

**EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (CONTRACTING-OUT)
(AMENDMENT) REGULATIONS 2006**

2006 No. 1337

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

These Regulations allow the payment of lump sums, in cases of serious ill-health, in place of a Guaranteed Minimum Pension (GMP). (GMP is an occupational pension based on pensionable service in a contracted-out defined benefit occupational pension scheme between 1978 and 1997. Contracted-out rights are built up by individuals who have opted out of the state additional pension – formerly the State Earnings Related Pension Scheme (SERPS)).

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

None.

4. Legislative Background

4.1 Section 21(1) of the Pension Schemes Act 1993¹ includes a provision that allows a lump sum to be paid instead of a GMP in certain circumstances.

4.2 Regulation 60 of the Occupational Pension Schemes (Contracting-out) Regulations 1996² sets out the various circumstances in which a lump sum can be paid instead of a GMP. Regulation 60 is amended by this instrument to allow the payment of a serious ill health lump sum in place of a GMP, provided that the scheme retains the liability to pay a survivor's benefit, where appropriate.

5. Extent

The Regulations extend 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.

¹ As amended from 6 April 2006 by section 284(1) of the Pensions Act 2004.

² As substituted from 6 April 2006 by article 8 of the of the Taxation of Pension Schemes (Consequential Amendments of Occupational and Personal Pension Schemes Legislation) Order 2006.

7. Policy background

7.1 A number of changes have recently been made to the ways in which contracted-out rights can be taken as lump sums and the age at which those rights can be taken. These, in general, are to bring the treatment of contracted-out rights into line with changes being made by Her Majesty's Revenue & Customs (HMRC) to the taxation of pension scheme benefits. The changes have been taken forward in an HMRC Order³ which covered changes consequential or dependent on changes applying to pension rights in general in the Finance Act 2004. The changes to contracted-out rights, which include, for example, an increase to the limit for commuting small pensions to a lump sum and the ability to take a 25% tax free lump sum from protected rights (contracted-out rights in defined contribution schemes), came into force from April 2006.

7.2 Current legislation already allows the payment of serious ill health lump sums in place of contracted-out pensions in defined contribution schemes and in place of contracted-out pensions accrued in defined benefit schemes since 1997. (The effect of HMRC legislation on serious ill health lump sums is that these may be paid where the member has been diagnosed as suffering from a terminal illness, with a life expectancy of less than a year.) The amendments in these Regulations extend the serious ill health commutation facility to GMPs accrued in defined benefit schemes between 1978 and 1997, bringing the treatment of all contracted-out rights into line.

7.3 This policy change was included in a consultation paper on miscellaneous amendments to regulations on contracted-out pensions in March 2005. Most of the proposed changes were technical in nature. Thirteen responses were received from the occupational pensions industry. All respondents who commented on the proposal to extend the facility to commute GMPs to a lump sum in cases of serious ill health were in favour. The proposal - for all contracted-out pensions - was for the scheme to retain the liability to pay a survivor's pension to a spouse or civil partner (where appropriate) after the member's death and some consultees queried how, in the light of this, the lump sum should be calculated. The Government response was that, in respect of GMP commutation, the scheme actuary should adopt normal actuarial principles in making the necessary calculation, which would be consistent with similar calculations which he or she would need to carry out in other circumstances. (For example, survivor's benefits may need to be valued in calculating the amount of a transfer payment when a member wishes to move his rights into a different pension scheme.) The amendments contained in these Regulations do not, therefore, set out a methodology for this calculation.

7.4 There are no plans to consolidate this legislation in the near future, though the Department publishes "The Law Relating to Social Security" which is regularly updated to account for amendments and is available both online and in hard copy. Occupational pension scheme administrators and advisers often also subscribe to one of the internet-based services which provide updated copies of relevant pensions and tax legislation, together with updated copies of official guidance (for contracted-out occupational pensions schemes, this guidance is mainly issued by the HMRC National Insurance Contributions Office).

³ The Taxation of Pension Schemes (Consequential Amendments of Occupational and Personal Pension Schemes Legislation) Order 2006 (S.I. 2006/744)

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has only a negligible impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is negligible.

9. Contact

Tim Found at the Department for Work and Pensions, tel: 020 7962 2409 or email: tim.found@dwp.gsi.gov.uk regarding any queries regarding this instrument.