

# **PENSIONS:INDEXATION AND INFORMATION REQUIREMENT**

**Government response to the consultation**

**THE PERSONAL AND OCCUPATIONAL PENSION SCHEMES  
(INDEXATION AND DISCLOSURE OF INFORMATION)  
(MISCELLANEOUS AMENDMENTS) REGULATIONS 2005**

March 2005

**DWP** Department for  
Work and Pensions

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## INTRODUCTION

1. In December 2004 the Government undertook a consultation on amendments to various sets of regulations in connection with the changes to the indexation of money purchase benefits and the introduction of a new information requirement. The consultation ended on 31 January.
2. Eighteen 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 regulations.
3. The Personal and Occupational Pension Schemes (Indexation and Disclosure of Information) (Miscellaneous Amendments) Regulations 2005 will be laid shortly, in time for implementation on 6 April 2005.
4. The regulations will be available on HMSO's website at <http://www.legislation.hmso.gov.uk/stat.htm#2005>
5. This document is available on the Department's website at <http://www.dwp.gov.uk/consultations/2005/index.asp>
6. A paper copy of this document can be obtained from:  
  
Jane Bonner-Morgan  
Department for Work and Pensions  
3<sup>rd</sup> Floor  
Adelphi  
1-11 John Adam Street  
London WC2N 6HT  
Email: Contractingout@dwp.gsi.gov.uk
7. This document describes the policy underpinning the changes being made. Comments on the regulations should not however be taken as an authoritative interpretation of the law. Such an interpretation can only be provided by a court.

# RESPONSES TO CONSULTATION

## Introduction

1. This document sets out the main points made in response to the consultation exercise and provides the Government's response. Three topics attracted the most interest with a range of comments on other issues. This response therefore discusses comments received on:

- hybrid pension schemes
- transfer issues
- the information requirement
- other issues

2. There was a general welcome for the removal of indexation from money purchase benefits, the simplifications this would provide for schemes and the choice it would provide for individuals.

## Hybrid Pension Schemes

### Points made

3. Several respondents to the consultation thought that the legislation covering the indexation of benefits paid from hybrid pension schemes did not reflect the Government's policy intention.

4. There were also concerns about how the new indexation regime would apply to schemes which were money purchase except for any death in service benefits provided. Two issues were raised: would all benefits offered by these schemes be caught by the requirement to index (because they include a salary related element) and would the death in service element need to be indexed?

### Response

5. The policy is that indexation should no longer be a requirement for money purchase pensions, but should remain a requirement for defined benefit pensions. This extends to pensions paid from hybrid schemes.

6. It was originally our view that this policy intention was achieved through primary legislation – section 51 of the Pensions Act 1995 as amended by the Pensions Act 2005. However, after considering the consultation comments we agree that additional provisions are necessary to make the position clear, and a new regulation has been added to achieve this. The regulation is made under a power in section

125(2) of the Pensions Act 1995 which allows regulations to prescribe how Part 1 of the Pensions Act 2004 is to apply to hybrid schemes.

7. The Government has also considered the points raised on death in service benefits. The intention is that where a scheme is money purchase except for any death in service benefits provided, it is only the latter would have to be indexed. Any money purchase benefits would not. This is because the Primary legislation operates to exclude money purchase benefits (rather than money purchase schemes) from the indexation requirement. An amendment to the Personal and Occupational Pension Schemes (Miscellaneous Amendments) Regulations 1997 has now been included in the regulations to clarify the position of schemes offering death in service benefits.

8. If death in service benefits are salary related and paid as a pension (rather than a lump sum) then they will be required to be indexed. The same arguments apply here as for retaining indexation for salary related benefits in general. That is - removing indexation from defined benefit pensions would result in a reduction in the value of an individual's pension and indexation is therefore being retained for these benefits.

9. Respondents also raised queries on particular types of hybrid schemes, for example cash balance schemes and schemes with underpins. The Government's approach is that the general policy should be applied to specific schemes. That is, if the pension is money purchase it will not have to be indexed. If it is defined benefit then indexation will be required. It is for schemes to decide what type of benefit the pension provides.

## **Transfer issues**

### Points made

10. Several respondents made points about the indexation of pensions derived from benefits transferred in from other pension arrangements. There were concerns from representatives of money purchase scheme interests that, whilst they will have no need to keep track of parts of the pension pot for indexation purposes, this will still be required in case a transfer is made to a salary related scheme. There were strong representations that the necessary tracking of rights in a money purchase scheme would be onerous and would negate the simplification effect of removing indexation. Several respondents suggested alternative ways of treating transferred in rights so that this tracking was not required. The most common suggestion was that all contracted out rights transferred to a salary related scheme should be

treated as post 2005 9(2B) rights – resulting in one level of indexation being applied to all of these rights. Similar issues were raised where the transfer was being made from a section 32 (or buy-out) policy.

11. There were also more general queries about what exactly the new rules on indexation on transfer achieved and how they applied to particular pension schemes and arrangements.

### Response

12. The issues concerning indexation on transfer arise because of the changes being made to indexation rules in general. Existing indexation rules apply according to whether a pension is occupational or personal. The Pensions Act 2004, together with this set of draft regulations, changes that split to pensions which are money purchase or salary related.

13. Existing rules on the indexation of rights transferred from other schemes mean that the indexation that applied to rights when they accrued would continue to apply if those rights were transferred to another arrangement. The indexation of rights transferred to occupational pension schemes are covered by the Occupational Pension Schemes (Indexation) Regulations. Transfers to personal pension schemes are covered by section 162 of the Pensions Act 1995 which applies to all protected rights, including those derived from rights transferred in.

14. The Government intends that mandatory indexation be swept away completely for money purchase pensions where these come into payment after April 2005. Therefore, as has always been the intention, there will be no indexation required on money purchase benefits (held in either a personal, occupational or hybrid pension scheme) even where any of these rights were previously subject to indexation.

15. We had originally proposed to change the indexation rules for salary related schemes so that any money purchase rights transferred into them did not have to be indexed. Amendments to the Occupational Pension Schemes (Indexation) Regulations to achieve this were included in the consultation document. But consultation comments received have led us to reconsider our approach. We acknowledge that this is a complex issue. After consideration we have decided that (for salary related pensions coming into payment after 6 April 2005):

- where a transfer has been made before 6 April 2005, existing indexation rules continue to apply to salary related schemes receiving transfers.

- where a transfer is made after 6 April 2005, contracted-out rights from any scheme and all post 1997 rights from salary related schemes should be indexed if transferred to a salary related scheme.
16. In arriving at this proposal we have considered the need to:
- keep things as simple as possible for the importing scheme. The transferred rights will need to be divided up and dealt with appropriately. We have avoided changing the rules for any transfers already made to salary related schemes as it would be unreasonable to expect schemes to unpick the calculations made to convert rights into salary related benefits.
  - keep things as simple as possible for the exporting scheme which will have to track different parts of the pension pot in case of transfer (see discussion below).
  - keep in line with the removal of indexation where this is not needed to protect people's pensions against inflation.
17. It should be borne in mind that, wherever indexation is not required it can still be offered by the scheme or chosen by the individual if they are selecting an annuity.
18. Careful consideration has been given to the matter of how transferred rights should be treated by receiving schemes. In particular we have looked at rights transferred to salary related schemes and the suggestion that we should legislate to allow these rights to be treated as post 2005 rights.
19. Whilst we agree that money purchase schemes should not have to track rights unless necessary, pre-1997 protected rights have to be identified as such, in case they are transferred into a defined benefit scheme, where they become a Guaranteed Minimum Pension (GMP). We accept that removing this requirement would make the administration of the protected rights easier but such a change would not be possible without significant changes to primary legislation.
20. The Government has therefore decided that salary related schemes receiving a transfer will still be required to identify pre-1997 rights and other contracted out rights. This also applies to transfers received from buy-out policies.

## Information requirement

### Points made

21. The information requirement attracted many comments. Several respondents felt the requirement was being rushed in before the rules were clear or the necessary leaflet was available from the Regulator. Some felt that it would increase burdens on trustees and others urged that the arrangements for occupational and personal pension schemes should be consistent. In addition some respondents thought the matter of when the individual had the choice of annuity, and hence when information, had to be provided, was not clear.

### Response

22. Members in money purchase schemes will, from April 2005, be able to choose whether to have indexation built into their annuity (this applies to all members of personal pension schemes and members of occupational schemes where the scheme allows). Whilst this increased choice is a good thing it is essential that individuals have the information they need to help them make this choice. Ministers therefore decided to introduce an information requirement so that schemes would be required to provide information about indexed and level annuities. Ministers also decided they wanted this requirement to be introduced from April 2005 to coincide with the indexation changes.

23. These regulations introduce the new requirement for occupational pension schemes. The amendment to the schedule of information that must be disclosed lists the new information that must be given and states that, to meet the requirement to describe the features of different types of annuity, the scheme may provide a leaflet prepared by the Pensions Regulator. The FSA are proposing changes to their Conduct of Business rules to impose a similar requirement for personal/stakeholder pension schemes and a FSA leaflet already in use is being updated to reflect the changes. The FSA have consulted on the changes for personal pensions and we are working with them to ensure a consistent approach across all money purchase schemes.

24. The Government appreciates that schemes are being asked to introduce a new information requirement at short notice. However it was felt important that the information requirement should be introduced at the same time as the indexation changes so that individuals approaching annuity purchase start to receive this information as soon as possible. We have been working closely with the Regulator on the development of the information requirement for occupational schemes and the leaflet will be available by 6<sup>th</sup> April 2005.

25. The Government does not wish to place unnecessary extra burdens on trustees and has endeavoured to make this requirement as straightforward as possible for them to introduce. This is a new requirement – but one which trustees can fulfil with minimum extra work if they choose to use the leaflet available from the Pensions Regulator. They can, if they prefer, provide their own version of the information. If they choose to do so it will, it is acknowledged, be more costly, although it will be clear from the leaflet what sort of information would satisfy the requirement. The requirement to send information will begin from April 2005 – ie it will cover people retiring from October 2005.

26. The Government has taken on board the comments about ensuring consistency between occupational and personal pension schemes and has been working closely with the FSA as they develop their parallel requirement to cover personal/stakeholder pension schemes. The FSA have decided that, as well as requiring schemes to give basic information about level and indexed annuities, they will extend this to cover joint/single life annuities and annuities with/without guarantee on early death of the scheme member. (Firms that comply with the FSA's current regime by providing a copy of the FSA's factsheet about annuities are already providing this information). As a result of further consideration we have decided that the list for occupational schemes should be similarly extended. This avoids focusing on, what is after all, only one of the annuity choices facing individuals and will ensure a level playing field with personal pensions. This required information will be included in the leaflet being prepared by the Pensions Regulator and so, if trustees use this leaflet, it will make no difference to procedures.

27. We acknowledge that not everyone in an occupational money purchase scheme will be able to choose their own annuity. At present, some schemes may offer an "in house" choice of annuity. Others may permit their members to use the open market option. In either case the scheme will be required to provide information on annuity choice. From April 2006 the open market option will apply to all members of money purchase occupational schemes, so all will be covered by the new information requirement.

## **Other comments**

### GAD tables

28. The Government specifically sought views on the proposal in the consultation document to remove the need for separate protected rights tables to be used for calculating payments made under an interim

arrangement. From April 2005 all rights held in a personal pension would be used in the same way.

29. There was a general welcome for these changes which we can confirm will go ahead. The protected rights tables will be removed from April 2005. We do not expect the non-protected rights tables to be revised until April 2006. The new arrangements will operate from the normal review date after April 2005.

### Pension Shares

30. A couple of respondents made points about pension credit rights and how they were affected by the new indexation regime. It might be useful therefore to set out the Government's policy on this.

31. Pension sharing means a clean break in as much as a pension sharing order has been implemented there is no further link between the former spouse's pension and the member's pension. The pension credit may then be held in either a defined benefit or a money purchase scheme.

32. For pension credits held in defined benefit schemes indexation will continue to apply. The indexation cap in place when entitlement to the credit arises will apply to the pension credit benefit when it comes into payment. (Therefore if entitlement to a pension share arises pre 6 April 2005 5% will apply, if entitlement arises on or after 6 April 2005 2.5% will apply).

33. Pension credits held in a money purchase pensions, where the pension comes into payment on or after 6 April 2005, will not be subject to indexation.

34. One respondent made a point about AVCs in relation to pension shares. To confirm – although AVCs are not rights which attract indexation, they are shareable for pension credit purposes.

### The Pensions Regulator

35. Several respondents queried the increase in the penalties available to the Pensions Regulator.

36. Unlike Opra, the Pensions Regulator will be able to issue an Improvement Notice to deal with a minor breach of pensions law. These Notices allow the Regulator to prescribe the action to be taken (and by whom) to rectify the breach without resorting to formal sanctions, although failure to comply with an Improvement Notice may attract a

civil penalty. Improvement Notices are not suitable for all instances, and in cases of serious default, or serious risk to members' benefits, the Regulator is likely to proceed directly to sanctions, prosecution, or other regulatory actions.

37. Given these circumstances, the Government has no wish to fetter the Regulator's powers where the latter feels obliged to sanction a scheme in respect of a very serious breach of pensions legislation.

38. One respondent queried the removal of paragraph 24 of Schedule 1 of the Disclosure of Information which refers to registration under s.6 PSA. This is a minor simplification measure.

### General comments

39. A couple of respondents suggested that the indexation requirement should also be removed from salary related pensions. The Government's view is that this would not be in the interests of salary related schemes members as they would lose out without an actuarial uplift to benefits to compensate for removing indexation.

40. There was also a suggestion that protected rights should be further simplified by the removal of the requirement to purchase survivors' benefits. The Government has made it clear that it believes it is important to protect the position of surviving spouses by providing for survivors' benefits. Abolition would have a disproportionate effect on women who are still less likely to have their own private pension arrangements.

41. There were also a number of more minor drafting suggestions and requests for clarification in the legislation. We have taken these on board where necessary or desirable.

### **Thanks**

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

**List of respondents**

ABI  
ACA  
Actuarial Profession  
Addleshaw Goddard  
Aegon UK  
Alba Life  
Aon Consulting  
Barclays  
Hewitt Bacon and Woodrow  
Law Society of Scotland  
NAPF  
Norwich Union  
PMI  
Prudential  
Scottish Widows  
Skandia Life  
SPC  
Watson Wyatt