

Consultation Document - Abolition of defined contribution (DC) contracting-out: treatment of protected rights accrued in the past and proposed operational arrangements.

Response from Prudential plc

Key Points

1. We welcome the proposals to remove the current Protected Rights rules. However we do not believe their removal is conditional on the abolition of DC contracting-out and we would therefore like to see the proposed changes implemented as soon as practicable. If the proposals are adopted providers will need time to implement changes to processes, systems and documentation. There would therefore need to be prior notice of at least one year before the changes come into force.

The chief benefit of removing the rules will be for consumers by removing complexity and by allowing them to select the most appropriate form of benefit for their personal circumstances. Providers will incur short-term costs in adapting existing systems, processes and literature, but should see longer-term savings arising from the simplification of the retirement process.

2. Due to the short timescale for this consultation we have been unable to make a detailed estimate of the cost of implementing the abolition of DC contracting-out. In particular we are unclear about the costs involved with any reconciliation exercise, with the level of customer enquiry that abolition will produce and with the cost of amending systems and customer literature.

Responses to specific questions

1. **The removal of the existing rules concerning protected rights would bring about considerable simplification 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 provision of their own. Should this possibility prevent the simplification measure (in respect of survivor benefits) being introduced?**

We believe that the interests of individuals and their partners are best served by being able to choose the type of benefit most suitable to their personal circumstances. In addition it is not clear that it is appropriate for legislation to require annuitants to buy benefits that may not be suitable for their personal circumstances.

Unfortunately the current requirement to secure a joint life benefit forces some annuitants to buy benefits that are not appropriate. The number of people in this position is likely to increase due to rising levels of independent pension provision.

Clearly there is a risk that some individuals may make an inappropriate choice, and that their spouse or partner may be disadvantaged by the non-replacement of contingent rights that would have been available under the state scheme. The extent to which this is a risk to consumers, providers and Government needs to be considered.

The risk can be mitigated by effective communication when retirement benefits are being decided. Options for communication range from requiring written

confirmation from the spouse/partner that they understand the implications and agree to the purchase of a single life annuity, through to the provision of information before the member makes their choice. The first option introduces other risks by making the retirement process more complex, and could lead to consumer detriment if it delays the acceptance of quotes. A possible middle way may be to require the member to specifically confirm that they have discussed the position with their spouse who agrees with the purchase of a single life annuity. In view of previous Government concerns on this issue, their view of the risk must be included in their response to the consultation exercise.

However, on balance, we believe the provision of choice with appropriate risk mitigation is more sustainable than the current rules, under which there is no scope to avoid the purchase of inappropriate benefits.

In the circumstances we do not believe that the possibility identified should prevent the introduction of the simplification measures proposed.

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?

We have not identified any alternative approach.

3. If the requirement to provide a survivor benefit were removed, would it be practicable to introduce a rule requiring an explanation of 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?

This information could be provided as part of the information provided in the 4 month & 6 weeks warm-up letters and with any annuity quotation. We believe this information should be defined by and branded as DWP and included as part of the standard information provided to all annuitants (for example, as an "If you are married/in a civil partnership" document) rather than issued only to those with Protected Rights funds.

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

We do not believe the rule should be framed in this way.

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?

In addition to removing the rules identified in paragraph 6, it is important that the simplification reforms remove the requirement that investment-linked annuities from Protected Rights funds cannot fall below the initial starting income. Removing this requirement would bring the rules for protected rights funds into line with the treatment of other funds and thereby remove complexity for consumers and annuity providers.

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 believe the chief benefit from these proposals will be to customers through the removal of complexity and the ability to secure benefits appropriate to their personal circumstances.

There would be longer-term cost savings as a result of simplifying the treatment of Protected Rights funds and the 'at retirement' process. However these are difficult to quantify.

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

We are not in a position to provide a detailed estimate of the cost of abolition within the timescales of this consultation. However we believe there is likely to be a net cost because of the need to amend our various pension systems, processes and literature and the cost of any reconciliation exercise.

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

Yes, we believe an automatic cessation would ease administrative issues for schemes, providers and HMRC. However the timing of this will need to be carefully considered so that rebates arising from late employer returns, or corrections, can still be processed. More detailed discussion is therefore required.

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

There does not appear to be any logical or simple alternative.

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

No. Nor for transfers from DB.

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 calculate this information within the timescale of this consultation. However we do not believe the cost would be significant.

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

Yes, the cost is unlikely to be significant but we are unable to quantify without more detailed work.

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 believe Government and Regulators will have an important role to play in terms of raising public awareness of what is being proposed, the reasons for abolition and the practical impact of the change. We believe the DWP should prepare and agree with the industry a form of words that is used to tell people that contracting-out is ceasing and what it means for them. There may also be a

role for a DWP telephone helpline to deal with general enquiries regarding abolition, alongside those relating to wider changes to State Pensions.

For schemes and providers the most cost-effective way of informing specific members of the abolition of contracting-out would be as part of the annual review package. If this information were provided in this way it would avoid the cost of a one-off mailing. For this approach to be taken there needs to be a lead-in time of at least a year between the confirmation of the abolition of contracting-out and date of abolition.

We believe there is a risk that abolition will cause increased levels of customer enquiries. However it is not clear at this stage how significant any increase might be.

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

See response to Question 13 above.

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

We do not see any need for different arrangements, other than the fact that activities for some schemes will be carried out by trustees and for others by providers.

However it will be important for schemes to review their terms in good time and communicate with members on potential implications that contracting-out withdrawal may have on scheme their scheme design.

As some members will have both occupational and personal pension savings it will be important to ensure that all communication is consistent.

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

We are unable to provide a detailed estimate within the timescale of this consultation. However the cost should be marginal if information is provided on the basis outlined in response to Question 13.

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?

Given the scale of the exercise and the scope for data mismatching we believe that this exercise will need to be phased over a number of years and that it is unlikely to be completed until after the date of abolition. It must also take into account the ongoing data cleaning which occurs as part of normal processing.

The precise objectives of any reconciliation exercise must be well defined and we believe further discussion in this respect would be useful.

We believe that if this exercise is to be carried out it is critical that HMRC has and retains sufficient resources to complete the work involved.

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

We are unable to provide an estimate within the timescales of this consultation. However we are concerned that the cost could be significant, given the number of member records potentially involved.

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

We have not identified any alternative proposals.

20. DWP needs to know whether or not a deceased person had secured their protected rights, in order to identify whether a half or full COD should be applied 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?

We believe that any requirement to track Protected Rights would remove many of the benefits of simplification. In addition we do not believe the current rules are sustainable in an era where more people are expected to take partial or phased retirement.

We therefore recommend that the DWP adopt a simple rule to identify the type of COD that will apply. For example, the rule could specify that half rate COD applies if the member was above state pension age at the time of their death.

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

On the basis of our answer above we do not believe extra costs will arise in this situation.

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 are not aware of any difficulties that would arise for members.

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?

Not applicable.

Prudential plc
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