EXPLANATORY MEMORANDUM TO
THE PENSIONS REGULATOR (CONTRIBUTION NOTICES) (SUM SPECIFIED FOLLOWING TRANSFER) REGULATIONS 2010

2010 No. [DRAFT]

1. This Explanatory Memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument sets out how the Pensions Regulator will calculate the amount in a contribution notice, where:

- the grounds for issuing a contribution notice have been met, and
- a transfer of two or more members has occurred to a work-based, defined contribution pension scheme.

2.2 A contribution notice is a notice which requires a person to pay money into an underfunded work-based pension scheme.

2.3 A defined contribution pension scheme is a scheme in which the benefits payable are based on the amount of contributions made to it rather than on a member's salary and length of service.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 This is the first use of the power to make regulations under section 39A(5) of the Pensions Act 2004. The regulations are being made to complete the implementation of one of the changes to the Pensions Regulator's anti-avoidance powers first announced in April 2008, and made under the Pensions Act 2008.

4.2 The changes to the Regulator's anti-avoidance powers included a new provision to allow the Regulator to issue a contribution notice where there has been a transfer of members to another pension scheme (where certain conditions are met). This includes situations where that transfer is to a defined contribution pension scheme. Existing legislation sets out how the Regulator must calculate the amount to be specified in a contribution notice. However, this existing calculation only relates to defined benefit pension schemes, and does not work in respect of a transfer to a defined contribution pension scheme. Therefore provision was made for regulations to specify how the Regulator must calculate the sum where the members had transferred to a defined contribution pension scheme.

4.3 The regulation-making power that provides for this instrument was briefly outlined during the Report stage of the Pensions Act 2008 in the House of Lords – Hansard (**27 Oct 2008 : Column 1434**). There were no further amendments or debates on this point, or the amendment to primary legislation to enable the Regulator to use its contribution notice power in certain circumstances where there had been a transfer. There was brief discussion on two other regulation-making powers included in the amendments, but these do not pertain to this instrument.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain. Corresponding provisions will be made in Northern Ireland.

6. European Convention on Human Rights

The Minister of State for Pensions and the Ageing Society, Angela Eagle, has made the following statement regarding Human Rights:

In my view the provisions of the Pensions Regulator (Contribution Notices) (Sum Specified following Transfer) Regulations 2010 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 The Pensions Act 2004 gave the Pensions Regulator a number of 'anti-avoidance' tools to protect pension scheme members' benefits, and to protect the Pension Protection Fund (PPF) against abuse. For example, where employers sponsoring defined benefit pension schemes seek to avoid their obligations. The PPF, in general terms, is the statutory compensation fund for eligible underfunded defined benefit occupational pension schemes where the employer experiences certain insolvency events. One of the Regulator's anti-avoidance powers is the ability to issue contribution notices – to companies or to individuals – requiring money to be put into pension schemes under certain conditions. The Pensions Act 2008 extended these powers in the light of the Regulator's experience, and changes in the pensions market. This included amendments to address the unforeseen effect of the legislation whereby an employer could avoid a contribution notice by transferring members out of the scheme. The primary legislation closed this loophole and specified how the Regulator could act in these circumstances.

7.2 These regulations provide the technical details that will complete the implementation of this amendment by setting out how the Regulator must calculate the amount to be specified in the contribution notice issued, where the transfer is to a defined contribution scheme. These regulations are required because the existing statutory method for calculating the amount in a

contribution notice[1] is based on the defined benefit funding rules and the relevant deficit in a defined benefit scheme. These rules do not apply to defined contribution schemes.

7.3 The policy intention of these regulations is to provide a calculation which offers equivalent protection as the existing calculation, but one which is applicable where there is a transfer to a defined contribution scheme.

7.4 The level of public interest has been relatively low, given the technical nature of these regulations. Responses were received from seven organisations, including representatives of key pensions professions, for example the Association of Pensions Lawyers, and the Association of Consulting Actuaries. These regulations specify how the Regulator should calculate an amount payable under existing legislation, and do not place any new requirements on business. The principle of enabling the Regulator to act in these circumstances was set out in the primary legislation, and there were no objections raised during the passage of the Bill on this particular point. Without the regulations the Regulator would be unable to issue a contribution notice where the conditions for it were met and a transfer had occurred from a defined benefit to a defined contribution scheme.

- ***Consolidation***

7.5 This instrument is the first set of regulations under the enabling power. Therefore consolidation is not applicable.

8. Consultation outcome

8.1 The consultation on the draft regulations ran for eight weeks from 19 October to 11 December 2009. A shortened consultation period was chosen because:

- the regulations are specialised and technical in nature and of interest to a limited audience;
- the proposed regulations will only affect a small number of transactions related to pension transfers where the legal tests for issuing a contribution notice have already been satisfied;
- the consultation on the primary legislation dealt with the principle of the Pensions Regulator being able to act where a transfer has occurred, and so interested parties will be aware of the provision to develop regulations. During consultation on the primary amendments, a significant number of stakeholders' responses, and further discussions with representative organisations (including the Confederation of British Industry and the Trade Union Congress) indicated that closing this loophole was a sensible amendment.

8.2 The draft regulations and consultation document was sent by email to key stakeholders and other interested parties (61 copies were sent in total), and placed on the DWP website. Written responses were received from seven

[1] Section 39 of the Pensions Act 2004

organisations, all of which were broadly supportive of the policy intention and the structure of the regulations. Five points were made on the drafting detail, relating to clarification. The Government considered these very carefully and accepts most suggestions – it has therefore made some clarificatory changes to the regulations:

- The Government has expanded the regulations to include additional definitions of technical terms ('shortfall sum', 'rights acquired', 'earner') with the intention of making the provisions as transparent as possible.
- For clarity, the Government has also specified that the aggregate cash value is to be calculated as at the time of the acquisition of rights in the transferee scheme, and that this calculation is for the Regulator to perform.

8.3 A full analysis of the consultation outcome has been published; this is available on the DWP website: http://www.dwp.gov.uk/consultations/2009/ (19/10/09 entry). The response includes a summary of responses from the consultees and provides the Government's position.

9. Guidance

9.1 The Department for Work and Pensions does not plan to issue guidance in relation to the regulations. The Pensions Regulator is primary user of these regulations. The Department worked closely with the Regulator in the development of the regulations, and they reflect the level of specificity in other equivalent legislation available to the Regulator. The regulations do not place new requirements on employers or the pensions industry. The Government response to the consultation will be published on the DWP website for stakeholders and members of the public to access.

9.2 The Regulator has guidance on clearance and pension scheme abandonment which are relevant to this area. This guidance was updated following the amendments in the Pensions Act 2008. The Regulator does not intend to further update at this point, as these regulations do not place new requirements on business.

10. Impact

10.1 The impact on business, charities or voluntary bodies is nil.

10.2 The impact on the public sector is negligible.

10.3 A full Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Department for Work and Pensions will work closely with the Pensions Regulator to ensure the legislation remains appropriate. As these

regulations relate to how the Regulator must calculate the amount in the contribution notice, the effectiveness can be measured by the ease and outcome of the application in any case in which the Regulator applies them. The Department will look at general principles arising from the Regulator's experience, to ensure that they remain effective and deliver the Government's policy intention. The timing of this review process is dependent on the Regulator's experience.

13. Contact

Lizzy Holliday at the Department for Work and Pensions - Tel: 020 7449 7416 or email: Lizzy.Holliday@dwp.gsi.gov.uk - can answer any queries regarding the instrument.