

**EXPLANATORY MEMORANDUM TO
THE PROTECTED RIGHTS (TRANSFER PAYMENT)
(AMENDMENT) REGULATIONS 2005**

2005 No.2906

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. **Description**
 - 2.1 These regulations provide for the bulk transfer of protected rights from one scheme to another without the consent of the member having to be obtained.
3. **Matters of special interest to the Joint Committee on Statutory Instruments**
 - 3.1 None.
4. **Legislative Background**
 - 4.1 The pensions industry has made representations about the difficulty of consolidating pension schemes where members' pension rights include protected rights. ("Protected rights" are a type of pension right which a person accrues where they are contracted out of the State Second Pension.) The legislation currently provides that members can only be transferred from one scheme to another with their consent. Clearly the consent of each individual member can be difficult to obtain, especially if the member left the scheme some time ago and there is no up-to-date address.
5. **Extent**
 - 5.1 This instrument applies to Great Britain.
6. **European Convention on Human Rights**

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.
7. **Policy background**
 - 7.1 An employer may have a number of company pension schemes, perhaps as a result of mergers and acquisitions, and may want to consolidate them into one scheme, for ease of administration and to reduce costs. A consolidation involves the transfer of members' pension rights from one scheme to another. For most kinds of pension rights, the legislation already provides for employers to bulk transfer members' pension rights from one scheme to another. The formal consent of the member is not needed to these

transfers but there are prescribed safeguards in legislation. These are longstanding arrangements.

7.2 However the existing legislation on bulk transfers does not apply to protected rights, a particular type of pension right. For protected rights the existing legislation provides that the formal consent of the member is required for any transfer. It can be very difficult to obtain the consent of each and every member and as a result, consolidation activity, where protected rights are involved, has tended to be stymied.

7.3 The effect of these amending regulations is to put the treatment of protected rights, in respect of bulk transfers, on broadly the same footing as other pension rights. The regulations provide for two methods of making a bulk transfer. Under one method the member has the right to object to the transfer of his protected rights; in the absence of the member's formal objection, the transfer of his rights can go ahead. With the other procedure, a transfer of the member's rights can be made provided that an actuary certifies that the pension rights the member is to acquire in the new scheme are broadly no less favourable than in the transferring scheme. Under both methods a further safeguard is that these transfers can only be made where the transferring and receiving pension schemes are related in a prescribed way. It is estimated that these regulations will save pension schemes around £10 million over three years.

7.4 The regulations have been the subject of a public consultation and there were 11 responses. Respondents generally welcomed the changes but wanted the changes to go further. In particular respondents were concerned that the regulations only applied to deferred members and not active members of the scheme. ("Deferred members" are people no longer accruing rights in the scheme, usually because they have left the employment.) There was also an issue about members having the right to object to the transfer even where there were safeguards. Both of these issues have been addressed in the regulations (see para 7.3).

7.5 More widely the regulations reflect the Government's wish to simplify the administration of private pension schemes in order to make it easier for employers to provide pensions for their employees.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 These regulations impose no new costs on the public sector. Protected rights are a feature of money purchase occupational pension schemes whereas virtually all public service pension schemes are salary related.

9. Contact

Mike Rochford at the Department for Work and Pensions Tel: 020 7962 8126 or e-mail: mike.rochford@dwp.gsi.gov.uk can answer any queries regarding the instrument.

THE PROTECTED RIGHTS (TRANSFER PAYMENT) (AMENDMENT) REGULATIONS 2005

REGULATORY IMPACT ASSESSMENT

Introduction

1. Representations have been made to Government by the pensions industry about constraints that make the consolidation of occupational pension schemes more difficult. This regulatory impact assessment considers options for making the procedures more straightforward.

PURPOSE AND INTENDED EFFECT

(i) Objective

2. Arising out of mergers and acquisitions activity, employers may have several pension schemes which they would like to consolidate into one scheme. Having a single scheme would simplify administration and therefore save the employer money.

3. The policy objective is to introduce arrangements to allow the bulk transfer of protected rights from one occupational pension scheme to another without having to obtain the consent of each member, whilst at the same time putting in place safeguards to make sure that members are not adversely affected. Simplifying the arrangements will allow employers to administer schemes more effectively and reduce their costs.

(ii) Background

4. The existing Protected Rights (Transfer Payment) Regulations 1996 are drafted in terms of member consent. Where the member has protected rights, a transfer can only be made if the member consents to it. If an employer with several pension schemes wants to consolidate them, members can only be “moved” from one scheme to another if the consent of each individual member can be obtained. There can be difficulties in obtaining consent where members have left the employment and perhaps moved to another part of the country. For example the employer may no longer have up to date addresses.

5. By contrast, in respect of other kinds of pension rights apart from protected rights, trustees can transfer the rights of members from one scheme to another without consent, provided certain safeguards, prescribed in legislation, are met. At this point in time, it is not clear why protected rights were treated differently in the regulations.

6. This is a change that has actively been sought by the pensions industry. As an example of the problem, in the consultation one respondent said that since 1993 his scheme had been trying to consolidate 50 small schemes into one. However because of the difficulty of obtaining consent, after 12 years the number of schemes has only been reduced to 27. For all of these remaining schemes, separate audited accounts have to be produced each year and separate records maintained. As the respondent makes clear, this is inefficient and adds unnecessary costs to the business.

Rationale for Government intervention

7. If no changes are made employers and trustees would continue to be hindered in their attempts to consolidate their pension schemes. Employers would have to meet the costs of administering these small closed schemes. If the Government introduces new, more straightforward rules, that will have the effect of reducing the burden on business.

CONSULTATION

8. Within Government, a number of bodies have been consulted, including the Treasury, the Government Actuary's Department, HMRC, and the Office of Fair Trading.

9. A public consultation was also undertaken and 11 responses were received. The respondents were very positive about the changes and in fact made a number of suggestions as to how the proposals could be taken further. The comments made in the consultation have led to modifications in the Options (see below).

OPTIONS

10. Three options are considered:

Option 1: Do nothing.

Option 2: Allow the transfer of deferred members' rights without consent.

Option 3: Allow the transfer of deferred and active members' rights without consent.

Option 1: Do nothing

11. If no changes were made, employers and trustees would remain unable to transfer members' pension rights in bulk from one scheme to another. Because of the need to obtain member consent, the risk is that the number of small closed schemes would continue to increase. An increase is likely because of mergers and acquisitions activity. Employers would incur unnecessary expenditure in the administration of these schemes.

Option 2: Allow the transfer of deferred members' rights without consent

12. This option would only allow the transfer of deferred members' right, not the rights of active members. The consent of active members would still be needed. Additionally a member could object to the transfer of his rights, in which case his rights would have to remain in the original scheme and the intended rationalisation of the scheme would be prevented.

13. The risks attached to this option were fully brought out in the consultation. Respondents were concerned that the consent of active members would have to be obtained to the transfer. Respondents commented that this would add to costs and they pointed out that this requirement was at odds with other provisions in pensions

legislation that allowed the pension rights of active members, other than protected rights, to be transferred without consent. Respondents were also concerned about giving deferred members the right to object to the transfer. Again they argued that if the safeguards which already exist in pensions legislation were applied in this case, that should be a sufficient safeguard and that there was therefore no need for members to have the right to object. The Government has considered these arguments and accepts they have merit.

Option 3: Allow the transfer of deferred and active members' rights without consent

14. The option as consulted on was the same as Option 2 but Option 3 covered both active and deferred members.

15. Respondents to the consultation welcomed the inclusion of active members in the Option but remained concerned that members could object to the transfer.

16. As a result of the concerns expressed in the consultation, Option 3 has therefore been modified. The key points about this revised Option are as follows:

- There will be two Methods by which trustees can transfer members' pension rights without consent.
- Both Methods apply to active and deferred members.

Method 1

- Members will be notified about the proposed transfer of their protected rights and will have three months to consider the matter.
- If the member fails to reply or raises no objections, the transfer can go ahead.
- If the member objects, his protected rights will not be transferred. His protected rights will remain in the scheme. If, subsequently, it is decided to wind up the scheme, the rights of any remaining members in the scheme may be discharged, without their consent, into policies of insurance. There may be costs to the member if rights are discharged into policies of insurance.
- As a safeguard, transfers can only be made where the transferring and receiving scheme are related in one or more prescribed ways.

This Method will probably be most suitable where the scheme has already established that members would be content with a bulk transfer of their protected rights.

Method 2

- A transfer of protected rights can be made where an actuary can certify that the member's rights in the receiving scheme will be broadly no less favourable than in the transferring scheme.

- The member cannot object to the transfer.
- The member must be notified about the proposed transfer at least one month in advance.
- As a safeguard, transfers can only be made where the transferring and receiving scheme are related in one or more prescribed ways.

This Method may be more suitable for more complex transfers of protected rights. This Method is broadly the same as the provisions for the bulk transfer of non protected rights, contained in regulation 12 of the Occupational Pension Schemes (Preservation of Benefit) Regulations S.I 1991/167, and so the same procedures can be used to undertake the bulk transfer of both sets of rights.

17. The two Methods contained in this Option address the risks highlighted in the consultation. Firstly both active and deferred members are included in the requirement. Secondly transfers can be made by the trustees without the member being able to object. The safeguard for members however is that such transfers can only be made with actuarial certification and transfers have to be made between schemes that are connected in some prescribed way. These arrangements are consistent with the longstanding and non-controversial rules on bulk transfers contained in the Preservation of Benefit regulations.

Implementation

18. This is a permissive change which schemes can use if they want to. It will be up to employers and trustees to decide if and when they want to use it.

COSTS AND BENEFITS

Sectors and groups affected

19. The groups affected by these proposals are:

- the trustees or managers of contracted-out money purchase occupational pension schemes¹;
- employers associated with these schemes
- the scheme members.

Public sector pension schemes should not be affected by these changes. This is because public sector pension schemes are salary related, whereas protected rights are a feature of money purchase schemes.

1. In addition to contracted-out money purchase schemes, the proposals will also affect trustees and managers of contracted-out mixed benefit schemes and formerly contracted-out versions of these schemes.

Option 1

20. This option would prevent scheme rationalisation and would therefore be unhelpful to trustees; it would be particularly detrimental to employers who would have to meet the continued cost of administering these schemes. Members could also be disadvantaged; if the scheme were to be wound up, the protected rights could be discharged into a policy of insurance. It is possible that the member would have to meet some or all of the costs associated with that discharge. For example there may be an annual charge on the insurance policy that the member might have to meet. This would usually be a percentage of the value of the policy, perhaps 1% per annum.

Option 2

21. Option 2 would have some limited benefit to trustees and employers insofar as transfers could be undertaken but only where the members were deferred and where none of them objected. Active members would still need to give formal consent. This option would provide minimal savings for pension schemes.

Option 3

22. This option would allow both active and deferred members to be transferred without consent. This option would therefore benefit trustees and employers because it would facilitate the consolidation of schemes. In terms of safeguarding the interests of members, Method 1 would allow the member to opt out. This would mean that the member's rights remained in the scheme. Under Method 2 whilst members would have no say in the transfer of their rights, the safeguard would be that an actuary would have to certify that the member's rights in the receiving scheme were broadly no less favourable than in the transferring scheme. As an additional safeguard, transfers could only be made where the schemes were related in a prescribed way.

Equity and fairness

23. These proposals do not have any race equality aspects. They would apply equally to all members of a pension scheme where a bulk transfer was to be applied.

Benefits

24. Option 1 would have no benefit for schemes and Option 2 would only have limited benefits (there is no firm cost information on these limited benefits although they would certainly be less than offered by Option 3). Option 3 would provide an estimated gross saving to pension schemes of around £13 million, cumulative over three years. Savings have been estimated on the basis that around 2,500 schemes might take advantage of these new arrangements in the first three years and that the savings in administration costs per scheme might be around £2,000 per year.

Costs

25. Option 1 would mean schemes having to continue to meet unnecessary costs (there are no firm estimates of these costs). It would also mean that schemes would be unable to realise savings of around £10 million over three years. Utilising the procedures in Options 2 and 3 means that schemes will incur some one-off costs. Schemes will have to contact members, make changes to their systems and procedures and cover any actuarial costs. Over a three year period it is estimated that

these costs would be of the order of £3 million for Option 3, somewhat less for Option 2.

Summary of costs and benefits

26. The net benefit to schemes of Option 3 over a three year period is estimated to be around £10 million.

Small Firms Impact Test

27. These changes are not obligatory and employers can choose to use the new procedures if they want to. Most schemes holding protected rights are associated with small to medium size employers. These changes should therefore benefit those employers in particular, allowing them to make savings in the costs of administering their pension schemes.

Competition assessment

28. These proposals will not impact on any particular sector of the market. Where an employer decides to use the procedures for a bulk transfer, the costs should be the same across the piece, allowing of course for economies of scale where larger pension schemes are involved in the transfer arrangements.

29. The proposals will not prevent companies setting up new pension schemes.

Enforcement, sanctions and monitoring

30. The Government will gauge how the new procedures are working through general communications with the pensions industry. Information should also come from various surveys which are carried out to provide statistical information.

Implementation and delivery plan

31. This is not an obligatory measure and employers will be free to use it if they wish. An implementation and delivery plan is not therefore appropriate. However there will be a press release which the pensions industry's news services will publicise.

Post implementation and review

32. The Government will review the way the measure is working after one year by seeking the views of appropriate bodies.

Summary and recommendation

33. The attached table summarises the costs and benefits of the proposal.

OPTION 1 - Do nothing	
This would not address the objective of introducing arrangements to allow the bulk transfer of protected rights without member consent.	
<ul style="list-style-type: none"> • Employers The option would hinder the consolidation of pension schemes and would thereby act against the more efficient administration of schemes. • Members Members may be disadvantaged by this option. If the employer decides to wind up the scheme because he cannot consolidate it with another scheme, the member's rights could be discharged into a policy of insurance. This might mean that the member has to meet some of the associated costs. 	
OPTION 2 - Allow the transfer of DEFERRED members' rights without consent	
Some limited benefit to employers and schemes.	
<ul style="list-style-type: none"> • Employers This option would allow a bulk transfer of deferred members' rights to be made without formal consent. However any member who objected would prevent the transfer of his rights. The formal consent of active members would still be needed. • Members As with Option 1, members may be disadvantaged if the employer decides to wind up the scheme and discharge the rights into policies of insurance. 	
Option 2 would provide minimal savings for pension schemes.	
OPTION 3 - Allow the transfer of ACTIVE and DEFERRED members' rights without consent	
This Option would allow the bulk transfer of both active and deferred members.	
Benefits	<ul style="list-style-type: none"> • Employers It is estimated that the gross saving to employers of this Option would be around £13 million, cumulative over 3 years. The Option would facilitate the consolidation of schemes and provide for their more efficient administration. • Members Safeguards included in the regulations would mean that the member's rights in the new scheme would have to be broadly no less favourable than in the transferring scheme OR they would have the right to refuse consent.
Costs	<ul style="list-style-type: none"> • Employers There would be costs involved in the consolidation of schemes. These would be one off costs and it is estimated that they would be of the order of £3 million over 3 years.
Net Benefit Overall it is estimated that this Option would provide a net saving to employers of around £10 million, cumulative over 3 years.	

34. The Government's objective is to allow the bulk transfer of members' protected rights without consent, provided that there are adequate safeguards for members. Simplifying the arrangements will allow employers to administer schemes more effectively and reduce their costs. Option 1 (do nothing) would not help employers or schemes. Option 2 would only apply to deferred members and not to active members. It is in effect a halfway house. Option 3 is the recommended option because it provides the best means of delivering the objective. This option will allow the bulk transfer of both active and deferred members; it thereby provides benefits for employers and it also includes safeguards for members.

Ministerial Declaration

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed *Stephen Timms*

Date *18 October 2005*

STEPHEN TIMMS MP

Minister of State for Pensions Reform

Department for Work and Pensions

Contact Point

Mike Rochford
Department for Work and Pensions
3rd Floor, Adelphi
1-11 John Adam Street
London WC2N 6HT

Tel: 020 7962 8126

Email: Mike.Rochford@dwp.gsi.gov.uk