

Stepped Pension

Pension Guide – Information for members

BAE SYSTEMS

If you are an active or deferred member of the BAE Systems Pension Scheme – Levels 125, 167, 187 and 200 or 2000 Plan Benefits – you will be offered a stepped pension option if you retire before State Pension Age (SPA)¹, unless on grounds of ill-health. This Pension Guide provides information about this option in more detail.

What is a Stepped Pension?

The stepped pension option allows you to redistribute your benefits, so that your overall income throughout retirement is spread more evenly. **It is not an enhancement to your Scheme pension, rather it is just a redistribution of when your Scheme pension is received.** It is achieved by you choosing to increase your Scheme pension received in the years up to your State Pension Age, in exchange for reducing your Scheme pension beyond your State Pension Age. The example below illustrates how this works in practice and there are a set of diagrams appended to show this information visually.

John retires from the Scheme at age 60 on a pension of £10,000 a year. His SPA is age 66 so he would not receive his State pension for a further six years. The State pension² at the date of John's retirement (age 60) from the Scheme is £6,000 a year. John decides to take the option of a stepped pension. In order to calculate John's stepped pension a factor is applied to the current State pension. In this example, the stepped factor for a male retiring at age 60 is 0.7724.

Stepped up pension = £6,000 x 0.7724 = £4,634.40 a year.

Therefore, on retirement (age 60) he receives a 'stepped up' Scheme pension of: £10,000 + £4,634.40 = £14,634.40 a year. This pension receives increases each year (for illustration purposes, 2% each year for the next six years is used). When John reaches SPA (age 66) his pension will be:

$£14,634.40 \times 1.02^6 = £16,480.71$ a year.

When John reaches his SPA of 66, his Scheme pension is stepped down. This is calculated referencing the original £6,000 State pension in force at the date of John's retirement (age 60). This is then increased each year using the increases applied to his Scheme pension, rather than those that would have been applied by the State. Using 2% each year for illustration purposes, by age 66 this would have grown to £6,756.97 (£6,000 x 1.02⁶). The 'stepped down' pension is therefore:

$£16,480.71 - £6,756.97 = £9,723.74$ a year.

From age 66, the 'stepped down' Scheme pension of £9,723.74 a year, which will continue to receive any relevant Scheme increases. John will also start to receive his State pension, which may be more or less than the amount of £6,756.97 a year noted above.

¹ Your SPA is the date that you will receive any State pension to which you are entitled.

² Your State pension is not payable until your SPA age.

How much is my State Pension and when will I receive it?

You can check your State Pension online and obtain a forecast of how much you could get by visiting [gov.uk/check-state-pension](https://www.gov.uk/check-state-pension). To use this service, you will need to create either a Government Gateway or GOV.UK Verify account.

The service will also confirm when you will reach State Pension Age (SPA), under the law as it stands. In November 2018, SPA was age 65 for men and women. However, this is gradually increasing and now depends on when you were born. It will reach age 67 by 2028. SPA is going to be kept under review, which means that it could change again in the future, depending on different factors, such as changes in general life expectancy.

Taking account of your State pension in the stepped pension option

As you can see in the example, at your SPA the stepped down pension is calculated by reference to the increases applied to your Scheme pension. It is therefore only at this point that the stepped down pension can be calculated. There are three things relating to the stepped pension calculation that you should be aware of:

1. *Beware: Changes to your SPA*

It is important to understand that once a stepped pension has been set up, **the step down will happen when you reach the SPA that was in force at the date of your retirement**. Any later increases that the Government might introduce to SPAs would not be taken into account. As a result, there is the potential for there to be a gap between when the step down is applied and when your State pension starts. Please refer to diagram 3 in the appendix which illustrates this.

If you are likely to be affected by any change to your SPA after you have retired, it will be important that you consider your financial arrangements carefully so that you can manage the effects of the temporary drop in your income.

2. *In rare cases, the calculated step down in pension may be more than the Scheme pension in payment*

There may be the very rare situation where the calculated step down in pension is more than the Scheme pension in payment at SPA. In this situation your Scheme pension will cease. The only exception to this, is that any Guaranteed Minimum Pension (GMP) if you are a BAE Systems Pension Scheme (Levels 125, 167, 187 and 200) member, will continue to be paid. More information about GMP can be found in the BAE Systems Pension Scheme booklet at baesystems.com/pensions.

3. *Scheme specific step down dates*

If you are a member of the BAE Systems Pension Scheme – Levels 125, 167, 187 and 200 – then the step down in your Scheme pension occurs from the 1st of the month following you reaching your SPA. If you are a member of the BAE Systems Pension Scheme – 2000 Plan Benefits, then the step down in your pension occurs on the last day of the month in which you reach your SPA.

If I choose the stepped pension option, would this affect the pension payable to my spouse or civil partner?

No. Any pension payable to your spouse or civil partner in the event of your death in retirement will ignore the effect of you having chosen the stepped pension option. If you are a member of the BAE Systems Pension Scheme - Levels 125, 167, 187 and 200, this also extends to any dependant's pension that may become payable.

What would be the impact to the stepped pension if a pension sharing order on divorce was implemented?

The Cash Equivalent Transfer Value provided as part of the sharing order will take into account the total value of your Scheme pension, including the stepped pension. For a 50% split, for example, you (the member) would receive 50% of the Scheme pension you are currently receiving from the date the sharing order takes effect until SPA. Your ex-partner would receive the other 50%. When the step down is applied, this is based on 50% of the pre-divorce step down, so that you would then receive 50% of the benefit you would have received from the Scheme in addition to any State pension you are entitled to.

If I choose the stepped pension option, will this impact my Annual Allowance usage?

If you take the stepped pension option this will act to enhance your pension at the point of retirement, thereby increasing your Annual Allowance usage. It will be important that you consider this prior to choosing this option if you believe you could be affected. More information about the Annual Allowance is explained in your Scheme member booklet and can also be found on the BAE Systems Pension website in the More Info section under 'How are my benefits taxed?' Visit baesystems.com/en-pensions/more-info/how-are-my-benefits-taxed.

Unused Annual Allowance from the previous three Pension Input Periods can be used to offset against a tax charge, if your pension savings exceed the Annual Allowance. This is called carry forward. Information about how to calculate, declare and pay a tax charge can be found on the HMRC website at gov.uk/tax-on-your-private-pension/annual-allowance.

Making a decision

If you are looking to retire before your SPA, any retirement estimate provided by the Scheme administrator will automatically show the stepped pension option as part of your retirement options.

The Trustee, the Company or the Scheme administrator are not able to provide you with advice about how to exercise any options available to you at retirement. We would ask you to take the time to read this Pension Guide carefully before taking any further action.

If you are in any doubt as to whether this could be a beneficial option for you on your retirement, you should engage a financial adviser. More information about getting independent financial advice can be found in the separate Pension Guide, *Independent Financial Advice*.

Appendix: The three simple bar charts below help visualise the difference between taking a 'normal' early retirement pension compared to taking a 'stepped' early retirement pension and what happens where your State Pension Age changes between deciding to take the stepped option and reaching your State Pension Age. In these examples, the individual retires at age 60, with a State Pension Age of 66.



