

PENSIONS ACT 2007

EXPLANATORY NOTES

SUMMARY AND BACKGROUND

Non-State Pensions Measures

Abolition of contracting-out for defined contribution pension schemes

Current Position

73. Contracting-out provides a private sector alternative to the state second pension. Under the contracting-out arrangements, employees forego all or part of their additional state pension for the years in which they are contracted out and in return pay lower-rate National Insurance contributions and/or receive payments into their pension scheme. These reductions and payments are known collectively as the contracted-out rebate. Contracting-out is allowed for occupational pension schemes that contract out on a defined contribution (also known as money purchase) basis (known as a COMP) or on a defined benefit (salary-related) basis. Personal pension schemes are also allowed to contract out. A contracted-out personal pension scheme is referred to as an appropriate scheme (APP).
74. When a private pension scheme contracts out, Her Majesty's Revenue and Customs (HMRC) (which provides for the operational side of contracting-out) issues a certificate identifying the scheme's contracted-out status. Certificates for occupational pension schemes are referred to as "contracting-out" certificates, whilst certificates for personal pension schemes are referred to as "appropriate scheme certificates". When the scheme ceases to contract out, it surrenders the certificate. The certificate can be withdrawn by HMRC if the scheme is not complying with the relevant statutory requirements.
75. Money purchase schemes must, as a condition of contracting-out, provide protected rights. Protected rights are derived from the contracted-out rebate and the investment return on the rebate. They are subject to certain rules regarding where they can be invested, where they can be transferred, the purchase of a unisex annuity when the protected rights are secured, and the purchase of a dual life annuity if the scheme member is married or in a civil partnership at the point of annuitisation.
76. In addition to the protected rights, a scheme member may build up additional rights under the scheme's own rules. The rules applying to protected rights will not apply to the rights built up under the scheme rules unless the scheme has designated that they do so. If the scheme does not do so, the protected rights will have to be tracked separately from the scheme rights and they could be treated differently at the point of annuitisation.
77. Those who were contracted-out pre-1997 are still treated as having an entitlement to the additional state pension for the years in which they were contracted out up to 1997 and a contracted-out deduction is made from the additional state pension entitlement, to avoid double provision. When the scheme member dies, his or her surviving spouse or civil partner is entitled to some or all of the deceased member's additional state pension rights and, where the member was contracted-out pre-1997, a contracted-out deduction is also applied to the survivor benefit.