

# Consultation on the abolition of defined contribution contracting out

A response by

The National Association of Pension Funds

October 2006

## **Introduction**

1. The National Association of Pension Funds (NAPF) is the leading voice of workplace pension provision in the UK. Some 10 million working people are currently in NAPF Member schemes, while around 5 million pensioners are receiving valuable retirement income from such schemes. NAPF Member schemes hold assets of some £750bn, and account for over one sixth of investment in the UK stock market

2. The NAPF welcomes the opportunity to respond to the consultation by the Department for Work and Pensions. We set out our views below.

## **Executive Summary**

- NAPF supports the policy of abolishing contracting out for defined contribution schemes to simplify and reduce the costs of providing pensions through the workplace.
- NAPF also supports the deregulation of protected rights funds and aligning it with other defined contribution monies for the same reason.
- As a safeguard for survivors, annuity purchase ought to be a properly informed decision.
- The special circumstances of Contracted Out Mixed Benefit Schemes (COMBs) need to be taken into account in the transition.

## **General comments**

NAPF supports the policy of abolishing contracting out for defined contribution schemes as this will go some way to simplifying the complex interface between workplace pension schemes and the state second pension. It should lead to lower costs and better communication and understanding for scheme members.

NAPF also supports the deregulation of protected rights so that these funds are aligned with other defined contribution funds. We recognise that there are sensitivities and social policy issues over the removal of the requirement for survivors' pensions where there is a spouse or civil partner. When a member dies, the surviving partner may not inherit a pension which nevertheless is notionally deducted from any state additional pension.

We think that the best way of dealing with this is for information to be provided to both the member and spouse or civil partner at the point of retirement so that an informed decision can be made. Since women are potentially likely to be most affected by this change, we are confident that improvements to the state scheme and a widening of the opportunity to build up second pension rights will more than offset any disadvantage. Given that protected rights funds are comparatively modest in any case, the change is proportionate and acceptable.

The protected rights sections of contracted out mixed benefit schemes need also be considered. In effect there will be a closed section of defined contribution benefits and schemes will have to convert those members who are contracted out via protected rights to final salary. Although the number of members who are affected is comparatively small, it is nonetheless important to ensure that all circumstances are addressed before framing the legislation.

#### Answers to specific questions

- 1. The removal of the existing rules concerning protected rights would bring about considerable simplifications for members and schemes by treating the whole pension pot in the same way. However, a scheme member could opt not to provide a survivor benefit for his or her spouse or civil partner even though the spouse or civil partner may not have any adequate pension provision of their own. Should this possibility prevent the simplification measure (in respect of survivor benefits) being introduced?*

We do not think so. There is much to be gained by deregulating protected rights funds and treating them in the same way as other defined contribution monies. This would simplify the retirement process by enabling all of the DC pot to be handled in the same way without the need for separate recording and processing. Safeguards for survivors could be introduced at the point of annuity purchase. For example, the position under the State scheme should be made clear and if the annuitant has a spouse or civil partner, the form of annuity should be a joint decision. We believe that the sensitive issue of survivors' pensions should be best dealt with by openness and allowing couples to reach a joint decision.

- 2. Is there another way in which a survivor pension could be assured for surviving spouses and civil partners out of the protected rights that would also allow for simplification?*

Please see our recommendation above.

- 3. If the requirement to provide a survivor benefit were removed, would it be practicable to introduce a rule requiring an explanation about survivor benefits and the application of the COD to entitlement to State Additional Pension to be provided to the member and possibly their spouse or civil partner, at the point of annuitisation?*

We believe that this is indeed practical and most probably desirable that there is full and open information provided to the couple.

- 4. If a rule, as described in question 3, only applied where the pension fund contained protected rights, would it be possible to identify such funds if, for example, the member had transferred his or her provider?*

We cannot say for certain.

- 5. Do you foresee any problems that could arise from withdrawing other rules that currently apply to protected rights as described in paragraph 6 above?*

We are unable to identify any.

- 6. Can you provide an estimate of the potential savings on ongoing administration costs that could be achieved from removing the rules applying to protected rights?*

We are unable to provide estimates.

- 7. Can you provide an estimate of any one-off costs/savings associated with the abolition of contracting out for DC schemes?*

We are unable to provide estimates.

- 8. Would the automatic cessation of scheme certificates ease administrative or procedural problems for schemes?*

We believe that automatic cessation is a sensible and practical answer for occupational schemes.

- 9. Is there an alternative to automatic cessation or surrender of scheme certificates?*

We cannot think of any.

- 10. Should there be different approaches for APPS and COMPS/COMBS?*

Automatic cessation need not apply to APPS providers because of the comparatively small number which would make it practical for HMRC to monitor and follow up.

*11. Could you provide an estimate of the potential one-off administrative costs to your organisation of surrendering the contracting out certificate?*

We are unable to provide estimates.

*12. Would there be any one-off administrative costs associated with automatic cessation?*

We are unable to provide estimates.

*13. What do you consider would be the most effective way of ensuring that the abolition of DC contracting out is communicated to scheme members?*

We would like there to be a general communication either singly or jointly from DWP and/or HMRC explaining in simple terms the effect of the change which trustees and providers could either pass on to scheme members or adapt and incorporate in their own communications.

We would also strongly recommend that there be a special national telephone helpline similar to the stakeholder helpline run by TPAS volunteers and a dedicated website.

*14. For example, should the information be provided by pension providers, trustees of occupational pension schemes or HMRC?*

See our answer to question 13. HMRC is best placed to provide authoritative generic information while trustees can complement it with scheme specific information.

*15. Should there be different arrangements for occupational and personal pension schemes?*

Other than the procedures for automatic cessation of contracting out certificates, we cannot identify any.

*16. Could you provide an estimate of the potential costs to your organisation of providing this information to members?*

We are unable to provide estimates.

17. *Do you agree that a reconciliation exercise should be carried out prior to the abolition of DC contracting out? If so, how long before the cessation date do you think this should take place?*

A reconciliation of scheme membership against HMRC records while useful in principle would be limited if it took place before the abolition because of the changes that would take place in the interim. A further reconciliation would therefore be necessary.

18. *Can you provide an estimate of the costs to your organisation of participating in a reconciliation exercise?*

We are unable to provide estimates.

19. *If you disagree with this proposal, what alternative arrangements should be put in place?*

Schemes should be encouraged to follow good data management in the period before abolition.

20. *DWP needs to know whether or not a deceased person had secured their protected rights, in order to a survivor benefit from the inherited State Additional Pension. Is there a straightforward way in which this information could be provided and by whom, once protected rights have been turned into scheme rights and/or transferred to another scheme?*

A requirement for the scheme or the provider to notify HMRC when a member dies is probably sufficient.

21. *Could you provide an estimate of the potential cost to your organisation of providing such information?*

Although not relevant to NAPF, we would say that the cost arises only as additional to the procedure which applies at present.

22. *Would the fact that HMRC ceases to track schemes that were once contracted-out be likely to cause any particular difficulty for the members of those schemes?*

We do not think so and the Pensions Tracing Service ought to cover any gaps.

23. *If you consider that there are likely to be difficulties, would they be any different from the type of difficulties that could arise for members of schemes that have never been contracted-out?*

Our answer above deals with the point. The difficulties are in principle no different from non-contracted out pension rights.