

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES
**(POWER TO AMEND SCHEMES TO REFLECT ABOLITION OF CONTRACTING-
OUT) REGULATIONS (NORTHERN IRELAND) 2015**

S.R. 2015 No. 372

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 24(5) and 51(6) of, and paragraphs 2(3) and (4), 4, 6, 10(1), 12, 13 and 14(1) and (2) of Schedule 14 to, the Pensions Act (Northern Ireland) 2015 and is subject to the negative resolution procedure.

2. Purpose

- 2.1 These Regulations enable private sector employers that sponsor salary related occupational pension schemes, subject to certain restrictions, to amend their scheme rules to reflect the abolition of contracting-out when the new State Pension is introduced in April 2016. They also set out how the actuary appointed by the employer must certify that the amendments proposed by the employer do not go beyond the limits to the changes an employer can make.

3. Background

- 3.1 Introduction of the new State Pension will abolish the additional pension for those reaching pensionable age after the start date on 6th April 2016. The Pensions Act (Northern Ireland) 2015 (“the Act”) therefore, includes provision for the ending of the option for sponsoring employers of salary related occupational pension schemes to contract their employees out of the additional pension. Under contracting-out, both employer and employee paid reduced rate National Insurance contributions (known as “the National Insurance rebate”). The National Insurance rebate will end from 6th April 2016.
- 3.2 The Act includes provision to enable employers to amend their pension schemes to take account of the increase in employer’s National Insurance contributions due to the abolition of contracting-out – the “statutory override”. Section 24 of the Act includes provision for this power not to apply to a member who is a protected person in relation to a scheme, as defined in regulations.
- 3.3 Schemes may be amended to increase employee contributions or alter the future accrual of benefits, or both. However, the extent to which the scheme rules may be amended using the power is limited to the amount needed to recoup the increase in the sponsoring employer’s National Insurance contributions due to the abolition of contracting-out.

3.4 The Regulations set out the detail of how the power may be used, in particular how an actuary is to calculate and certify that the value of the proposed amendments is not greater than the increase in the employer's National Insurance contributions. In summary, the Regulations –

- define who is a “protected person in relation to a scheme”. These are employees in former nationalised industries, such as the electricity industry, who were given certain promises at the time of privatisation and in relation to whom the legislation enacted at the time of privatisation continues to have effect;
- define what is meant by certain terms, for example, the “total annual employee contributions of the relevant members” and specify how the actuary is to calculate amounts;
- set out what earnings data should be used in the calculations and further requirements for how the actuary is to carry out the calculations, and for the use of other data and actuarial methods and assumptions when making the calculations;
- provide that when an employer is using the power to make scheme amendments on a second or subsequent occasion the calculation date must be the same as the original calculation date;
- restrict the type of amendments that may be made, for example, an employer may not make an amendment that would take the power to determine any matter away from the trustees or managers of the scheme;
- describe the category of person who may act as the actuary appointed by the employer and set out what the actuary must certify before any proposed amendments may take effect;
- set out the information that must be included in the certificate that the actuary must provide to the trustees or managers and sponsoring employer or principal employer in a multi-employer scheme;
- require the trustees or managers of a scheme to provide any information requested by the sponsoring employer or principal employer in connection with the use of the power;
- modify certain provisions of the Act and the Regulations as they apply to multi-employer schemes. In respect of sections of a multi-employer scheme that have a single sponsoring employer, each section is to be treated as a separate scheme and each employer may make amendments. In schemes not segregated, or sections of schemes which have more than one employer, the principal employer in relation to the scheme or section may make amendments;

- provide that the employer or principal employer must consult with the scheme trustees or managers about an appropriate date for the amendments to take effect and, after consultation, notify them of the amendment date. No amendments made using the power can take effect before 6th April 2016 when contracting-out for salary related occupational pension schemes is due to be abolished.

4. Consultation

- 4.1 There is no requirement to consult on these Regulations. 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) 2015 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. They are technical in nature and have little implication for any of the section 75 categories. The Department has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

6. Regulatory Impact

- 6.1 These Regulations do not impose any direct costs on employers. The use of the power is at the discretion of the employer. If employers chose to use the power there will be associated costs. There is no impact on the public sector as the power to amend scheme rules is only available to employers who sponsor a private sector scheme. A 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 Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations 2015 (S.I. 2015/118) which came into force on 6th April 2015.

REGULATORY IMPACT ASSESSMENT

THE OCCUPATIONAL PENSION SCHEMES (POWER TO AMEND SCHEMES TO REFLECT ABOLITION OF CONTRACTING-OUT) REGULATIONS (NORTHERN IRELAND) 2015

The costs and savings outlined in this Regulatory Impact Assessment are calculated on a United Kingdom-wide basis.

Background

The State pension system currently

1. There are two parts to the current state pension. The basic State Pension is a flat rate pension and full entitlement is gained by building up 30 qualifying years of National Insurance contributions (NICs) or credits. There is also an earnings-related component of state pension provision known as the additional state pension (AP) – the main component of AP is the State Second Pension (S2P) (formerly State Earnings Related Pension Scheme (SERPS) before 2002).

Problem under consideration

Abolition of contracting-out through DB schemes

2. Employers who sponsor a defined benefit (DB) scheme that meets the requirements pay lower NI and so do members. With the introduction of a new State Pension, there will be no AP. As a consequence, contracting-out AP will come to an end for DB schemes.
3. From 6 April 2016, employees who are contracted-out when the new State Pension is introduced will be automatically brought back into the full state scheme. Both employers and employees will stop paying a lower rate of NI and instead pay the same rate of NI as all other employers and employees. The impact of the abolition of contracting-out on employee NICs is considered on pages 15-17 of the updated Impact Assessment document published by the Department for Work and Pensions (DWP) in July 2014. More detailed information, including impact on employer NICs is available in Chapter 5 of the Impact Assessment which accompanied Royal Assent of the Pensions Act 2014.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332996/single-tier-pension-impact-assessment-update-july-2014.pdf

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/311316/pensions-act-ia-annex-a-single-tier-state-pension.pdf

Employer amendment power

4. Many organisations who responded to the government's consultation on state pension reform, "*A State Pension for the 21st Century*" (the Green Paper), highlighted the significant implications that ending contracting-out for DB schemes would have for sponsoring employers, schemes and employees. The Pensions Bill 2015 contains provisions to grant sponsoring employers an amending power by allowing them to alter the terms of their DB schemes without trustee consent to recoup the cost of the additional NICs which will result from the end of contracting-out.
5. The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations (Northern Ireland) 2015 set out the detail of how the employer amendment power may be used and in particular, the calculations that actuaries will be required to make, how they should make them and what certification will be required. This Impact Assessment focuses on the costs and benefits associated with the provision of the amending power for employers.

Consultation

6. DWP consulted on two sets of regulations from 8 May to 2 July 2014 that support the abolition of DB contracting-out schemes:
 - The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations; and
 - The Occupational Pension Schemes (Schemes that were Contracted-out) Regulations.

The feedback has been summarised in the response to the consultation.

<https://www.gov.uk/government/consultations/occupational-pension-schemes-abolition-of-defined-benefit-contracting-out>

Rationale for intervention

7. The rationale for intervention is to ensure that the sustainability of DB schemes is not undermined, by giving a way if needed to ease the burdens on employers who will no longer receive the NI rebate.

Policy objective

8. The policy objective for an amending power is to ensure that the sustainability of DB schemes is not undermined by giving employers the option to offset the

loss of the NI rebate. It gives employers, if all else fails one way to amend their scheme rules to reflect the loss of NI rebate.

Description of options considered

Option 1: Do nothing

9. In this instance the do nothing option relates to doing the minimum needed to achieve the abolition of contracting-out without the provision of the employer amendment power. This option would depend on whether an employer could continue to run their scheme and adjust for the loss of the NI rebate.
10. Employers have asked for an option to mitigate the impact of the loss of the NI rebate. In the absence of an amending power employers might have to bear the cost of the loss of the NI rebate while maintaining the same occupational scheme benefits. Some employers are limited in their ability to modify scheme structure, for example, members with protected person status in legislation. In many cases scheme rules can only be changed by the trustees or with trustees' consent. As changes resulting from the abolition of contracting out are likely to be detrimental to members' workplace pension income, it is possible that trustees may not consent to them. Without the employer amendment power some employers may be more likely to close their scheme.

Option 2: Provide an employer amendment power for sponsoring employers from 2016 to mitigate the loss of the NI rebate

11. Introducing an amending power ensures that the vast majority of employers have a range of options available to them to mitigate the loss of the NI rebate.
12. Section 24(2) of the Pensions Bill 2015 gives employers a limited power to amend scheme rules for this purpose without trustee consent. This power enables employers to make an adjustment to future pension benefits or contribution rates to offset the end of the NI rebate. The new power will be allowed to be used more than once so employers can phase in changes if they choose. However, any scheme changes must be certified by an actuary as "recouping no more than" the employers loss of the NI rebate before proposed changes under the employer amendment power can be implemented. The amending power will only be available for 5 years after 6 April 2016.

Preferred option

13. The preferred option is option 2, to introduce an employer amendment power for private sector sponsoring employers as in the Pensions Act (Northern Ireland) 2015.

Monetised and non-monetised costs and benefits

14. The impact of the abolition of contracting-out on employee and employer NICs is considered in chapter 5 of “*The single-tier pension: a simple foundation for saving*” Impact Assessment:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/311316/pensions-act-ia-annex-a-single-tier-state-pension.pdf

15. This Impact Assessment focuses on the costs and benefits associated with the provision of the employer amendment power.
16. According to the Occupational Pension Schemes Survey (OPSS) 2013, (ONS)¹, there are currently 1.3 million active members² of contracted-out DB schemes in the private sector (see Table 1). There has been a decline in the number of active members of contracted-out DB schemes in the private sector from 2.4 million in 2008³ to 1.3 million in 2013, this reflects the wider decline in DB schemes in the private sector⁴. In 2012 there were 2,500 contracted-out DB schemes in the private sector.

Table 1: Number of active members of contracted-out DB schemes in the private sector, 2008-2013

Year	Private Sector membership
2008	2.4
2009	2.1
2010	1.8
2011	1.7
2012	1.4
2013	1.3

Source: OPSS data

Note: Totals may not sum due to rounding

¹ <http://www.ons.gov.uk/ons/rel/fi/occupational-pension-schemes-survey/2013/index.html>

² Active members are those that continue to accrue new pension rights in a scheme.

³ Historic figures from Contracting Out of Private Sector DB Schemes 2012 derived using OPSS data.

http://www.ons.gov.uk/ons/dcp171766_352604.pdf

⁴ See for example “*Pensions: Challenges and Choices, -The First Report of the Pensions Commission*”, 2004.

Table 2: Number of contracted-out DB schemes, by size of membership in private sector in 2012

Membership size	Private Sector
5000+	160
1,000-4,999	320
100-999	1,390
12-99	620
2-11	--
Total	2,500

Source: OPSS data 2011 and 2012

Note: Totals may not sum due to rounding

Data from table 2 showing the number of private sector occupational schemes with only one section: by size and route to contracting-out. Only contracting-out Salary Related Schemes are included here and “—” indicates cells that have been suppressed to protect confidentiality

17. In April 2016, when the new State Pension is implemented and contracting-out is abolished, all employees who were members of a contracted-out scheme immediately before implementation will cease to receive the ‘NI rebate’ and will start to pay standard NICs, bringing them into line with the rate of NI that is paid by other employees.

Costs to private sector employers (option 2)

18. Many stakeholders indicated that employers thought it unreasonable that they had to bear the cost of paying higher NICs whilst maintaining the same scheme benefits. They therefore wished to reduce the level to which they must fund their scheme by the same amount as the loss of the NI rebate, reflecting the fact that employees would be brought back fully into the state pension system when contracting-out ends. This could be done by reducing future pension benefits or increasing employee contribution rates to their pension schemes or a combination of the two.
19. The Occupational Pension Schemes (Power to Amend Schemes to Reflect Abolition of Contracting-out) Regulations (Northern Ireland) 2015 do not impose any direct cost on employers. They set out the detail as to how employers may use the amending power. The use of the power is at the discretion of the employer. It is important to note that if employers choose to amend their scheme rules then there will be professional and administrative costs associated with making amendments, regardless of whether they use the amending power to effect that change. The amending power enables employers to make changes without trustee consent.
20. It is not known with any certainty the proportion of private sector employers sponsoring a contracted-out DB scheme that will use the employer amendment power. As noted in the White Paper, “*The single-tier pension: a simple foundation for saving*”, many employers have indicated a strong appetite for a mechanism to mitigate the impact of the end of contracting-out. For the purposes of the calculations presented here it is assumed that all schemes would use the amending power. This is in line with the assumption

made in the single-tier Impact Assessment that employers would pass on the costs of the lost NI rebate to their employees immediately and in full by increasing employee contribution rates to their pension schemes, reducing future pension scheme benefits or a combination of both.

21. If employers choose to use the amending power to change their scheme rules there will be professional fees (legal and actuarial costs), administration costs and communication costs. These costs represent costs to changing their scheme and are voluntary and not imposed directly as a result of the regulations. Industry sources have advised that the costs associated with using the amending power will vary depending on whether employers choose to change contribution rates or change future pension benefits. An increase in contribution rates is likely to be less complex and therefore cheaper to implement, whereas a change to future benefits is likely to be more complex to implement and therefore more costly.
22. Industry experts have suggested that if the change is relatively straightforward and a simple consultation exercise is undertaken, a large scheme (1000 plus members) may spend around £100,000 changing their scheme rules using the employer amendment power, a medium sized scheme (100-999 members) may spend around £50,000 and a small scheme around £20,000 (fewer than 100 members). If all private sector contracted-out schemes used the amending power the estimated cost of changing scheme rules would be around £130m in 2014/15 prices in 2016/17 (Table 3). These costs represent the costs associated with making voluntary changes to scheme rules to mitigate the impact of the NI increase and are not directly imposed as a result of the employer amendment power.

Table 3: Estimated transitional costs of using the employer amendment power (2014/15 prices)

Scheme Size	Number of Schemes	Estimated Cost per scheme £m	Estimated Cost £m
5000+	160	0.1	16
1000 to 4999	320	0.1	32
100 to 999	1,390	0.05	70
Below 100	620	0.02	12
Total	2,500	-	130

Source: DWP calculations and the Occupational Pensions Scheme Survey 2012

23. These estimates assume that the amending power is used only once and employers reduce their costs by the required amount first time. There is no information on how many times an employer would use the powers, but the expectation is that employers will seek to minimise cost and use the power once only.
24. DWP received a number of responses to the consultation question about the estimates of the cost per scheme of using the employer amendment power:

these costs ranged from the low thousands of pounds to £1.5 million; these costs could be reduced if linked to a triennial valuation. Given the level of uncertainty about the estimates of the cost per scheme and a number of organisations who were not able to provide an estimate, it was decided to keep the initial estimate of the cost per scheme of using the amending power.

25. Although there is a cost to employers of using the amending power it is a voluntary decision made by the employer to mitigate the ending of the NI rebate. Any costs incurred by the sponsoring employer in using the amending power would be in the expectation that these would be outweighed by the longer-term benefits of making these changes. As a consequence, it is estimated that the benefits to employers if they all use the amending power, will be greater than the £130m estimated cost of implementing the changes required to scheme rules. The exact level of benefits will depend on what changes employers make to their scheme: they are limited to the maximum changes they make, but some may choose to make changes which do not fully reflect the loss of the NI rebate.
26. If not all schemes use the employer amendment power then the costs and benefits would be lower, but as the amending power is voluntary, it would still be expected that the benefits would outweigh the costs. For example, some employers may not use the amending power if there are positive but relatively modest (and uncertain) net returns from using it or if they have reached agreement with the trustees to how the scheme may be amended.

Protected Persons

27. There is a small group of individuals (approximately 70,000) employed in some formerly nationalised industries (including electricity, nuclear waste and decommissioning), where the employers and trustees are limited in their ability to change scheme rules by legislation made during privatisation. This legislation prevents employers from making changes to the pension benefits offered to those employees who were previously employed by the State.
28. The regulations define a “protected person in relation to a scheme” and provide that employers should not be allowed to use the amending power to alter the pension schemes in relation to members with protected person status on the amendment date or later (i.e. when the changes made by the employer take effect). There is no reliable information to robustly quantify this impact; therefore no allowance has been taken for protected persons in the calculations presented here.
29. Further details on protected persons can be found in the government’s response to the protected persons consultation and in the supporting Impact Assessment:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/278979/government-response-protected-persons-consultation.pdf

Risks and Assumptions

30. The main assumptions used in the estimates are:
- all private sector employers sponsoring contracted-out DB schemes will use the amending power; this implies that the full cost of the loss of the rebate is passed on immediately to employees in the private sector;
 - the costs associated with using the amending power to change scheme rules without trustee consent are £100,000 for schemes with greater than 1000 members; £50,000 for schemes with 999-100 members; and £20,000 for schemes with fewer than 100 members, based on information provided confidentially by the industry;
 - the costs associated with using the amending power occur in 2016/17.
31. There is uncertainty around the estimates of the one-off cost of using the employer amendment power. This is because it is not known with any certainty what proportion of employers sponsoring contracted-out DB schemes will in fact use the amending power. In addition there are also uncertainties around the costs associated with using the amending power which will be influenced by whether employers increase contributions or change future benefits. The estimate of the costs associated with using the amending power is based on Occupational Pension Scheme Survey (OPSS) data about the number of contracted-out private sector DB schemes and the size of these schemes. Data on scheme numbers is weaker than other OPSS estimates as the survey is designed primarily to measure membership numbers. It is also assumed that the amending power is used only once. The expectation is that employers will seek to minimise cost by using the amending power once.
32. The estimate of the costs of using the amending power to change scheme rules without trustee consent should be interpreted with caution given the uncertainties outlined above. Nevertheless, as use of the employer amendment power is voluntary, employers choosing to use the amending power to change their scheme rules without trustee consent are likely to do so in the expectation that the longer-term benefits will outweigh the short-run costs associated with changing scheme rules.

Small and Micro Business Assessment

33. The majority of contracted-out DB schemes are large and medium-sized. However, it is recognised that some small and micro businesses will be affected by the ending of DB contracting-out. The availability of the amending power will ensure that the vast majority of private sector employers, of any size, have a range of options to mitigate the impact of the loss of the NI rebate.

Rationale and evidence that justify the level of analysis

34. All costings and numbers are on a UK-wide basis. The statistics used in this assessment have been provided by the Department for Work and Pensions and the Occupational Pension Schemes Survey 2012.

Other Impacts

Equality

35. Proposals for the Pensions Bill 2015 were subject to a full Equality Impact Assessment and the regulations are in consequence of the Bill. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the proposals for the regulations and considers that the regulations do not have any additional implication for equality of opportunity.

Environmental

36. There are no implications.

Rural proofing

37. There are no implications.

Health

38. There are no implications.

Human rights

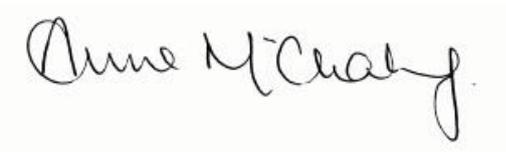
39. The Department considers that the regulations are compliant with the Human Rights Act 1998.

Competition

40. There are no implications.

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

Signed for the Department for Social Development

A handwritten signature in black ink, reading "Anne McCleary". The signature is written in a cursive style and is centered within a light gray rectangular box.

Anne McCleary
Director of Social Security Policy and Legislation

19 June 2015

Contact points: Alan O'Hagan, Social Security Policy and Legislation Division,
Level 1, James House, 2-4 Cromac Avenue, Gasworks Business Park,
Ormeau Road, BELFAST BT7 2JA

Tel: 028 9081 9123

E-mail: alan.ohagan@dsdni.gov.uk