EXPLANATORY MEMORANDUM TO

THE PENSIONS (2012 ACT)
(TRANSITIONAL, CONSEQUENTIAL AND SUPPLEMENTARY PROVISIONS)
REGULATIONS (NORTHERN IRELAND) 2014

S.R. 2014 No. 204

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Social Development to accompany the Statutory Rule (details above) which is laid before the Northern Ireland Assembly.

1.2 The Statutory Rule is made under sections 70(5), 93(1), (2)(b) and (3)(c), 97AF(1), (3)(b) and (4)(b), 97I, 97L(1) and (2)(b), 109, 149(1) and (2)(c), 177(2) to (4) and 178(1) of the Pension Schemes (Northern Ireland) Act 1993, Articles 10(3), 37(4)(a) to (c) and (e) and (8), 47(5)(a), 64(3)(b), 73(6), (7) and (8)(a), 75(5) and (10) and 166(2) and (3) of the Pensions (Northern Ireland) Order 1995, Articles 21(1)(b), 27(1) and 73(4) of the Welfare Reform and Pensions (Northern Ireland) Order 1999, Articles 103, 110(1)(b) and (5), 119(4), 122(10)(a), 130(1), 145(3)(b), 162(1)(a) and (3), 171(11)(b), 172(1), 189, 211 and 287(2) and (3) of, and paragraphs 12(3A)(b), 17(3A)(b), 20(7) and 33 of Schedule 6 to, the Pensions (Northern Ireland) Order 2005 and sections 28(1) and (2), 29(1) and 31(1)(a), (b) and (d) of the Pensions Act (Northern Ireland) 2012 and is subject to the negative resolution procedure.

2. Purpose

2.1 These Regulations make transitional, consequential and supplementary provision, in light of the commencement of section 27 of the Pensions Act (Northern Ireland) 2012 which clarifies the definition of money purchase benefits in the existing law.

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3. Background

3.1 The definition of money purchase benefits is fundamental to pensions law. The law treats money purchase benefits differently from other benefits, such as those offered by final salary schemes. A range of statutory provisions protect members with benefits that are not money purchase against the risk that their scheme is not able to meet the pensions promise. These provisions do not apply to money purchase benefits.

3.2 The Supreme Court judgment in *Bridge Trustees v Houldsworth and another (2011)* decided that certain benefits could be considered money purchase benefits even though it was possible for them to have a shortfall in their funding. This created uncertainty about the type of benefit structures that fall within the definition of money purchase benefits. In light of the Supreme Court judgment, section 27 of the Pensions Act (Northern Ireland) 2012 clarifies the definition of money purchase benefits by limiting it to those benefits where there is no risk of a funding deficit. Section 27 has retrospective effect back to 1 January 1997 to ensure that, where appropriate, schemes can have their past actions validated.

3.3 Decisions taken by schemes between 1 January 1997 and the date section 27 and these Regulations come into operation will in most cases be validated. In almost all areas, the practical effect of section 27 upon schemes which took decisions incompatible with the clarified definition will only be prospective.

3.4 Occupational pension schemes offer benefits that are either money purchase benefits or non money purchase benefits. The Government's view is that the term 'money purchase benefits' should only refer to those pension rights which are wholly backed by matched assets and cannot develop surpluses or deficits. These Regulations set out how existing regulatory requirements will apply to benefits that have been treated as money purchase but do not meet the clarified definition of money purchase benefits.

3.5 Regulations which also form part of the implementation of section 27 will amend primary legislation for transitional and consequential purposes with prospective effect and should be read in conjunction with Part 7 of these Regulations in relation to the revaluation of benefits and Part 12 in relation to decisions by the Board of the Pension Protection Fund. The majority of schemes affected will be those offering a mix of money purchase and non money purchase benefits.

3.6 These Regulations make transitional, consequential and supplementary provision to enable schemes to comply with the definition of money purchase benefits. They provide transitional protection to ease compliance. For example, where a scheme has entered the Pension Protection Fund based on a valuation that did not include benefits treated as money purchase benefits, this decision will stand.

3.7 From the coming into operation date, schemes including benefits that are not money purchase must comply with regulatory requirements for non money purchase schemes within the periods specified. For example, pension protection levy bills will not include affected benefits until the first full levy year, which is 2015/16.

3.8 The requirements under each part of these Regulations are explained below.

<u>The definitions of cash balance, money purchase underpin and top-up benefits</u>

3.9 These Regulations describe the features of certain types of benefits, in particular:

- cash balance benefits - where a pot of money (which may be a notional pot) is built up through contributions, but there is some form of promise in relation to the amount accumulated. No promise is made in relation to the level of pension to be provided;
- underpin benefits - an arrangement where the member has a right to the greater or greatest of two or more types of benefit under the scheme; for example, the greater of a money purchase pot or a final salary pension;
- top-up benefits - an arrangement calculated by the difference between the amount of a money purchase benefit and a pre-set level or value.

3.10 These Regulations make it clear that the existence of a contingent promise to a non money purchase benefit either as an underpin or top-up benefit under a scheme does not affect the categorisation of money purchase benefits. This is provided that the money purchase benefit, at the time the benefits are being valued, is of greater value than that of the underpin benefit or pre-set level in a top-up benefit.

Protected rights

3.11 Until 6 April 2012, contracting out of the State Second Pension was allowed on a money purchase basis. Scheme members who were contracted out received rebates on their national insurance contributions at the standard rate. This rebate, and in some cases, other contributions, were invested as a protected right money purchase benefit to provide a money purchase pension as an alternative to the State Second Pension.

3.12 These Regulations validate the treatment of cash balance benefits, the defined benefit minimum in an underpin benefit, and top-up benefits as money purchase benefits for the purposes of the protected rights legislation. This will apply both before and after this form of contracting out was abolished in April 2012 in order that these benefits meet the legislative requirements for protected rights.

Modification of schemes

3.13 The rules of some occupational pension schemes include a power of amendment which allows accrued rights to benefits to be modified. These Regulations validate the exercise of such a power to convert benefits treated as money purchase to money purchase benefits prior to the coming into operation date, provided that the actuarial value of the benefit was maintained.

3.14 They also protect members by preventing detrimental modifications to a contingent promise to provide an underpin benefit or top-up benefit. The nature of these benefits is that members' entitlement to money purchase or non money purchase benefits will not be clear until the point at which they are paid.

Winding up

3.15 These Regulations protect schemes treated as money purchase schemes and those schemes that offered both money purchase and non-money purchase benefits, where winding up has begun before the coming into operation date, whether or not it is completed by this date.

3.16 Where trustees treated schemes providing cash balance benefits or pensions derived from money purchase benefits as money purchase schemes, decisions not to apply the legislative priority order for discharging benefits in an underfunded scheme will be validated. Only schemes providing these benefits, money purchase benefits or benefits payable on the death of a member are covered, as the current definition of money purchase scheme could not encompass a scheme which might provide a non-money purchase benefit.

3.17 Where a scheme is being assessed for entry to the Pension Protection Fund before the coming into operation date but subsequently does not enter the Fund, the trustees may continue to treat the specified benefits as money purchase for the purposes of winding up the scheme under the priority order.

3.18 These Regulations extend the trustees' powers to discharge as money purchase benefits pensions which come into payment before 1 April 2015 and which are derived from additional voluntary contributions. This will ensure that members are treated in the same way, whether the scheme enters the Pension Protection Fund or winds up outside it.

Deficiencies in assets

3.19 Where an employer ceases to participate in an occupational pension with non-money purchase benefits, that employer is, unless other arrangements are made, required to make good any shortfall between the assets and the liabilities of the scheme. These Regulations ensure that in most cases the trustees and managers of schemes will not have to revisit past decisions or debt calculations.

3.20 Further provision is made for schemes that provided non money purchase benefits which were treated as money purchase, but which were not affected by the Bridge judgment or by section 27. Provided that the scheme is not in winding up, and is either fully funded or has in place a recovery plan within 18 months of the coming into operation date, the trustees or managers will not have to calculate any debt on an employer in relation to the scheme.

Revaluation, indexation and preservation of benefits

3.21 These Regulations allow cash balance benefits accrued before the coming into operation date to be revalued using a modified money purchase method which includes notional returns as well as actual investment returns. These Regulations and the Regulations which will amend primary legislation to introduce a method of revaluation for cash balance benefits, which will allow deferred members' benefits to be revalued in any way in which they would have been if the member had remained in the same pensionable service, need to be read together in such cases.

3.22 These Regulations also prevent schemes from having to unpick existing pensions in payment where the pension has been calculated without inclusion of the statutory limited price indexation required for non money purchase benefits.

3.23 The pensions of scheme members who leave before the normal pension age of their scheme are preserved. These Regulations amend existing provisions to remove the uniform accrual requirements in relation to money purchase benefits.

Transfers

3.24 These Regulations provide that, from the coming into operation date, the cash equivalent value of cash balance benefits will be calculated in a similar way to transfer values for money purchase benefits, but, if the scheme is underfunded, the transfer value may be proportionately reduced.

Early leavers: Cash Transfer Sums and Contribution Refunds

3.25 The cash transfer sum available to those who leave certain types of pension scheme after less than two years is calculated in a similar manner to the transfer values of preserved pensions. Schemes will not have to recalculate cash transfer sums where the transfer has already taken place before the coming into operation date. From that date, cash transfer sums relating to cash balance benefits will be calculated in a similar way to money purchase benefits but, if the scheme is underfunded, the transfer value may be reduced proportionately.

Payment of surplus funds to employer

3.26 Existing legislation requires that before payments of surplus funds from an occupational pension scheme that is not a money purchase scheme are made to an employer certain conditions, including arranging an actuarial valuation, must be met. Payment of surplus funds from a money purchase scheme (resulting, for example, from deceased members' benefits) may be made to an employer without meeting the conditions: because members' benefits are ring-fenced, there is no risk of underfunding.

3.27 The Regulations provide that schemes do not have to revisit such decisions made up to the commencement date. Where a scheme wishes to make a surplus payment after the coming into operation date it is required to use a valuation which reflects the clarified definition.

Scheme Administration

3.28 Occupational pension schemes that are non money purchase are required to appoint an actuary. Schemes that have not appointed an actuary are exempted from this requirement in relation to past periods, but must do so on or before 6 October 2014. An actuary is not required to be appointed in relation to a period during which the scheme is exempted from that requirement by the Scheme Administration Regulations.

3.29 Trustees or managers will not have to revisit scheme accounts produced before the coming into force date.

The Pension Protection Fund

3.30 The Pension Protection Fund protects members of non money purchase occupational pension schemes if the sponsoring employer of their scheme has become insolvent on or after 6 April 2005. A scheme that is newly protected by the Pension Protection Fund will need to submit the first valuation for levy purposes by 31 March 2015. Pension protection and administration levies will be due in the 2015/16 financial year. Schemes already eligible will not need to revisit levy payments for any financial year prior to 2015/16. This will allow time for the trustees and managers of schemes to comply with requirements for valuations used to calculate the levy. These Regulations give the Board of the Pension Protection Fund the power to request that affected schemes provide an out of cycle valuation.

3.31 Valuations or funding determinations used by the Board to determine whether it should assume responsibility for a scheme will remain valid for any date prior to the coming into force date. Where the Board has discharged certain benefits that do not meet the clarified definition of money purchase benefits before the coming into operation date, such actions will not need to be revisited. This recognises that it would not be practical for schemes to unpick such decisions nor fair to their members.

3.32 Some members receive a pension from additional voluntary contributions made alongside contributions to a defined benefit pension. Where such a pension (resulting from money purchase benefits or from other affected benefits) comes into payment before 1 April 2015 it will be treated as money purchase if the scheme enters an assessment period at any time on or after the coming into operation date. This recognises that scheme members may have chosen to convert their additional voluntary contributions to a scheme pension on the understanding that the pension

would be discharged as money purchase benefits if the scheme entered the Pension Protection Fund.

3.33 The Pension Protection Fund Entry Rules are amended so that where a compromise agreement has been made prior to the coming into operation date, the scheme will not be excluded from eligibility for the Pension Protection Fund for this reason. The amendment also provides for a newly eligible scheme to be treated in the same manner as a newly established scheme in terms of the period of time it must be eligible before it may transfer to the Pension Protection Fund.

3.34 Pension compensation paid by the Board of the Pension Protection Fund is mainly based on the scheme's promise of income stream in retirement. Where the scheme has offered a guarantee on a lump sum to the member there is no income stream. These Regulations extend existing provisions to include schemes that promise a lump sum so that the Pension Protection Fund can convert this into an income. Actuarial factors will be applied to the lump sum to turn it into an income that will then be regarded as the protected pension rate, to which compensation arrangements can be applied. Where a member's pension is not being indexed, it will remain unindexed once the member receives pension compensation.

3.35 Decisions made by the Board of the Pension Protection Fund relating to the discharge of benefits previously considered to be money purchase will be reviewable under the existing review process. These decisions are to be included in the list of reviewable matters set out in the Regulations which will amend the primary legislation.

Scheme Funding

3.36 These Regulations allow any scheme treated as a money purchase scheme to be treated as a newly created scheme for the purposes of scheme funding valuations. This means the effective date at which the assets and liabilities are valued must be within 12 months of the coming into operation date and that the valuation must be completed within 15 months of the effective date.

3.37 Where schemes have previously carried out valuations but have not included benefits that they had considered money purchase, these benefits will need to be included in the next scheme valuation, if they do not meet the clarified definition of money purchase benefits. Any valuation completed prior to the coming into operation date will continue to be valid. If the trustees or scheme managers of a scheme consider it appropriate, these Regulations give them the flexibility to carry out a valuation earlier than is normally required.

Schedules of Payments

3.38 Occupational pension schemes are required to have in place a process to collect and record the contributions which fund the scheme. For money purchase schemes this is represented by a schedule of payments and for non money purchase schemes, a schedule of contributions is required.

3.39 Schemes that become subject to scheme funding requirements for the first time will not have to prepare a schedule of contributions immediately, as the existing schedule of payments will remain in operation until the first schedule of

contributions is certified. Schemes will have up to 27 months from the coming into operation date to comply with existing scheme funding requirements.

Equality

3.40 These Regulations give certainty that schemes which apply different actuarial factors for men and women when converting money purchase benefits to a rate of scheme pension will continue to be able to do so.

Pension Sharing on Divorce

3.41 Where the pension sharing process had begun before the coming into operation date, any valuation already undertaken to enable the couple to come to a financial settlement will not be affected. In addition, any further valuation of the same rights as part of the pension sharing process may be made on the same basis as the first. This will avoid schemes having to undertake revised valuations because the cash equivalent value of money purchase benefits is calculated differently to that of non money purchase benefits.

Cross-border Schemes

3.42 Occupational pension schemes which are based in the UK are able to receive contributions from European employers. The requirements for authorisation to receive contributions are different for money purchase schemes and non money purchase schemes.

3.43 Any affected schemes will have up to a year from the coming into operation date to apply to the Pensions Regulator for authorisation on a non money purchase basis. The existing money purchase authorisation will remain valid until the Pensions Regulator either grants or refuses the fresh application.

Disclosure

3.44 The content of information trustees or managers of an occupational pension scheme are required to give to members can be different depending on whether benefits are money purchase or not. Schemes will not have to go back and change the information they have provided before the commencement date. These Regulations also amend existing requirements to set out what information should be provided in relation to cash balance benefits.

4. Consultation

4.1 There is no requirement to consult on these Regulations as they make in relation to Northern Ireland only provision corresponding to provision contained in regulations made by the Secretary of State for Work and Pensions in relation to Great Britain.

5. Equality Impact

5.1 Proposals for the Pensions Act (Northern Ireland) 2012 were subject to a full Equality Impact Assessment. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the legislative proposals for these Regulations. As the amendments are technical in nature, the proposals would have little implication for any of the section 75

categories. In light of this, the Department has concluded that the proposals would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

6. Regulatory Impact

6.1 The impact on business, charities or voluntary bodies is beneficial. The impact on the public sector is minimal and arises from the need to ensure that members of occupational pension schemes are included in pension protection measures in respect of non money purchase benefits. A copy of the Regulatory Impact Assessment is attached as an Annex to this Explanatory Memorandum.

7. Financial Implications

7.1 None for the Department.

8. Section 24 of the Northern Ireland Act 1998

8.1 The Department has considered section 24 of the Northern Ireland Act 1998 and is satisfied that these Regulations –

(a) are not incompatible with any of the Convention rights,

(b) are not incompatible with Community law,

(c) do not discriminate against a person or class of person on the ground of religious belief or political opinion, and

(d) do not modify an enactment in breach of section 7 of the Northern Ireland Act 1998.

9. EU Implications

9.1 Not applicable.

10. Parity or Replicatory Measure

10.1 The corresponding Great Britain Regulations are the Pensions Act 2011 (Transitional, Consequential and Supplementary Provisions) Regulations 2014 (S.I. 2014/1711) which come into force immediately after section 29 of the Pensions Act 2011 comes into force. Parity of timing and substance is an integral part of the maintenance of single systems of social security, child support and pensions provided for in section 87 of the Northern Ireland Act 1998.

Annex

REGULATORY IMPACT ASSESSMENT

THE PENSIONS (2012 ACT) (CONSEQUENTIAL AND SUPPLEMENTARY PROVISIONS) REGULATIONS (NORTHERN IRELAND) 2014 AND THE PENSIONS (2012 ACT) (TRANSITIONAL, CONSEQUENTIAL AND SUPPLEMENTARY PROVISIONS) REGULATIONS (NORTHERN IRELAND) 2014

The costs and savings outlined in this Regulatory Impact Assessment are calculated on a United Kingdom-wide basis. Section 27 of the Pensions Act (Northern Ireland) 2012 makes provision for Northern Ireland analogous to section 29 of the Pensions Act 2011.

BACKGROUND

1. The definition of money purchase benefits is a key component of pensions law. The regulatory framework that protects members of occupational pension schemes is built on the understanding that money purchase benefits cannot develop a funding deficit. Consequently they are not subject to a regulatory regime in respect of funding or accrued rights in the same way as occupational non-money purchase schemes.
2. Section 27 of the Pensions Act (Northern Ireland) 2012 ("section 27") will remove any uncertainty created on 27 July 2011 by the Supreme Court judgment (*Bridge Trustees v Houldsworth and another (2011)* (*Bridge)* on the legal definition of money purchase benefits in section 176(1) of the Pension Schemes (Northern Ireland) Act 1993. It clarifies the definition of money purchase benefits and restores it to the meaning it had before *Bridge*.
3. The Regulations to be made under sections 28(1) and (2), 29(1) and 31(1) of the Pensions Act (Northern Ireland) 2012 (and other regulation making powers in pensions legislation) will provide transitional, consequential and supplementary measures or modify the effects of section 27.
4. This impact assessment covers the effects of the regulations and does not cover section 27 of the Pensions Act (Northern Ireland) 2012. An enactment impact assessment was published in 2012 and showed no new impact on business. This is because the clarified definition of money purchase benefits in section 27 restored the legal position (following the judgment of the Court of Appeal in KPMG v Aon Trust) that existed prior to the Supreme Court judgment. It is expected that section 27 will be commenced in summer 2014.
5. Section 30 of the Pensions Act (Northern Ireland) 2012 gives powers to amend the clarified definition (section 27 of the Act). There are no plans to use this power.

Issue

6. Section 27 will have retrospective effect from 1 January 1997**1** when it comes

1 This is the earliest relevant instance of money purchase pension in existing legislation

into operation. The Department for Work and Pensions ("DWP") has engaged with the industry through informal stakeholder engagement and a formal consultation on their corresponding draft Regulations. This has shown that a number of schemes have been acting in a manner not consistent with the meaning of money purchase benefits in section 27. These schemes will be affected by section 27 when it is commenced, meaning they would have to revisit past decisions and it would not be clear how they could become compliant going forward.

7. To address this issue, these Regulations provide transitional protection, including limiting the retrospective impact of section 27 in pensions legislation and providing mechanisms for schemes to become compliant.

8. These Regulations provide that affected schemes will only have to comply from the commencement date of section 27 unless the scheme is winding up on commencement, or where a multi-employer scheme is in deficit following an actuarial valuation in specified circumstances.

9. It has been difficult to establish the precise scale of this issue. Data from the Pensions Regulator shows that there are currently 40,000 occupational pension schemes in the UK containing money purchase benefits.

10. Following engagement with stakeholders DWP determined that hybrid schemes (those that provide money purchase as well as non-money purchase benefits) are most likely to be affected by section 27. Only around 2% of schemes in the UK containing money purchase benefits are hybrids - approximately 800 schemes.

11. In addition to the hybrid schemes that might be affected, the DWP is only aware of approximately half a dozen schemes that have been treated as wholly money purchase schemes, and therefore are not hybrids, but could be affected by section 27.

12. It has not been possible to quantify the exact number of affected schemes as trustees and scheme managers are only required to make detailed reports to the Pensions Regulator on benefits that they consider to be non-money purchase. Schemes do not provide detailed reports of benefits that they consider to be money purchase.

13. Stakeholders have been unable to share detailed scheme level data as this information is sensitive and restricted. A small number of consultation responses indicated the size of the scheme and the potential costs involved, however the information is not representative of all the schemes affected and cannot be reliably used to produce an aggregate estimate.

14. Despite not being able to quantify the impacts in detail stakeholders were unanimous that without transitional protection costs would arise for schemes not already compliant with section 27, especially where they would be required to revisit past decisions.

15. The protections in these Regulations will ensure that any costs schemes would face as a result of having used an understanding of money purchase benefits inconsistent with section 27 are minimised. However, some schemes have been behaving consistently with section 27 and therefore will be validated by commencement of that section, and will not be affected by these Regulations.

Policy objectives

16. There are three key policy objectives:

- **Protection for members** The Department will affirm its commitment to protect member benefits and also ensure that it continues to meet its obligations under Article 8 of the European Union's Insolvency Directive (2008/94/EC), and Articles 15 to 17 of the Directive on the activities and supervision of institutions for occupational retirement provision (2003/41/EC) to protect member benefits;
- **Minimising the burden on industry** The Regulations are intended to ease the practical burdens that schemes may face in order to comply with section 27 when it comes into operation. The purpose of the Regulations is to modify the effect of existing legislation on schemes either treated as money purchase schemes, or providing benefits treated as money purchase benefits, that will become subject to the legal framework for pension protection once section 27 is commenced;
- **Consistency with Departmental and Governmental priorities and providing clarity and certainty in the law.** Clarifying the definition of money purchase benefits in law through section 27 of Pension Act (Northern Ireland) 2012 and its effect through the Regulations ensures clarity and consistency in the existing legal framework. This is important to provide clarity and certainty on how affected occupational pension schemes transition into the regulatory requirements in both primary and secondary legislation. This is essential to minimising the burden on industry and ensuring protection for members. The measures also provide for consequential changes.

Options considered

17. Option Zero: Do nothing following commencement of section 27. This means all schemes would be required to comply with retrospective effect from 1 January 1997.

18. Option One: Use regulation making powers to modify the effects of section 27 and to make transitional, consequential and supplementary provision. This is for schemes which may have taken decisions based on different understandings of money purchase benefits to that clarified in section 27 or as understood prior to the Bridge judgment.

19. These Regulations provide transitional measures to assist affected schemes in three ways:

- retrospective protection so that schemes do not have to revisit past decisions where these have been made on a basis different to the meaning of money purchase in section 27, and there is very likely to be no detrimental material impact on member benefits;
- temporary prospective protection to give schemes a reasonable transitional period to comply with the legislative requirements in existing legislation; and
- consequential changes arising from the above.

20. The DWP consultation responses confirmed that there was no feasible

alternative to Option One to achieve the policy objectives. Commencing section 27 to protect member benefits without appropriate transitional measures could result in some schemes having to revisit past decisions to demonstrate that they are complying with section 27. In practice this would not be feasible, particularly if they had to revisit decisions going back to 1997.

Consultation

21. DWP launched a consultation on Regulations on 31 October 2013[2]. The consultation ended on 12 December 2013.

22. The consultation document asked stakeholders for their views on the proposed policy and draft regulations. It also asked for information to assist in quantifying the number of schemes affected by the proposals, and to assist with the monetisation of the costs and benefits. DWP received 95 responses.

23. Responses were received from: trustees (whose role is to represent members); industry bodies; employers; and pensions professionals (including lawyers and actuaries). Where DWP felt further information was needed in the initial stages of the consultation it approached the appropriate organisations directly. For instance, when it became apparent that there was a growing concern about the impact of the proposed changes to the employer debt regulations on employers in multi-employer schemes, DWP actively sought comment from leading employer representative bodies.

24. Over the course of consultation DWP held four stakeholder forum events, with over one hundred stakeholders in attendance. Among other issues DWP used these events to try to get a sense of likely costs arising from schemes not being compliant with the meaning of money purchase in section 27. However, stakeholders were unable to provide estimates.

25. Despite these efforts DWP is unable to quantify the impact of the Regulations on the schemes that are likely to be affected. There is no data available at an industry-wide level and the consultation did not elicit sufficient data at scheme level to allow us to produce reliable estimates of the impacts on schemes, employers or members.

26. A majority of responses (sixty eight) said that where the schemes had not acted consistently with DWP's understanding of money purchase benefits, they could incur some costs if the Regulations required them to revisit past decisions. This was assuming that such revisitations were even possible. Only two respondents took the view that it was reasonable to require schemes to revisit decisions taken after July 2011. The remaining twenty five respondents were silent on this issue.

27. Therefore, having considered the consultation responses the decision was taken to alter the retrospection proposed at the consultation stage in respect of three key areas:

    - wind-up;
    - employer debt; and
    - associated amendments in respect of Pension Protection Fund assessment periods.

2 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254445/pensions-act- transitional-and-consequential-regs-2014-consultation.pdf

28. At the consultation stage the draft Regulations modified the effect of section 27 on legislation in respect of dates before July 2011 in these three key areas for non-compliant schemes. This meant that these schemes may have had to revisit decisions taken since that date.

29. Following consultation, the Regulations will modify the effect of section 27 up to the commencement date except in certain circumstances where a scheme is in wind-up. Affected schemes will not have to revisit decisions made prior to that date, unless:

    - they have started to wind up before commencement; or
    - have put member benefits at risk in prescribed circumstances and;
    - where the sponsoring employer is not insolvent.

30. DWP took into account the strongly expressed views of those in the industry. Having carefully considered these responses, DWP was persuaded that this change to the policy will not appreciably increase risk to members' entitlement or make any material difference to members' pension outcomes, given the protections put in place through these Regulations.

31. There was no support during the consultation for Option Zero.

Final proposal

32. The Regulations provide that, in most cases, section 27 will only come into operation with prospective effect unless the scheme has benefits which are not directly affected by section 27 on commencement.

33. The legislative requirements around employer debt will not apply retrospectively unless the scheme is in wind-up on commencement in limited prescribed circumstances.

34. The employer debt requirements will also not apply retrospectively to an ongoing multi-employer scheme, unless an employer debt event occurred before the commencement date, and at the first actuarial valuation after this date the scheme is under-funded and not able to put in place a recovery plan within a specified time.

35. In both cases, the scheme must have provided benefits which are not directly affected by the commencement of section 27. That means that the scheme provided benefits which are not money purchase benefits and the benefits do not fall within the exemptions for cash balance benefits, underpin benefits, top-up benefits, or pensions in payment derived from these benefits or money purchase benefits.

36. For most schemes that have begun winding up prior to the coming into operation date, the employer debt provisions are entirely disapplied in relation to the exempt benefits where schemes have treated these benefits as money purchase.

37. These schemes will therefore not have to revisit decisions made before section 27 is commenced, regardless of whether or not they made decisions consistent with the meaning of money purchase benefit in section 27.

38. At the same time, member benefits most at risk from schemes in winding-up will be protected. For compliant schemes, the commencement of section 27

with retrospective effect to January 1997 will validate their actions and the Regulations do not change that.

39. The Regulations provide transitional measures for non-compliant schemes to ease them into the regulatory requirements in certain areas like scheme funding and the Pension Protection Fund levy, while at the same time ensuring member benefits will be protected.

Rationale for the final stage proposal

40. To support members, trustees, scheme managers and employers, the Regulations will:

    - provide that affected schemes will not be required to revisit acts or omissions in respect of scheme funding, wind-up, employer debt, revaluation and indexation or in respect of any requirement specified under pensions legislation prior to the coming into operation date for section 27. This protection applies to benefit types where the Department recognises that schemes could reasonably have interpreted the existing meaning of money purchase benefits in law in a way inconsistent with section 27, and that interpretation does not materially impact on members' entitlement to benefits under the scheme**;**
    - give schemes time and mechanisms through which to come into compliance with section 27; and
    - make permanent amendments prospectively to the pensions regulatory framework. These changes are de-regulatory.

41. This ensures schemes do not incur unnecessary practical costs where there is no appreciable benefit to members or risk to members' entitlement.

42. The Regulations will ensure that members of schemes affected by section 27 will, over a transitional period, have access to pension protection. It will also ensure that trustees, scheme managers, members and employers have certainty as to how the law applies to their scheme.

Costs and benefits of final stage proposal Monetised and non-monetised costs and benefits

43. As previously discussed there is insufficient information available to accurately estimate the number of schemes affected by these regulations. There are approximately 40,000 private occupational pension schemes in the UK which include money purchase benefits. About 2% of these are hybrid schemes.

44. This is the principal type of scheme affected by section 27. DWP is only aware of half a dozen schemes that regard themselves as wholly money purchase and could be affected. Therefore, taking both hybrid and wholly money purchase schemes, at most section 27 and the Regulations are likely to affect around 2% of all occupational pensions schemes (about 800).

45. The small proportion of all occupational pension schemes affected by section 27 could incur disproportionate administrative, legal and actuarial costs if they are required to revisit past decisions.

46. Prior to consultation DWP commissioned additional questions in the Pensions Regulator annual survey to gather information on the numbers of schemes that may be affected. DWP also engaged with the wider pensions industry in an effort to more accurately determine the number of non-compliant and compliant schemes potentially affected by section 27.

47. The consultation sought further information to enable some quantification of costs and benefits, but insufficient information was forthcoming. Two respondents did provide some scheme level data but taken in isolation it is not sufficient to allow impacts to be extrapolated across the industry.

48. Many respondents represented multiple pension schemes but were unable or unwilling to say how many would be affected or to specify the amount of costs likely to be incurred by non-compliant schemes in complying with section 27.

Impacts on schemes

49. Based on engagement with the industry prior to consultation, DWP believed that only two specific benefit designs (cash balance benefits, and scheme pensions derived from cash balance benefits or money purchase benefits) would be likely to be affected by section 27.

50. However the consultation identified other benefit designs that might also be affected. As a consequence, the scope of the transitional measures was widened. This is to ensure that benefit designs commonly called underpin benefits and top-up benefits, as well as pensions derived from cash balance benefits, will also be able to use the transitional measures in the regulations.

51. Other ongoing schemes can access these protections if their assets are equal to or greater than their liabilities, or if they agree a recovery plan with the Pensions Regulator.

52. The Department recognises that only a small proportion of all schemes with money purchase benefits will be affected by section 27. However, it also accepts that the impact of revisiting past decisions since July 2011 for individual schemes could be significant, while the impact on member benefits would be negligible. Therefore the impact of the Regulations would be to lift costs that would otherwise be significant to some schemes.

Impacts on scheme members

53. Theoretically in some cases where a scheme has used an interpretation of money purchase benefits incompatible with section 27 a member might have received less benefit than they would otherwise have done. However, two factors mean the Department does not believe this is likely to occur in practice.

54. First, all administrative, legal or actuarial costs that schemes face are ultimately paid for by the scheme members (in the form of reduced benefit value) or employers (in the form of increased contributions) depending on the scheme rules. Therefore even if revisiting past decisions could potentially benefit individual members the costs of doing so could fall across all members. Following consultation with the industry, DWP was persuaded that members would not appreciably benefit from revisitation.

55. Secondly, in many of the policy areas, it would not be practical because

schemes no longer hold the necessary data or there has been a subsequent restructuring, dissolution or insolvency of a relevant employer.

56. If the existing decisions cannot in practice be amended then there is no realistic prospect of anyone benefiting from a requirement for schemes to revisit past decisions.

57. Prospectively, the Regulations will give schemes with benefits affected by section 27 a transitional period in which to become compliant, while ensuring that members are not excluded from pension protection measures.

58. Benefits that are already recognised by their trustees or scheme managers as non-money purchase will not be affected by commencement of section 27, and therefore the Regulations will have no impact on them.

Summaries of policy areas

59. The Regulations will impact on a number of existing policy areas and the legal framework for pension schemes. Each of these policy areas is addressed separately below.

60. Section 27 will apply to both occupational pension schemes and personal pension schemes. The former are sponsored by an employer and are typically trust-based, while the latter take the form of arrangements between a pension provider and individual, which may or may not be work-based.

61. No consequences to existing legislation (other than in relation to disclosure requirements) affecting personal pension schemes resulting from the commencement of section 27 have been identified, and therefore there are no transitional provisions for them.

Policy area/legal framework for pension schemes	**Does this policy provide temporary support?**	**Does this policy make a permanent change to the pensions landscape?**
Winding Up		
Employer Debt		
Revaluation		**X**
Indexation	**X**	
Preservation		**X**
Transfers		**X**
Scheme Surpluses	**X**	
Scheme Administration	**X**	
Pension Protection Fund Levy	**X**	
Pension Protection Fund Compensation		**X**
Internal Annuities/ AVCs	**X**	
Scheme Funding	**X**	
Financial Assistance Scheme (FAS)	**X**	
Equality		**X**
Pension Sharing on Divorce	**X**	
Cross-Border Schemes	**X**	
Disclosure	**X**	**X**
Underpins and Top-Up benefits	**X**	**X**
Contracted-out Protected Rights	**X**	
Scheme Modifications		
Schedules of Payment	**X**	**X**

***NB**: All policy areas provide retrospective protection so that schemes do not have to revisit decisions made before the commencement date of the Regulations and section 27, except in limited prescribed circumstances for schemes in winding-up on this date. This protection is available to schemes that have used a definition of money purchase benefits that is inconsistent with the amendment that will be made by section 27 to section 176(1) of the Pension Schemes (Northern Ireland) Act 1993.

Impacts of Regulations on schemes and employers

Winding up

62. Occupational pension schemes complete wind-up when all assets and liabilities are discharged or transferred to a separate scheme. Winding-up may be triggered by the sponsoring employer's insolvency. If the scheme assets are insufficient to fund all the benefits under the scheme, then the scheme must wind up in accordance with Article 73 of the Pensions (Northern Ireland) Order 1995, which sets the priority order by which the liabilities must be discharged.

63. Article 73 only applies to non-money purchase schemes. If a scheme with only money purchase benefits somehow becomes under-funded there is no statutory priority order which applies, as, until the Bridge judgment, it was not possible for a money purchase scheme to become under-funded except where there was fraud or error.

Impacts

64. The Department recognises that where schemes in wind-up have made decisions on a basis incompatible with section 27, revisiting these decisions will give rise to costs. For schemes that have in effect completed winding-up, it will be practically impossible.

65. In its consultation DWP proposed that schemes should have to revisit winding-up decisions made between 27 July 2011 and the coming into operation date, where those decisions were incompatible with section 27. DWP believed this was necessary to protect members, and proportionate, since it had made its intention to introduce retrospective legislation clear in its statement on 27 July 2011. It was also noted that this practice is not uncommon when foreshadowing the introduction of retrospective changes to pensions legislation.

66. Following consultation, it was accepted that members would not appreciably benefit from retrospection, except in the limited circumstances where a scheme is winding up on commencement and benefits are underfunded. All but one respondent believed that protection was not necessary. Having carefully considered submissions and representations, DWP was persuaded that the statement in July 2011 had the desired effect of giving the many schemes that had been compliant with the understanding of the meaning of money purchase benefits assurance that legislation would be introduced to validate their actions. This means that they did not need to revisit past decisions or rearrange existing arrangements. DWP is fully aware that the statement did not have the force of law and that was never its intention.

67. DWP also recognised that it would not necessarily have been sufficient in law for schemes to rely on the statement when making winding-up decisions between July 2011 and the commencement date. This is particularly the case where section 27 would have changed the way trustees treated benefits provided by the scheme. Although one scheme was able to reconcile DWP's statement with the prevailing law, most respondents, including professional advisers, believed this was not generally possible.

68. The Regulations therefore modify the retrospective application of winding up legislation so that wind-ups that commenced before the coming into operation date are not required to be reopened, unless the winding up is underway at commencement in limited prescribed circumstances. These are where benefits are not and have never been affected by section 27, but trustees have nevertheless treated the benefits as money purchase not in compliance with the existing definition of money purchase benefits in section 176(1) of the Pension Schemes (Northern Ireland) Act 1993.

69. Overall the measures here present a nil cost to schemes because past decisions will not need to be revised. However, cost could arise in the following circumstances: a scheme is still winding up on commencement; or there is a risk to member entitlement because the scheme is not able to fund the benefits provided under the scheme that fall outside the current definition of money purchase benefit.

70. The only other class of member who could benefit from requiring schemes to revisit past winding up decisions are non-money purchase members who have taken early retirement. Even these members could only benefit where the amount of money available increases to a level above the Pension Protection Fund minimum, but below their full entitlement.

71. Some employers in relation to multi-employer schemes that began winding up prior to the coming into operation date and on a basis incompatible with section 27, could conceivably benefit from the scheme having to go back and revisit earlier decisions. However, we have no way of quantifying this benefit or even knowing if there are any employers in this position as none have come forward.

Deficiencies in assets (employer debt)

72. An employer debt can be triggered by the insolvency of an employer participating in a pension scheme or by the scheme commencing a wind-up. This can also happen when an employer stops employing active members in a multi-employer scheme and at least one other employer continues to employ active members.

Impacts

73. Transitional regulations will modify the retrospective application of the employer debt legislation where schemes are newly affected by section 27.

74. The Regulations provide that, in most cases, section 27 will only come into operation with prospective effect. The legislative requirements around employer debt will not apply retrospectively except in two limited cases where the scheme has benefits which are not directly affected by section 27 on commencement.

75. The first case is where a scheme has been treated as a money purchase scheme and falls within either one of two categories.

76. Category one is where the scheme is winding up on the commencement date. After this date the trustees must secure a valuation of the scheme's assets and liabilities under regulation 5 of the Occupational Pension Schemes (Employer

Debt) Regulations (Northern Ireland) 2005[3] ("regulation 5").

77. Where this valuation reveals a deficit in the scheme, a debt is due on the employer under Article 75 of the Pensions (Northern Ireland) Order 1995 unless the employer is insolvent, the scheme enters the Pension Protection Fund assessment period, or there is a voluntary wind-up of the employer.

78. Category two is where an employer debt event occurred before the commencement date in a scheme that is an ongoing scheme. Here, after commencement the trustees must secure a valuation of the scheme's assets and liabilities under regulation 5, and where this shows a deficit, an Article 75 debt is due on the employer who triggered the employer debt event unless the employer is insolvent.

79. However, trustees are not required to undertake the valuation under regulation 5 if this scheme is able to meet the statutory funding objective at the first valuation after commencement, or is able to put in place a recovery plan within a specified time.

80. In this first case, the scheme must have provided benefits which are not directly affected by section 27 on commencement i.e. benefits that are not money purchase benefits, death benefits, cash balance benefits, or pensions in payment derived either from cash balance benefits or money purchase benefits.

81. The second case is where a scheme is not a money purchase scheme but as with the first case provides benefits which are not directly affected by section 27 on commencement as set out above.

82. If an Article 75 debt was due on the employer before the commencement date, then trustees will be required to secure a valuation of the scheme's assets and liabilities under regulation 5 after this date.

83. Where this valuation shows the scheme is in deficit, the trustees must impose an Article 75 debt on the employer unless the scheme is able to meet the statutory funding objective at the first actuarial valuation after commencement or to put in place a recovery plan within a specified time.

84. For most schemes that have begun winding up prior to the coming into operation date the employer debt provisions are entirely disapplied in relation to the exempt benefits, where schemes have treated these benefits as money purchase benefits.

85. These transitional measures should be regarded as a cost saving provision for schemes, which would otherwise have to revisit decisions as far back as 1997. In light of the feedback from trustees and employers during DWP's consultation it was accepted that in all cases, with the exceptions of the circumstances set out above, the costs of schemes having to revisit decisions of this nature could be high with no benefit to members. This kind of revisitation may not be possible at all.

86. It was also accepted that any deficit arising from a past debt being calculated incompatibly with section 27 in an ongoing scheme would be small relative to the assets of the scheme. These would be absorbed by the remaining employers, who consultation responses indicate are willing to accept additional liabilities in the next scheme funding cycle, so there would be no loss to members.

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3 S.R. 2005 No. 168

87. As with winding up, DWP's consultation proposed that affected schemes should be required to revisit past employer debt determinations between 27 July 2011 and the commencement date. DWP believed that it was reasonable to expect schemes to have behaved compatibly with section 27 after 27 July 2011 because DWP issued a statement on that day setting out the Government's intention to make retrospective legislation to clarify the definition.

88. Following consultation, DWP acknowledged that neither this statement, nor the clarified definition in section 27, which was enacted but not commenced in November 2011, was necessarily sufficient for schemes to rely on. This is particularly the case if they had never been compliant in the first place. DWP accepted that the industry could not be absolutely sure of the form that the commenced definition of money purchase benefits would take, because of the power to amend the definition by regulation in section 30 of the Act. In the event this has not been done.

89. In the course of its consultation DWP contacted employer representative organisations, including the British Chamber of Commerce and Business in the Community, and did not received representations disputing that this is a reasonable solution.

Revaluation

90. Where a member has left a scheme prior to normal pension age, schemes are required to revalue many deferred benefits relative to inflation when the member reaches that age. For non-money purchase schemes, this is generally done by reference to the annual Revaluation Order or in accordance with the scheme rules, if these are more generous. However, average salary and flat rate benefits relating to deferred members may be revalued on the same basis as that used to revalue the benefits of active members. In the case of money purchase benefits, the member must receive any investment income growth on the preserved fund that he would have received if he had still been an active member.

91. With the commencement of section 27, there may be schemes which have revalued benefits in a way incompatible with the new definition. Schemes could face administrative costs if they were obliged to revisit calculations made prior to the commencement of section 27.

92. It is appreciated that the detail of the final salary, average salary and money purchase methods of revaluation do not apply neatly to many cash balance schemes. A new cash balance method of revaluation, available for all eligible future accruals, will give trustees and scheme managers an alternative to the default final salary method with the Revaluation Order. This new method (actually an extension of the flat rate method), is based on the same principles as the money purchase and average salary methods, that active and deferred members should be treated in the same way.

93. Prior to its consultation DWP did not have evidence of any schemes in this situation but understood that they existed. The DWP consultation document published on 31 October 2013 therefore asked for evidence from trustees. Responses indicate that there are schemes that have been revaluing benefits in a way that is not compatible with section 27, but no firm details of the number of either schemes or members affected could be established.

94. Going forward, the provision of a revaluation method specifically for cash balance schemes will give trustees and scheme managers of those schemes a clear, easy-to-administer option for the revaluation of future accruals.

95. Few consultation responses commented on this aspect. Those that did indicated that affected schemes would have to identify accruals before and after the commencement of the change separately.

> "Records will need to show the split of benefit accrual, although we would not anticipate this creating much effort"

(Pensions consultants)

96. The Department believes that this would mainly apply to schemes which had previously been revaluing by the default Revaluation Order method and would consequently have little impact as this revaluation method already has different requirements for different periods of accrual.

97. Every consultation response which commented on the revaluation proposals agreed that schemes should not be required to revisit benefits which had already been revalued. Although no figures were given, all respondents agreed it would be difficult, time consuming and expensive to attempt to do so.

> "It would be costly to revisit past calculations….for each pensioner".
>
> "Cost are difficult to quantify and will depend on the numbers of members involved so could be significant in a large schemes and in any case material to smaller schemes. Practical issues would involve having to change member records and explain the changes to the member…"

(Pension administrator)

98. The provisions which allow trustees and scheme managers to use the money purchase method in relation to periods before the commencement of section 27 will avoid the need for trustees and scheme managers to undertake complex and possibly costly reviews of benefits already in payment. It will also avoid having to seek costly legal advice at the expense of scheme funds for little or no discernible benefit to affected members.

Indexation

99. Indexation is the amount by which a pension in payment is increased each year to take into account the effect of inflation. Schemes are required to increase non-money purchase benefits accrued after 1997 by a minimum of Limited Price Indexation.

100. Money purchase benefits have not been subject to indexation requirements since 2005. Pensions resulting from cash balance benefits are required, where the pension came into payment prior to the 3 January 2012, to be

indexed to at least Limited Price Indexation[4].

101. The effect of commencement of section 27 on affected benefits would not be clear in the absence of consequential modifications of the indexation requirements. In some circumstances it would impose an indexation requirement on incomes in payment, the terms of which would have already been agreed between the member and the scheme or annuity provider. To add indexation to such benefits would mean revisiting and unpicking that decision at additional cost, with no discernible benefit to the member.

102. It remains unclear how many schemes and members may be affected if schemes had to revisit benefits in payment. It is, however, unlikely to be very many as very few advisors and lawyers admitted to being aware of one or more schemes. Only one pension scheme admitted to providing un-indexed benefits in a manner not compatible with section 27. Around 80 per cent. of over 3,500 members in this scheme who chose scheme pensions would be affected as well as an unknown number who opted for external annuities.

103. The Regulations will ensure that the statutory minimum indexation requirements do not apply, going forward, to any scheme pensions derived from funds which were either money purchase or cash balance benefits in the accrual phase, and which are not required to be indexed under the rules of the scheme or under a statutory requirement.

104. Further transitional arrangements will ensure that there is no impact on the indexation rate of any existing pensions in payment. Where a pension in payment derived from cash balance benefits came into payment prior to 3 January 2012 and was not subject to indexation, the transitional measures will allow the pension to be continued to be paid at a flat rate after the commencement of section 27.

105. This will benefit schemes, which will not have to revisit the terms of existing agreements and meet the associated administrative costs.

106. All responses to DWP's consultation agreed that pensions in payment should not be revisited. The responses are definite that attempting to revisit and recalculate pensions in payment would be difficult, time consuming and expensive. They were unclear on whether external annuities could be amended or whether the scheme (and sponsoring employer) would end up paying for the indexation.

> "There would … be considerable time spent in recalculating the [scheme pensions] manually and correcting them, together with informing the member what has happened."

(Pensions scheme)

Preservation

107. Legislation provides a level of benefit protection to a member of an occupational pension scheme who has accrued benefit but leaves before the

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4 Limited Price Indexation requires that, once in payment, pensions accrued between 1997 and 2005 must be increased by inflation capped at 5 per cent per annum. For pensions accrued from 2005 onwards, the figure is inflation capped at 2.5 per cent per annum

normal pension age of that scheme. This is referred to as preservation.

108. Commencing section 27 will create technical inconsistencies between section 70 of the Pension Schemes (Northern Ireland) Act 1993 and the Occupational Pension Schemes (Preservation of Benefit) Regulations (Northern Ireland) 1991 ("the Preservation Regulations") by suggesting that a benefit which meets certain criteria could still be a money purchase benefit, whereas section 27 means it should be a non-money purchase benefit.

109. The Regulations omit regulation 14 and substitute regulation 14A of the Preservation Regulations on commencement of the transitional arrangements for section 27. The new regulation 14A sets out how short term benefits should be calculated.

110. This will benefit trustees and scheme managers who had faced uncertainty as to the effect of the Preservation Regulations. This does not give rise to costs nor affect member benefits in a material way.

111. DWP consultation responses did not produce any concerns or evidence about the impact on schemes.

Transfers

112. A member of a pension scheme can transfer the value of their pension to another scheme or an insurance provider in the accumulation phase subject to certain conditions. For money purchase benefits the transfer amount is the current cash value of the fund.

113. For non-money purchase benefits, other than cash balance benefits, schemes take account of the projected preserved pension that would be payable at the scheme's normal retirement age and the value of the fund needed to provide that pension. For all non-money purchase benefits, the transfer value may reflect any deficit within the overall fund.

Impacts

114. A new provision will enable the transfer value of non-money purchase benefits which are cash balance benefits to be calculated at the current value of the fund. This will include any notional interest, guarantees, bonuses or discretionary payments but subject to an adjustment if the scheme is underfunded. This will make it easier for schemes affected by section 27 to calculate the transfer values of these benefits and explain it to members. This is a permanent change to pensions legislation and not a time-limited transitional provision.

115. It is necessary to make it clear that the transfer value of money purchase benefits cannot be reduced to reflect scheme underfunding, but that transfer values for non-money purchase benefits, which can become underfunded, may be reduced proportionately to scheme underfunding in that category of benefits.

116. To do anything different might mean that a member's transfer value could be determined to be higher than the underlying assets. This would impact

detrimentally on the scheme's funding position. Therefore this measure is beneficial to schemes as it increases their stability and protects their funding level for the benefit of all members.

117. Revisiting past transfers between schemes would be practically very difficult.

118. It is theoretically possible that there would be some distributional impact between schemes if their transfer value was revisited. However, the Department believes that the administrative costs associated with this would be disproportionate.

119. Responses to DWP's consultation unanimously agreed with this position, although few provided any specific figures.

> "It is impractical to unwind past transfers. Data may not be available for transfers going back 17 years and there will be disproportionate and substantial costs involved…."

(Pension lawyers)

Scheme surpluses

120. Payments of surplus funds from an occupational pension scheme can be made to an employer, providing that the conditions in Article 37 of the Pensions (Northern Ireland) Order 1995 and the Occupational Pension Schemes (Payments to Employer) Regulations (Northern Ireland) 2006 are met.

121. The conditions for withdrawing surpluses from a scheme are different for non-money purchase schemes than those for a money purchase scheme.

122. Where any of the schemes affected by section 27 have made surplus payments to an employer before the coming into operation of these Regulations, these transactions will not be subject to Article 37 of the Pensions (Northern Ireland) Order 1995 and the associated regulations. This ensures that scheme assets and the interests of members are protected.

123. The Regulations provide that a valuation made on the basis that affected benefits were money purchase benefits, cannot be used to support any future payment to employers after the Regulations come into operation. If the trustees or managers of the scheme want to make a payment of surplus funds to the employer beyond that date, they must obtain a new actuarial valuation of assets and liabilities.

Impacts

124. If there is an intention to make a surplus payment after the Regulations have come into operation, the scheme would need to ensure that any actuarial valuation used to do so reflects the non-money purchase nature of the scheme's benefits. However, this merely reflects the requirement for any non-money purchase scheme and is not an additional cost.

125. Overall this is a potentially cost saving measure for schemes, which would otherwise be required to bear the cost of revisiting and unpicking past surplus

payments, which may have been made to employers no longer associated with the scheme.

Scheme Administration

126. Article 47 of the Pensions (Northern Ireland) Order 1995 requires occupational pension schemes to appoint an actuary. However, money purchase schemes are exempted from this requirement by regulation 3(2) (a) of the Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997.

Impacts

127. When section 27 comes into operation affected schemes that had been considered to be money purchase and will now be treated as non-money purchase, could be in breach of the requirement in Article 47 of the Pensions (Northern Ireland) Order 1995, without transitional protection.

128. The Regulations therefore makes transitional provisions so that these schemes will be treated as if they were money purchase schemes, in relation to periods before the coming into operation date. Schemes will also not be required to appoint an actuary until three months after the coming into operation of these Regulations.

129. If a scheme affected by section 27 at the appointed day becomes wholly money purchase by buying out its non-money purchase benefits within three months of the coming into operation date, it will not be required to appoint or re- appoint an actuary under Article 47 of the Pensions (Northern Ireland) Order 1995 if it has no benefits which are money purchase at that time.

130. Without this “period of grace” schemes would incur the cost of having to appoint an actuary immediately, which might not be possible given the need of the trustees to complete a selection process and ensure they are getting value for money.

Pension Protection Levy

131. Article 158 of the Pensions (Northern Ireland) Order 2005 requires the Board of the Pension Protection Fund to impose an annual levy on occupational pension schemes with members who may be eligible to receive compensation.

Impacts

132. Transitional regulations under sections 28, 29 and 31 of the Pensions Act (Northern Ireland) 2012 will be used to modify the retrospective application of the levy requirements. This will ensure that trustees of any of the schemes affected by section 27 do not have to revisit past valuations on which the levy is based. This should be seen as a cost saving for schemes because they will not need to construct historic valuations (which trustees would be required to do without the regulations covered in this impact assessment).

133. Any of the schemes that become eligible when section 27 comes into operation will be treated as ineligible for any period before 1 April 2015. This will allow time for trustees and managers to make arrangements to comply with the requirements of the Pension Protection Fund.

134. For hybrid schemes already paying the levy on non-money purchase benefits, modifying the effect of section 27 will save the cost of revisiting past valuations.

135. Levy bills take account of scheme assets and liabilities and revisiting them in respect of benefits previously treated as money purchase could result in over and underpayments. The practical implications of such a task would be complex and costly for schemes and the Pension Protection Fund, and would not benefit other levy payers.

Pension Compensation

136. At present legislation on how the Pension Protection Fund pays pension compensation is primarily based on the scheme having promised the member an income in retirement.

137. Where the scheme has offered a guarantee on a lump sum to the member, for example using a guaranteed minimum investment return, there is no income stream. On retirement the member would normally take the lump sum and convert it into an income stream either on the open market, or through a mechanism provided by the scheme itself.

138. The Pension Protection Fund is currently able to pay compensation to members of cash balance schemes which guarantee the amount of a lump sum under the compensation provisions for such schemes. However there is no provision for other non-money purchase lump sums.

Impacts

139. These Regulations will clarify the process by which a non-money purchase lump sum is converted to periodic compensation in the future. By applying standard actuarial factors to the lump sum it can be turned into an income. This will then be regarded as the protected pension rate, to which compensation arrangements can be applied.

140. This will provide members who have a guarantee on a lump sum whose schemes enter the Pension Protection Fund with a mechanism through which they can be paid compensation.

141. This does not give rise to administrative costs for either schemes or members since it merely provides a method for the Pension Protection Fund to take in the rights and to pay compensation. This will apply from the commencement of section 27.

Internal annuities from additional voluntary contributions

142. Some schemes offer members the option of making money purchase

additional voluntary contributions alongside their defined benefit pension, and on retirement using these to take a pension from the scheme funds rather than buying a pension from an external provider. Such benefits will not be money purchase once actuarial factors are applied to the accumulated fund to convert it to an income stream in the form of an internal annuity. In the past such internal annuities may have been treated as money purchase benefits for pension protection purposes.

143. At present, if the scheme entered the Pension Protection Fund the member would receive compensation for the salary related pension scheme and separately an external annuity purchased by the scheme in place of the internal annuity they were receiving from scheme funds. On commencement of section 27 the internal annuity will not meet the definition of money purchase benefits, so the compensation would be calculated on the combined total of their salary related pension and internal annuity.

144. For members who have not yet reached normal scheme retirement age and have not taken early retirement on medical grounds, an age related cap is applied and compensation is paid at 90 per cent. This means that a few members who retire early could receive significantly less benefit without protection from these Regulations.

Impacts

145. For scheme members in receipt of an internal annuity at commencement of section 27 and for members whose additional voluntary contributions come into payment within a limited period after commencement, transitional arrangements will allow such benefits to continue to be treated as money purchase benefits. As such the trustees or managers of the scheme could discharge them from scheme funds should the scheme enter a Pension Protection Fund assessment period.

146. Members with internal annuities bought with additional voluntary contributions and which are in payment at the coming into operation date will benefit if their scheme winds up or enters the Pension Protection Fund, as their pension payment in respect of the annuity will not be reduced.

147. Where a scheme winds up outside the Pension Protection Fund, treating internal annuities as money purchase benefits and discharging in full will reduce the scheme assets available to meet non-money purchase benefits with a lower priority. This could potentially reduce non-money purchase benefits for scheme members to a minimum level of pension compensation that would have been paid by the Pension Protection Fund.

148. Internal annuities would also be treated as money purchase benefits for the purposes of the priority order in Article 73 of the Pensions (Northern Ireland) Order 1995 if the scheme winds up outside the Pension Protection Fund. This means that the member will continue to receive the full amount of their annuity, without it being potentially reduced in line with Pension Protection Fund compensation rules.

149. This protection will also be extended to scheme members who use money purchase additional voluntary contributions to purchase an annuity within

twelve months of the coming into operation of section 27.

150. This approach allows time for members who are making additional voluntary contributions to be made aware that if they choose an internal annuity in the future, their benefit will be not be treated as money purchase from that point for pension protection purposes.

Scheme funding

151. Trustees of schemes containing non-money purchase benefits must obtain regular actuarial valuations. If a funding deficit is identified, a recovery plan must be prepared, setting out how the deficit will be dealt with.

152. Past scheme funding valuations in line with the clarified definition will be validated by the commencement of section 27, but without suitable transitional arrangements, valuations which used an incompatible definition may need to be revisited and potentially unpicked.

Impacts

153. These Regulations will be used to modify the retrospective application of the scheme funding provisions. This should be seen as a cost saving for schemes because historic valuations will not need to be revisited, or undertaken where they had not previously been deemed necessary.

154. Schemes will still have to carry out prospective valuations using the definition in section 27. This will not reduce member protection as, where trustees or scheme managers believed affected benefits were money purchase, matching assets and liabilities relating to those benefits should have been set aside.

155. However, liabilities in hybrid schemes for non-money purchase benefits accrued in relation to periods of pensionable service will be required to be taken into account for the purposes of prospective valuations from the commencement date in accordance with Part 4 of the Pensions (Northern Ireland) Order 2005. This is regardless of whether they were accrued before or after the commencement of section 27. This will apply where a scheme contains benefits which are covered by section 27, but which have been treated as money purchase benefits in previous valuations.

156. Schemes which will no longer be recognised as wholly money purchase once section 27 is in operation will be required to obtain an initial actuarial valuation. This will be with reference to an effective date not later than one year from the date of commencement of section 27. This is a position analogous to a newly created scheme. Engagement with the industry and the Pensions Regulator suggests that there will not be many schemes in this position.

157. Prospectively these schemes will still have to meet the requirements associated with being non-money purchase. However, regulations will lift the need for them to undertake retrospective funding valuations. These Regulations will therefore benefit schemes which would otherwise have to take action to revisit past decisions once section 27 is commenced.

Equality

158. The Occupational Pension Schemes (Equal Treatment) Regulations (Northern Ireland) 1995 supplement the requirements for equal treatment in Articles 62 to 66 of the Pensions (Northern Ireland) Order 1995. Regulation 15 allows the use of actuarial factors which differ for men and women in relation to the calculation of employers' contributions in certain circumstances, and the provision of certain benefits.

Impacts

159. Regulation 15 will be amended to give certainty that schemes which apply different actuarial factors for men and women when converting money purchase benefits to a rate of scheme pension will continue to be able to do so.

160. This will not give rise to any costs.

Pension sharing (on divorce)

161. The value of pension rights are included as part of the couple's assets on divorce or dissolution of a civil partnership, for the purpose of calculating a financial settlement. Options include either sharing the value of the pension or offsetting the value. If pension sharing is chosen, the pension rights are valued a second time, immediately before the pension sharing order is implemented.

162. Pension sharing on divorce legislation is mainly contained in the Welfare Reform and Pensions (Northern Ireland) Order 1999 and associated regulations.

Impacts

163. Money purchase and non-money purchase pensions are valued in different ways. If a scheme valued the rights by the money purchase method but then, after the commencement of section 27, had to value the rights by the non-money purchase method, complexity and confusion could arise. This could lead to an administrative burden on the few schemes that could find themselves in this situation.

164. Transitional regulations made under section 27 of the Pensions Act (Northern Ireland) 2012 will ensure that, where a scheme is in the process of valuing pension rights or implementing a pension sharing order, the scheme can continue using the same valuation method, rather than switch during the implementation process. Schemes will also not have to revisit valuations or pension sharing which has already taken place.

165. These provisions will benefit schemes which have provided valuations or are in the process of valuing pension rights in respect of a member's divorce. They will not be required to undertake a costly revision of valuations which

have already taken place or are in progress.

166. Theoretically some members/former spouses would benefit from revisiting decisions already taken, while other members/former spouses would lose out to an equal degree.

167. Consultation responses were again unanimous that valuations and pension sharing which had already taken place should not be revisited. Respondents also supported the position that pension sharing valuations or implementations commenced but not completed before the Regulations come into operation, should continue using the original methodology.

Cross-border schemes

168. Cross-border schemes must be authorised by the Pensions Regulator to receive contributions from a European employer. Different authorisation requirements apply to money purchase benefits as opposed to non-money purchase benefits. If a scheme has regarded itself as wholly money purchase but contains benefits affected by section 27, the authorisation will be invalidated.

169. The Department has therefore included provision in the Regulations to enable an existing authorisation on a money purchase basis to remain valid for a period of a year, during which period affected schemes would need to have re- applied on the non-money purchase basis.

Impacts

170. After DWP's consultation the Department is not aware of any cross-border schemes that will be required to re-apply for authorisation. However, in order to ensure that any schemes which might be in this position are not in breach of the legislation on cross-border schemes, the Department believes that the provisions in the Regulations should be retained.

171. If there are any affected schemes, they will be required to provide an actuarial valuation within a year of the date of the further application.

172. These measures would represent a cost saving to schemes since they would have a year to come into compliance with section 27, including re-applying for authorisation as hybrid schemes if appropriate.

173. Ultimately, there will be additional administration and actual cost in ensuring that affected schemes, if any, are correctly authorised, for example, the requirement to provide annual valuations. The scheme would also be subject to the wider legislative requirements for a non-money purchase scheme, such as scheme funding and the Pension Protection Fund levy. However, these requirements are in line with the existing requirements for any non-money purchase cross-border scheme.

Disclosure

174. The Occupational and Personal Pension Schemes (Disclosure of

Information) Regulations (Northern Ireland) 2014 ("the Disclosure Regulations") set out the information which must be disclosed in certain situations; to whom the information must be disclosed; the timescales for doing so, and the manner in which the information should be provided.

175. Some disclosure requirements currently apply only to money purchase benefits, while others apply only to non-money purchase benefits.

176. The policy intention here is that the distinction should be drawn between:

- pensions that in accumulation principally comprise a defined set of assets, even if they are also subject to other factors such as a guaranteed rate of return; and
- pensions that, in accumulation are defined in terms of a defined income in retirement.

This is because different types of information are useful to members in respect of each of these benefits. The Regulations will amend the Disclosure Regulations to reflect this distinction as appropriate.

177. When a member approaches retirement the Department would want to ensure that schemes are required to disclose the right to the Open Market Option (to buy an annuity from an insurance provider) and provide the relevant information to those members who have that right. The right to the Open Market Option is contained in the Finance Act 2004 and is not amended or affected by bringing into effect section 27. These Regulations will amend the Disclosure Regulations to reflect the Finance Act 2004 definition, and require that members approaching retirement be given information on the Open Market Option.

Impacts

178. This will benefit members who will receive the appropriate information in respect of their benefit entitlements.

179. The Department expects that the few affected schemes, being hybrid schemes, will already be using both types of disclosure and therefore will not face additional costs arising as they move to the correct type following the coming into operation of section 27.

Underpins and top-up benefits

180. Many pension schemes offer an "underpin" benefit, where the scheme rules provide for the member to receive a money purchase benefit only if its value exceeds the value of a specified non-money purchase benefit.

181. Schemes have also treated certain top-up arrangements in a similar way, for example where a benefit is calculated by taking the difference between a money purchase benefit and a pre-set amount.

182. Underpin and top-up benefits were not considered by the Supreme Court in the Bridge case but there is an argument that the definition of money purchase benefit in section 27 impacts on these types of arrangements.

Impacts

183. DWP's consultation brought to light that some schemes have been treating these types of benefits as money purchase. If the Regulations do not cover these types of benefits, on commencement of section 27 schemes would have to look retrospectively at decisions that they have made from January 1997.

184. DWP received a number of consultation responses that detailed concerns that it would be a considerable cost to the industry if this type of benefit was not considered within the transitional arrangements.

185. Taking these and other responses into consideration, it was decided that if provision was not made to include underpin and top-up benefits within the scope of the transitional legislation (in a situation where a defined benefit guarantee bites), schemes would have to revisit decisions, or at least seek professional advice. Either of these actions could give rise to significant costs and likely in practice prove to be almost impossible to do as asserted by respondents.

186. Transitional provisions will validate actions of trustees who have treated underpin and top-up arrangements, as described above, as money purchase benefits.

187. The Department's provision in this area will therefore represent a cost saving for schemes and employers with no discernable impact, based on available information, on members' entitlement.

188. Where schemes have benefits that fall into the definition for underpins in Article 73 of the Pensions (Northern Ireland) Order 1995, as modified by regulation 13 of the Occupational Pension Schemes (Winding Up) Regulations (Northern Ireland) 1996, the current provision will apply.

189. The transitional provisions will replicate the application of the current legislation to money purchase underpin benefits and money purchase benefits which are subject to a "top-up arrangement", with no additional impacts on schemes.

Contracted-Out Protected Rights

190. Contracting-out has provided an alternative to the state additional pension. People have been able to contract out of the state additional pension provided certain conditions are met.

191. Until 6 April 2012, contracting-out was permitted for occupational pension schemes on a money purchase (also known as defined contribution ("DC")) basis, and is still permitted on a salary-related (also known as defined benefit) basis.

192. In a contracted-out DC occupational pension scheme, the employer and employees paid a reduced rate of National Insurance contributions and Her Majesty's Revenue and Customs made an annual age-related payment into the scheme. The amount of an individual's pension fund derived from this

rebate, its investment return and any tax relief on the rebate were known as “protected rights”.

193. There are certain restrictions that applied to the protected rights, including that they should be money purchase benefits.

194. In 2005 an independent Pensions Commission set up by the Government recommended abolishing contracting-out for pension schemes which contracted out on a DC basis. The Commission found that contracting-out rules on defined contributions were too complex and poorly understood, and that it was increasingly difficult for individuals to determine whether it was better to contract-out or remain in the state additional pension.

195. The Government accepted the Commission’s recommendations, resulting in the abolition of contracting-out on a DC basis from 6 April 2012, although the rebates for the period up to this date could continue to be paid in certain circumstances.

196. There were no provisions in DWP’s consultation draft of the Regulations on contracted-out protected rights. However, responses to the consultation on the Regulations has revealed that some defined benefit schemes contracting-out on a DC basis held these protected rights as cash balance benefits or money purchase underpin benefits. Schemes considered these benefits to be money purchase benefits.

197. Under section 27, cash balance benefits or a defined benefit (in relation to a money purchase underpin benefit) would be non-money purchase benefits. Schemes with these arrangements could therefore be in breach of the requirement in section 27 of the Pension Schemes (Northern Ireland) Act 1993 that protected rights should be money purchase benefits.

Impacts

198. Whilst acknowledging that schemes operating in this manner were in breach of section 27 of the Pension Schemes (Northern Ireland) Act 1993, the Department recognises that requiring schemes to unpick all decisions that were based on the understanding that benefits of this type were money purchase would impose significant burdens on schemes. Without any transitional provisions in these Regulations, schemes would be required to revisit actions taken since 1 January 1997, the date from which section 27 of the Pensions Act (Northern Ireland) 2012 will apply. Based on the information received in DWP’s consultation, the Department understands that of the 40,000 schemes in the UK with some money purchase elements very few could find themselves in this situation.

199. Aside from the administrative task of revisiting decisions and the cost of potentially having to seek professional advice, the Department understands that in some cases schemes would be hard pressed to isolate these benefits.

200. The Department therefore proposes to validate the treatment of these arrangements as money purchase benefits from 1 January 1997, by applying transitional protection to allow these types of benefits to satisfy the requirements for protected rights, both before the appointed day, and for limited purposes after the appointed day.

201. These provisions will represent a cost saving for schemes and employers with no associated impact for members, in terms of assets being depleted in having to revisit decisions taken by the scheme.

Scheme modifications

202. The rules which govern changes to rights or entitlements are detailed in Article 67 of the Pensions (Northern Ireland) Order 1995. During the course of DWP's consultation on the proposals, stakeholders advised that there could be schemes which have inadvertently changed their benefits from non-money purchase to money purchase, for example by removing a guarantee from a cash balance scheme. The change would have been made in accordance with their interpretation of the law in force at the time.

Impacts

203. The few schemes whose benefits have been re-classified from non-money purchase to money purchase as a consequence of section 27, may not, therefore have secured member consent as required by the scheme modification rules.

204. To avoid unnecessary burdens for these schemes in unpicking decisions in the past, transitional arrangements will deem the requirements of Article 67 of the Pensions (Northern Ireland) Order 1995 to have been satisfied where the actuarial equivalence requirements were met before such a scheme modification before the appointed day took effect.

205. The Regulations protect schemes from the administrative burden and cost of a requirement to revisit decisions taken prior to the commencement of section 27 and the coming into operation of these Regulations.

206. A provision preventing a scheme from modifying benefit structure so as to remove a defined benefit guarantee, at a time when a member is entitled to money purchase benefits, has also been put in place to meet concerns raised in DWP's consultation.

Schedules of payment

207. Trustees or scheme managers of occupational pension schemes offering money purchase benefits must prepare and maintain a schedule of payments. For schemes offering non-money purchase benefits a schedule of contributions must be prepared which has to be actuarially certified.

208. Any of the few schemes that had previously classified themselves as entirely money purchase, but which will change their classification to having non-money purchase benefits under section 27, will no longer have to prepare a schedule of payments, but will have to prepare a schedule of contributions.

Impacts

209. Without transitional provision an affected scheme would be in breach of its

obligations as soon as section 27 is commenced.

210. The Department is therefore proposing that the schedule of payments for an affected scheme will continue to be in force with full effect until the trustees or managers prepare the scheme's first schedule of contributions under Article 206 of the Pensions (Northern Ireland) Order 2005.

211. The transitional provisions for scheme funding in the Regulations require a scheme to prepare the first schedule of contributions within 15 months of the effective date, which must be a date that is not more than one year after the commencement of section 27.

212. By providing schemes with 15 months to secure their schedule of contributions the Department is allowing them a cost saving easement. It is not expected that anyone would benefit from requiring schemes to prepare their schedule more quickly than this, or from invalidating past schedules.

Risks and Assumptions

213. Although the Pensions Regulator reports that only 2% of the 40,000 private occupational pension schemes in the UK which include money purchase benefits are hybrid schemes, the Department has no way of knowing how many, if any, of these will be affected by commencement of section 27 of the Pensions Act (Northern Ireland) 2012. Only schemes which have been acting inconsistently with the definition of money purchase benefits set out in section 27 will be affected. Therefore it is likely that less than 2% of all occupation pension schemes containing money purchase benefits will be affected. These assumptions remain intact following DWP's consultation.

IMPACT TESTS

Competition

1. There are no implications for competition policy.

Small firms

2. There are no specific impacts on small firms. These proposals apply to all sizes of business and micro-businesses are not exempted. However, in practice, micro-businesses will not be involved in the administration of pension schemes. For occupational schemes, pension scheme administration will be contracted out to large third-party providers upon whom the impacts of these proposals would fall.

Legal aid

3. There are no implications for legal aid.

Sustainable development, carbon assessment, other environmental impact

4. There are no implications.

Health

5. There are no implications for health.

Human rights

6. There are no implications for human rights.

Rural proofing

7. There are no implications for policy on rural issues.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed for the Department for Social Development



Anne McCleary
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