EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL AND PERSONAL PENSION SCHEMES (MODIFICATION OF SCHEMES – MISCELLANEOUS AMENDMENTS) REGULATIONS 2016

2016 No. 231

1. Introduction

1.1 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 The purpose of The Occupational and Personal Pension Schemes (Modification of Schemes – Miscellaneous Amendments) Regulations 2016 - "the Regulations" - is to make changes to secondary legislation[1] resulting from the ending of contracting-out for salary related occupational pension schemes from 6 April 2016. The Regulations provide a power for schemes that choose to do so, to modify their scheme rules enabling them to provide for fixed rate revaluation for guaranteed minimum pension (GMP) from when pensionable service ends rather than when contracted-out service ends (6 April 2016). Schemes may use this power to make retrospective changes to have effect from 6 April 2016. Where schemes make such changes, whether using this power or their own power of amendment, this instrument provides that they are not required to consult their scheme members on the change.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 Sponsoring employers of salary related occupational pension schemes are allowed to contract their employees out of the additional State Pension on the condition that the scheme meets certain statutory requirements. These have changed over the years: the main requirements are contained in Part 3 of the Pension Schemes Act 1993[2] ("the PSA 1993").

4.2 In return for the employer providing a scheme that meets the statutory minimum both the employer and employee pay lower levels of National Insurance (NI) Employer contributions are currently reduced by 3.4 per cent and employee contributions by 1.4

[1] The Occupational Pension Schemes (Modification of Schemes) Regulations 2006 - http://www.legislation.gov.uk/uksi/2006/759/made; the Occupational Pension Schemes (Schemes that were Contracted-out) (No.2) Regulations 2015 http://www.legislation.gov.uk/uksi/2015/1677/contents/made; the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006- http://www.legislation.gov.uk/uksi/2006/349/schedule/paragraph/7/made.

[2] http://www.legislation.gov.uk/ukpga/1993/48/contents/enacted

per cent. This is known as the "NI rebate", and is set out in the PSA 1993, section 41(1A) and (1B).

4.3 The introduction of the new State Pension on 6 April 2016 means that there will no longer be an additional State Pension and consequently contracting-out will come to an end as will the NI rebate.

4.4 Section 24(1) of, and Schedule 13 to, the Pensions Act 2014[3] plus the provisions in the Occupational Pension Schemes (Schemes that were Contracted-out) (No.2) Regulations 2015[4] (S.I. 2015/1677), set out the key legislative changes that are necessary as a result of the abolition of contracting-out for salary-related occupational pension schemes.

4.5 These Regulations provide for schemes to be able to modify their scheme rules in order to provide for fixed rate revaluation of members' guaranteed minimum pensions from when the members' pensionable service ends after 6 April 2016, as provided for by amendments made to section 16[5] of the PSA 1993.

5. Extent and Territorial Application

5.1 The extent of this instrument is Great Britain.

5.2 The territorial application of this instrument is Great Britain.

5.3 Subject to the agreement of the Northern Ireland Assembly, the Department for Social Development in Northern Ireland will be making corresponding provisions for Northern Ireland.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 From 1978 occupational defined benefit (DB) pension schemes were able to remove their members ("contract-out") from the state earnings related pension scheme (additional State Pension) and provide a "guaranteed minimum pension" ("GMP") in return. These provisions were widely used. The GMP was intended to provide a minimum amount of weekly pension, broadly equivalent to the amount of additional state scheme pension that the member would have been entitled to, had the member not been contracted-out. The GMP is payable for life at age 60 for a woman or 65 for a man, and a survivor benefit is payable to a widow, widower or civil partner. This system was in operation until 5 April 1997; although rights no longer accrue, those rights are, and will continue to be, protected.

7.2 From 6 April 1997, a different test, referred to in legislation as the statutory standard, is applied to schemes that contract-out of the state system[6]. This is still in operation, and is commonly known as the Reference Scheme Test. This test requires a scheme to provide benefits broadly equivalent to the reference scheme, which requires the

[3] http://www.legislation.gov.uk/ukpga/2014/19/contents
[4] http://www.legislation.gov.uk/uksi/2015/1677/contents/made
[5] Section 16(2) is amended by paragraph 16 of Schedule 13 to the Pensions Act 2014
[6] Section 12A of the Pension Schemes Act 1993

scheme to provide a pension at age 65; to have an accrual rate of 1/80th of qualifying earnings in the last three years before the end of contracted-out employment; and to pay a survivor's pension to a widow, widower or civil partner of 50 per cent of benefits that the member was being paid before death.

7.3 With the introduction of the new State Pension from 6 April 2016 the process of contracting-out mentioned above will be abolished as the additional State Pension will no longer exist.

7.4 Where a person leaves contracted-out service (in most cases by leaving their employment and the associated pension scheme) before pension age, the value of their GMP is inflation proofed until they reach pension age. Currently, trustees have the choice of two different methods of revaluing GMPs: fixed rate revaluation or revaluation by earnings. Whichever method a scheme chooses, it must be applied to all scheme members.

The Pensions Act 2014

7.5 In response to concern from the pension industry that when contracting-out ends, fixed rate revaluation would be automatically triggered by the ending of contracting out regardless of whether the earner remains in employment and stays a member of the scheme, the PSA 1993 was amended by the Pensions Act 2014, with the result that from 6 April 2016 schemes will have to choose:

(a) to operate fixed rate revaluation (but from the date when pensionable service ends, not from the date contracted-out employment ends), or

(b) to calculate earnings revaluation by reference to earnings in the final tax year of the earner's working life i.e. by reference to increase orders under Section 148 in force.

However, schemes have to choose to amend their scheme rules to carry out fixed rate revaluation under section 16 PSA 1993, as amended by the Pensions Act 2014, even if they had chosen fixed rate previously as the preferred method. This is because schemes are being presented with a new choice. Recently, stakeholders advised the Department that many schemes will not be able to exercise this choice because their scheme rules are restrictive, preventing them from making the necessary changes. As a result, the option to choose fixed rate for such schemes will fall away when contracting out ends.

7.6 The Regulations provide schemes with a statutory power to modify their rules in order to be able to choose fixed rate revaluation of the GMP from the day pensionable service ends for those whose contracted-out service ended on abolition (6 April 2016). They provide for such a change to have retrospective effect, that consultation with members is not required, and that such a change is a permitted change under the Occupational Pension Schemes (Schemes that were Contracted-out) (No.2) Regulations 2015.

Consolidation

7.7 Informal consolidated text of instruments is available to the public free of charge via 'The Law Relating to Social Security' (Blue Volumes) on the Department for Work and Pensions website at http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/ or the National Archive website

legislation.gov.uk. An explanation as to which instruments are maintained on each site is available from http://www.dwp.gov.uk/docs/lawvolnews.pdf.

8. Consultation outcome

8.1 The Department did a short, informal, consultation by correspondence over a number of days with industry specialist stakeholders to establish if they were content with the draft Regulations. Stakeholders were broadly positive and made a number of technical drafting comments. They also made a substantive point which was whether schemes which make the same change to their rules using their own powers of amendment (i.e. where they are able to make the change without using the statutory modification power that we are providing), could also be exempt from the requirement to consult. We agreed with the argument that it would be inconsistent to exempt schemes that use the statutory modification power from this requirement, but not schemes which use their own rules to achieve the same result. The regulations were altered to exempt schemes which use their own powers to make the change from the requirement to consult.

9. Guidance

9.1 In relation to this provision, HMRC, in conjunction with the Department for Work and Pensions, is updating guidance for schemes and pension administrators following the end of contracting out and should be available in spring 2016. In addition, a telephone advice line service will be available for pension scheme administrators and managers.

10. Impact

10.1 There is no impact on business, charities or voluntary bodies.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses but does not place any additional burden on small businesses.

12. Monitoring & review

12.1 It is not appropriate in these circumstances to make statutory provision for review of this Order. Regulation 2 provides for the statutory modification power introduced by the Regulations to cease on 6th April 2017. The remaining provisions in the Regulations do not place any additional burden on individuals or the industry over that identified as a consequence of the abolition of contracting-out in the Pensions Act 2014. As such, the cost of conducting a statutory review and monitoring impacts would be disproportionate to the economic impact of the provision in the Order.

12.2 The Department will, however, continue to work closely with its stakeholders, including industry bodies and employer organisations, in the period following the abolition of contracting-out and will take a keen interest in how the arrangements are working. The Department always keeps policy under review, and should any issue arise with these arrangements, it will assess the evidence and, if appropriate, consider whether any changes may be necessary.

13. Contact

13.1 Ivor Millen at the Department for Work and Pensions, Telephone: 020 7449 7384 or email: Ivor.Millen@dwp.gsi.gov.uk can answer any queries regarding the instrument.