

**EXPLANATORY MEMORANDUM TO THE
STATUTORY MATERNITY PAY (GENERAL) (AMENDMENT)
REGULATIONS**

2005 No. 729

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

2. Description

2.1 These regulations amend regulations 21(7) and 21B of the Statutory Maternity Pay (General) Regulations 1986 (SI 1986/1960). They are necessary to implement a judgement of the European Court of Justice. The amendments ensure that the employer will re-calculate Statutory Maternity Pay if a woman is awarded a pay rise (or would have been awarded a pay rise had she not been on maternity leave) which takes effect at any time between the start of the period used to calculate her SMP (the relevant period) and the end of her maternity leave. SMP must also be re-calculated to reflect pay rises taking effect before the start of the relevant period but where the earnings used in the calculation had not, at the time of the calculation, been adjusted to reflect that pay rise.

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

3.1 None.

4. Legislative background

4.1 On 30 March 2004 the European Court of Justice (ECJ) gave its judgement in the case of M K Alabaster-v-Woolwich PLC and the Secretary of State for Social Security (ECJ reference C-147/02). The ECJ said that where a woman's maternity pay is determined

"on the basis of pay she earned before her maternity leave began, any pay rise awarded between the beginning of the period covered by the reference pay [the period used to calculate her maternity pay] and the end of the maternity leave must be included in the elements of pay taken into account in calculating the amount of such [maternity] pay."

4.2 In the UK most pregnant working women get Statutory Maternity Pay from their employer as pay and therefore the rules of the statutory scheme are affected by the judgement. Sections 164 to 171 of the Social Security Contributions and Benefits Act 1992 (the Act) contain the primary legislation governing the SMP scheme. The Statutory Maternity Pay (General) Regulations 1986 contain the detail.

4.3 Access to the SMP scheme depends in part on the level of a woman's normal weekly earnings which are calculated in accordance with regulation 21(relevant power section 171(6) of the Act). This calculation also determines the weekly amount of SMP she receives. The regulations currently provide that her earnings are calculated using payments actually made to her in a specified period. Where a backdated pay rise is awarded which effects earnings already paid in that specified period, then the employer must re-calculate SMP taking account of the pay rise which, had it been paid on time, would have been paid in the specified period.

4.4 If such a recalculation results in SMP entitlement for the first time, then the employer will only be liable to pay SMP to the extent that any sum exceeds Maternity Allowance paid by the Department for Work and Pensions (regulation 21B, relevant power section 164(9)(a)).

4.5 The requirement to recalculate because of an award of a backdated pay rise was introduced in 1996 following an earlier ECJ decision in "Gillespie" (ECJ reference C-342/93). The latest ECJ judgement in "Alabaster" clarifies that earlier judgement.

4.6 The Amendment Regulations, effective from 6 April 2005, implement the latest ECJ judgement to ensure that the employer recalculates a woman's SMP entitlement (or potential entitlement) to reflect any pay rise that the woman would have received but for her maternity leave and that is effective at any time between the start of the period used to calculate her SMP and the end of her maternity leave. As now the amendment regulations will ensure, in the event of SMP becoming due for the first time, that the employer should only pay SMP to the extent that it exceeds Maternity Allowance paid.

4.7 The Statutory Maternity Pay (General) Amendment Regulations 2005 (the Amendment Regulations) are subject to the negative procedure. They have been considered by the Social Security Advisory Committee in accordance with section 172(1) of the Social Security Administration Act 1992. The Committee has agreed that the proposals should not be referred to it. The regulations must also have the concurrence of the Commissioners of Inland Revenue under section 171(7) of the Contributions and Benefits Act 1992.

5. Extent

5.1 This instrument applies to Great Britain.

5.2 Northern Ireland will implement regulations to mirror this change.

6. European Convention on Human Rights

6.1 Not applicable.

7. Policy Background

7.1 Around 300,000 pregnant working woman a year receive Statutory Maternity Pay from their employer and it is therefore the main maternity payment made to women to help them take time off work on maternity leave. One of the two qualifying conditions for SMP is that a woman's normal weekly earnings must be at or above the Lower Earnings Limit for National Insurance contributions (£79 a week currently). If this condition is satisfied, SMP is payable at 90% of the woman's normal weekly earnings (no upper limit) for the first 6 weeks of the 26 week Maternity Pay Period and then the lower of that 90% rate or a standard rate (currently £102.80) for the remaining 20 weeks.

7.2 A woman's normal weekly earnings are calculated using payments actually made to her in a specified period. Generally speaking, this period is the 8 weeks immediately preceding the 14th week before the expected week of childbirth (defined in regulations as the "relevant period" and roughly equating to the 4th to 6th month of a woman's pregnancy). If a backdated pay rise effects earnings already paid in that period, then the SMP calculation must be re-calculated.

7.3 The purpose of the 8 week calculation period is to arrive at as fair a reflection as possible of a woman's earnings during her pregnancy and to do so in a way that is as simple as possible to operate. It is not perfect and has its difficulties, as employers representatives and woman's organisations would be the first to acknowledge. But the consensus of opinion (most recently when an alternative method was proposed in the run up to the 2003 improvements to maternity pay and leave) was to keep the current method.

7.4 The purpose of the Amendment Regulations is to ensure that the SMP earnings calculation reflects the terms of the ECJ judgement in "Alabaster". The regulations provide that the SMP earnings calculation takes account of any pay rise which the woman has received, or would have been entitled to receive had she not been on maternity leave, and which applies to part or all of the period between the start of the period used to calculate her SMP and the end of her maternity leave.

7.5 Most employers are likely to grant an annual pay award so it is likely that most women getting SMP will see an increase in their SMP as a result of at least one increase between the start of the period used to calculate their SMP and the end of their maternity leave. In practical terms, for example, a 3% pay rise taking effect during a woman's maternity leave, would have to be applied to the earnings figure used to work out her SMP. Her earnings related SMP would thus increase for the first 6 weeks of the maternity pay period, or for the whole of the 26 weeks payment period if the 90% rate was paid for 26 weeks (where 90% rate was less than the standard rate). If her earnings would

otherwise be below the threshold for entitlement such an increase would result in her becoming entitled to SMP.

7.6 We have had the opportunity to take soundings from employers organisations, payroll groups and software specialists on the impact of this change through attending meetings of the Inland Revenue Employers' Umbrella group and the British Computer Society. We are working with these organisations, the Inland Revenue and woman's organisations such as the Maternity Alliance to ensure that guidance on this change, both for employers and employees, is as helpful as possible.

7.7. Feedback indicates that overall the change itself is straightforward but due to the inherent detail involved in individual pay rises, the change is likely to be difficult to automate and some payroll administrators are likely to find it easier to calculate manually.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

9.1 Kate Wheeler at the Department for Work and Pensions Tel: 020 7340 4165 or e-mail: kate.wheeler@jobcentreplus.gsi.gov.uk can answer any queries regarding this instrument.

THE STATUTORY MATERNITY PAY (GENERAL) (AMENDMENT) REGULATIONS 2005

This Regulatory Impact Assessment (RIA) considers the impact of proposals to amend the earnings calculation used to both qualify for and calculate the rate of Statutory Maternity Pay. The proposals implement a European Court of Justice (ECJ) judgement in the case of M K Alabaster-v-Woolwich PLC and the Secretary of State for Social Security (ECJ reference C-147/02).

The specific changes which the Government propose to implement will ensure that:

- if a pay rise is awarded which applies to the period starting with the beginning of the period used to calculate the woman's normal weekly earnings (the relevant period) and ending with the end of her ordinary or additional maternity leave, employers must re-calculate her normal weekly earnings to include that pay rise as though it was effective from the start of the relevant period;
- if such a re-calculation results in SMP liability for the first time, employers will only pay such SMP due as exceeds Maternity Allowance paid. This reflects the existing arrangements.

Purpose and intended effect of the measure

Objective

1. The purpose of the change to the earnings calculation for SMP is to implement the ECJ's judgement. The ECJ's judgement in "Alabaster" results from Mrs Alabaster's challenge to the way the UK implemented the earlier ECJ judgement in "Gillespie" (ECJ reference C-342/93). In its latest judgement the Court found that *"...any pay rise awarded between the beginning of the period covered by the reference pay [ie, the relevant period for calculating SMP] and the end of the maternity leave must be included in the elements of pay taken into account in calculating the amount of such pay. This requirement is not limited to cases where the pay rise is backdated to the period covered by the reference pay."*

Background – current scheme

2. One of the two qualifying conditions for SMP is that a woman's normal weekly earnings must be at or above the Lower Earnings Limit (LEL) for National Insurance purposes (£79 currently). If this condition is satisfied, SMP is payable at 90% of the woman's normal weekly earnings (no upper limit) for the first 6 weeks of the 26 week Maternity Pay Period and then the lower of that 90% rate or a standard rate (currently £102.80) for the remaining 20 weeks.

3. A woman's normal weekly earnings are calculated using payments

actually made to her in a specified period. Generally speaking, this period is the 8 weeks immediately preceding the 14th week before the expected week of childbirth (defined in regulations as “the relevant period” and roughly equating to the 4th to 6th month of pregnancy but it may start earlier than this in any individual case). As a result of the ECJ decision in “Gillespie”, amending regulations in 1996 ensured that if, subsequently, a backdated pay rise is awarded which affects earnings already paid in that “relevant period”, then the employer must recalculate SMP by taking into account that part of the pay rise which, had it been paid on time, would have been paid in the “relevant period”.

Background – what the judgement does

4. The ECJ judgement in “Alabaster” clarifies “Gillespie” and decides that the requirement to take pay rises into account is not limited to cases where that pay rise is backdated into the period used for calculation. This means, from a UK perspective, that employers will have to re-calculate SMP entitlement or potential entitlement to take account of pay rises applying to the whole or any part of the period from the beginning of the relevant period to the end of the woman’s maternity leave. They would do this by applying the pay rise to any of the earnings in the relevant period which did not already reflect that pay rise and pay arrears of SMP.

Background – what about past cases

5. The ECJ clarified the law in its judgement which was given on 30 March 2004. The judgement, although concerned with Mrs Alabaster’s particular circumstances, nevertheless clarified the effect of pay rises on all forms of maternity pay, including the UK’s statutory maternity pay scheme. The case, which was referred to the ECJ by the Court of Appeal to clarify the pay rise issue, returns to the Court of Appeal on 8/9 February 2005 for it to consider outstanding domestic procedural issues which govern how past periods may be addressed. It is not possible to make the amending legislation itself operate retrospectively. However, once the Court has given its decision, it will be possible to issue guidance to employers on dealing with past cases, both those arising before the ECJ judgement in Alabaster and in the period between the judgement and the coming into force of the proposed amending legislation.

6. The fact that the case must return to the Court of Appeal however is not sufficient grounds to delay any further amending domestic legislation to reflect the courts judgement. The law was clarified in March 2004. However until these regulations come into force, women are unable to benefit from pay rises on a UK statutory basis and employers are unable to recover the appropriate amount of these additional payments.

Options

7. The Government accepts that the ECJ's decision is binding on the UK and wishes to ensure that the judgement is reflected in UK legislation on Statutory Maternity Pay. Legal advice is clear on what must be done. Doing nothing would mean that the UK Government would not be complying with EU legislation, would be open to further challenge and possible infraction proceedings against the UK, with the risk of individuals making a claim against the Government for damages if they can show they have suffered as a result of a failure to implement fully. This course is potentially expensive to the Government. In addition failing to amend UK legislation would leave employers and employees to interpret the judgement as best they may. This latter course is not acceptable. Options for implementation therefore centre on the effective date for the amending legislation. Legal advice is clear that the judgement should be implemented as soon as reasonably possible.

8. There are two reasonable courses to take – implement from 6 April 2005 or leave implementation until October 2005. Both would fulfil DTI's undertaking with industry to introduce new legislation on just two dates each year. In considering options it is important to bear in mind that it is not just the statutory scheme which is affected by this judgement. 39% of employees receive occupational maternity pay from their employers (Maternity and Paternity Rights in Britain 2002:Survey of Parents). Therefore since the judgement was given employers will have to have considered how it impacts on their own schemes. It makes sense therefore for amendments to the Statutory scheme to be made as soon as possible to assist employers in this.

9. Changing the legislation from an earlier rather than a later date would also enable employers to comply with the judgement and to recover additional sums as far as appropriate. Without appropriate legislation they will be unable to do this.

10. Introducing the change from 6 April 2005, fits with the beginning of the tax year. The Inland Revenue has amended the Employer Helpbooks covering Statutory Maternity Pay for 2005 and will provide further guidance as necessary. Feedback from payroll companies indicates that it is quite possible that some elements of the change would not lend themselves to automation so this is not material to the implementation date.

11. Representatives from industry and payroll have indicated that whilst the principles underlying this change are straightforward, their application has the potential in some circumstances to be difficult. This is because the difficulties stem from the nature of the judgement which requires employers to focus on the woman's own circumstances and her own particular pay arrangement with her employer. Delaying implementation to October 2005 will have no material bearing on these difficulties.

12. The legislation has not attempted to define a pay rise. This is in recognition of the fact that employers pay arrangements differ from one employer to another and also between employees, rendering it almost impossible to state in general terms whether a commission or bonus payment (just to cite two examples) may be a pay rise or not. Whilst every effort is

being made to provide guidance which is as helpful as possible, practically speaking we recognise that given the individual nature of many pay agreements, attempting to provide guidance on whether a particular type of payment is a pay rise or not would be treacherous and potentially misleading. We believe that in the majority of cases it will be clear to both the employer and employee concerned what is or is not a pay rise. Where there is disagreement, all the statutory payment schemes provide that the employee may ask the Inland Revenue to decide the issue.

13. Taking the above factors into account it was considered that the start of the 2005 tax year, rather than October 2005, was the most sensible implementation date.

Costs and Benefits

14. The impact of the revised calculation of average earnings for SMP will be to increase the level of SMP. Depending on the level of earnings this would affect SMP paid for the first 6 weeks of the Maternity Pay Period or for the whole 26 week payment period if 90% of earnings were paid for the whole 26 weeks. Such an increase will be of benefit to women taking time off work on maternity leave.

15. For a small number of women a re-calculation will result in qualification for SMP for the first time. These are women whose pay hovers just under the Lower Earnings Limit (LEL) for National Insurance contributions and where a pay rise may just nudge them into SMP entitlement. Maternity Allowance information indicates that around 10,000 women a year get SMP because they fail the SMP earnings test. Around 3000 women receive MA at a rate which suggests their average earnings hover around the LEL but not all of these 3000 would have failed the SMP earnings test. Therefore less than 3000 women are likely to benefit by qualifying for SMP for the first time as a result of a pay rise.

16. The measure will result in an ongoing cost, both to employers and the state, of the additional costs of increased SMP. There will also be additional implementation costs for employers both in initial and subsequent ongoing administration.

Business Sectors affected

17. Any employer employing women of child bearing age and therefore having a potential liability for paying SMP to women on maternity leave may be affected. The business sectors most likely to pay SMP are those with a high proportion of women in their workforce such as hairdressing, health services, education, retail, cleaning services, footwear and clothing, and hotel and catering. However, in practice, around 5% of all employers (around 70,000 of 1.5 million employers) pay SMP in a year (information from employers end of year returns).

Female Employment by Industry Sector

Industry Sector	Percentage of Total Female Employment.
Health & Social Work	20.31
Wholesale, Retail & Motor Trade	17.14
Education	13.62
Real Estate, Renting, Business Activity	9.88
Manufacturing	8.27
Public Administration & Defence	7.44
Other Community, Social & Personal	6.10
Hotels & Restaurants	5.29
Financial Intermediation	4.86
Transport, Storage, Communication	3.66

(LFS Autumn 2003)

Number of potential beneficiaries

18. Around 300,000 women a year receive SMP from their employer. Almost all of these women will be entitled to both ordinary and additional statutory maternity leave and it is likely that most will be entitled (or would have been entitled if they had not been on maternity leave) to at least one pay rise in the period which starts with the beginning of the period used to calculate their SMP and which ends with the end of their maternity leave.

19. In practical terms, a 3% pay rise taking effect during a woman's maternity leave, would have to be applied to the earnings figure used to work out her SMP. Her earnings related SMP would thus increase by 3% for the first 6 weeks of the maternity pay period, or for the whole of the 26 weeks payment period if the 90% rate was paid for 26 weeks (where 90% rate was less than standard rate and subject to the standard rate as a maximum payment for the last 20 weeks). In more detail take a woman expecting her baby in week commencing 15.05.05, she is paid monthly: -

- Relevant period for calculating normal weekly earnings is 1.12.04 to 31.01.05. In that period she received two monthly payments and her gross earnings were a total of £3550. Her average weekly earnings are £409.615 which results in a weekly earnings related SMP rate of £368.66.
- Her maternity leave began on 20.03.05 and will last until 18.03.06. She is due an annual pay award on 1st February of each year.

Given this information, this woman's earnings related SMP will have to be revised twice to reflect the pay award made on 1 February 2005 and then again following the pay award on 1 February 2006. She was due a 3% pay rise from 1 February 2005, so her original gross earnings of £3550 should be increased by 3% to £3656.50. Her new average weekly earnings figure is thus £421.903 and she is due a new 90% rate of SMP of £379.62. The employer will pay arrears due of £65.76. Any pay rise due from 1 February 2006 will have to be applied to the "new" average weekly earnings figure of £3656.50 and the process worked through again.

Costs to business

Compliance costs

20. Overall employers meet 8% of the costs of SMP paid out; larger employers recover 92% of SMP paid out and smaller employers (those whose gross National Insurance contribution payments in the previous tax year are £45,000 or less) recover 104.5%. The additional annual cost to employers is estimated to be £1.2 million and to the state £16.9 million. This estimate is based on a wage rate increase in the whole economy of 3.33% (ONS Economic Trends June 2004) and that all women who receive SMP will benefit further from a pay rise whilst on maternity leave.

Administrative Costs

21. When a pay award is made, employers will need to take account of women who are on maternity leave or who are about to go on maternity leave and ensure that any pay rise is taken into account in the calculation of SMP due. Employers will need to re-calculate SMP for around 300,000 women who get SMP in a year (rounded figure – the last actual figure for 2001/2 has 291,000 recipients of SMP for that year), and also ensure that SMP is re-calculated for any women who did not qualify because her earnings were below the Lower Earnings Limit. Maternity Allowance information indicates that there are around 10,000 women a year who get MA through failing the SMP earnings condition, some 3000 of whom (see paragraph 15 above) might have average earnings hovering around the LEL. We have been able to take soundings from employers, payroll groups and software specialists on the impact of this change by attending a meeting of the Inland Revenue Employers' Umbrella Group and a meeting with the British Computer Society. We have also received ongoing feedback on the impact of the change.

22. Current rules, which take account of backdated pay rises, impact largely on the public sector because backdated pay rises are rare outside this sector. The new rule however requires all pay rises to be reflected in a woman's SMP and will therefore impact on practically all employers who pay SMP.

23. Feedback indicates that the principal of the change is straightforward but due to the inherent detail involved in individual pay rises, the exact impact of the change for the re-calculation of SMP will vary from business to business and be dependant on the size of the employer and how complex the individual's pay package is. Extra administrative costs will be incurred in identification of these women and in re-calculating the SMP due. The annex to this RIA shows the steps which might be needed in any individual case.

24. To get some idea of costs we asked a payroll software expert and also asked for feedback from representatives of industry and payroll on the Inland Revenue Employers Umbrella Group. We are grateful for the help we have received which reveals a consensus that the additional calculation might take 30 to 45 minutes and that employers will have to give some thought to the

best way of maintaining records to identify the need for re-calculation. Larger organisations are likely to have more elements of pay (and thus the greater need for re-calculation). The larger organisation however will have more automation available and the work will be done by a payroll clerk. The smaller business (owner director) may have a more straightforward re-calculation to do but will take the same time (half an hour) because this is likely to be done manually and SMP cases will not be familiar to the person running a small business. A payroll manager in a medium sized company may earn around £40,000 a year, which with added costs is £52,000 a year or £1000 a week. On a 40 hour week this is £25 an hour and thus £12.50 per SMP calculation.

24. Given the above the additional administrative cost for employers of this change is estimated at between £1.5m to £3.5m a year depending at what level the work is done.

Equity and Fairness

25. The ECJ specifically found in its judgement in Case C-147/02 “Alabaster” that Article 119 (now Article 141) of the Treaty of Rome dealing with equal pay, *“must be interpreted as requiring that, in so far as pay received by the worker during her maternity leave is determined at least in part on the basis of pay earned before her maternity leave began, any pay rise awarded between the beginning of the period covered by reference pay and the end of the maternity leave must be included in the elements of pay taken into account in calculating such pay.”*

Small firms impact test

26. Small employers do not deal with SMP very often and when they do they check the rules afresh each time. Whilst an individual employer may experience more pregnancies in the establishment than another in any given year, on average an employer with 10 employees or less has a pregnant employee one year in every 10 and employers with 25 employees or less, one year in every 5 (Employers’ survey on support for working parents, DTI, 2000). Paragraph 23 above shows that a small business director may incur £12.50 per SMP case in additional administrative costs.

Competition Assessment

27. The overall programme cost to employers of this change is estimated as £1.2 million a year which will be borne by the 30,000 larger employers paying SMP. Smaller employers can claim back the extra cost of SMP paid. It is unlikely that this measure will have any effect on competition between employers.

Enforcement and Sanctions

28. Through its established programme of compliance surveys, the Inland Revenue will monitor employers' compliance with the new measure in the same way as they monitor employer compliance with the SMP scheme generally. In particular the Inland Revenue will provide technical support and advice and guidance to employers through their 2005 Helpbook and provide up to date advice through their employers' helpline. Employees who disagree with their employer's assessment of SMP due will be able to ask the Inland Revenue to decide the matter as now.

Consultation

29. These regulations have been considered by the Social Security Advisory Committee who have a statutory duty to give advice on social security issues as it thinks fit and to consider and report on regulations referred to it. These regulations were considered by the Committee on 3 November 2004 and it has decided that the regulations should not be formally referred to it. As previously mentioned we have been able to take soundings from employers organisations, payroll groups and software specialists through the Inland Revenue Employers' Umbrella Group. The Umbrella Group set up a sub-group who provided feedback on the change which enabled us to develop and share with them and others a Question and Answer brief and early sight of the proposed amending regulation.

Contact details

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Calculations required for SMP on a Pay Rise following Alabaster

Step	Action	Comments
1	Identify pay rise affecting employee	Trigger from announcement of rise
2	Establish if it affects SMP (is/was maternity leave extant)	Must include employees on maternity leave but not entitled to SMP on earnings grounds
3	Calculate new rates(s) of SMP	
3.1	For each element of pay, calculate the increased rate	Could be many elements with different increases
3.2	Take account of any revised salary sacrifice applicable in the relevant period	
3.3	Calculate the new NI'able earnings in the relevant period	
3.4	Calculate average earnings	
3.5	If necessary, add in class 1B "earnings" and recalculate	
4	Calculate the difference	
4.1	For each pay period in which SMP has already been paid: <ul style="list-style-type: none"> • recalculate the new amount due • calculate the difference from the amount already paid in the period • record the new amount as the amount paid in the period • record the difference. Pay the sum of the differences.	
4.2	For employees previously excluded from SMP on earnings grounds but now entitled: <ul style="list-style-type: none"> • calculate the new amount due • calculate the difference from the higher rate of Maternity Allowance • record the new amount as the amount paid in the period • record the difference. Pay the sum of the differences.	
4.2	For the current and all future pay periods in which SMP may be due: <ul style="list-style-type: none"> • calculate the amount due from the new average earnings 	

Declaration

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

Signed by the responsible Minister.....P.Hollis.....

Date...15 March 2005...