

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

2015 No. 118

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

2. **Purpose of the instrument**
 - 2.1 The purpose of these Regulations is to set out the detail to enable employers that sponsor a salary related occupational pension scheme to amend their scheme rules, in order to mitigate for the increase in National Insurance costs which will occur as a consequence of the end of contracting out when the new State Pension is introduced in April 2016. In particular to 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. The purpose is also to impose restrictions on the use of the power, in particular the regulations define who is a ‘protected person in relation to a scheme’ and excluded from any changes an employer might make to scheme rules.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**
 - 3.1 None.

4. **Legislative Context**
 - 4.1 Sponsoring employers of salary-related occupational pension schemes are allowed to contract their employees out of the Additional State Pension on the condition that the scheme meets certain statutory requirements. Although these have changed over the years, the primary legislation is contained in section 9 of the Pension Schemes Act 1993 (PSA ‘93).
 - 4.2 In return for the employer providing a scheme meeting the statutory minimum, both the employer and employee pay reduced rates of National Insurance (NI) (employer contributions are currently reduced by 3.4% and employee contributions by 1.4%). This is known as the NI rebate, and set out in PSA ’93, sections 41(1A) and (1B).
 - 4.3 The State Pension is being reformed from April 2016 into a single-tier pension – the “new State Pension”¹ - for future pensioners. The introduction of the new State Pension means that there will no longer be an Additional State Pension from which to contract-out: contracting-out and the NI rebate will come to an end on 6 April 2016.

¹Cm 8528 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/181229/single-tier-pension.pdf

- 4.4 Section 24(1) of, and Schedule 13 to, the Pensions Act 2014 (the ‘Act’) provide for the abolition of contracting-out for salary related occupational pension schemes. Section 24(2) and schedule 14 of the Act provide for employers who sponsor contracted-out pension schemes in the private sector to make limited changes to the rules of their pension schemes (where they are normally prevented from doing so) in order to offset the loss of the employer’s NI rebate, by reducing scheme benefits for future accruals or increasing members’ pension contributions. Any changes to scheme rules made under the primary power cannot take effect until 6 April 2016.
- 4.5 These Regulations set out the detail of how the primary power may be used by employers to amend scheme rules. During passage of the Pensions Bill 2013-14 in Parliament, the Minister for Welfare Reform made two commitments regarding these Regulations. First, that the Department would address how an employer will apply the rebate rate to calculate the rise in NI costs (Letter to Members of the House of Lords, dated 10/1/14). Second, that the Department would specify who is a ‘protected person’ (Lords Report, Hansard ref 25.02.14, Col 805). The Regulations reflect these commitments.
- 4.6 We plan to make further statutory instruments to support the abolition of contracting-out later this year.

5. Territorial Extent and Application

- 5.1 This instrument applies to Great Britain.
- 5.2 Subject to agreement of the Northern Ireland Assembly, the Department for Social Development in Northern Ireland will be making corresponding provisions for Northern Ireland.

6. European Convention on Human Rights

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

7. Policy background

- What is being done and why

- 7.1 In 2012 there were 2,500 salary related contracted-out schemes in the private sector. Employer sponsors of contracted-out occupational pension schemes will pay the standard rate of NI contributions, an increase of 3.4% based on relevant earnings (i.e. between the Lower Earnings Limit(LEL) and the Upper Accrual Point (UAP))²when contracting-out comes to an end. Employers indicated that it is unreasonable that they would have to bear this extra cost whilst maintaining a scheme providing the same level of benefits. They wished to reduce the level by which they must fund their scheme by the same amount as the increase in NI

² The LEL is £5,772 , the UAP is £40,040 , 2014/15 annualised figures.

contributions. This could be done by amending the scheme rules to reduce the accrual of future pension benefits or by increasing members' contribution rates.

- 7.2 Some employers who sponsor a private sector scheme are limited in their ability to amend scheme rules either by legislation or by the scheme rules which may give the scheme trustees control over amendments to scheme rules. Without Government intervention, in the form of legislation, many employers may be unable to change schemes rules to mitigate for the NI increase. The policy objective is to ensure that the sustainability of salary related occupational pension schemes is not undermined by minimising the impact of the loss of the NI rebate on employers. By giving employers a limited amendment power, the Department is ensuring that the vast majority of employers sponsoring a private sector pension scheme will have an option to mitigate the impact of the ending of contracting-out.
- 7.3 The policy is to limit the extent to which employers may amend the scheme rules so that these would not result in increases in member contributions or reductions in scheme benefit accrual greater than the increase in the employer's NI contributions. To ensure these limits are complied with, the regulations set out how an actuary will estimate the value of the employer's additional NI costs and the value of the amendments proposed to recoup that cost: the Regulations provide a framework for the calculation that the actuary will undertake. The regulations set out how the actuary must certify the proposed amendments meet these requirements.
- 7.4 The Department's intention is to enable any employers who sponsor a private sector scheme, including those who sponsor multi-employer schemes, to be able to use the power to amend scheme rules if they are unable to agree changes with the scheme trustees. To that end the Regulations make provision so that, depending on the structure of the multi-employer scheme, either each employer may act or one employer the 'principal employer' may act on behalf of all employers in the scheme. The regulations make other provision to enable the power to be used such as requiring trustees to provide employers with data that the employer's actuary will need to use in carrying out the required calculations. We anticipate the amendment power being used only where the employer and trustee cannot come to an agreement on how to mitigate for the loss of the NI rebate. We would expect employers to already be in discussions with trustees about how to make scheme arrangements for the end of contracting-out.
- 7.5 The employer amendment power cannot be used to change the rules in respect of scheme members who are "protected persons". Certain former nationalised industries are limited in their ability to change scheme rules by legislation made at the time of privatisation – people so protected are known as "protected persons". Following a public consultation in 2013-14, the Government decided to stand by the promises that were made to protected persons. Employers will not be allowed to use the amendment power to alter their pension schemes for members with protected persons' status at the date the amendments take effect. These regulations define who is a protected person in relation to a scheme as required under section 24(5) of the Act so that this exclusion operates as intended.

- Consolidation – not applicable as these Regulations do not amend other sets of regulations.

8. Consultation outcome

- 8.1 The Department invited views on its proposals for state pension reform, including the end of contracting-out, in a White Paper, “The single-tier pension: a simple foundation for saving” which was published 14 January 2013. The White Paper included the proposal to give employers an amendment power.
- 8.2 The Department worked very closely with a range of industry stakeholders, including the actuarial profession and lawyers, throughout this process. In 2013, the Department undertook a formal 8 week consultation on whether “protected persons” (approximately 70,000 scheme members of formerly nationalised industries whose pension scheme status is protected by legislation in force at the time of privatisation) should be within scope of scheme amendments made by employers³. Meetings were also held with stakeholders during the consultation period. This consultation received 145 responses, with polarised arguments for and against on a complex issue. The Government decided, on balance, to honour the promises made at the time of privatisation; and so to retain the scheme members’ protection in legislation and exclude them from the employer’s amendment power.
- 8.3 During the development of these draft regulations, an informal consultation exercise took place over three weeks in 2013, with industry representative groups and technical stakeholders. A formal public consultation on the draft regulations ran for 8 weeks from 8 May until 2 July 2014. The consultation sought views on both these regulations and other proposed legislative changes which are needed as a result of the abolition of contracting-out for salary related schemes.
- 8.4 The Department received 34 written responses to the formal consultation from a wide range of organisations, including employer organisations, pension providers, lawyers, actuaries and trade unions. Most respondents recognised that this was a complex area, and broadly supported the Government’s approach, with the exception of the trade unions, who were opposed to any power being given to employers.
- 8.5 Respondents raised technical issues such as the timeframe in which information needed by the employer’s actuary should be passed to the employer by the trustees. We have amended the regulations so that the employer and trustee can agree a reasonable timescale. Respondents wanted clarity on a number of issues, such as how broadly the words ‘earnings data’ in regulation 7 are to be interpreted - if too narrowly, it could restrict use of other data. We decided, however, not to make any changes to the regulation on the grounds that the term ‘earnings data’ is generally understood by actuaries.

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221418/abolition-of-contracting-out-protected-persons-consultation.pdf

8.6 Stakeholders raised some points of policy. For example, they expressed concerns about the need to consult members over the changes to scheme rules using the employer's amendment power. The main issues were:

- why require consultation when the changes to members' pensions are limited and members are protected;
- the cost to employers of the consultation; and,
- how the consultation requirement would work for multi-employer schemes.

The Department's policy is that employers using the amendment power must consult in accordance with the existing statutory obligation to consult when changes are made to scheme rules. Employers using the amendment power still have some choice over how to amend scheme rules so there are options which scheme members should be consulted on. During the passage of the Pensions Bill 2014, Ministers gave assurances that employers would consult when using the amendment power. As to the issue of employer costs, the Department acknowledges that employers will incur costs. But these arise as a result of the requirement to consult which would apply whether employers make amendments by agreement with the trustees in the ordinary way or by making changes using the amendment power. These are not additional costs imposed because the employer is using the amendment power.

As to how the consultation requirement would work for multi-employer schemes, the normal consultation arrangements will apply to these schemes in the same way as when any other change is proposed to pension scheme rules.

8.7 We have addressed the respondents' comments in the Government's response to the consultation, published on gov.uk. :

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

8.8 Some responses from member representative organisations objected in principle to the power to amend scheme rules. There have been discussions with the organisations at Ministerial and official level to explain the intention of the legislation.

9. Guidance

9.1 The Government's Response to the consultation on the Regulations provides information for schemes on how to interpret these Regulations. In addition, the Department for Work and Pensions and Her Majesty's Revenue & Customs have been working with industry representatives on a general communication strategy to ensure that information about the abolition of contracting-out is targeted at those who need to know. A working group which included industry stakeholders has been developing communication products. In November 2014, the Department for Work and Pensions published online a series of factsheets for employers, employees and trustees - these can be found on gov.uk:

<https://www.gov.uk/government/publications/new-state-pension-information-for-employers-and-trustees-with-open-contracted-out-defined-benefit-pension-schemes>.

- 9.2 Her Majesty's Revenue & Customs publish regular bulletins aimed at employers, pension scheme administrators and others in the pensions industry:

<https://www.gov.uk/government/publications/nispi-countdown-bulletins>

10. Impact

- 10.1 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.
- 10.2 There is no impact on the public sector because the employer power to amend scheme rules is only available to employers who sponsor a private sector scheme. It cannot be used to make amendments to a public service scheme or a scheme of a description specified in regulations. The Government has also given a commitment to Parliament that the reforms to public service pensions should endure for twenty-five years (Public Service Pensions Act 2013).
- 10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

- 11.1 The legislation applies to small business. The Department recognises that some small and micro businesses will be affected by the ending of DB contracting-out. The availability of the employer power to amend scheme rules will ensure that the vast majority of employers who sponsor a private sector scheme, of any size, have a range of options to mitigate the impact of the loss of the NI rebate.

12. Monitoring & review

- 12.1 This is time limited legislation designed to help employers. The relevant powers in the Act are repealed at the end of the period of 5 years beginning with 6 April 2016, unless extended. The Department will continue to work closely with its stakeholders, including industry bodies and employers organisations, during this period and will take a keen interest in how the arrangements are working. The Department always keeps policy under review, and should any issues arise with these arrangements, it will assess the evidence and if appropriate consider whether any amendments may be necessary.

13. Contact

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Clare.Yiannakou@dwp.gsi.gov.uk can answer any queries regarding the instrument.