

**RECTIFYING DISCREPANCIES IN CONTRACTED-OUT BENEFITS:
DEALING WITH SPECIAL CASES**

Corrective payments may be more complex (and costly) to achieve in relation to some classes of member – for example, those who have died or transferred out. Schemes (and sponsors underwriting reconciliation costs) may also be less willing to incur the costs of correcting payments for some categories of member, for example those who have commuted their benefits. Trustees should aim to establish a strategy for payments which is fair to members overall and consistent with their fiduciary duties – this can include taking cost/benefit issues into account. Different schemes are likely to adopt different strategies as a proportionate response to dealing with rectification issues revealed through the reconciliation process.

This note considers particular aspects of dealing with typical ‘non-standard’ cases and sets out the legal principles and some practical points relating to rectification of payment errors, in particular factual situations. It is intended to assist trustees in understanding the issues involved, but trustees should consider taking legal advice in relation to specific situations.

For more information on general principles around rectifying errors following a reconciliation exercise, please see Guidance Note 5: ‘Rectifying discrepancies in contracted-out benefits: next steps following data reconciliation’.

Deceased members

Where a member has died before the scheme’s reconciliation exercise, this is normally treated as a ‘no further liability’ case and no data will be supplied by HMRC in respect of the member unless requested. However, any spouse’s pension may be incorrect as a result of the error and may need to be corrected back to the point at which it was set up.

Overpayments

Where a pension has been overpaid and the member has since died, it is theoretically possible that this could be reclaimed – however, trustees would need to consider carefully the practical and reputational issues involved in following this course of action. Similarly, where it is identified that a balance of a five-year guarantee period has been overpaid as a consequence of a pension being paid at too high a rate, trustees could consider approaching the recipient(s) of the lump sum death benefit with a view to reclaiming the overpayment, but again should take account of the practical and reputational issues involved.

Underpayments

Schemes should consider correcting underpayments in benefits paid before a member’s death (whether or not a spouse’s pension is in payment – though, as noted above, errors may not be identified unless a spouse’s pension is in payment).

In theory, schemes should be able to pay any amounts owed by the scheme to the personal representatives (PRs) of a deceased member – PRs hold office for life (unless formally removed), so

even if the estate has been fully administered, the PRs would still have capacity to recover any assets which fall into the deceased member's estate. However, as noted below, there may be practical difficulties in taking this course of action.

Payments of arrears of pension can be made to a member's estate; such a payment will be an authorised payment under regulation 16 of the 2009 regulations if certain conditions are met. If the member died on or after 6 April 2006, then the making of the payment will be treated as a benefit crystallisation event (BCE 9) and so will be tested against the member's remaining lifetime allowance.

However, trustees should consider whether payments are likely to be practicable or cost-effective where the death occurred some time ago and the estate has been closed. In these cases, the estate would need to be reopened to receive the balancing payment and it may be difficult to identify or locate the PRs. The potential difficulty of finding a recipient for the payment does not necessarily bar any legal right to the payment, though it makes a claim less likely in practice.

Historic transfers

The GMP information used in calculating a transfer value would typically be checked on receipt from HMRC, but errors may not have been identified at that point, leading to the potential for transfer values to be underpaid. However, historic transfers-out are not normally included within a scheme's reconciliation exercise. If the appropriate transfer forms were completed and actioned by HMRC, the error may be identifiable only by the receiving scheme.

The receiving scheme for any transfer (or any subsequent arrangement to which the member has transferred) may therefore have to decide whether to require or accept any additional payment where the transfer amount was underpaid. Schemes may wish to consider setting thresholds for making/requesting corrective payments; in cases involving bulk transfers, schemes may need to take advice on the terms of the agreement governing the transfer payment to determine where liability for corrections may lie. Transferring schemes may also wish to consider and take legal advice on the effectiveness of any discharge provided by the member at the point of transfer.

Overpayments

There is currently no provision covering the situation where a member's transfer value has been overpaid. The excess is technically a breach of trust and an unauthorised payment, unless scheme rules are amended/benefits augmented accordingly. Recovery is unlikely to be possible.

Underpayments

If a transferring scheme becomes aware that a transfer has been underpaid due to an error in calculation, regulations 6 and 7 of the 2009 regulations provide a route for making a corrective payment not exceeding £10,000 (or the value of the accretion if less). Note that any corrective payment under this rule must be made within six months of the scheme administrator becoming aware of the underpayment. These provisions also apply following the purchase for a member by the scheme of a scheme pension or annuity from an insurance company.

In any event, the receiving scheme should consider correcting member GMP information to avoid a mismatch between scheme records and the notifications which will be sent to members by HMRC in 2018.

Pension sharing orders

Where a pension sharing order applies to a member's benefits, rectification is normally considered on a case by case basis. Often, the pension credit member will have transferred their benefits to another scheme.

Overpayments

Where a pension sharing order has been implemented on the basis of an overpayment, it is unlikely that the overpayment could be recovered from a member/former spouse as both parties will have relied on the pension sharing order and it will have been a factor in the wider divorce settlement.

Underpayments

Where the error has caused an underpayment, schemes will not be in a position to know how the correction of scheme benefits would have affected the overall divorce settlement; reopening the proceedings is obviously impractical. Trustees may consider whether it is reasonable to rectify only the member's payment, although a risk may remain of claims from the member's underpaid ex-spouse.

Members who have commuted their benefits

Where members have commuted their benefits, including GMP entitlements, it may not be possible for HMRC to identify that benefits have been fully commuted. We understand that letters sent to members about their contracted-out entitlements are likely to reference the possibility that scheme benefits including the GMP entitlement may already have been received via commutation, but in some cases this may give rise to member queries.

Commutation cases give rise to number of issues:

- the GMP data used in commutation calculations would have been obtained from HMRC, but may not have been subject to detailed checking at the time;
- schemes may have provided details underlying commutation calculations to members, or may simply have quoted the commutation amount arising from that calculation;
- schemes may or may not have retained data in relation to members who have commuted their benefits.

Trustees may, however, be aware from trends shown in the wider reconciliation exercise that particular commutation calculations are likely to have been incorrect. Some members may also query the amount they received, based on information provided to them by HMRC in relation to the calculation of their foundation amount for the single-tier pension (because a larger deduction may be shown in relation to past contracted-out service than was reflected in the member's commutation lump sum calculation).

Overpayments

There is currently no provision covering the situation where a member's trivial commutation or small lump sum has been overpaid on the basis of an incorrectly calculated pension. Any excess is technically a breach of trust and an unauthorised payment, unless scheme rules are amended/benefits augmented accordingly.

Underpayments

If a past commutation payment has been underpaid, there is currently no provision through which a scheme may make up the shortfall as an authorised payment. In addition, the fact that payment did not extinguish the member's rights in the scheme will mean that the original payment did not meet the conditions for commutation; and any additional payment is likely to be outside the 12-month commutation window and could also mean that the commutation threshold is exceeded (potentially triggering a tax charge in excess of the additional payment).

As there is a significant administration cost attached to revisiting these cases, which relate to benefits below the applicable triviality threshold at the time of payment, trustees may consider that their budget is best directed towards other member categories. Past commutation cases are likely to be a low priority for schemes considering corrective action, but past underpayments could give rise to member complaints in future if discrepancies are not addressed.

Given the increase in commutation thresholds and the greater frequency with which these payments are now made (for example as part of a trivial commutation exercise), schemes should ensure that rigorous checking on GMP data informs the calculation of current and future commutation payments.

This guidance forms part of a series of notes offering guidance to UK pension schemes on principles for approaching reconciliation of contracted-out benefits in a pragmatic and proportionate way.

This note is not a definitive guide to the issues involved, nor is it a substitute for legal advice on which any particular pension arrangement may rely. It is intended to assist those in the industry to establish appropriate approaches to dealing with the complexity of addressing reconciliation and rectification issues in relation to contracted-out benefits.

This note is based on current understanding and awareness of HMRC processes as at February 2016 and will be revised and updated as information about further developments becomes available.