Protected Rights – a potted history

Early days

Private pensions have been around for a long long time. When Henry VIII dissolved the monasteries the abbots, the lucky ones at least, got pensions. When Samuel Pepys landed a plum job in the Navy in about 1667 he gave 1/3rd of his salary as a pension to the chap he had nudged out.

There was no State pension until Lloyd George's 1908 Old Age Pensions Act, intended to "lift the shadow of the workhouse from the homes of the poor", introduced a pension of up to five bob sorry 25p per week for people over 70 with incomes of less than 12s/60p.

The Graduated Scheme

Benefits crept up and retirement ages came down, but the State scheme remained flat rate until 1961 when the Graduated Scheme came in. This generated a lot of paper but not much pension. In today's values the maximum is £7.53 p/w for a man and £6.31 for a woman.

More significantly for our industry, some barmpot invented contracting out, whereby a company scheme replaced the Graduated benefit and the State scheme only paid the flat rate bit. Occasionally we still come across Equivalent Pension Benefits or EPBs, usually tiny, preserved as part of occupational pensions.

SERPS and S2P

The Graduated Scheme ran until 1975. There was 3 years' limbo and then in 1978 the State Earnings Related Pensions Scheme, affectionately known as SERPS, was introduced. This was a complex but much better arrangement. Again there was contracting out, and the company scheme had to provide a replacement, known as the Guaranteed Minimum Pension or GMP, the calculation of which was actuarial magic. Only final salary schemes could contract out, and most did. The carrot was reduced National Insurance contributions for both company and member.

From 2002 the State Second Pension (S2P) was introduced, similar to SERPS except that benefits are tilted more towards the lower paid. Contracting out is also quite similar, except that from 1997 the conditions for a final salary scheme are less stringent: the scheme just has to be as good.

Rebate policies – Protected Rights generated by NI payments

From 1987 a new form of contracting out was introduced. The Tories wanted to tempt the younger generation away from SERPS and they knew that final salary schemes were on the decline. The method was much simpler than "old" contracting out; NI contributions were paid in full but a portion was channelled to the chosen insurer providing the personal pension.

These were known as "Rebate" policies and no other contributions were paid to them. Their funds were called Protected Rights, which unlike GMP's had no benefit promises attaching to them; however at State Pension Age pensions had to be in a set form, with no tax-free cash, 50% spouses' benefits and limited inflation proofing. The age restriction has now gone, and benefits can now be taken at 50 (55 from 2010). Up to 25% of the fund can now be taken as Tax free cash.

Transfers - Protected Rights from GMP's

If a benefit was transferred from a final salary scheme the value of the GMP became Protected Rights, and again there were no guarantees but the form of the pension was proscribed. An amazing anomaly is that all benefits accrued after 6.4.97 tend to be treated as Protected Rights.

Protected Rights in a SIPP

The Liberty Pension is an Appropriate Personal Pension (APP) and as such people could in theory use it to contract out, though it's proposed that this type of contracting out will cease after 2012. It is less popular than it was in the 80's and 90's, but the facility is still there.

However most Protected Rights come into SIPPs from transfers, some directly from company schemes but far more from other personal pensions, many of which were themselves transfers from final salary schemes a generation ago.

Investment of Protected Rights

Protected Rights have traditionally been invested more cautiously than Non Protected. Under a personal pension the insurer would often insist on with profits or some other safe fund. Until 1st October 2008 we will restrict investment to insured unit-linked funds, but from October all this changes and, whilst until 2012 the respective amounts in each pot will still have to be recorded, Protected Rights will have exactly the same investment freedom as Non-Protected.