EXPLANATORY MEMORANDUM TO THE TRANSFER OF EMPLOYMENT (PENSION PROTECTION) REGULATIONS

2005 No. 649

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 Section 257 of the Pensions Act 2004 defines the qualifying conditions that employees must satisfy to be eligible for employer pension provision following a business transfer. Section 258 of the Pensions Act 2004 provides the options that the transferee employer must offer these employees. These comprise membership of a non money purchase occupational scheme (Defined Benefit) which must meet either the Reference Scheme Test or such alternative requirements that may be prescribed, or membership of either a money purchase occupational pension scheme (Defined Contribution) or a stakeholder pension scheme where the employer makes relevant contributions.

2.2 The Transfer of Employment (Pension Protection) Regulations 2005 prescribe the alternative requirements for a non money purchase (DB) occupational pension arrangement. They also provide the level and detail of relevant contributions to be made to a money purchase (DC) occupational or stakeholder pension arrangement which the new employer may offer.

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

3.1 There are no matters of special interest.

4. Legislative Background

4.1 European Council Directive 77/187/EEC, implemented into UK law by the Transfer of Undertaking (Protection of Employment) Regulations 1981 (commonly referred to as TUPE), prescribes that EU member states safeguard employees’ terms and conditions of employment when a business transfer occurs, on a like for like basis.

4.2 This Directive however, specifically excluded the right to old age, invalidity or survivors’ benefits under an occupational pension scheme. TUPE Regulations do not therefore make provision for ongoing occupational pension provision following the transfer.

4.3 Directives 98/50/EC and 2001/23/EC update and consolidate the transfer provisions and removed the occupational pension exclusion if member states otherwise provide.

4.4 The Pensions Act 2004 now provides protection for those employees who have access to occupational pension provision prior to a TUPE transfer.

4.5 Section 257 of the Pensions Act 2004 prescribes the qualifying conditions that must be satisfied for an employee to qualify for ongoing employer pension provision.

4.6 Section 258 prescribes the pension provision that the new employer must offer these qualifying employees. This is membership of either:
a non money purchase (DB) occupational pension scheme which meets the existing Reference Scheme Test or prescribed alternatives, or
a money purchase (DC) occupational pension scheme or stakeholder scheme to which the employer makes prescribed contributions.

4.7 This instrument is the first use of the powers under section 258 of the Pensions Act 2004 and is being made in order to provide alternative requirements for a DB pension arrangement and specify the contribution requirements for a DC or stakeholder pension arrangement.

5. Extent

5.1 This instrument applies to Great Britain

6. European Convention on Human Rights

Not applicable

7. Policy background

7.1 The policy objective is to ensure that all employees who had access to occupational pension provision with employer contributions prior to a business transfer are afforded an acceptable standard of employer pension provision following the transfer.

7.2 Section 102 of the Local Government Act 2003 sets out the requirements for the protection of pension provision for Local Authority employees where there is a business transfer. Employees in the wider public sector have their occupational pension provision protected to some degree following a business transfer within the guidelines set out in Annex A of the Cabinet Office Statement of Practice. There is currently no occupational pension protection for employees in the private sector when the business transfers. The Pensions Act 2004 provides the legislative protection for the private sector and will underpin the wider public sector good practice guidance where necessary. This provision is therefore politically important.

7.3 The provisions in the Pensions Act do not mirror the TUPE Regulations in that they do not require the new employer to provide the same pension provision as that of the old employer unlike all other terms and conditions of employment.

7.4 The provisions in the Act require that where the new employer wishes to offer a non money purchase occupational scheme (DB) it must meet the Reference Scheme Test (RST), which actuaries are familiar with and is currently only applied to contracted out pension schemes or *alternative prescribed requirements.* Where the employer wishes to offer a money purchase occupational scheme (DC) or a stakeholder pension scheme the employer must make *prescribed contributions*.

7.5 The Transfer of Employment (Pension Protection) Regulations provide the detail of the *alternative requirements* for non money purchase occupational schemes. The alternative requirements include:

7.5.1 Where the new employer wishes to offer a non money purchase scheme, final salary or a hybrid scheme such as a cash balance arrangement, then the scheme must provide benefits worth at least the equivalent in present value of six per cent of a member's pensionable pay, excluding member's own contributions, for each member. The employee will not be required to contribute more than of 6% of pensionable pay.

7.5.2 Where the new employer has a mixed benefit scheme, where the non money purchase (DB) arrangement is no longer available and the employer wishes to offer transferred employees membership of the money purchase arrangement then the employer must match the employee's contributions up to 6 per cent of pensionable pay each time that remuneration is paid. This provision requires that the scheme is treated as if it were a money purchase scheme and is therefore afforded a similar requirement.

7.6 Where the scheme offered is an occupational money purchase (DC) or stakeholder arrangement it will be up to the employee to decide on the amount of contributions which the employer will then be required to match, up to a 6 per cent prescribed maximum. The contribution will be attributed to the pension arrangement each time remuneration is made by the employer and will be calculated on pensionable pay defined as basic pay for this purpose. Employers and employees may agree any improvements to the basic pay definition. Additionally either party can contribute more than the 6 per cent at their own discretion.

7.7 Statistics show that there are between 150,000 to 180,000 employees who transfer each year. Around 19,000 of these employees transfer to an employer who does not offer pension provision. Analysts consider that around 14,000 of these would take up employer pension provision if that provision were offered. Currently there is no requirement for an employer to provide pension provision when there is a business transfer, although some employers will provide a level of provision as part of good business practice.

7.8 Throughout the passage of the Act there was full consultation with employers, pension experts, employers' representatives and employee representatives and the proposals were widely available to the general public. Public consultation has taken place on the Regulatory proposals with individuals, employers, union organisations, pension lawyers and pension scheme actuaries providing comment. Consideration was given to the comments raised and the necessary amendments made. A number of comments received suggested that the provision was either too high or too low. The regulatory proposals set out have however been generally accepted. The provisions have been widely welcomed by industry.

8. Impact

8.1 As published in the Regulatory Impact Assessment, the cost to employers for the proposals for pension protection on transfer of employment was estimated to be around £5m and as with many other estimated costs and savings, this may have significant risks attached to it. This is the estimated cost of employers' pension contributions. The administrative cost of setting up a pension scheme has not been explicitly calculated, however. In the simplest case where a Stakeholder or defined contribution scheme is set up the employer's administrative cost is likely to be minimal in comparison to the contribution costs. If the employer sets up a defined benefit or hybrid scheme, administrative costs are likely to be higher. Actual costs to employers may be lower or higher (possibly up to around £10 – 15m under plausible assumptions). A range was not presented in the RIA.

8.2 There is unlikely to be any impact on the public sector.

9. Contact

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