

# The Occupational Pension Schemes (Contracting-out and Modification of Schemes)(Amendment) Regulations 2012

Public consultation on draft amendments

August 2011

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# Introduction

This consultation asks for views on two proposed changes to regulations that concern contracting-out. These are: to increase the amount of the compound interest used in the fixed rate revaluation of Guaranteed Minimum Pension for early leavers from 6 April 2012 to 4.75 per cent; and, to introduce a regulation to allow trustees of formerly contracted-out defined contribution occupational pension schemes to change their scheme rules to take into account the abolition of “protected rights” after 6 April 2012.

The consultation also advises of a technical drafting correction to the Occupational Pension Schemes (Contracting-out) Amendment Regulations 2011 (SI 2011/1294), which comes into force on 1 October 2011. The correction provides clarification for actuaries certifying that contracted-out salary-related occupational pension schemes meet the contracting out conditions.

## Impact of these Regulations

The revision of the fixed rate revaluation percentage will not introduce any new administrative burdens for employers sponsoring contracted-out defined benefit occupational pension schemes as they are already required to revalue the GMPs of early leavers. Similarly the technical correction simply clarifies the position for actuaries certifying that a contracted out defined benefit scheme meets the contracting out requirements and has no impact on any particular group.

An impact assessment for the consequential changes and benefits resulting from the abolition of defined contribution contracting out was published in May 2011<sup>1</sup>.

## About this consultation

### Who this consultation is aimed at

We welcome comments on draft regulations 2(2) and 3 from pension scheme trustees, their advisers, and employers who sponsor contracted-out occupational pension schemes. This consultation document can be found on the DWP website at: [http://www.dwp.gov.uk/consultations/2011/Occupational Pension Schemes \(Contracting-out and Modification of Schemes\)\(Amendment\) Regulations 2012](http://www.dwp.gov.uk/consultations/2011/Occupational%20Pension%20Schemes%20(Contracting-out%20and%20Modification%20of%20Schemes)(Amendment)%20Regulations%202012).

### Purpose of the consultation

The purpose of this consultation is to obtain comments on the proposed changes contained in the draft regulations. However, draft regulation 2(3) makes a technical

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<sup>1</sup> <http://www.dwp.gov.uk/docs/ia-abolition-contracting-out-dc-schemes.pdf>

drafting correction to a previous statutory instrument; we are not seeking views on this correction.

## **Scope of consultation**

This consultation applies to England, Wales and Scotland.

## **Duration of the consultation**

The consultation period begins on 15 August 2011 and runs until 6 November 2011.

## **How to respond to this consultation**

Please send your consultation responses, preferably by email, to:

[ContractingOut@dwp.gsi.gov.uk](mailto:ContractingOut@dwp.gsi.gov.uk)

or, by post to:

Clare Yiannakou

Contracting-out regulations consultation

Department for Work and Pensions

Caxton House

Tothill Street

London

SW1H 9NA

Please ensure your response reaches us by **6 November 2011**.

When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents, and where applicable, how the views of members were assembled. We will acknowledge your response.

## **Queries about the content of this document**

Please direct any queries about the subject matter of this consultation to the email address given above.

## How we consult

### Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact:

Central Freedom of Information Team  
The Adelphi  
1-11, John Adam Street  
London WC2N 6HT

[Freedom-of-information-request@dwp.gsi.gov.uk](mailto:Freedom-of-information-request@dwp.gsi.gov.uk)

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. More information about the Freedom of Information Act can be found at [www.dwp.gov.uk/freedom-of-information](http://www.dwp.gov.uk/freedom-of-information)

### The consultation criteria

The consultation is being conducted in line with the Government Code of Practice on Consultation – [Government Code of Practice on Consultation](#) (BIS). The seven consultation criteria are:

**When to Consult.** Formal consultation should take place at a stage when there is scope to influence the outcome.

**Duration of consultation exercises.** Consultations should normally last for at least 12 weeks, with consideration given to longer timescales where feasible and sensible.

**Clarity of scope and impact.** Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence, and the expected costs and benefits of the proposals.

**Accessibility of consultation exercises.** Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is designed to reach.

**The burden of consultation.** Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

**Responsiveness of consultation exercises.** Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

**Capacity to consult.** Officials running consultation exercises should seek guidance in how to run an effective consultation exercise, and share what they have learned from the experience.

## **Feedback on the consultation process**

We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator:

Roger Pugh  
DWP Consultation Coordinator  
1<sup>st</sup> floor, Crown House  
2, Ferensway  
Hull HU2 8NF

Phone 01482 584681

>> [roger.pugh@dwpgsi.gov.uk](mailto:roger.pugh@dwpgsi.gov.uk)

In particular, please tell us if you feel that the consultation does not satisfy the consultation criteria. Please also make any suggestions as to how the process of consultation could be improved further.

If you have any requirements that we need to meet to enable you to comment, please let us know.

We will publish the responses to the consultation in a report on the consultations section of our website [www.dwp.gov.uk/consultations](http://www.dwp.gov.uk/consultations). We will do this within three months of the consultation closing date. The report will summarise the responses and the action that we will take as a result of them.

# Chapter 1– increase in the fixed rate revaluation of Guaranteed Minimum Pension for early leavers

## Background to fixed rate revaluation for Guaranteed Minimum Pension

1. A Guaranteed Minimum Pension, or GMP, is a pension built up in a contracted-out, defined benefit, occupational pension scheme between 1978 and 1997. This proposed change may apply where a person was a member of such a scheme but left that employment before the age a GMP could be taken (60 for a woman, and 65 for a man). In these circumstances, the scheme has a statutory duty to revalue the amount of GMP due to the member until GMP pensionable age. Schemes may choose from more than one method, but to provide certainty for the sponsor, a scheme can choose to use the fixed rate revaluation method.
2. Section 16(3) of the Pension Schemes Act 1993 allows for the fixed rate revaluation “to be increased by at least the prescribed percentage for each relevant year after the last service tax year”. Each relevant year’s percentage is defined in Regulation 62(2) of the Occupational Pension Schemes (Contracting-out) Regulations 1996 (SI 1996/1172).
3. Every five years the Government Actuary provides a report, with recommendations for the Secretary of State of the Department for Work and Pensions, as part of his review of the reduced rates and rebates of National Insurance contributions applicable to members of contracted-out occupational and personal pension schemes for the next five years.
4. The most recent of these reports, the “Occupational and Personal Pension Schemes: Review of Certain Contracting-Out Terms”<sup>2</sup>, was published in February this year. This report followed a public consultation, which ran from 23 August to 15 November 2010<sup>3</sup>. Section 15 of that report includes a recommendation that the fixed rate revaluation for GMPs from April 2012 to April 2017 should be 4.75 per cent.

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<sup>2</sup>[http://www.gad.gov.uk/Documents/Pensions%20Policy%20&%20Regulation/Contracting%20Out/Report\\_to\\_parliament\\_on\\_the\\_2011\\_review\\_of\\_contracting-out\\_terms.pdf](http://www.gad.gov.uk/Documents/Pensions%20Policy%20&%20Regulation/Contracting%20Out/Report_to_parliament_on_the_2011_review_of_contracting-out_terms.pdf)

<sup>3</sup>[http://www.gad.gov.uk/Documents/Pensions%20Policy%20&%20Regulation/Rebate\\_Consultation/Consultation\\_by\\_GAD-Review\\_of\\_contracted-out\\_rebates\\_2012-2017.pdf](http://www.gad.gov.uk/Documents/Pensions%20Policy%20&%20Regulation/Rebate_Consultation/Consultation_by_GAD-Review_of_contracted-out_rebates_2012-2017.pdf)

## **New rate from 6 April 2012**

5. Presently, where a person's pensionable service ends on or after 6 April 2007, the percentage used for revaluation purposes is 4 per cent. The Government Actuary has recommended that where pensionable service ends on or after 6 April 2012, this figure should rise to 4.75 per cent. Schemes which use the fixed rate method of revaluation will, subject to the Secretary of State's approval of this recommendation, need to adopt this figure for individuals who leave the sponsor's employment on or after 6 April 2012.

## **Consultation question 1:**

Do you consider that 4.75 per cent should be used as the fixed rate for revaluation of GMPs for early leavers for the period April 2012 to April 2017? If you think this is the wrong percentage, please tell us what you believe the correct percentage should be, and give detailed reasons for your conclusion.

## **Chapter 2 – technical amendment: draft regulation 2(3)**

6. Draft Regulation 2(3) contained in this instrument makes a technical drafting correction to the Occupational Pension Schemes (Contracting-out) Amendment Regulations 2011 (SI 2011/1294), which comes into force on 1 October 2011. The correction provides clarification for actuaries certifying that contracted-out salary-related occupational pension schemes meet the contracting-out conditions.
7. We are not seeking views on this technical correction.

## **Chapter 3 – modification of scheme rules**

### **Background: abolition of defined contribution contracting-out**

8. In their second report ("A New Pension Settlement for the Twenty-First Century"<sup>4</sup>) the Pensions Commission recommended that contracting-out on a defined

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<sup>4</sup> published 30 November 2005

contribution (DC) basis should be abolished. The recommendation was accepted by the Government at that time, and proposals for abolition were included in the Pensions Acts 2007 and 2008. Completing that process, consequential legislation was approved by Parliament in July 2011. Contracting-out on a DC basis will be abolished from 6 April 2012.

## **Protected Rights**

9. From 6 April 2012, all rules and references to “protected rights” in pensions-related legislation will either be repealed, or where appropriate, amended. In contracted-out DC schemes, protected rights are either the rights to money purchase benefits under the scheme, or where the scheme rules specify (under section 10(2) of the Pension Schemes Act 1993), the amount of an individual’s pension fund derived from the rebate, its investment return, and any tax relief on the rebate. On abolition, protected rights will cease to exist. They will become ordinary money purchase scheme benefits.
10. There are certain requirements attached to protected rights which have been a source of complexity for schemes and members. For example, protected rights have to be tracked separately from non-protected rights, as there is a legal requirement for annuities deriving from protected rights to provide for survivor’s benefit where the annuitant is married or in a civil partnership. The requirements result in an additional administrative cost for schemes and members, and have led to more complex arrangements and less choice for the member.
11. Following a public consultation in 2010 on the draft consequential legislation<sup>5</sup>, a number of respondents were concerned that in some cases, occupational pension scheme rules relating to protected rights will not automatically fall away on 6 April 2012. This is because some occupational pension schemes rules are written in such a way as to build in the legislative protected rights requirements, rather than make reference to the relevant provisions in pensions legislation.
12. Until the protected rights rules are removed from the scheme rules, pension providers may not be able to take advantage of the easements introduced by the abolition. In some cases, schemes do not have powers to change their scheme rules. Schemes have sought help to extend the benefits of abolition of DC contracting-out to all their members by requesting a power to modify scheme rules. In the response to the consultation on the consequential legislation<sup>6</sup>, the Government said it would consider the issue further.

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<sup>5</sup> “Abolition of contracting out on a defined contribution basis: consultation on draft consequential legislation” which ran from 28 July to 19 October 2010 <http://www.dwp.gov.uk/docs/abolition-contracting-out-dc-consultation.pdf>

<sup>6</sup> <http://www.dwp.gov.uk/docs/abolition-contracting-out-dc-response.pdf> published 30 November 2010

## Subject of consultation

13. We wish to provide schemes with the ability to modify their scheme rules in order to remove protected rights requirements which apply to accrued rights without going through the statutory requirements of section 67 of the Pensions Act 1995 (the subsisting rights provisions).
14. Section 68 of the Pensions Act 1995 allows the trustees of a trust scheme to, by resolution, modify the scheme for the purposes listed. Section 68(2)(e) allows further purposes to be prescribed in relation to this modification power. Regulation 3 of this draft instrument prescribes the removal of scheme rules relating to protected rights which are no longer required as a result of the coming into force of the legislation providing for the abolition of protected rights and the abolition of contracting out on a DC basis. The use of the power in section 68 is not subject to the requirements of section 67 as it is not a power “conferred on any person by an occupational pension scheme” but is a power provided by statute.
15. The power provided by these Regulations is designed to enable schemes to remove former protected rights requirements from their schemes rules, but it will not enable changes to rules governing rights which were not formerly protected rights, even if it is thought that those scheme rules were initially adopted in order to meet the requirements of protected rights legislation. The Government does not think it appropriate to provide a wider power of amendment which is not subject to section 67 which would affect members’ accrued rights in the scheme which are not former protected rights.
16. The power provided is time limited; trustees will have until the end of the 3 year transitional period (6 April 2015) for the abolition of protected rights to make amendments to their rules. This allows for rule changes to be made and to have effect during this 3 year period, as the relevant legislation to which the changes relate is brought into force.

## Consultation question 2:

Do you consider that the statutory power to modify scheme rules, as drafted, would enable trustees to alter their scheme rules to remove the requirements of the protected rights legislation in order to extend the benefits of DC contracting-out abolition to their members?