

**EXPLANATORY MEMORANDUM TO
THE**

ARMED FORCES PENSION SCHEME ETC. (AMENDMENT) ORDER 2009

2009 NO. 544

1. This explanatory memorandum has been prepared by the Ministry of Defence (MOD) and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The Armed Forces Pension Scheme etc. (Amendment) Order 2009 amends the Armed Forces Pension Scheme Order 2005 (SI 2005/438) (“the principal Order”) which established the new Armed Forces Pension Scheme 2005 (“AFPS 05”) and the Armed Forces Early Departure Payment Order (SI 2005/437) which established a new Armed Forces Early Departure Scheme (“EDP”).

2.2 Both Orders mentioned in paragraph 2.1 were made under section 1(1)(a) of the Armed Forces (Pensions and Compensation) Act 2004. The AFPS 05 is a pension scheme. The EDP scheme also provides benefits on termination of service but is not a pension scheme.

3. Matters of special interest to the Joint Committee on Statutory Instruments (JCSI)

3.1 The JCSI will note that, while the Armed Forces Pension Scheme etc. (Amendment) Order 2009 features Articles which are numerically sequenced (in accordance with SIP 4th ed. paragraph 1.5.7), the rules referred to in Articles 7 onwards follow lettered parts at the first division. Whilst this is unusual for a statutory instrument, the AFPS 05 rules (which are set out in Schedule 1 to the principal Order) are drafted in this way, as is common for pension schemes; and any amendments made need to follow the principal Order.

4. Legislative context

4.1 The 2004 Act establishes a statutory framework to enable provision to be made to establish new pension and compensation schemes for the Armed Forces, with the scheme rules set out in statutory instruments.

4.2 Section 3(1) of the 2004 Act provides that the power to modify a scheme where such modification might (or would) adversely affect any entitlement, accrued rights or pension credit right of any scheme member may only be exercised if either the consent requirements are satisfied or the scheme is modified in the prescribed manner (see section 3(1)(a) and (b)). The amendments relating to increases for inflation might adversely affect entitlements and accrued rights and therefore SI 2009/262, which came into force on 6 March 2009, prescribes the manner of modification of the scheme in order to make these changes. The modifications are set out in Article 7 of this Order. Other modifications do not

affect entitlements, accrued rights or pension credit rights and section 3 does not therefore apply to those changes.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom, as do the instruments that it amends.

6. European Convention on Human Rights

6.1 As the Order is subject to negative resolution procedures, and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The most significant changes provided for in this statutory instrument is to the rules on determining final pensionable earnings and final relevant earnings in the AFPS 05 and the EDP Scheme respectively and the rules on applying increases to pensions or awards. This is to ensure that inflation increases are applied to the correct periods and to remove the risk of double indexation. Various other changes are also made, none of which are detrimental to scheme members. All the amendments have been subject to consultation with the Central Advisory Committee on Pensions and Compensation on which representatives of the serving and ex-Service communities all sit. All respondents were supportive of the proposed changes.

7.2 Articles 3 and 4 correct an error and remove the risk of double indexation from the EDP Scheme. Article 3 replaces the original article 7 (adjustments for inflation in determining final relevant earnings) to correct the drafting error which applied inflation adjustments to any part of the period of 365 days which fell into a previous tax year. Inflation increases are now applied to any period that falls into a previous year (the end of the current year being the last day of service). Article 4 amends article 11 so that the inflation adjustment is disregarded when calculating the award under article 9, but is taken into account when the award is in payment. This ensures that when benefits come into payment they are not doubly adjusted.

7.3 The only other change to the EDP Scheme Order is set out in Article 5. It brings those leaving with EDP benefits who then join the Non Regular Permanent Staff Pension Scheme into line with those rejoining the regular Armed Forces or the Full Time Reserve Service (where EDPS payments are suspended).

7.4 Article 7 amends the AFPS 05 to correct the same problems as identified in the EDP Scheme at paragraph 7.2 above.

7.5 Article 8 introduces rules for the counting of previous non-pensionable service (gratuity-earning service) as qualifying and reckonable service for those who change to pensionable terms. The Armed Forces no longer allows new engagements on gratuity-earning service but there are still a number of individuals who are on gratuity-earning service who might wish to take advantage of this rule.

7.6 Article 9 protects the position of individuals who leave the regular Armed Forces and rejoin at a lower rank within six months. Without this amendment, individuals who leave after 18 years having achieved non-commissioned officer status and then join the Military Provost Guard Service as a private without achieving promotion would have all their benefits calculated at the lower final pensionable pay because the period of service would be treated as continuous. Individuals are given the option to disregard the break as there is the potential in individual cases this may be financially more beneficial.

7.7 Article 10 reduces the age at which Pension Credit Members are entitled to a pension from 65 to 55 for those with a pension sharing orders made on or after 6th April 2009. Article 11 gives those with orders made before this date and who are entitled to a pension at age 65 the option to receive early payment of a pension from age 55 with actuarial reduction.

7.8 Article 12 contains minor amendments to the AFPS 05 designed to correct grammatical and other errors, remove unnecessary requirements, insert a necessary definition and to ensure that the rules do not lead to unauthorised payments being made. The most significant of these are the changes to rule D.8 (member's request for review of ill-health awards) which are necessary to avoid the additional payments being treated as unauthorised as a result of the changes introduced by the Finance Act 2004.

7.9 Rule D.8 provides for the review of an ill-health award made under rule D.6 or an award under article 16 of the EDP Scheme to see if the member has suffered a permanent breakdown in health. Since the scheme rules were written, Her Majesty's Revenue and Customs pension tax rules have changed making the payment of a second lump sum an 'unauthorised payment' which attracts tax penalties for both the member and the scheme. Article 12(5) provides for any lump sum which would otherwise be due to be converted into additional pension to avoid this.

7.10 Article 12(7) gives effect to the Department of Work and Pension decision that, where an individual in serious ill-health wants to exchange his whole pension for a lump sum, any Guaranteed Minimum Pension element which may exist should be included in the calculation.

7.11 The original Orders have been amended several times since 6 April 2005. During the passage of the Armed Forces (Pension and Compensation) Bill through Parliament, the Armed Forces Pay Review Body was asked to provide a regular external validation of AFPS 05 in comparison with other schemes. This was to occur at least every five years (but more often if events justified it) and the arrangement was made to meet the concerns expressed that there should be some independent oversight of the scheme. The first five yearly comparison is due in Spring 2010 and we propose that a consolidation exercise should follow with a view to the production of a new Order by April 2011.

8. Consultation outcome

8i.1 Although the Armed Forces do not have Trade Union representation, these proposals have been put to the Central Advisory Committee on Pensions and Compensation and also appear on our website. The Central Advisory Committee comprises representatives of the main ex-Service organisations, including the Forces Pensions Society, and serving personnel who represent each of the three Services. The Forces Pensions Society worked closely with the Department on the design of AFPS 05 and view the proposals as non-controversial. No other comments have been received on the proposals.

9. Guidance

Updated guidance on both the EDP Scheme and AFPS 05 will be issued in due course to explain these changes, which are available both in hard copy and on the intranet.

10. Impact

10.1 A Regulatory Impact Assessment has not been prepared for this Order as it has no significant impact on business, charities or voluntary bodies.

11. Regulating small business

11.1 This legislation does not apply to small business.

12. Monitoring and review

12.1 During the passage of the Armed Forces (Pension and Compensation) Bill through Parliament, the Armed Forces Pay Review Body was asked to provide a regular external validation of AFPS 05 in comparison with other schemes. This arrangement was made to meet concerns expressed that there should be some independent oversight of the scheme. The first five yearly comparison is due in Spring 2010.

13. Contact

13.1 Contact Nick Shaw, Ministry of Defence, 0207 218 0564, email Nick.Shaw460@mod.uk if you have any queries on this memorandum.