



simply pensions

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⇒ Pensions Act 2004

early leavers' benefits

Here we give information for trustees of money purchase schemes about the new rules that apply to early leavers' benefits.

As part of the process of improving security for pension scheme members, the Government introduced changes to the benefits that must be provided for scheme members if they leave before completing two years' pensionable service. The changes are included in the Pensions Act 2004 and the Pensions Regulator issued a Code of Practice (Regulatory Code of Practice No. 4) to give guidance to trustees who need to operate these new rules.

Affected schemes/members

The new rules only apply to occupational pension schemes where there are members who leave before completing two years' pensionable service and do not become entitled to a paid-up benefit under the scheme.

Not all pension schemes operate on this basis. Some schemes automatically provide a paid-up benefit for members who leave the scheme before they take their benefits. These schemes are not affected by the new legislation.

In addition, even where the pension scheme normally offers refunds of contributions to members who leave before completing two years' pensionable service, some of these members will not be eligible to receive a refund of contributions – for example where a transfer of benefits from a personal pension plan has been made to the pension scheme for them. These members are not affected by the new legislation.

Your scheme rules will set out the basis that operates under your scheme. If you always provide a paid-up benefit for members who leave before taking their benefits, these new rules will not affect you.

Effective date of change

The new requirements came into force on 6 April 2006.

The new legislation

From 6 April 2006, affected schemes have to offer affected members who leave having completed at least three months' pensionable service, but less than two years' pensionable service, the choice of:

- a transfer payment to another pension arrangement, based on both the value of their own contributions and their employer's contributions, and
- a refund of their own contributions, less tax



The transfer payment or contribution refund is calculated using the normal cash equivalent transfer principles, although it may be reduced or increased where required or allowed by legislation.

Such members who leave before completing three months' pensionable service will still only have to be given a refund of their own contributions, less tax, depending on the scheme rules.

Information that must be provided to affected members

If the member is being offered the choice of a refund or a transfer payment then, within a reasonable timescale of the member leaving the scheme, you will have to give them a written statement detailing certain information, including, amongst other things:

- confirmation of their rights
- the amount of the cash transfer sum and contribution refund, and the amount of tax that would be paid on the contribution refund
- if the values for the transfer sum and contribution refund have been reduced, or increased and, if so, the reasons why and the amount of the reduction or increase
- details of any contribution equivalent premium that would be deducted from the refund to reinstate state pension entitlement
- how, and by when, they can choose which option to take
- that if they do not make a choice within the allowable timescale, you will be entitled to pay the refund of their contributions less tax

The Pensions Regulator has indicated in its Code of Practice that a 'reasonable period of time' is within three months from the member leaving the scheme.

If it is going to take longer, you must keep the member informed and give the written notice as soon as possible.

Timescale for decision

You have to give the member a reasonable period of time in which to make their decision and you must give a deadline for their response in the written notice.

The Pensions Regulator states in the Code that this should be a minimum of three months from the date the member is given the statement of information. A longer period of time may be appropriate in some circumstances, for example if the member has moved abroad.

If the member does not respond within the timescale you have set, you can extend the deadline (which you must tell the member about), but you're not obliged to do this.

Responding to the member's decision

You should arrange for whichever payment has been chosen by the member to be made within a maximum of three months from the date the member makes their choice.

Member chooses a cash transfer payment

If the member chooses to take the cash transfer payment, they will need to tell you who to pay it to. This must be to a registered pension scheme or to a qualifying recognised overseas pension scheme. If the transfer payment contains any contracted-out rights, the receiving scheme must be able to accept these rights.

Member chooses a refund of contributions

If the member chooses to take a refund of their own contributions (less tax), they can ask you to pay it directly to them, or to another person.

If the member does not make a decision

If the member does not make a decision within the timescale you set, you can pay them a refund of their own contributions, less tax. The Pensions Regulator states in the Code that you should wait for one month after the deadline for the member's decision (or the end of any extended period you have granted) before taking this action.



If your scheme is in wind-up

If your scheme is winding up, different rules apply. Unless you automatically provide a paid-up pension, members who are still in the scheme at the date of wind-up, and who have completed less than two years' pensionable service, will only be entitled to a refund of their own contributions, less tax. They will not be entitled to the cash transfer payment option unless they had left the scheme before it started to be wound up and their choice had not yet been actioned.

Penalties for failure to comply

If you have affected members in your scheme and you do not comply with the new legislation, the Pensions Regulator can impose a financial penalty. This can be up to £5,000 for an individual and up to £50,000 for a corporate trustee.

Action

You need to make sure you know whether your scheme automatically provides paid-up benefits for members who leave before completing two years' pensionable service.

If you always provide paid-up benefits for everyone, you do not need to take any action. If you offer refunds of contributions for eligible members, you will need to put suitable procedures in place to make sure the affected members are given the right information at the right time, and that you implement the member's decision within the timescales allowed.

This information is based on Scottish Equitable's understanding of current law and guidance, which may change.