

Chapter 4 – Private pensions reform

Strengthening existing private pension provision

Objectives

- 4.1 To simplify private pension provision in order to make it easier for employers and providers to administer and more transparent for individuals to understand.

Background

- 4.2 The United Kingdom has a long history of private pension provision. Traditionally, many employers have provided high quality pension schemes for their employees, supporting them with employer contributions. In 1978 the Government recognised this by allowing contracting out from what was then the State Earnings Related Pension Scheme (SERPS).
- 4.3 Since then successive Acts have added layers of regulation to the legislation surrounding private pensions, including the rules on contracting out. This has produced an extremely complicated system, both for schemes to operate and for members to understand.

The structure of contracting out

- 4.4 Contracting out provides a private sector alternative to the State Second Pension (which reformed SERPS in 2001), but in doing so adds significant complexity to the pensions system. Under the contracting out arrangements, employees forego all or part of their State Second Pension entitlement and, in return, pay lower rate National Insurance contributions and/or receive annual payments into their pension scheme. These reductions and payments are known collectively as the contracting-out rebate.
- 4.5 In a contracted-out defined benefit (DB) occupational scheme, the employer and employee pay reduced rate National Insurance Contributions and the scheme provides benefits that are calculated by reference to the individual's earnings and length of pensionable service. To get the rebate, DB schemes must meet an overall test of scheme quality called the Reference Scheme Test. This was introduced in 1997. Before that, contracted-out DB schemes were required to provide a Guaranteed Minimum Pension (GMP) under rules which were intended to broadly mirror SERPS.

- 4.6 In a contracted-out defined contribution (DC) occupational scheme, the employer and employee pay reduced rate National Insurance Contributions and the Government makes an annual payment into the scheme. In a contracted-out personal pension scheme (including a Stakeholder scheme) both the employer and the employee pay full unrebated National Insurance Contributions with the rebate being paid annually by HMRC direct to the scheme at the end of the tax year. There are restrictions on how the rebate is invested and annuities derived from the rebate are subject to specific legislative conditions over and above those that apply to annuities derived from other scheme rights.
- 4.7 Figure 4.1 below provides a summary of the numbers contracted-out and the rebate costs in 2003/4, the latest year for which data is available.

Figure 4.1: Contracted-out scheme membership and costs

Type of scheme	Membership (millions)	Annual Rebate Cash Flow Cost (£ billions)
Defined benefit, of which:	7.6	6.5
• Private sector	(2.8)	(2.5)
• Public sector	(4.8)	(4.0)
Occupational Defined contribution	0.6	0.5
Personal Pensions	2.9	3.1
Total	11.1	10.1

Source Second Tier Pension Provision 2003/04

- 4.8 Figure 4.2 sets out the contracted-out rebate rates from April 2007. These apply to earnings between the Lower Earnings Limit (£4,368 in 2006/07) and the upper earnings limit (£33,540 in 2006/07). They vary by the type of pension and, in DC schemes (both occupational and personal), by the age of the individual. The figure shows the rebate for both Stakeholder Pensions and Appropriate Personal Pension schemes (APPs)

Figure 4.2: Contracted-out rebate rates from 6 April 2007

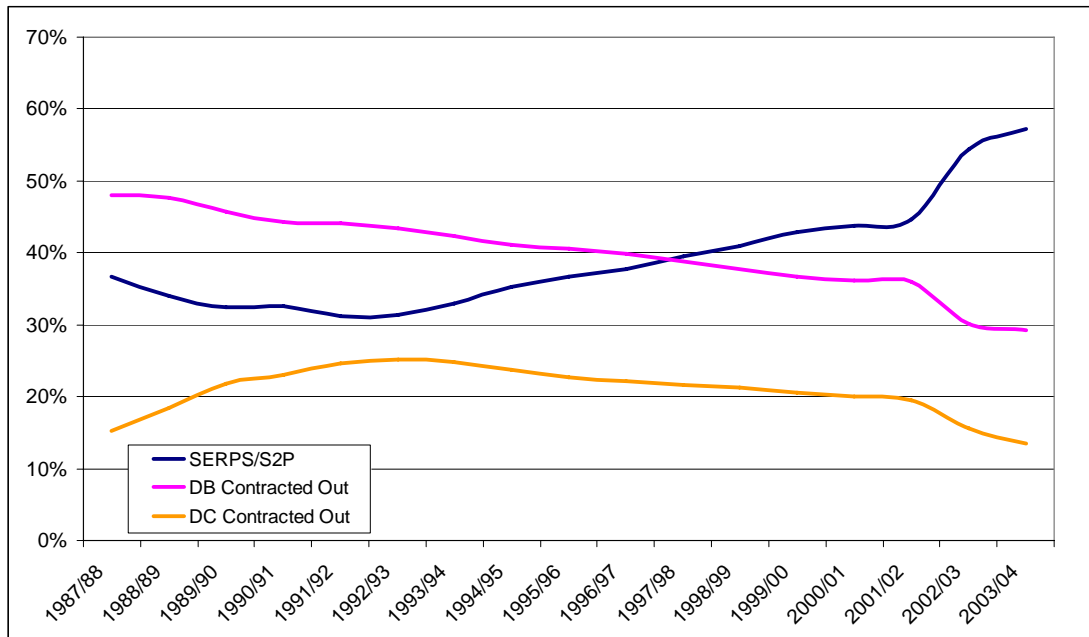
Rebate payable to	Pension scheme type			
	Defined benefit	Defined contribution occupational		APP/Stakeholder
		Flat-rate	Age-related top-up	
Employer	3.7%	1.4%	0.0%	0.0%
Employee	1.6%	1.6%	Between 3.0% and 7.4%, depending on age	Age-related rebate between 4.7% and 7.4%

Source: *The Social Security (Reduced Rates of Class 1 Contributions, Rebates and Minimum Contributions) Order 2006: S.I. 2006 No. 1009*

Rationale for change

4.9 There is an ongoing shift amongst employers from DB to DC occupational pension schemes and this is accompanied by a move from contracted-out to contracted-in schemes, perhaps because of the legislative and administrative complexity associated with contracting out.

Figure 4.3: Proportion of employees with second tier pension provision by scheme type and contracted-out status, 1987/88 – 2003/04



Source: *Second Tier Pension Provision 2003/04*

- 4.10 Some personal pension providers have been advising policy holders to contract back in. Those that take this advice begin to build up their full entitlement to State Second Pension. Other providers are taking positive action to contract their policyholders back in, offering an opt-out option for people who wish to stay contracted-out. These moves reflect the complexity of decision making for individuals around contracting out.
- 4.11 Against this background, the Pensions Commission recommended the abolition of contracting out in DC schemes, the retention of DB contracting out because of the potential impact on overall DB pension provision that would arise through the withdrawal of the rebate, and the introduction of a facility to convert GMPs into ordinary scheme benefits. The Commission also noted that the rebate for DB schemes would be likely to be lower as a result of the proposed changes to State Second Pension.

Abolition of contracting out in DC schemes

- 4.12 In DC schemes, particularly personal pensions, the value of the rebate and the inevitable tension that arises from substituting a DB pension (the State Second Pension) with a DC pension that depends on investment return, introduces an element of risk into the decision. This makes it difficult for pension providers to advise individuals on whether they would be better off contracted-out.
- 4.13 With personal pension schemes, the decision to remain contracted-out is one that people should make annually. Additionally, in all DC schemes (including occupational schemes), contracted-out rights (known as protected rights) must be tracked separately from other scheme rights. This is because of the legislative conditions that apply mainly at the point of annuitisation. These add further to the complexity for advisors and individuals.
- 4.14 The reformed state pensions system, described in Chapter 2, provides a clear foundation for state pensions and the introduction of personal accounts will provide a simpler vehicle for additional pension saving. Employers operating occupational schemes will be able to apply for an exemption from personal accounts. Against this background, contracting out for DC schemes will no longer offer the stimulus to private pension saving that the Government seeks. The Government therefore proposes to abolish contracting out on a DC basis.

DB contracting out and State Second Pension changes

- 4.15 The decision on contracting out is not so easily reversed in DB schemes as in DC schemes. This is mainly because of the long-term nature of decisions made on contributions and benefit structures as well as funding levels. These considerations require a longer lead-in time for introducing

any changes to contracting out for DB schemes. Also, as the Pensions Commission recognised, a sudden and significant change affecting DB provision is more likely to prompt scheme closure than to spur additional savings. The Government therefore proposes to retain DB contracting out.

- 4.16 However, the proposed changes to State Second Pension mean that, unless consequential changes are made to scheme benefit or contribution levels, the reduction in the rebate as a result of State Second Pension moving to become flat rate would gradually increase employers' payroll costs and reduce employees' take home pay.
- 4.17 More detailed information on how the reform of State Second Pension will impact on DB contracting out is in Chapter 2.

GMP conversion

- 4.18 Although GMPs ceased to accrue from 1997 and were replaced by the Reference Scheme Test, contracted-out DB schemes are still liable to provide GMPs and they give rise to very considerable complexity. Proposals to allow schemes to convert GMPs into ordinary scheme benefits, on the basis of actuarial equivalence, have therefore been developed. The aim is to allow schemes to adopt a unified and streamlined benefit structure which will enable administrative savings to be made as well as offering advantages to members. Members would benefit from understanding their rights in the scheme and being able to transfer them to other schemes more easily.

Consultation

Abolition of contracting out in DC scheme

- 4.19 DWP has consulted with the insurance industry and engaged with individual insurance companies and pension schemes to identify the potential impact that the proposed contracting out reforms might have on private pensions.

GMP conversion

- 4.20 The proposal to convert GMPs into scheme benefits was first considered as part of the work leading up to the 2004 Pensions Act. At that time the Government ran a consultation exercise to consider three different methods of dealing with the GMP. The option allowing schemes to convert GMPs into ordinary scheme benefits on the basis of actuarial equivalence was the one which found most favour at that time.

Options for contracting out reform

Option 1: Do nothing

4.21 Under this option individuals would continue to be able to contract-out of the State Second Pension through a DC arrangement. The regulatory burden on firms is left unchanged and nothing is done to simplify the savings decision for individuals. By not giving contracted-out DB schemes the option to convert GMPs into scheme benefits, such schemes would have to continue to provide and track GMPs. Individuals would continue to find difficulty in being able to transfer these rights elsewhere.

4.22 The Government therefore rejects this option.

Option 2: Simplify contracting out

4.23 This option presents a package of proposals to simplify contracting out:

- abolish contracting out in DC schemes;
- as a consequence of the proposals to hasten the flat-rating of State Second Pension, the contracting out rebate for DB schemes will be reduced in parallel. More information on the effect reform of State Second Pension will have on DB contracting out is in Chapter 2; and
- allow schemes to convert GMPs into ordinary scheme benefits of an actuarially equivalent value.

This broadly reflects the Pensions Commission's recommendations and is the option that the Government proposes to adopt.

Consequences arising from abolishing contracting out in DC schemes

4.24 The abolition of contracting out in DC schemes would apply to both occupational and personal pension schemes including stakeholder schemes.

4.25 In contracted-out DC schemes, that part of an individual's pension fund derived from the rebate and its investment return and any tax relief on the employee's share of the rebate are known as protected rights. Certain conditions are attached to protected rights. The main ones are:

- investment is restricted to certain types of pension schemes;
- an annuity securing protected rights must be provided on a unisex basis; and

- an annuity securing the protected rights of a scheme member who is married or in a civil partnership at the point of annuity purchase must make provision for a survivor benefit.
- 4.26 As stated in paragraph 4.13 above, these restrictions have been a source of complexity for schemes and members. The abolition of contracting out in DC schemes, means that active members will cease to accrue new protected rights. However, schemes will still hold such rights accrued prior to abolition.

Consequences for DB schemes arising from the flat-rating of State Second Pension

- 4.27 Although DB schemes will continue to be able to contract-out, because the earnings on which State Second Pension is accrued will gradually reduce, it will mean that the amount needed to replace it (the contracted-out rebate) will gradually reduce also.

Consequences for DB schemes arising from being able to convert GMPs into scheme benefits by way of actuarial equivalence

- 4.28 As noted above, prior to 1997, a contracted-out DB scheme was required to provide a pension that was at least as good as a statutory minimum - the GMP.
- 4.29 The Government proposes to allow GMPs to be converted into scheme benefits by way of actuarial equivalence. This would make scheme administration easier, reduce the complexity of the records schemes need to keep and make it easier for members to understand their entitlement.

Costs and benefits

Impact on individuals

Abolition of contracting out in DC schemes

- 4.30 With the abolition of contracting out in DC schemes, members of those schemes would start to accrue full rights to State Second Pension and would no longer have to make a complicated decision on whether to

contract-in or contract-out. They would be able to consider their pension savings options over and above what they would get from the State, making the decision more transparent and easier to understand.

- 4.31 As they would be building up full State Second Pension rights, members of personal pension and stakeholder pension schemes would no longer receive the age-related payment into their scheme at the end of the year. Similarly, employees in occupational DC schemes would start to pay full rate National Insurance Contributions and would no longer receive the age-related rebate at the end of the year. The increase in National Insurance Contributions could be offset by a reduction in occupational scheme contributions. As shown in table 4.iv below, the value of the rebate depends on the age and earnings of the employee. In each case they would instead begin to accrue full entitlement to State Second Pension.
- 4.32 The loss of the rebate would not prevent them from continuing to make their own contributions to a DC scheme (or to other savings vehicles) in addition to the rights that they will be building up in the State scheme.

Figure 4.4: Value of the age-related rebates in 2006/07

Earnings (per annum)	Age	Type of pension	Employee NICs	Age-related payment
£15,000	30	DC Occupational	£176	£99
		Personal pension	-	£842
£18,250	40	DC Occupational	£143	£230
		Personal pension	-	£1018
£32,760	50	DC Occupational	£292	£1110
		Personal pension	-	£2130

Source DWP estimate

- 4.33 Tables 4.5 and 4.6 show the distribution of individuals in all contracted-out schemes, broken down by gender, age and earnings. They show the largest group of individuals affected by the abolition of contracting out in DC schemes would be men aged 30-49 and those with earnings of less than £20,000 a year.¹ These groups represent around 50 per cent of the people contracted-out into DC schemes. The age distribution is similar for men and women but there is a higher concentration of women in the central age groups (30 to 39 and 40 to 49).

¹ Some of the individuals in this group are zero earners who are not making contributions to their personal pensions in that particular tax year - Source: Second Tier Pension Provision 2003/04

Figure 4.5: Percentage of individuals in contracted-out schemes – by age and gender

Age	Defined Contribution Schemes			Defined Benefit Schemes		
	Total	Men (% of total)	Women (% of total)	Total	Men (% of total)	Women (% of total)
Under 20	0%	0%	0%	1%	1%	0%
20 to 29	7%	4%	3%	14%	6%	8%
30 to 39	46%	27%	19%	29%	13%	15%
40 to 49	33%	22%	11%	31%	15%	17%
50 to 59	13%	10%	2%	23%	11%	12%
60 and over	1%	1%	0%	2%	2%	0%
Total	100%	64%	36%	100%	48%	52%

Source : Second Tier Pension Provision 2003/04

Figure 4.6: Percentage of individuals in contracted-out schemes – by amount of earnings on which national insurance has been paid and gender

	Defined Contribution Schemes			Defined Benefit Schemes		
	Total	Men	Women	Total	Men	Women
£5,000 - £9,999	14%	6%	8%	12%	2%	10%
£10,000 - £14,999	18%	10%	7%	17%	5%	12%
£15,000 - £19,999	20%	14%	6%	18%	8%	10%
£20,000 - £24,999	17%	13%	4%	17%	9%	7%
£25,000 - £29,999	13%	11%	3%	15%	9%	6%
£30,000 and over	18%	15%	3%	22%	15%	6%

Source Second Tier Pension Provision 2003/04

- 4.34 Overall, abolition of contracting out in DC schemes would affect around 3 million policyholders and 500,000² members of around 14,000 occupational schemes.³ This group would begin to build up full State Second Pension rights.

GMP conversion

- 4.35 Converted members will benefit from obtaining pension rights which can be more easily understood, compared to the existing situation where there may be different tranches of benefit involving a complex mixture of rules. Furthermore, they should benefit from being able to transfer their post-conversion rights to another scheme more readily. At present, many occupational schemes will not accept an incoming transfer which includes GMP rights. The proposed legislation also includes a facility for schemes to convert an individual member's rights in order to facilitate the transfer of his or her rights out of the scheme, even where no scheme-wide conversion exercise is undertaken.
- 4.36 The requirement for actuarial equivalence in respect of the benefit rights to be awarded to each individual member in a converting scheme means that no-one will suffer any loss at the point of conversion. It is possible that actual experience of future variables such as inflation may differ from the assumptions made at the time. However, in these cases a member could receive more or less pension over the period of retirement than would otherwise have been the case. Such possible effects are unquantifiable but unlikely to be significant.

Impact on employers and occupational pension schemes

Abolition of contracting out in DC schemes

- 4.37 Employers running contracted-out DC occupational schemes would start to pay full rate National Insurance Contributions (the rebate is currently 1 per cent for employers). However, since the employer is currently required to pay an amount equivalent to the rebate into the scheme, the additional National Insurance Contributions cost would be offset by the removal of this requirement.
- 4.38 There is limited data available on the administration costs of defined contribution occupational pension schemes. On the basis of evidence obtained from several sources,⁴ DWP estimates the aggregate annual

² STPP 2003/04. In contracted out DB schemes 50 per cent are men and 50 per cent women.

³ Source: GAD Occupational Pensions Schemes Survey 2005

⁴ Watson Wyatt – Pension administration cost survey 2006
IDS pensions service – Pension trustees and administration

administration cost for all occupational defined contribution schemes to be £34 million. These costs are based on the number of active members within contracted-out occupational DC schemes and the average administration cost per member.⁵ Since the administration costs due to contracting out are relatively small and the schemes would still incur the remaining administration cost after the abolition of contracting out in occupational DC schemes, the proportion of costs saved as a result of abolition would be small.

- 4.39 In the recent consultation exercise about the treatment of accrued protected rights and operational arrangements once contracting out for DC schemes is abolished, questions about one-off costs associated with abolition were asked. Responses suggested savings ranging between £4000 and £4.5 million per scheme – the former for an occupational DC scheme and the latter for a large insurance company. These costs arise mainly in respect of changes to scheme documentation and IT systems.
- 4.40 On the question about one-off costs associated with requiring schemes to surrender scheme certificates, respondents estimated these to be within a range of £300 per scheme for small schemes up to £0.5m per scheme for larger schemes. However automatic cancellation by HMRC of scheme certificates was estimated to be minimal by most respondents and within a range of £25-30k per scheme over a range of schemes by one respondent.

GMP conversion

- 4.41 GMP conversion would be an option for schemes; no scheme would be required to convert. The proposal would only affect DB occupational pension schemes that were contracted-out prior to April 1997.
- 4.42 The proposed legislation includes a requirement for trustees to obtain the prior agreement of the scheme's sponsoring employer before undertaking a conversion exercise.
- 4.43 There would be a one-off cost for a scheme to go through the conversion procedure, resulting from the need to modify IT software and incur legal, actuarial and other administrative costs. Once converted, a scheme will be able to benefit from ongoing administrative economies as a result of having adopted a unified benefit structure. These savings would arise through no longer having to purchase actuarial advice for GMP calculations, no longer having to deal with queries from members on their

GAD - Survey of expenses of occupational pension schemes 1997 (which has been up rated to today's prices)

⁵ GAD - Occupational pension scheme 2005 report and Survey of expenses of occupational pension schemes 1997 (which has been uprated to today's prices)

GMPs, simpler awards of benefit when members reach pensionable age and simpler uprating of pensions in payment.

- 4.44 Whilst costs and benefits will vary significantly according to the circumstances of the particular scheme, for the purposes of making a broad indicative estimate of the possible effects of this reform, we have assumed an average initial cost of £7,000 for smaller schemes and £12,000 for larger schemes. Using an assumption that 25-50 per cent of schemes may choose to convert their GMPs, the total initial cost across all schemes is estimated to be between £11m and £22m, with a total annual cost saving of £6m to £13m.

Impact on the financial services sector and on personal and stakeholder pensions

Abolition of contracting out in DC schemes

- 4.45 As already explained, the current trend in DC schemes is towards contracting back in. Informal discussions between DWP and insurance professionals have indicated that, whilst the rebate provides a reliable flow of income, the complexity surrounding decisions on contracting out and the level of understanding required to make such decisions outweigh the benefits of the rebate to providers. Consultation with some major insurance companies has also suggested that abolishing contracting out in DC schemes would not have a significant impact on the insurance industry because of the current trend to contract back in.
- 4.46 However, some commentators from the insurance industry have also argued that contracting out could help saving levels if the level of the rebate was increased to allow individuals and their advisors to make a straightforward decision on whether or not to contract-out.
- 4.47 In terms of premium income to insurance companies, the rebate for DC schemes was £3.5 billion in 2003/04. The total UK insurance net premium income from individual pensions, other pensions and the rebate was £54 billion in 2004.⁶ The rebate therefore constitutes only around 6 per cent of total net premium income.
- 4.48 Together with the introduction of personal accounts, therefore, these proposals will have some impact on the financial services sector, with a reduction in income from the rebate but a forecast net increase in savings of £4-5 billion from personal accounts. The Government will consider carefully the implementation of these proposals, and the timescale over

⁶ Source: Association of British Insurers

which they are implemented will provide the financial sector with time to prepare for the new opportunities and challenges.

GMP conversion

- 4.49 The GMP conversion proposals apply only to DB occupational pension schemes and would not therefore affect the financial services sector and personal/stakeholder pensions.

Impact on The Exchequer

Abolition of contracting out in DC schemes

- 4.50 The costs of the contracting out rebate presented in the White Paper were based on forecasts from Autumn 2005. The forecasts have since been updated to reflect the impact of the rebate review (S.I. 2007/1009) and new data on the numbers of people choosing to contract-out. The costs of the contracting out rebates under reform are estimated in Annex A (tables A3, A.6 and A.9).
- 4.51 Individuals who contract-out into a personal pension receive tax relief at the basic rate on the employee's share of the contracted-out rebate. This tax relief is paid by HMRC together with the end of year rebate payment. Abolishing DC contracting out will save the cost of this tax relief, as well as the cost of the rebate. This benefit will accrue to HMRC. HMRC estimate that the cost of tax relief for personal pension rebates was £171million in 2004/05 and £149m in 2005/06.
- 4.52 DB schemes will continue to be able to contract out, although the rebate will be affected by the changes to State Second Pension accrual. Table 4.7 below shows the estimated cash flow cost in millions of tax relief in future years. The estimates are based on the estimated number of people contracted-out into personal pensions now and in future and the income distribution of these people today. These figures are best estimates of the cash flow benefit from saving tax relief on personal pension rebates, but they are only rough estimates. These estimates assume that the tax system is unchanged and that the distribution of income of people who are contracted-out stays the same.

Figure 4.7: Estimated cost of tax relief on Appropriate Personal Pension rebates in future

	2012	2015	2020	2030	2040	2050
Cost of Tax Relief (£m, earnings terms)	150	140	130	100	70	70
Cost of Tax Relief (£m, 2006/07 prices)	170	170	170	170	140	170

Source: DWP estimates

4.53 In addition, these proposals will lead to one-off costs to the public sector as it prepares and adapts to the changes. For the package of private pension reforms, these are estimated at £8m up to 2011/12. In addition, there will be administrative savings for HMRC that will arise as a result of abolishing DC schemes starting in 2013.

GMP conversion

4.54 Initial HMRC's project and IT development costs arising from GMP conversion are estimated to be around £3 million.

Gender impact

4.55 As 70 per cent of those contracted-out into DC schemes are men,⁷ changes to the contracting out regime for DC schemes will affect more men than women. However, both men and women who can no longer contract -out will start to build up rights to State Second Pension.

4.56 Current equal treatment legislation already requires occupational pension schemes to provide equal pensions to men and women. This will be reflected in the actuarial calculations carried out in converting GMPs into scheme benefits. There is no reason to expect that this proposal would have anything other than uniform impact on each gender.

⁷ Source: Second Tier Pension Provision 2003/04

Race impact

4.57 The effects of these proposals will apply to all individuals. There is no data available on the ethnic breakdown of individuals who are contracted-out but there is no evidence to suggest that the contracting out proposals would have anything other than uniform impact on each ethnic group.

Impact on small firms

Abolition of contracting out in DC schemes

4.58 Data from the Employer Pension Provision Survey (EPP) 2005 can be used to make an initial assessment of the impact on small firms.

Figure 4.8: Distribution of employer size by scheme type

Size of employer	Contracted-out		Contracted-in		Partly contracted-out	
	Employees	Schemes	Employees	Schemes	Employees	Schemes
1 to 4	0.0%	0.3%	0.0%	0.5%	0.0%	0.0%
5 to 49	0.0%	3.2%	0.1%	11.6%	0.0%	1.5%
50 to 249	0.3%	8.6%	0.8%	16.3%	0.1%	4.5%
250 and over	99.7%	87.9%	99.1%	71.7%	99.9%	94.0%
Total	100%	100%	100%	100%	100%	100%

Source: Employer Pension Provision 2005

4.59 The results are shown in table figure 4.8 above. These figures show that the impact on firms is highly concentrated on larger firms, with nearly 100 per cent of affected employees and 88 per cent of schemes belonging to employers with more than 250 employees. About 3 per cent of schemes are run by employers with fewer than 50 employees. Only a small minority of small firms run pension schemes and would thus be affected.

GMP conversion

4.60 No significant differences are anticipated from GMP conversion according to business size. The initial one off costs are likely to vary depending on the size of firm (see costs set out above).

Impact on competition

4.61 The key markets that will be affected by the changes to contracting out are those that operate in private pension provision. The Government does not expect these changes to have any significant effect on competition.

Enforcement, sanctions, monitoring, implementation and review

4.62 The abolition of contracting out in DC schemes will be implemented at the same time as the basic state pension is up-rated in line with earnings. At that time, the rebate will cease to be paid by the Government and scheme members will no longer built up separate rights from other rights in the scheme that are subject to separate rules.

4.63 GMP conversion will be a permissive power. Legislation will allow for schemes to convert all or some of their GMPs, but it will be the scheme trustees, with the sponsoring employer, who decide whether or not to convert and which members should have their GMP converted. Where the conversion is done individually, on transfer, it will be for the member to ask for his GMP to be converted. The following measures to protect members will be in place:

- the Pensions Regulator will issue guidance on the consultation with members which the legislation will require schemes to conduct as part of the conversion exercise;
- the Pensions Regulator will be able to intervene in or suspend a GMP conversion exercise if it is not being conducted satisfactorily and will be able to apply sanctions where necessary; and
- members will have the right to complain to the Pensions Regulator.

4.64 The impact of the contracting out changes will be monitored as part of DWP's on going monitoring of the number of people who are contracted-out and of the overall level of saving. The number of schemes taking advantage of the GMP conversion provisions will also be monitored. The contracting out changes will also be included as part of the overall evaluation of the pensions reform package.

Summary and recommendation

Figure 4.9: Summary of Costs and Benefits

Option	Costs	Benefits
Contracting out reform		
Abolition of contracting out in DC schemes	Small one-off administration costs to contracted-out DC schemes	Simplified decisions. Small reduction in administration costs.
	Immediate saving to the Exchequer balanced by increase in long-term liabilities Individuals lose option of contracted-out rebate but gain state second pension entitlement	
GMP conversion	One off administration costs to schemes that choose to convert GMPs	On going reduction in administration costs to schemes that choose to convert GMPs. More transparency for scheme members.

Notes:

(a) The age-related (AR) top-up payable to members of Contracted-out DC occupational schemes includes the combined employer/employee flat-rate rebate payable through reduced-rate NICs. Actual top-up payable ranges between 0.0 per cent and 4.4 per cent.

(b) For individuals contracted-out with an APP or Stakeholder scheme, the whole of the rebate is delivered through the age-related rebate.

(c) The rebate is paid on earnings between the Lower Earnings Limit (LEL) = £4,368 (2007/8) and the upper earnings limit = £33,540 (2007/8)

Background to removal of the Secretary of State's approval of actuarial guidance

In order for actuaries to calculate pensions liabilities consistently, all actuaries are required to use agreed guidelines. These guidelines are called either "Guidance Note" (GN) or "Technical Memorandum" (TM). There are seven GNs and one TM referred to in pensions legislation. The Secretary of State is required by primary legislation to approve three of these GNs and the TM.

Historically the actuarial profession has produced these GNs. The professional bodies for actuaries - the Institute of Actuaries in England and Wales and the Faculty of Actuaries in Scotland - have combined the role of regulator with that of professional body. Because of the professions' dual role the Faculty and Institute of Actuaries are required to obtain the Secretary of State's approval of the GNs and TMs to maintain the public's confidence.

The Morris Review of the Actuarial Profession recommended in March 2005 that the Financial Reporting Council (FRC) should establish a new regime to set actuarial standards and to oversee the regulation of the profession. The FRC is the UK's independent regulator for corporate reporting and governance. The Government accepted this recommendation and the FRC has now set up the Board for Actuarial Standards (BAS) to promote confidence in corporate reporting and governance by setting high quality actuarial standards. The Faculty of Actuaries and the Institute of Actuaries continue to exist as the professional bodies for the profession in their respective jurisdictions.

On 6 April 2007 BAS will adopt and take responsibility for the existing versions of the pensions GNs and the TM. Since the FRC and through it BAS are the UK's independent regulator for corporate reporting and governance, the requirement for the Secretary of State to approve certain GNs and the TM will be removed from primary legislation.