

Amending contracted-out rights and bulk transfers: new rules

New regulations which came into force on 6 April 2013 will affect the amendment of post-1997 contracted-out rights and bulk transfers.

Amending post-1997 contracted-out rights

Since 6 April 1997, occupational pension schemes have been able to contract out of the State Second Pension (“**S2P**”) if their rules provide for benefits which are broadly equivalent to, or better than, those that would be provided by a notional scheme described in the legislation as the “reference scheme”. Special rules apply to amendments affecting the rights that members have built up since April 1997 in schemes contracted-out on this reference scheme basis (“**post-1997 contracted-out rights**”).

To date, where a scheme has wished to amend post-1997 contracted-out rights, the scheme actuary has been required to provide written confirmation that benefits accruing under the scheme in the future will continue to satisfy the reference scheme test (“**section 37 confirmation**”). Absurdly, this requirement arguably applied even if the amendment only affected contracted-out rights that had accrued in the past, and the scheme had later closed to future accrual.

The new regulations make it clear that section 37 confirmations are only required in relation to changes to contracted-out rights which are to build up in future. They will not be required for amendments that affect only accrued contracted-out rights.

Where there is a proposal to amend accrued post-1997 contracted-out rights, new and different requirements will apply instead. The amendment will only be possible if either:

- after the amendment, the benefits to be provided by the scheme in respect of post-1997 contracted-out service are at least equal to the benefits that the

statutory reference scheme would have provided (note that “broad equivalence” would not meet this test); or

- the amendment is not adverse; or
- s67 Pensions Act 1995 (“**s67**”) does not apply to the amendment for some other reason – for example because the amendment is made under a statutory power or because regulations say that s67 does not apply; or
- if the amendment would or might adversely affect a member’s accrued benefits:
 - the s67 actuarial equivalence test is met (i.e. various procedural requirements are satisfied and the scheme actuary certifies that members’ rights after the amendment are at least equal in value to their pre-amendment rights),
 - post-1997 benefits for surviving spouses or civil partners are not reduced, and
 - the amendment would not reduce any pensions in payment or convert any defined benefits into money purchase benefits.

Bulk transfers

The new regulations also allow:

- bulk transfers of accrued contracted-out rights without member consent between two schemes which have been contracted-out in the past, even if neither scheme is currently contracted-out; and
- bulk transfers of accrued rights to certain European pension schemes without member consent.

Additional requirements apply in both cases. These include protection of the value of accrued rights and a requirement to give members notice of the proposed transfer at least a month before it takes place.

Comment

Trustees, employers and pension practitioners will welcome the confirmation that accrued contracted-out rights can be transferred without member consent into formerly contracted-out schemes. Some scheme mergers have had to be put on hold because the intended receiving scheme has ceased to contract out. It may now be possible to put those mergers back on the agenda.

Also clearly sensible are the new rules confirming that section 37 confirmations are needed only for changes to contracted-out benefits that are to accrue in the future. It made no sense to require them for changes to rights that members had already built up.

But schemes will have to bear in mind that the regulations now impose different restrictions on amending accrued post-1997 contracted-out rights. These restrictions will only affect potentially adverse changes that would have been caught by s67 anyway

(and then only if the post-amendment benefits could be less than the reference scheme would have provided). But where they do apply, they will add further restrictions, protecting survivors' rights in particular, to the many restrictions and process requirements that s67 would have imposed anyway. In practice, they will add to the complexities that schemes already face when considering amendments that could adversely affect a member's accrued post-1997 contracted-out rights. Given that s67 already generally prevents amendments that would reduce the overall value of a member's benefit package, some commentators have questioned whether these additional restrictions add anything useful to those that are already in place.

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