.

   Two final points to note in this scenario, is that:

- An interfund adjustment could not take place under regulation 22(5) of the LGPS Regulations 2013. This is because there is no entitlement to an interfund, because the refund should have been paid before the expiry of 5 years from leaving active membership. To allow the payment of an interfund, would in effect place the member in a better position than a member who re-joins the scheme after the expiry of 5 years from leaving active membership, who took payment of their refund within the prescribed manner.
- A cash transfer sum could not be paid to another registered pension scheme under regulation 96 of the LGPS Regulations 2013. Again this is because there is no entitlement to cash transfer sum, because either a cash transfer sum or a refund should have been paid before the expiry of 5 years from leaving active membership.

Group policy recommendation

Taking all of the above considerations into account the group have recommended the following policy approach to the payment of a refund of contributions in respect of a member who left active membership on or after 1 April 2014:

General principle

The group agreed that a refund should be paid from the fund before the expiry of 5 years of the member leaving active membership. However, the group acknowledges in practice, this is not always possible. Where this is the case the following approach should be followed:

Old refunds (i.e. those where the member left on and after 1 April 2014, the administering authority has already communicated with the member – though no response has been received)

1) On approach to the expiry of 5 years from leaving active membership provide the member with a statement containing the prescribed information (i.e. value of refund and cash transfer sum (CTS) plus the rest of the information as set down in sections 101AC and 101AI of the Pension Schemes Act 1993 and regulation 7 of the Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006 [SI 2006/33] – at this point it would be appropriate to set the 'reply date' to around a month before the expiry of 5 years from leaving active membership – this will allow the administering authority sufficient time to receive the completed mandate and pay either the CTS or the refund before the expiry of 5 years from leaving active membership).

   a) If a fully completed mandate is returned from the member and the administering authority can pay the refund before the expiry of 5 years from leaving active membership – pay the refund -no further action.
   Interest would be added to the payment in accordance with regulation 18(3) of the LGPS Regulations 2013.

   b) If a fully completed mandate is returned from the member though the administering authority cannot pay the refund before the expiry of 5 years from leaving active membership. Then the refund may be paid though it will be recorded as a breach against the scheme regulations and depending upon the circumstances may be subject to a tax charge (see points 1 and 2 in **group discussion**).
   Interest would be added to the payment in accordance with regulation 18(3) of the LGPS Regulations 2013, though capped on the expiry of 5 years from leaving active membership (as agreed in a meeting with MHCLG (as was DCLG) on 22 April 2015.

   c) If a fully completed mandate is not returned by the member, leave the payment in the fund – no further action (i.e. the group agreed not to waste time or money on using Tracing services in respect of members who have been contacted repeatedly and do not reply). Though it may be beneficial to record the 'frozen refund' as a 'post

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14 frozen refund' to differentiate between the entitlements of a 'pre 14 frozen refund' (i.e. a post 14 frozen refund cannot be aggregated with later membership if the member were to re-join the scheme).

New refunds (i.e. those where the administering authority is communicating for the first time 'now')

1) Within a reasonable period after leaving active membership provide the member with a statement containing the prescribed information (i.e. value of refund and cash transfer sum (CTS) plus the rest of the information as set down in sections 101AC and 101AI of the Pension Schemes Act 1993 and regulation 7 of the Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006 [SI 2006/33] – for all new refunds, at this point it would be appropriate to set the 'reply date' to coincide with the date of intended communications at point 2 below, maybe 4 years 9 months?). If the member makes a positive election for either a CTS or a refund, pay in accordance with the members instructions.

   If the member does not respond:

2) On approach to the expiry of 5 years (i.e. on the date that the 'reply date' was set in the previous point) from leaving active membership provide the member with a written Statement containing only the value of the refund of contributions (because the administering authority can refuse to pay a CTS where the member has not made an election before the reply date in point 1).

   a) If a fully completed mandate is returned from the member and the administering authority can pay the refund before the expiry of 5 years from leaving active membership – pay the refund -no further action.
   Interest would be added to the payment in accordance with regulation 18(3) of the LGPS Regulations 2013.

   b) If a fully completed mandate is returned from the member though the administering authority cannot pay the refund before the expiry of 5 years from leaving active membership. Then the refund may be paid though it will be recorded as a breach against the scheme regulations and depending upon the circumstances may be subject to a tax charge (see points 1 and 2 in **group discussion**).
   Interest would be added to the payment in accordance with regulation 18(3) of the LGPS Regulations 2013, though capped on the expiry of 5 years from leaving active membership (as agreed in a meeting with MHCLG (as was DCLG) on 22 April 2015.

c) If a fully completed mandate is not returned by the member, leave the payment in the fund – no further action (i.e. the group agreed not to waste time or money on using Tracing services in respect of members who have been contacted repeatedly and do not reply). Though it may be beneficial to record the 'frozen refund' as a 'post 14 frozen refund' to differentiate between the entitlements of a 'pre 14 frozen refund' (i.e. a post 14 frozen refund cannot be aggregated with later membership if the member were to rejoin the scheme)"."

Consideration

Prior to the 2013 Regulations there had been no time limit on when any refund of contributions had to be paid. Inevitably, this resulted in orphan refunds not being claimed with a resultant administrative overhead and the need to continue making reasonable effort to make the payment.

At the request of administering authorities, the 2013 Regulations introduced a time limit of 5 years from the date the entitlement to a refund first arose for the payment to be made. The wording of Regulation 18(5) is such that there would appear to be no allowance for payments to be made after the five year period has elapsed with the result that where payment has not been possible, a technical breach has occurred which may be reportable. There is also the concern that the strict wording of the regulations may not allow an administering authority to transfer the sum owed into an ESCROW account or other third party account.

For these reasons, the Technical Group is recommending to the Scheme Advisory Board that the refund of contributions provisions in the 2014 scheme should revert back to the position under the former regulations, that is, with no time limit on when payment has to be made.

Recommendation

That the committee considers the paper from the Technical Group and invites the Scheme Advisory Board to consider the proposal as submitted or as amended by agreement of the committee.

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