These notes refer to the Pensions Act 2007 (c.22)
which received Royal Assent on 26 July 2007

PENSIONS ACT 2007

EXPLANATORY NOTES

SUMMARY AND BACKGROUND

Non-State Pensions Measures

Conversion of guaranteed minimum pensions

Current position

70. Sections 13 to 23 of the PSA1993 set out the requirements on contracted-out salary related occupational pension schemes to provide a guaranteed minimum pension to members contracted out of the state earnings related pension scheme through membership of occupational schemes between 6 April 1978 and 5 April 1997. From 6 April 1997 the requirements applying to contracted-out schemes were simplified and no further rights to guaranteed minimum pensions accrued from that date onwards.

Changes

71. In the White Paper, the Government proposed to introduce a facility for schemes to convert members' rights to a guaranteed minimum pension into rights to an ordinary scheme pension, calculated under the scheme's own rules, subject to certain safeguards to protect the members' interests. Each member's post conversion benefit would be required to be at least as actuarially valuable as their rights immediately prior to conversion.

72. By conducting a guaranteed minimum pensions conversion exercise, a scheme may be able to adopt a unified and streamlined benefit structure which will enable administrative savings to be made as well as offering advantages to members (in terms of understanding their rights in the scheme and being able to transfer them to other schemes more easily). It would be for scheme trustees to decide whether they wished to make use of this facility.

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.

Changes

78. The Act abolishes contracting-out for occupational and personal pension schemes that contract out on a money purchase basis. Contracting-out certificates for COMPs and appropriate scheme certificates will be automatically cancelled. The result will be that, from the date of cancellation, members of schemes that had been contracted-out on a money purchase basis will be contracted back into the state second pension and will start to build up entitlement to a state second pension. The Act amends and repeals certain provisions of the PSA1993 and other legislation to abolish contracting-out for money purchase schemes. As a result the contracting-out rebate will no longer be available for money purchase schemes. The Act also removes the rules that apply to the protected rights, except for the rule concerning the provision of survivor benefits from the protected rights if the member is married or in a civil partnership at the point of annuitisation.

Dispute resolution arrangements

Current position

79. Currently, trustees or managers of occupational pension schemes are required to have in place formal arrangements for the resolution of disagreements relating to the scheme. The existing dispute resolution procedure requires a two stage process, with someone nominated by trustees giving a decision at the first stage, and then the matter being referred to the trustees if the applicant is still not satisfied.

Changes

80. The measure in the Act will make it possible to replace the two-stage internal dispute resolution procedure with a single-stage arrangement where all decisions would be taken by trustees or managers. This would not be compulsory, however, and schemes will be able to retain the present two-stage arrangements if they wish.

81. This amendment would give effect to the proposal announced in the 2002 Green Paper *Simplicity, security and choice: Working and saving for retirement*.

Removal of Secretary of State's role in approving actuarial guidance

Current position

82. In order for actuaries to calculate pension schemes' liabilities consistently, all are required to use an agreed set of guidelines. These guidelines are contained in documents referred to either as 'Guidance Notes' or as a 'Technical Memorandum'. There are seven Guidance Notes and one Technical Memorandum referred to in pensions legislation. The Secretary of State is required by primary legislation to approve three of these Guidance Notes and the Technical Memorandum.

83. Historically, the Actuarial Profession has produced these documents. The professional bodies for actuaries – the Institute of Actuaries in England and Wales and the Faculty of Actuaries in Scotland – have combined the role of regulator with that of professional body.

Changes

84. The Morris Review of the Actuarial Profession recommended that the Financial Reporting Council should establish a new regime to set actuarial standards and to oversee the regulation of the Profession. The Financial Reporting Council is the UK's independent regulator for corporate reporting and governance. The Government accepted this recommendation and the Financial Reporting Council has now set up the Board for Actuarial Standards to promote confidence in corporate reporting and governance by setting high quality actuarial standards. The Institute of Actuaries in England and Wales and the Faculty of Actuaries in Scotland continue to exist as the professional bodies for the profession in their respective jurisdictions.

85. On 6 April 2007, the Board for Actuarial Standards adopted and took responsibility for the existing versions of the pensions Guidance Notes and the Technical Memorandum.

86. In order to maintain the independence of the Financial Reporting Council, and through it the Board for Actuarial Standards, as the UK's independent regulator for corporate reporting and governance, the Act contains provisions removing from primary legislation the requirement for the Secretary of State to approve the three Guidance Notes and the Technical Memorandum.

Financial assistance scheme: increased levels of payments

Current position

87. Section 286 of the PA2004 requires the Secretary of State to make regulations setting up the financial assistance scheme ("FAS"). The FAS was announced on 14 May 2004 to assist those who had lost or who stood to lose significant amounts as a result of their pension scheme winding up underfunded with an insolvent employer. Regulations setting out the details of the FAS were made in July 2005 and the majority of those regulations came into force on 1 September 2005. Under those regulations and subsequent amendments, schemes must have started to wind-up between 1 January 1997 and 5 April 2005 and must meet certain other qualifying criteria in order for their members to qualify for assistance.

88. At present, members of qualifying schemes who were within 15 years of their normal retirement age on or before 14 May 2004 may qualify for assistance payments, which are tapered depending on proximity of the member to normal retirement age. Qualifying members are generally entitled to payments at age 65 (though early access to payments is possible for the terminally ill). Eligible survivors of qualifying members who have died may also qualify for payments (at a lower level) regardless of their age. FAS

payments top up any pensions being paid by the scheme during its winding-up or at the end of the winding up (taking account of the amount of assets allocated to members) to a specified proportion of members' “expected pensions”, as that term is defined in the July 2005 regulations (commonly referred to as members’ “expected core pensions”). Payments are subject to a cap (currently £12,000 a year) and are currently subject to a de minimis amount (of £520 a year). In general, payments made whilst pension schemes are winding-up (“initial payments”) are paid at a lower rate than final payments (“annual payments”), at up to 60% of expected core pensions.

Changes

89. An extension of the financial assistance scheme was announced by the Chancellor of the Exchequer in his budget speech of 21 March 2007. The Act makes provision, including by way of amendment to section 286 of the PA2004, to provide for part of that extension (the rest of the extension will be brought forward in regulations). The amendments to section 286 are designed to require regulations made under that section to provide for the removal of tapered assistance by requiring that the level of annual payments is set at no less than 80% of members' expected core pensions subject to any cap provided for in the regulations (and taking account of any assets allocated to members by their scheme). The amendments also ensure that the regulations must provide that that level of assistance will be received by all qualifying members, regardless of age. The Act also makes provision setting initial payments - paid whilst pension schemes are winding up - at a level of 80% and further provides that the level of those payments can be amended by regulations (which will be subject to the affirmative procedure). Regulations will be required to specify the precise level at which annual payments will be paid. However, the new provision to raise the level of initial payments to 80% takes effect from the date of Royal Assent.

90. The Act also requires the Secretary of State to make regulations imposing a temporary restriction on the purchase of annuities by trustees of qualifying schemes that are still winding up, unless they have entered into a binding commitment to do so or have obtained the permission of the FAS scheme manager. The regulations must be made as soon as is reasonably practicable and will apply for nine months from the date on which they come into force.

Personal Accounts Delivery Authority

Current position

91. As outlined in the White Paper, the Government intends to give effect to some form of personal accounts scheme from 2012. The Government intends to legislate for the personal accounts scheme in a planned future Bill.

92. However, to ensure delivery of a personal accounts scheme from 2012, much preliminary work must be done in advance of Royal Assent of the planned future Bill. The Government’s intention is that the delivery and eventual governance of the personal accounts scheme should be independent of Government, utilising the knowledge and skills of individuals with experience of private occupational pensions administration. No existing organisations were identified that currently have the necessary remit, skills and capacity for the work needed to deliver a system of personal accounts or the capacity to expand and adapt their operations to commence the work within the required timeframe.

Changes

93. The Act establishes a body corporate called the Personal Accounts Delivery Authority (referred to as the ‘Authority’) to undertake the preliminary work necessary for the establishment of a personal accounts scheme.

94. The Authority is being established with a remit limited to:

- Providing advice and recommendations to Government, helping it to think through the operational and commercial implications of its policy options.
- Preparing for the implementation of a personal accounts scheme, such as formulating a commercial strategy for the personal accounts scheme by preparing specific products which comprise a financial, technical and commercial strategy.

95. The Authority will be at a distance from Government and will be able to manage its own affairs. Schedule 6 gives details on the membership and structure of the Authority.

96. The Act also gives the Secretary the State the power to wind up the Authority if he considers that, owing to the abandonment or modification of relevant proposals on the personal accounts scheme, it is no longer necessary to have an Authority.

97. The Act gives the Authority limited powers, as detailed in paragraph 94. The Government will consider options to extend this remit in legislation planned for a later date, subject to the agreement of Parliament.