

**PENSIONS: CONTRACTING OUT – SELF
INVESTED PERSONAL PENSIONS AND OTHER
CHANGES**

Government response to the consultation on

**THE PERSONAL PENSION SCHEMES (APPROPRIATE
SCHEMES) (PROTECTED RIGHTS) (AMENDMENT)
REGULATIONS 2008**

27 June 2008

DWP Department for
Work and Pensions

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INTRODUCTION

1. In December 2007 the Government undertook a consultation on proposed amendments to *The Personal Pension Schemes (Appropriate Schemes) Regulations 1997: S.I.1997 No.470* changing the circumstances in which a personal pension scheme can be an appropriate scheme. The changes were aimed at permitting Self Invested Personal Pensions (Sipps) to hold protected rights.

2. The consultation also sought views on a proposal to remove a provision in *The Personal and Occupational Pension Schemes (Protected Rights) Regulations 1996: S.I.1996 No.1537* that permits a survivor's pension or annuity to continue to be paid to anyone during a five-year guarantee period. The consultation ended on 29 February 2008.

4. Thirty-six responses to the consultation were received. A list of respondents is at **Annex A**. The Government is very grateful to all who contributed to the consultation. The comments have been very helpful in finalising the draft legislation.

5. Both of the Regulations consulted upon will be introduced in *The Personal and Occupational Pension Schemes (Appropriate Schemes) (Protected Rights) (Amendment) Regulations 2008*¹. We plan to make these regulations in July 2008 and for them to come into force on 1 October 2008. The legislation will be available (at no cost) on the Office of Public Sector Information Website at <http://www.opsi.gov.uk/si/si-2008-index>. Please see paragraph 52 for details on the handling of the legislation.

6. This document is available on the Department's website at <http://www.dwp.gov.uk/consultations/2007/>

7. A paper copy of this document can be obtained from:

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8. This document describes the policy underpinning the changes being made. Comments on the legislation should not however be taken as an authoritative interpretation of the law. Such an interpretation can only be provided by a court.

¹ The final title of these regulations has not yet been decided upon and may be subject to change.

RESPONSES TO CONSULTATION

FOREWORD

1. This document summarises the main points made by respondents to the consultation and sets out the Government's response. The proposal to permit self invested personal pensions to hold protected rights attracted the most interest. The proposed change to the survivor's provision resulted in a number of comments (mainly of a technical nature), and there were a range of comments on other related issues. This response therefore takes account of all comments received and makes particular reference to those received on:

- self invested personal pensions
- survivor's benefits and the five-year guarantee period

2. The Government's proposal to permit Sipp's to hold protected rights was generally welcomed as many commentators believed the current regulations unnecessarily restrict investment choice. They also believed that the new flexibility would be received very positively by those who wish to take an active interest in the management of their pension fund. The proposal to remove the survivor's guarantee was generally viewed as necessary as it removes a conflict with the tax rules. Some correspondents did, however, suggest that further technical changes were required. These are discussed further in paragraphs 16 to 22 below.

SELF INVESTED PERSONAL PENSIONS

The draft regulations

Point made

3. A number of respondents had concerns about the changes being proposed to regulation 2 of the Personal Pension Schemes (Appropriate Schemes) Regulation 1997: S.I.1997 No.470 (the Appropriate Schemes Regulations). In particular the requirement that a personal pension scheme can be an appropriate scheme only if it is a scheme which from 6 April 2006 is, or is treated as, registered under section 153 of the Finance Act 2004 (FA 2004). Respondents believed that the drafting might mean that schemes set up after that date would be unable to meet this requirement as they were not set up "from" 6 April 2006.

Response

4. The Government agrees there is a risk that the proposed changes might have excluded schemes set up after 6 April 2006. We intend, therefore, to amend substituted regulation 2 so that the only requirement for a scheme to be an appropriate scheme is that it is, or is treated as, registered under section 153 of the FA 2004.

Point made

5. That by deleting the whole of existing regulation 2 of the Appropriate Schemes Regulations, the provision in existing regulation 2(5) and (6) which permit part of scheme to be an appropriate scheme, would be lost. It was suggested, therefore, that a transitional provision may be needed so that schemes currently operating in this way can continue to do so.

Response

6. The existing regulations impose two requirements, both of which must be met in order for a personal pension scheme to be an appropriate scheme. Firstly, it must be registered. Secondly, it must be one of the schemes listed in regulation 2(1)(b). Regulation 2(5) and (6) describe schemes which can fall within regulation 2(1)(b). The proposed amendment removes the second criterion, leaving only the requirement that a pension scheme must be registered in order to be an appropriate scheme. This means that all registered appropriate pension schemes, including those currently operating under regulation 2(5) and (6) will be able to continue to operate after the changes are introduced. We do not, therefore, intend to introduce a transitional provision.

Point made

7. Reference to “HMRC Commissioners” in draft regulation 2(6), should be to the “Secretary of State”.

Response

8. The reference to “Commissioners for Her Majesty’s Revenue and Customs” in draft regulation 2(6) originates from the Social Security (Transfer of Functions, etc.) Act 1999, which transferred certain functions of the Secretary of State to the Commissioners of Inland Revenue. The Commissioners for Revenue and Customs Act 2005 subsequently transferred the functions of the Commissioners of Inland Revenue to the Commissioners for Her Majesty’s Revenue and Customs. However, to avoid confusion, we have redrafted this

regulation so that the bracketed text does not refer to the Department receiving the information. It explains only what regulation 2(6) does.

Operational issues

Points Made

9. There were a number of operational issues raised on the following:

- how to apply for contracting-out status?
- when will the application form be ready?
- will it be possible to obtain a contracting-out certificate before October 2008?
- HM Revenue & Customs should streamline the application process to deal with multiple applications
- the need for early confirmation that our proposals are to be implemented so that schemes can amend their literature
- will it be necessary for applications for contracting-out certificates to be accompanied by scheme rules

Response

10. An application for an appropriate scheme certificate must be made on form APSS101 which can be downloaded online from the HMRC website - <http://www.hmrc.gov.uk/> Whilst tax registered Sipp schemes need not wait until October before applying (early applications would in fact help speed up the application process), the effective date for contracting out cannot be before 1 October 2008. Also, there is no requirement on form APSS101 for it to be accompanied by the scheme rules. The provision in the Appropriate Scheme Regulations for an application for a contracting-out certificate to be accompanied by a copy of the scheme rules is there only in case it is needed.

Administration costs

Point made

11. There was general consensus that administration costs would be small, but that a cost will arise from schemes being required to track protected rights separately from other rights. It was also the general consensus that all of the protected rights rules should be removed. Some correspondents referred directly to the need for an Impact Assessment and agreed that costs would be negligible and that an Impact Assessment would not be needed. Only one correspondent was of the view that administration costs would not be low.

Response

12. The Government is aware that there are some costs associated with schemes arising from the registration process and from having to track protected rights separately from other rights held in the scheme. However, this is a consequence of schemes becoming appropriate schemes rather than a result of additional requirements being imposed on appropriate schemes. Consequently, having considered carefully the views of correspondents, we believe that the changes will have a negligible impact on the costs of business, charities and the voluntary sector. A full impact assessment will not, therefore, be produced.

Financial Services Authority

Point made

13. That there will not be time for providers to take any Financial Services Authority (FSA) requirements into account in advance of the October 2008 implementation.

Response

14. The FSA Handbook currently requires that when a firm sells an appropriate personal pension policy, it must give the customer a "Contracting-out Comparison". This allows the customer to compare the State Second Pension given up with the potential return from the appropriate personal pension. The FSA now propose to amend their rules to extend this requirement to Sipp providers in respect of those who use a Sipp to contract out. Because the FSA are aware that some Sipp providers will not have systems in place in order to meet this requirement, their Quarterly Consultation Paper (issued in April 2008) detailing its policy asks whether providers agree with this proposal.

15. We accepted that the timing of the changes to the Appropriate Schemes Regulations would need to take account of the FSA's consultation. That is why our planned implementation date of April 2008 was put back to October. This will allow Sipp providers the time to put the necessary systems in place should they need to provide contracting-out comparisons. Whilst this may still be challenging, our dealings with the industry leading up to this consultation have led us to conclude that delaying implementation beyond October, would not be in the interests of consumers. The Government intends, therefore, to bring these regulations into force on 1 October 2008 as planned.

SURVIVOR'S BENEFITS AND THE FIVE-YEAR GUARANTEE PERIOD

The draft regulations

Point made

16. That regulation 12(11)(c) of the Personal and Occupational Pension Schemes (Protected Rights) Regulations 1996: S.I.1996 No. 1537 (the Protected Rights Regulations) may not be in conflict with the FA 2004 (the reason cited in the consultation for its omission) because “any person” could also be a “dependant” and will, therefore, fall within FA 2004.

Response

17. The Government accepts that there could be a situation where “any person” may also be a dependant. However, because the provision in regulation 12(11)(c) permits payment to a non-dependant, such payments *would* be in conflict with FA 2004.

Point made

18. Regulation 12(11)(b) may also be in conflict because “child of widow etc” might not be a dependant as defined in FA 2004. It was suggested, therefore, that regulations 12(11)(b) and (c) be repealed and replaced with a single provision permitting payment to any other person eligible to receive the pension or annuity under FA 2004.

Response

19. The provision in regulation 12(11)(b) allows for a survivor’s pension or annuity to be paid for the benefit of any child or children, in the event that the widow/widower/civil partner (the widow) dies whilst in receipt of the pension or annuity. This is consistent with FA 2004 which allows an annuity to make provision for more than one dependant. The respondent raising this issue believes the provision may breach FA 2004 as a child of the widow may not qualify as a dependant of the member. This is because paragraph 15(2) of Schedule 28 to FA 2004 defines a dependent child as being a “child of the member”, which may not necessarily be the case in respect of a child of the widow.

20. Whilst we do not dispute that such a scenario could arise, paragraph 15(3) permits payment to someone who is not a child of the member providing that the person was financially dependent on the member at the date of the member’s death. Consequently, we do not

believe that the provision in regulation 12(11)(b) is in conflict with FA 2004 and do not intend to introduce an amendment along the lines suggested.

Point made

21. That regulation 3 of the draft regulations should require further amendments to be made to regulation 12 of the Protected Rights Regulations to take account of 12(11)(c) being repealed.

Response

22. The suggested amendment was of a minor technical nature needed to tidy up the Protected Rights Regulations.

OTHER ISSUES

Survivor benefit rules

Points made

23. The following points were made on the current requirement for protected rights annuities to make provision for survivors where the member is married or in a civil partnership at the point of annuity purchase:

- as the gap between male and female private and state pension provision is reducing, the need for compulsory spouses provision is no longer necessary
- that emphasis should be on encouraging greater pension provision for everyone, rather than imposing complex rules
- if individuals reaching retirement receive accurate, user-friendly and timely information about the financial products they buy, they should be allowed to decide for themselves on the type of annuity they require
- that clarification of the survivor benefit rule must be made by the time the Sipps changes are implemented
- that if the survivor benefit rule is removed it should be subject to the written consent of the spouse or civil partner

Response

24. When the Government decided to abolish contracting out on a defined contribution (DC) basis it needed to consider how best to treat protected rights already accrued. Because of the complexity that the

existing rules impose on both providers and scheme members, the Government decided to remove most of the rules at the point of abolition. However, because of the potential consequences for a surviving spouse or civil partner, it was decided to consider the survivor benefit rule more thoroughly.

25. We looked at this as part of a more general consideration of joint-life annuity purchase in the context of the joint DWP and HMT review of the Open Market Option for annuities. The review involved a number of key stakeholders that included consumer groups and representatives of the pensions industry. The very positive work on annuity information products that emerged from that review has led the Government to conclude that it will be possible to remove the survivor requirement. The intention is to achieve this through the introduction of an amendment to the 2008 Pensions Bill. This means that, from the date contracting out on a DC basis is abolished, schemes will no longer have to track protected rights separately and individuals will be able to choose the pension or annuity that best suits their circumstances. The aim is to implement abolition of DC contracting out in 2012.

26. The Government gave careful consideration to replacing the survivor benefit rule with one that would, where appropriate, require the approval of the spouse or civil partner, but decided against it. This is because it would not be practical to impose such a requirement given the fact that in many cases, it would not be possible for schemes to track down the spouse or civil partner. It would also be unfair on scheme members who are not divorced or have not had their civil partnership dissolved, but have been estranged from their partners for a number of years.

Other protected rights issues

Point made

27. That all of the protected rights rules should be removed now rather than linked to abolition of contracting out on a DC basis.

Response

28. The abolition of contracting out on a DC basis and decisions about the protected rights rules are part of a wider package of pension reform and must be considered in that context. Removing all of these rules will also require major IT changes for HM Revenue & Customs and cannot be achieved without the appropriate lead-in time. We do

not, therefore, plan to remove the protected rights rules in advance of DC abolition.

Point made

29. That the Protected Rights Regulations should be amended to permit them to be used to buy investment-linked annuities. That the 50% survivor benefit rule should be more flexible.

Response

30. Investment-linked annuities can result in the pension in payment falling below that of the initial rate of payment. This would be in breach of the conditions that apply to pensions and annuities which give effect to protected rights – in particular regulation 4(1)(b)(ia) of the Protected Rights Regulations. Similarly, anything other than a 50% survivor's pension would be in breach of regulation 4(8)(b) of those regulations.

31. Although both of these requirements will fall once contracting out on a DC basis is abolished, it would be impractical for the Government to introduce changes piecemeal in advance of that. We do not, therefore intend to make any changes to the Protected Rights Regulations other than those that we have consulted upon.

Point made

32. Does the legislation permit protected rights funds in an unsecured pension to be transferred to another scheme and then to continue as an unsecured pension?

Response

33. Providing that the unsecured pension arrangement comes to an end, there is nothing in the Protected Rights Regulations to prevent the residual fund being transferred to another scheme where they can be taken as an unsecured pension.

Point made

34. That DWP rules should allow protected rights being taken under an alternatively secured pension (ASP) to be paid as a charity lump sum benefit where an individual dies without any dependants.

Response

35. Where someone taking their protected rights under an ASP dies without leaving a widow/widower/civil partner, the residual protected rights must be paid to a person or persons nominated in writing by the member, or to the member's estate. We have raised the issue of charitable payments with HM Revenue & Customs and are content that the meaning of "person or persons" can be interpreted to include "charities".

Point made

36. That the requirement to obtain member consent before protected rights can be transferred is a barrier that prevents providers with multiple schemes having the ability to wind up legacy schemes and transfer members to another one of their other schemes.

Response

37. Transfers of protected rights without member consent can now be made between contracted-out money purchase occupational pension schemes. The requirements are set out in regulation 3C of the Protected Rights (Transfer Payment) Regulations 1996: S.I. 1996 No. 1461. The measure came into effect in November 2005. The same provision does not extend to appropriate personal pension schemes.

Point made

38. Where a member dies without giving effect to his or her protected rights, do the written directions of the member take precedence over payment to the member's estate?

Response

39. Yes. Regulation 12 of the Protected Rights Regulations makes it clear that in the absence of a widow, protected rights can only pass to the estate where the member has not made a written nomination.

Point made

40. Will the changes permit full self-investment of protected rights?

Response

41. Protected rights held in a tax registered personal pension scheme (including a Sipp scheme), may be invested in the full range of investment products permitted by the tax rules.

Point made

42. Can protected rights be invested in small self-administered schemes?

Response

43. Small self-administered schemes are occupational schemes and are outside of the scope of the Appropriate Schemes Regulations. In order to be able to invest protected rights, such schemes must be able to satisfy the conditions that currently apply to contracted-out occupational schemes. Those conditions are different to those that apply to appropriate personal pensions. Consequently, the changes consulted on in these regulations will not enable small self-administered schemes to invest protected rights.

Point made

44. Will protected rights held in a Sipp need to be ringfenced from other rights?

Response

45. As with any appropriate scheme, protected rights held in a Sipp will need to be ringfenced until such time as all of the protected rights rules are repealed.

Wider contracting-out issues

Point made

46. Abolition of contracting out on a DC basis leaves an unlevel playing field with only those in defined benefit (DB) schemes having access to contracting out. Creates “dislocation” in contracting-out as a market.

Response

47. The decision to abolish contracting out on a DC basis was taken because it has become increasingly difficult to judge whether someone would be better off in the State Second Pension scheme or contracted out. This was also something that was identified by the Pensions Commission which concluded that the system was too complicated and poorly understood. They recommended, therefore, that it be abolished.

48. In DB schemes decisions regarding contribution levels and funding are taken over the longer term and this does not allow for sudden reforms. The Pensions Commission recognised this and concluded that early abolition of contracting out on a DB basis would be more likely to spur scheme closure and reduce national savings than to stimulate an increase. The Government agreed with this view but is committed to review the long-term future of DB contracting out at a later date.

Point made

49. That all registered DC schemes should be permitted to hold protected rights, not just those which are contracted out.

Response

50. Currently, legislation requires that any personal pension scheme wishing to hold protected rights must be an appropriate scheme and in receipt of a contracting-out certificate. Similar rules apply to occupational schemes wishing to hold protected rights. In order for all registered DC schemes (including contracted-in schemes) to hold these rights we would require changes to both the primary and secondary legislation. It would also have implications for HM Revenue & Customs who would require the appropriate lead-in change in order for it to be achieved.

51. Also, given that the abolition of contracting out on a DC basis (expected to be in 2012) will result in the repeal of all of the protected rights rules, abolition will free up the transfer of all pension rights between tax registered schemes. We do not, therefore intend to introduce further changes in advance of DC abolition.

HANDLING THE LEGISLATION

52. Having given full consideration to all the responses to the consultation, we now intend to go ahead with the proposal to introduce

changes to the Appropriate Schemes Regulations. This will, in particular, permit all Sipp schemes to hold protected rights. We also intend to remove the provision in regulation 12(11)(c) of the Protected Rights Regulations which provides for a survivor's pension to be paid to a person other than a dependant. The changes will be introduced in *The Personal and Occupational Pension Schemes (Appropriate Schemes) (Protected Rights) (Amendment) Regulations 2008*² and, save for some relatively minor technical amendments, are the same as those consulted upon. In both cases, amendments have also been made as set out in this document.

THANKS

53. We are most grateful to everyone who took the time to comment on the consultation document.

² The final title of these regulations has not yet been decided upon and may be subject to change

List of respondents

The Actuarial Profession
Aegon
AIG Life
Association of British Insurers
The Association of Independent Financial Advisers
Association of Investment Companies
Association of Member Directed Pension Schemes
Association of Pension Lawyers
A J Bell Group
European Pensions Management Limited
Lawrence Graham LLP
Hargreaves Lansdown
Hornbuckle Mitchell Group Plc
Institute of Directors
Investment and Life Assurance Group
The Law Society of Scotland
Lincoln Financial Group
Norwich Union
The Pensions Management Institute
The Pensions Regulator
Pointon York SIPP Solutions Limited
John Ralfe Consulting
Sanderson Law & Co. (Life & Pensions)
Scottish Life
Skandia Life
The Society of Pension Consultants
Standard Life
Suffolk Life
The Tax Incentive Savings Association
Wardour Partners LLP
Zurich Assurance Limited

Responses from individuals

Bev Davies
Nick Dobson
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