

WELFARE REFORM AND PENSIONS ACT 1999

EXPLANATORY NOTES

COMMENTARY

Pension debits

Section 32: Effect on contracted-out rights

This section amends the Pension Schemes Act 1993 to take account of the effect of a pension debit on a scheme member's guaranteed minimum pension (GMP) or protected rights. The section provides for reduction of GMPs or protected rights as a result of a pension debit. Entitlement to state benefits will be calculated as if the pension share had not taken place.

Before 6 April 1997, contracted-out occupational salary related (COSR) schemes had to provide a GMP roughly equivalent to the state earnings related pension scheme (SERPS). Following changes introduced in the Pensions Act 1995, such schemes are no longer required to pay a GMP for pensionable service from 6 April 1997. Instead, they must meet an overall quality test and a minimum funding requirement, and pensions in payment derived from post 6 April 1997 service must also rise by at least 5% a year, or in line with prices, whichever is the less.

Protected rights are the rights in a contracted-out occupational money purchase (COMP) scheme and appropriate personal pension (APP) scheme that derive from the rebate of National Insurance contributions, and in APP schemes only, tax relief on the employee's share of the rebate.

Subsection (2) amends section 10 of the Act. It provides for the reduction of any protected rights in a COMP or an APP, which are subject to a pension debit, by the percentage specified in the pension sharing order or agreement or, where the order is expressed in monetary terms (that is in Scotland) by the amount specified (up to the limit of the cash equivalent of the member's rights) expressed as a percentage of the cash equivalent of the member's rights.

Subsection (3) inserts section 15A into the Pension Schemes Act, which provides for the reduction of a GMP payable by a contracted-out salary related scheme where it is subject to a pension debit. For example, if the cash equivalent has been reduced by 40%, the GMP accrued at the date the order or agreement takes effect (which forms part of the cash equivalent) shall be reduced by 40%. Again where the order or agreement is expressed in monetary terms, the appropriate percentage is the amount specified (up to the limit of the cash equivalent of the member's rights) expressed as a percentage of the cash equivalent mentioned above.

However, where the member is in pensionable service on the day the order or arrangement takes effect, the reduction is by reference to the appropriate percentage of the hypothetical GMP to which he would have been entitled had he ceased to be in pensionable service immediately before that day (see section 31(2)).

*These notes refer to the Welfare Reform and Pensions Act 1999
(c.30) which received Royal Assent on 11 November 1999*

Subsection (4) amends section 47 of the Pension Schemes Act to ensure that a member of a contracted-out occupational scheme (whether salary related or money purchase) or APP scheme, will be treated as entitled to a full GMP for the purposes of calculating entitlement to relevant social security benefits (for example, the state additional pension). This is needed to ensure that the state does not become liable to make up the resultant shortfall in the GMP or protected rights paid by the scheme directly caused by pension sharing.

For example, the member might have been entitled to an additional pension of £12 per week but this is reduced to just £2 per week to offset the £10 GMP paid by the scheme to which he would have been entitled had the pension sharing order not been implemented. Under these provisions he will continue to be treated as entitled to a GMP of £10 per week and hence continue to receive an additional pension of just £2 per week, even though as a result of the pension debit his GMP has been reduced by 40% (that is by £4) to £6 per week.