EXPLANATORY MEMORANDUM TO

THE PENSIONS ACT 2008 (ABOLITION OF PROTECTED RIGHTS) (CONSEQUENTIAL AMENDMENTS) (NO. 2) (AMENDMENT) ORDER 2012

2012 No. 709

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument makes minor amendments to the Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) (No.2) Order 2011 (S.I. 2011/1730) in relation to amendments to be made to the Insolvency Act 1986 and the Pension Schemes Act 1993 in respect of protected rights payments. In contracted-out defined contributions (DC) schemes, the amount of an individual's pension fund derived from the National Insurance rebate, its investment return and any tax relief on the rebate are known as "protected rights".

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) (No.2) Order 2011 makes consequential amendments to primary legislation as a result of the abolition of contracting-out on a DC basis on 6th April 2012, which is provided for in the Pensions Acts 2007 and 2008. The rationale for abolition is explained in paragraph 7.6 below.

4.2 This instrument amends that Order before it comes into force, to remove the exclusion of protected rights payments from what counts as income for the purposes of Income Payments Orders made under section 310 of the Insolvency Act 1986 and from the scope of pension payments which cannot be assigned or charged under section 159 of the Pension Schemes Act 1993.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

The Minister for Pensions has made the following statements regarding Human Rights:

In my view the provisions of the Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) (No. 2) (Amendment) Order 2012 is compatible with the Convention rights.

7. Policy background

What is being done and why

Contracting-out

7.1 Contracting-out provides a private sector alternative to the state additional pension. People with occupational and personal pensions can contract out of the state additional pension provided certain conditions are met. Contracting-out is currently permitted for occupational pension schemes on a money purchase (also known as defined contribution (DC)) basis or on a salary-related (also known as defined benefit) basis.

7.2 In an occupational pension scheme the employer's and employee's National Insurance contributions (NICs) are reduced for employees who are members of a contracted-out pension scheme. In a contracted-out personal pension scheme, the full rates of NICs are paid by the employer and employee and the rebate is provided by HMRC through an annual payment into the scheme at the end of the tax year. These reductions and payments are collectively known as the contracted-out rebate.

7.3 In contracted-out DC schemes, the amount of an individual's pension fund derived from the rebate, its investment return and any tax relief on the rebate are known as "protected rights".

7.4 There are certain restrictions that apply to the protected rights e.g. how and where they can be invested; that the resulting annuity or pension must be purchased on a unisex basis; and that it must provide survivor benefits where the member is married or has a civil partner.

7.5 As well as protected rights, a scheme member may build up additional pension rights in the scheme from their own and/or employer's contributions. Legislation does not extend the above restrictions to these additional accruals, but scheme rules may. If the scheme does not extend the protected rights rules to the entire scheme accruals then the protected rights have to be tracked separately from the scheme's non-protected rights.

Abolition in 2012

7.6 From 6 April 2012 contracting-out on defined contribution (DC) basis will be abolished. As a consequence all rules and references to "protected rights" in pensions-related legislation will either be repealed, or where appropriate, amended. The abolition of contracting-out on DC basis was provided in the Pensions Acts 2007 and 2008. In July 2011 the Government introduced statutory instruments that made consequential changes to primary legislation as a result of these Acts. Together with the primary legislation, these instruments removed the rules and references that relate to contracting-out on a DC basis and protected rights.

What this instrument achieves

7.7 Immediately before the debate in the House of Commons, an issue was noticed with the way the proposed amendments in article 3 of the Pensions Act 2008 (Abolition

of Protected Rights) (Consequential Amendments) (No. 2) (Amendment) Order 2011[1], the Insolvency Act 1986 would work.

7.8 The Minister for Pensions made a statement to the delegated powers committee when introducing the debate[2]. This explained that Article 3 of the order makes a minor consequential amendment to the Insolvency Act 1986, but that it had become apparent that it will not be possible for this provision to have practical effect. The article amends provisions that currently provide that any pensions payments which derive from protected rights are not taken into account as income when a court considers making an income payments order for a debtor. The amendment seeks to provide that any pension payments which give effect to protected rights before the abolition date will continue to be exempt from counting as income for these purposes. However, it will not be possible for schemes post-abolition to identify such protected rights payments, as schemes will no longer be required to keep track of them. As such, this part of the amendment will have no practical effect, as the courts would be unable to identify pension payments which give effect to protected rights.

7.9 In response to the public consultation on consequential amendments for the abolition of contracting-out, para 25.2[3], the Government said that all protected rights that have been given effect to before the abolition date should retain their current status. However, tracking of such rights, as mentioned in 7.5 above, would cease post abolition of DC contracting-out and any protected rights that have been given effect before abolition date would not be tracked separately from any non-protected rights payment. Practically, it would not be possible, post-abolition, for schemes to identify pension payments derived from protected rights in case of insolvency so that no income payments orders could be passed by the court to divert these payments to creditors of a bankrupt scheme. As a result of this instrument protection from income payments orders will be removed as currently afforded to protected rights payments, from 6th April 2012.

7.10 This instrument also provides for amendments in current legislation to remove the current protections from charges and assignments in case of bankruptcy for protected rights payments. Both these amendments will bring consistency with changes made to the Bankruptcy (Scotland) Act 1985 by article 2 of S.I. 2011/1730.

Consolidation

7.11 There are no plans to consolidate the instrument that is being amended.

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[1] http://www.legislation.gov.uk/uksi/2011/1730/contents/made
[2] Hansard, Tuesday 28 June 2011, Column 5: http://www.publications.parliament.uk/pa/cm201012/cmgeneral/deleg3/110628/110628s01.htm
[3] http://www.dwp.gov.uk/consultations/2010/abolition-contracting-out-dc.shtml

8. Consultation outcome

8.1 No consultation has been undertaken on these specific amendments, because a full consultation was carried out on the original Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) (No.2) Order 2011, to which this instrument relates.

9. Guidance

9.1 This instrument makes a minor correction therefore no general guidance is necessary.

10. Impact

10.1 The impact on business and the civil society is negligible.

10.2 The impact on the public sector is negligible.

10.3 A full impact assessment was carried out for the consequential statutory instruments for the abolition of contracting-out on DC basis (including S.I. 2011/1730 to which this instrument relates). The impact assessment reflects this order and the figures remain valid; it was published alongside the Explanatory Memorandum on: http://www.legislation.gov.uk/uksi/2011/1245/memorandum/contents.

11. Regulating small business

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11.1 This legislation applies to all small businesses but the impact on them is beneficial but negligible.

12. Monitoring & review

12.1 The Department for Work and Pensions will monitor the effect of the consequential changes in October 2013 from information provided by Her Majesty's Revenue & Customs (HMRC). The Department may decide it is necessary to review this instruments following advice from HMRC.

13. Contact

Ivor Millen, Contracting-out policy team, at the Department for Work and Pensions – Tel: 020 7449 7384, can answer any queries regarding the instrument.