

EXPLANATORY MEMORANDUM TO
THE CONTRACTING-OUT (TRANSFER AND TRANSFER PAYMENT)
(AMENDMENT) REGULATIONS 2018

2018 No. 234

1. Introduction

- 1.1 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 correct a small anomaly arising from the abolition of salary-related contracted-out schemes on 6 April 2016. This amendment is required to secondary legislation¹, which restores the pre-abolition status quo that existed before contracting-out ended. The regulations will enable transfers of pension scheme members with contracted-out rights to take place in certain circumstances, without member consent, to newly established salary-related occupational pension schemes that have never been contracted-out (subject to the trustee receiving the necessary actuarial certificate).

3. Matters of special interest to Parliament

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 These regulations will enable transfer of contracted-out rights, without member consent, to newly established salary-related schemes that have never been contracted-out.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is Great Britain.
5.2 The territorial application of this instrument is Great Britain.
5.3 The Department for Communities will be making corresponding provisions in 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.

¹ <https://www.legislation.gov.uk/ukxi/1996/1462>

7. Policy background

What is being done and why

- 7.1 From 1978 salary-related occupational pension schemes were able to remove their members from additional State Pension (formerly known as State Earnings Related Pension Scheme (SERPS)) and provide a guaranteed minimum pension (“GMP”) instead. In return, both the employer and employee paid reduced National Insurance contributions. The system, known as “contracting-out”, was widely used. The GMP was intended to provide a minimum amount of weekly pension, broadly equivalent to the amount of additional State Pension that the person would have been entitled to had they not been contracted-out. The GMP is payable for life from age 60 for a woman or 65 for a man, and a survivor benefit may be payable for the scheme member’s widow, widower or surviving civil partner. This system was in operation until 5 April 1997; although rights no longer accrue, previously accrued rights are, and will continue to be, protected.
- 7.2 From 6 April 1997, a different test, referred to under section 12A of the Pension Schemes Act 1993² as the ‘statutory standard’, was applied to schemes that contracted-out of the State Pension system. This was commonly known as the “Reference Scheme Test” and operated until 5 April 2016.
- 7.3 Until the new single-tier State Pension³ was introduced on 6 April 2016, sponsoring employers of salary-related or defined benefit (DB) occupational pension schemes were permitted to contract their employees out of additional State Pension on condition that the scheme met certain statutory requirements.
- 7.4 Before contracting-out for salary-related schemes was abolished, it was possible for a contracted-out scheme or a formerly contracted-out scheme to transfer its members, without their consent, to either a contracted-out or a formerly contracted-out scheme. Where a transfer was to take place to a new scheme that had never contracted-out, the new scheme could become contracted-out for a short while (as a workaround), thus becoming a formerly contracted-out scheme and satisfying the legislative requirements.
- 7.5 Following the abolition of contracting-out from 6 April 2016, this workaround was no longer possible, because the new scheme could not become a formerly contracted-out scheme.
- 7.6 To address this issue, the Department for Work and Pensions has decided to revert to the position which existed before contracting-out ended, by making changes to secondary legislation to enable newly established schemes to perform these transfers where they are currently prevented from doing so by current legislation.
- 7.7 These regulations will enable transfers of scheme members, without consent to new established salary-related schemes that have never been contracted-out in specified circumstances.

Consolidation

- 7.8 An informal consultation text of the instrument is available to the public free of charge via the National Archive’s website: legislation.gov.uk.

² http://www.legislation.gov.uk/ukpga/1993/48/pdfs/ukpga_19930048_300617_en.pdf (the Pensions Schemes Act 1993 was amended by section 24 and schedule 13 of the Pensions Act 2014)

³ <http://www.legislation.gov.uk/ukpga/2014/19>

8. Consultation outcome

- 8.1 Due to the technical nature of these regulations, an informal consultation with the industry took place in advance of the formal consultation on these draft regulations. This is because there has been strong demand by the pension industry for these changes, and the industry have voiced their concerns in recent consultations⁴. This short informal consultation was limited to 1 week from 27 November 2017 to 3 December 2017. There were 6 responses from experts in the pension industry. Their informal responses enabled the Department for Work and Pensions to make minor and technical changes to ensure these regulations worked for salary-related schemes that have never been contracted-out and scheme members' accrued rights would continue to be protected.
- 8.2 A consultation on the draft Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2018⁵ ran for 4 weeks from 21 December 2017 to 17 January 2018. There were 18 responses from experts in the pensions industry and a member of the public. The consultation asked six questions:
1. Do you agree that the draft changes enable transfers of contracted-out pension rights without member consent to be made to schemes that have never been contracted-out as mentioned in paragraph 9?
 2. Do you think that the proposed changes to the regulations will provide adequate protection for deferred and pensioner members' benefits following transfers without member consent to schemes that have never been contracted-out?
 3. Do the proposed changes to the regulations allow further bulk transfers of contracted-out rights to take place without member consent from schemes which have never been contracted-out to other schemes?
 4. In your view, before contracting-out for salary-related schemes was abolished, how common were bulk transfers of contracted-out rights without member consent to schemes that have never been contracted-out, can you give examples of circumstances in which they occur?
 5. Can you give an indication of the time/costs of complying with the proposed previous requirements, number of contracted-out right transfers per year that you think might be helpful?
 6. Are there any other areas of transfers of contracted-out rights you believe require further attention and do you have examples of how they are not working?

Consultation questions 1 to 3: respondents raised the following issues:

- 8.3 There was broad agreement for the proposed changes in regulations with one exception concerning the draft regulations.
- 8.4 Five respondents raised the requirement that connected employer transfer payment of post 1997 contracted-out rights without consent must "not adversely affect the rights" of the transferring members. They argued that it appeared to be an onerous additional requirement and that it was not immediately clear how it would be assessed and who would be responsible for the assessment. They questioned why the benefit preservation requirements of regulation 12 of the Occupational Pension Schemes

⁴ <https://www.gov.uk/government/consultations/contracted-out-pensions-enabling-transfers-to-schemes-that-have-never-been-contracted-out>

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/669656/consultation-on-draft-contracting-out-transfer-and-transfer-payment-amendment-regulations-2018.pdf

(Preservation of Benefit) Regulations 1991⁶ (“the 1991 Regulations”) were insufficient. They also suggested an amendment to the definition of “connected employer transfer” and “connected employer transfer payment” to ensure consistency between the definitions in the Contracting-out (Transfer and Transfer Payment) Regulations 1996⁷ (“the 1996 Regulations”) and the 1991 Regulations. Following their intervention, the Government decided that the receiving scheme must provide benefits similar to those which a formerly contracted-out scheme would have provided in line with the appropriate legislation as it had effect at the time (see new regulation 2(4). Amendments were also made to the definition of “connected employer transfer” and “connected employer transfer payment” to ensure greater consistency between the 1996 Regulations and the 1991 Regulations.

- 8.5 Eight respondents argued that the inclusion of the word “accrued” in new regulation 8A prevented the transfer of pensions in payment which is not currently present in regulation 9 of the 1996 Regulations (as it currently applies to transfers to formerly contracted-out schemes) . A few respondents suggested deleting the word “accrued” or provided alternative wording. The Government proposes removing new regulation 8A and including the new transfer provisions in regulation 9 of the 1996 Regulations instead so that the regulation applies to both formerly contracted-out schemes and never contracted-out schemes (see new regulation 2(4)).
- 8.6 Respondents suggested that new provisions prevented the transfer of pensions in payment for pensioner members to schemes that have never been contracted-out. The Government agrees and has amended the legislation so that these transfers are possible.
- 8.7 Some respondents were concerned that making new schemes comply with the arrangements in the transferring scheme concerning commutation, forfeiture and suspension would mean that the newly established schemes would have to comply with several sets of requirements and provide a significant obstacle to restructuring, reorganisation or consolidation. . We recognise that this requirement would cause difficulties for newly established schemes in having to comply with several sets of rules and so have amended the legislation so that the commutation, suspension and forfeiture arrangements of the receiving scheme will apply.
- 8.8 One respondent raised two raised two issues concerning member communications. Firstly, that scheme members can be confused about whom their pension arrangement is with and where it is now, because of previous transfer activity. Secondly, in relation to the reference test for defined benefit schemes, the respondent asked for a clear test that members, employers and scheme administrator are able to understand and that can be clearly communicated. We recognise that it has always been the case that members should understand the details of any benefits that are payable from a pension scheme to which members belong. Although disclosure⁸ requirements have changed over time, trustees will be expected to provide relevant information if needed. Individuals can also take advantage of the Pensions Tracing Service if they have lost information detailing the whereabouts of their pension.

⁶ <http://www.legislation.gov.uk/ukxi/1991/167/contents/made>

⁷ <https://www.legislation.gov.uk/ukxi/1996/1462>

⁸ <https://www.legislation.gov.uk/ukxi/2013/2734/contents/made> - The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734) set out the information which trustees and managers of occupational and personal pension schemes must give to their members, the timescales for providing such information and the methods that may be used.

Consultation question 4:

8.9 Eight respondents suggested that such transfers were quite common before abolition where a business was required to set up a new scheme to facilitate transfers under the Transfer of Undertakings (Protection of Employment) Regulations 2006⁹ (or TUPE) arrangements, either in the private or public sector. One respondent mentioned that where a sponsoring employer wished to merge several schemes to facilitate management and administration, and to benefit from economies of scale, the preferred solution was frequently to set up a new scheme into which the other schemes were “tipped”. This enabled a fresh trust and accompanying scheme rules to be established, without the history and complications of the existing trusts.

Consultation question 5:

8.10 Seven respondents were unable to provide costs because pension schemes run commercially and independently and therefore do not routinely share working data to government or external regulators. Respondents did provide anecdotal evidence that organisations are currently being restricted or stopped from reorganising their defined benefit liabilities because it is not possible to make these types of transfers. One respondent mentioned that the resulting costs are in business sales and scheme consolidations that are frustrated as a result of inflexible legislation.

Consultation question 6:

8.11 Respondents suggested other minor changes, which we believe is out of scope of this consultation. The main suggestion was that they thought that the definition of salary-related pension schemes needed to be deleted or required amendment in order to meet the policy objective, essentially respondents wanted transfers without member consent to be made available to any scheme and not just salary-related ones. We disagreed as we wanted to avoid transfers to schemes which could potentially be money purchase arrangements (or defined contribution schemes). The policy intention of these regulations was to remove the requirement that salary-related schemes had to be formerly contracted-out schemes and we think these proposed regulations achieve that aim. However, in light of the points raised by certain respondents, the Government will consider further changes in relation to contracting-out transfers with the industry at a later date.

8.12 We received a number of other minor drafting suggestions, which we have accepted, and requests for further clarification. We have addressed the respondents’ comments in the Government’s response to the consultation, published on gov.uk¹⁰.

9. Guidance

9.1 The Government’s response to the consultation on these regulations provides information for schemes on how to interpret the regulations. HMRC publishes regular bulletins aimed at employers, pension scheme administrators and others in the pensions industry here¹¹.

9.2 HMRC, in collaboration with Department for Work and Pensions, is updating guidance for schemes and pension administrators following the end of contracting-out and this should be available after the regulations come into force, later this year.

⁹ <https://www.legislation.gov.uk/uksi/2006/246/contents/made>

¹⁰ <https://www.gov.uk/government/consultations/bulk-transfer-of-contracted-out-pension-rights-without-member-consent-draft-regulations>

¹¹ <https://www.gov.uk/government/collections/national-insurance-services-to-pensions-industry-countdown-bulletins>

10. Impact

- 10.1 There is no impact on business, charities or voluntary bodies, as the measures are permissive and the actions that it will enable businesses (incl. charities or voluntary bodies) to undertake are voluntary.
- 10.2 There is no impact on the public sector.
- 10.3 An Impact Assessment has been prepared for this instrument and will be made available alongside the legislation on www.legislation.gov.uk.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 Removing small businesses (i.e. small businesses sponsoring a defined benefit scheme(s)) from these regulations could adversely affect members and sponsoring businesses of the affected schemes because they would not be able to have their benefits / liabilities transferred to a new scheme in these circumstances despite it being in their interest to do so.

12. Monitoring & review

- 12.1 Guy Opperman MP, Parliamentary Under-Secretary of State for the Department for Work and Pensions, has made the following statement under section 28(2)(b) of the Small Business, Enterprise and Employment Act 2015¹². Having had regard to the Statutory Review Guidance for Departments published under section 31(3) of the Small Business, Enterprise and Employment Act 2015, in my view, it is not appropriate to make provision for review in the Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2018.
- 12.2 Given the technical and permissive nature of these amendments a statutory provision for a review of these regulations would be disproportionate, taking into account the economic impact of the regulations. The Department for Work and Pensions will, however, continue to work closely with stakeholders, including industry bodies and employer organisations, to keep these policies under review and should any issue arise with these policies, it will assess the evidence and, if appropriate, consider whether any changes may be necessary.

13. Contact

- 13.1 Lillian Coulson at the Department for Work and Pensions (Telephone: 0207 449 7232 or email: Lillian.Coulson@dwp.gsi.gov.uk) can answer any queries regarding the instrument.

¹² <http://www.legislation.gov.uk/ukpga/2015/26/contents/enacted>