

**Department of Work and Pensions
Q&As relating to Proportionality Rules of Protected
Rights and Non Protected Rights
22nd December 2008**

Following the AMPS paper dated 7th October 2008 setting out the Department of Work and Pensions (DWP) Q&As relating to Protected Rights and Income Drawdown, AMPS has sought further clarification from the DWP on issues relating to rules around drawing benefits proportionately from Protected Rights (PR) and Non Protected Rights (Non PR) funds.

Please note that the advice given below is only the Department of Work and Pensions view on how the legislation works, and should not be taken as a definitive statement of the law. A final and definitive judgement as to what the law is ultimately is for the Court. You should rely only on advice from your professional advisers.

1. **Question** – It is suggested that if an individual had already crystallised a totally separate PR fund, having taken the 25% lump sum and was taking income through income drawdown and then transfers that plan into a Sipp that contains uncrystallised Non PR funds, that the acceptance of that transfer should not mean that existing uncrystallised Non PR funds would have to be immediately crystallised, nor indeed should any future contributions to the plan. The logic being that PR are not being diminished any faster inside the SIPP than they previously were outside of the plan.

However, interpretation of DWP policy does seem to suggest that the Non PR would have to be fully crystallised in this scenario but perhaps proportionality only applies when 'effect' is given to protected rights benefits i.e. at the time it is crystallised, where in this scenario, crystallisation of PR took place under the completely separate scheme before it was transferred into the SIPP.

DWP advice - Section 28(2)(b)(ii) of the Pension Schemes Act (PSA) 1993 provides a power for protected rights to be transferred from a personal pension scheme, "to another personal pension scheme, to an occupational pension scheme or to an overseas arrangement."

Where those rights have already been used to provide payments under an interim arrangement (income drawdown) the existing rules do not specifically provide for the fund to be transferred to another scheme under the powers set out in PSA 28(2)(b)(ii). However, regulation 6 of The Personal and Occupational Pension Schemes (Protected Rights) Regulations 1996: S.I. 1996 No. 1537, requires that an interim arrangement provides for the member to be able to elect to terminate the interim arrangement at any time during the

interim period.

We are of the view, therefore, that once an arrangement has been terminated in one scheme, the residual fund can be transferred to another appropriate personal pension scheme (including a SIPP holding a contracted-out certificate) and, should the individual wish, be used to provide payments under a new interim arrangement. The receiving scheme will of course need to ensure that any income drawn upon in these circumstances, is applied at a proportionate rate to any non-protected rights held in the scheme.

2. **Question** - From your last paragraph (in point 1 above) it seems clear that in the scenario where a PR fund that has been crystallised and is in drawdown, is then transferred into a pension plan that has uncrystallised Non PR funds, then the uncrystallised Non PR funds would only have to be crystallised if the member chose to draw income from their transferred in crystallised PR fund, and then only to the extent that income from PR and Non PR was proportionate. In other words the mere transfer-in of crystallised PR does not trigger crystallisation of Non PR funds - it is the drawing of income from PR funds that is the critical factor. Please let me know if I have misinterpreted your response in this respect.

DWP advice - Where the entire protected rights fund has been crystallised and put into income drawdown, any subsequent transfer to a pension plan holding non protected rights, would, on the date that the transfer in takes effect, trigger the crystallisation of the entire non protected rights fund. However, should the transfer comprise part crystallised and part non crystallised protected rights, the proportion of non protected rights that need to be crystallised must be at least equivalent to the percentage of protected rights crystallised.

Put simply, whatever percentage of protected rights have been crystallised prior to the transfer, at least the same percentage must then be applied to the non protected rights from the date the transfer in takes effect.

The same rules require that proportionality continues when the crystallised funds are in drawdown. So, if a total of £100K (comprising £50K protected rights and £50K non protected rights) is put into drawdown and, after 5 years the income drawn upon results in the fund being reduced to £80K, then no more than £10K of that reduction could be apportioned to the protected rights. Conversely, the proportionality rule would permit the entire £20K to be apportioned to the non protected rights.

3. **Question** - Assuming the above is correct (i.e. proportionality only applies to income payments) it has now caused re-questioning of our original understanding that if a plan held say £50,000 PR and £50,000 Non PR and the member wanted to crystallise £50,000 then they could:
- a) crystallise all of the Non PR
 - b) crystallise say £10,000 PR and £40,000 Non PR

c) crystallise £25,000 PR and £25,000 Non PR

But could not crystallise a higher proportion than 50% of the PR fund i.e. £25,000

DWP advice - Section 28(A)(3A) of the Pension Schemes Act 1993 requires that “the proportion of the aggregate payment which gives effect to a person's protected rights must not be greater than the proportion of the value of the rights to money purchase benefits under the scheme that is attributable to the protected rights.”.

So, in the above example, a) and b) would result in a lower proportion of the value of the rights to money purchase benefits being given effect to and would, therefore, satisfy the requirements set out in s28(A)(3A). The amount crystallised at c) would result in an equal proportion (and not, therefore, greater than) of the value of the rights to money purchase benefits under the scheme being given effect to and would, therefore, satisfy the requirements set out in s28(A)(3A).

Anything in excess of £25,000, would be greater than the proportion of the value of the rights to money purchase benefits being given effect to and would, therefore, fail to satisfy the requirements set out in s28(A)(3A).

4. **Question** - However, if it is the drawing of income that is the critical factor regarding the application of proportionality, the question now arises as to whether it would be possible, using the above example, for the member to crystallise into drawdown all £50,000 of the PR, (including taking the 25% pension commencement lump sum from the £50,000) but not take any income from the drawdown arrangement and thereby not have to crystallise any of the Non PR fund.

DWP advice - The short answer (for the reasons set out in the answer to point 2 above) is “No”. Basically, the policy is for the proportionality test to be applied at both the crystallisation stage and again when the funds are in drawdown.

5. **Question** - To pose the question more technically this is the question received from a member firm:

“I would be grateful if you could clarify the scope of s28A(3A) – our interpretation of this is that it is purely limiting the level of income withdrawal paid from the PR (in proportion to that paid from the NPR). It is not restricting the proportion paid from the PR as a pension commencement lump sum, as it only deals with ‘the aggregate payment’ (which as defined in s28A(3), is only the income withdrawal payment). We do not think there is a similar restriction on payment of the pension commencement lump sum from PR. The amount paid here is restricted by Regulation 8(1D) of The Personal and Occupational Pension Schemes (Protected Rights) Regulations 1996 (SI 1996/1537). We

do not see the reference in (1D)(b)(ii) as having a similar impact as s28A(3A), as the context is 'the member's benefit crystallisation events' as defined in (i). We read (i) as only relating this defined term to the BCEs in respect of the PR only – we thought the point of this clause was to cover the position where less than 25% is payable because of HMRC restrictions.

DWP advice - Whilst the proportionality rules set out in Regulation 8(1D) of The Personal and Occupational Pension Schemes (Protected Rights) Regulations 1996 (SI 1996/1537), apply to pension commencement lump sums, where the residual protected rights are then put into drawdown, at least a proportional amount of the non protected rights needs to be crystallised and put into drawdown. For example, if 100% of the protected rights fund is crystallised (25% PCLS and 75% through drawdown), 100% of the non protected rights needs to be crystallised as well. Though not necessarily in exactly the same way – for example there would be no requirement to take a PCLS.

6. **Question** - *As an example, if a member had £50,000 NPR and £50,000 PR, could they crystallise the PR, taking the 25% pension commencement lump sum and leave the NPR untouched, provided they drew Nil income from the PR (to conform with s28A(3A))? We would be interested in knowing the DWP Policy line on the above, particularly the intention behind Regulation 8(1D)(b)(ii) of SI 1996/1537".*

DWP advice - This question sets out a practical example of your member firm's understanding of the way in which the legislation works (described in point 5). So, unsurprisingly, the answer here is the same; it is not possible to crystallise protected rights by way of a drawdown arrangement without crystallising at least a proportional amount of the non protected rights. As for the policy behind 8(1D)(b)(ii), it is to ensure that where a PCLS is taken from a fund comprising protected rights and non protected rights, then no more than 25% of the protected rights fund can be taken as a PCLS.

7. **Question** – Overall there is confusion about whether it is the fact that PR are being crystallised into drawdown is the trigger for proportionality or whether the drawing of income from PR is the trigger or both. It should be noted that the drawing of income necessitates funds having been crystallised first but that crystallisation does not necessitate the drawing of income.

DWP advice - You will have noted from the above answers that proportionality must be applied both at the crystallisation stage, and at the point income is drawn upon under the drawdown arrangement. And, whilst you are correct in your assertion that crystallisation does not necessitate the drawing of income, this is because of the permissible range of income available under such an arrangement. But as soon as an income is drawn upon within this range (apart of course at £0), it has to be drawn upon on a proportional basis.