

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL AND STAKEHOLDER PENSION SCHEMES
(MISCELLANEOUS AMENDMENTS) REGULATIONS 2013

2013 No. 459

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

The changes made by these Regulations: (a) provide for the bulk transfer of accrued rights without member consent to non-UK pension schemes within the European Economic Area (EEA); (b) make amendments for actuaries on the tests to be applied in relation to rule changes in contracted-out salary-related schemes; (c) allow bulk transfer of scheme membership, without member consent, from contracted-out schemes to formerly contracted-out schemes and alter the definition of “connected employer”, (d) amend some wording from “the retail prices index” to “the general level of prices” following the Government’s decision to use the Consumer Prices Index rather than Retail Prices Index for the statutory minimum increases in defined benefit occupational pensions, (e) make similar changes for the calculation of increases to pensions which have been shared on divorce, and (f) make consequential, incidental and supplementary changes following the removal of the requirement for most employers to designate a stakeholder pension scheme.

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

None.

4. Legislative Context

4.1. Legislation permits bulk transfers without the consent of individual scheme members to be made to another occupational pension scheme. The applicable definition of occupational pension scheme in section 1 of the Pension Schemes Act 1993 was amended by the Pensions Act 2004¹ and means a scheme based in either the UK or outside the European Economic Area (EEA). The 2004 Act change removed the ability of schemes to make bulk transfers without consent to a non-UK scheme based in another EEA country. Regulation 2 of these miscellaneous amendment regulations reinstates that ability.

4.2. Contracted-out pension schemes must meet statutory requirements on the level of benefits payable to scheme members at pensionable age, and also those benefits payable from the scheme for their survivors. Existing legislation also provides protection for members’ rights that accrued (built up) where a pension scheme is, or has been,

¹ <http://www.legislation.gov.uk/ukpga/2004/35/section/239>

contracted-out, as those accrued rights replace the member's entitlement to the state additional pension. This is done by placing restrictions on amendments that can be made to those accrued rights. Regulation 3 of these miscellaneous amendment regulations makes changes to help scheme actuaries in respect of rights that have accrued and rights that are to accrue (build up in future). This will assist the scheme actuary's considerations when a contracted-out pension scheme wishes to change its scheme rules.

4.3. Legislation allows defined benefit pension schemes to make bulk transfers of scheme membership without member consent where the scheme members are in employment with the same employer, or the employers are involved in a take-over or merger, or are part of the same group of companies (this is known as the "connected employer test"). Contracted-out pension schemes have to meet an additional requirement when making this type of bulk transfer, in that the membership must be transferred to an active contracted-out scheme. Regulation 4 of these miscellaneous amendment regulations will alleviate administrative burdens in this area.

4.4. In 2010, the Government announced that, when considering increases to State benefits, State pensions and public service pensions, it would in future use the Consumer Prices Index as its preferred index when measuring increases in the general level of prices. It also considered it appropriate to use the same index for the statutory minimum level of increases to private pensions. Some consequential amendments to achieve the change from the Retail Prices Index were made to private pensions legislation in the Pensions Act 2011. Further consequential amendments are made in regulation 6 of these regulations to change an existing Retail Prices Index reference in the Transfer Value Regulations and in regulation 7 to ensure that pension credit benefits (that is, pension rights deriving from private pensions shared on divorce) are subject to similar provisions as main scheme benefits.

4.5. Additionally, some tidying up of the pension credit benefit regulations is needed in relation to which figure in the annual revaluation order should be used when calculating increases to certain shared pensions. This change is also made in regulation 7.

4.6. Another change introduced by the Pensions Act 2011 was the removal of the requirement for annuities bought by cash balance schemes to provide for indexation up to a certain cap (Limited Price Indexation). This easement also needs to apply to pensions in cash balance schemes which have been shared on divorce, and this change is made in regulation 7 as well.

4.7. Changes to the legislation in respect of stakeholder pensions took place when amendments to section 3 of the Welfare Reform and Pensions Act 1999 were commenced on 1 October 2012. These changes removed the requirement for an employer to designate a stakeholder pension scheme and also removed the obligation on them to comply with any new requests from employees for contributions to be deducted and passed on to the scheme. As a result, minor consequential changes are made to the Stakeholder Pension Scheme Regulations in regulation 8.

5. Territorial Extent and Application

This instrument applies to Great Britain.

6. European Convention on Human Rights

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 One change follows an undertaking given by the Department to the European Commission in relation to pension schemes outside the UK but within the European Economic Area. Two changes are being made as a result of requests from the pensions industry. Other changes are consequential on amendments which have already been made to legislation.

Bulk transfer of accrued rights without individual consent for EEA-based members (regulation 2(1) to (3))

7.2 Bulk transfers without the consent of individual scheme members cannot be made to pensions funds/schemes in other EEA member states, although they can be made to schemes based outside of the EEA. This is because the current regulations allow transfers without consent to another occupational pension scheme, which is defined by section 1(b) of the Pension Schemes Act 1993² as being based in either the UK or outside the EEA.

7.3 The policy intention has always been that bulk transfers without consent may be made to schemes based anywhere in the world, subject to certain safeguards being met. Before 22 September 2005, there was no territorial limitation on the definition of an occupational pension scheme; however, the Pensions Act 2004 amended the definition to a scheme which has its main administration in the United Kingdom or outside the EU member states (subsequently amended to EEA states) to make it clear that schemes based in other EEA states would be regulated by that state rather than by any UK provisions.

7.4 A consequence of this was to exclude transfers to EEA states. The proposed change will rectify this by allowing a transfer to a European pensions institution without consent, subject to existing bulk transfer safeguards.

Changes to contracted-out pension scheme rules (regulation 3)

7.5 Pensions industry representatives have informed the Department that there was confusion about how the relevant legislation (regulation 42 of the Occupational Pension Schemes (Contracting-out) Regulations 1996 (SI 1996/1172)) should be applied when a defined benefit pension scheme had ceased to contract-out and wanted to change its rules.

² <http://www.legislation.gov.uk/ukpga/2004/35/section/239>

The intention of the existing legislation is to protect accrued rights where schemes wish to alter their rules, so that those rights, accrued whilst the scheme met the standards set out in legislation, are not reduced. Those representatives were of the view that the legislation did not meet the policy intention and could not work in practice as the required test could not be applied to accrued rights, only to prospective rights..

7.6 The changes to regulations will provide assistance for the actuary, who is responsible for assessing the effect of proposed scheme rule changes on the benefits payable to members to see whether they are lawful. The amended regulation 42 will enable the actuary to undertake suitable tests of the effect of any proposed rule changes to those contracted-out rights that have already accrued and contracted-out rights that are to accrue in the future. In relation to changes to benefits to accrue in the future under a contracted-out scheme, the test remains the “reference scheme test” (RST) as set out in s.12A of the Pension Schemes Act 1993. In relation to retrospective scheme rule changes made by schemes to contracted-out rights that have already accrued, the RST is not appropriate. The new requirement means that retrospective scheme rule changes made by schemes cannot proceed if a member’s accrued contracted-out rights are replaced with a money purchase benefit and would or might result in a reduction of pension payment. Neither can a rule change take place which might adversely affect a member’s accrued rights unless the actuarial equivalence test set out in section 67 of the Pensions Act 1995³ is met (i.e. the change would have little effect on the overall value of the pension benefits to be provided). There is also a new requirement to preserve the value of survivors’ benefits, and the circumstances in which benefits are payable to survivors.

Bulk transfer of scheme membership without member consent (regulation 2(4) and 4)

7.7 Pensions industry representatives advised the Department that they thought the legislation that governs bulk transfer of scheme membership without member consent was inconsistent, and caused additional administrative cost and burdens for schemes that wished to consolidate pension provision. They thought there was also uncertainty about whether bulk transfers could take place between schemes where both schemes have the same sponsoring employer, but one scheme no longer has any active members (that is, the members are no longer employed by the sponsoring employer).

7.8 The regulations are being changed to assist the pensions industry and alleviate administrative burdens. For both contracted-out and not contracted-out schemes, the amendment will allow this type of bulk transfer to take place between schemes where members were or had been in employment with the same employer; and for contracted-out schemes, allow those bulk transfers to be made to active and formerly contracted-out schemes.

7.9 Regulations 5 and 9 are consequential changes required as a result of reinstating bulk transfers to schemes based outside the UK but within the European Economic Area, and ensure that new regulation 11B is referred to where needed.

³ <http://www.legislation.gov.uk/ukpga/2004/35/section/262>

Amendment of a reference to the Retail Prices Index (RPI) (regulation 6)

7.10 Following the Government's move to using Consumer Prices Index (CPI) rather than Retail Prices Index (RPI) for calculating statutory minimum pension increases, some references to the Retail Prices Index in legislation need to be amended. One is a reference in the Transfer Values regulations where pre-1986 leavers do not have a statutory right to request their pension be transferred to another scheme if the existing scheme revalues those rights by uncapped RPI. Changing the reference to "the general level of prices" will ensure that scheme members do not gain new, and unintended, transfer rights if their scheme has changed or changes to revaluing by uncapped CPI (rather than uncapped RPI).

Calculation of increases to pension credit benefit (regulations 7 and 10)

7.11 Pension credit benefit (not to be confused with the State income-related benefit for pensioners called Pension Credit) is the name for pension rights gained by a former spouse where a pension has been shared following a divorce. The intention is that, if the benefits remain in a defined benefit arrangement, those benefits should be subject to a similar statutory minimum indexation requirement as defined benefit pensions in general. For pension credit, pensions shared before 5 April 2005 must be increased by inflation capped at 5 per cent and rights shared after that date by inflation capped at 2.5 per cent.

7.12 The annual Revaluation Order publishes the statutory minimum figures to be used. However, the existing pension sharing regulations are not explicit as to which of the figures in the order should be used in which circumstances. The changes will set out which figures should be used and the method by which the appropriate indexation figure is calculated.

7.13 Regulation 10 revokes a provision which is spent and no longer needed (a definition (of "maximum percentage") which had been inserted into the regulations but is no longer used in the amended calculation).

Increases to pension credit benefit in schemes which index by scheme rules (regulation 7)

7.14 Some schemes have provisions in scheme rules for pension increases. The current statutory minimum level of indexation for schemes which use their own reference period to calculate increases (rather than the annual revaluation order) in the pension Credit Benefit Regulations refers specifically to the Retail Prices Index. This is being replaced with a reference to the Consumer Prices Index, in line with the change made for such schemes in general by the Pensions Act 2011. This will ensure that pension credit benefits will be indexed in the same way as other pensions including the main scheme benefits from which the pension shares have been derived.

7.15 Additionally, the Pensions Act 2011 introduced an easement for schemes which have always indexed by the Retail Prices Index and continue to do so in that they do not have to also track the Consumer Prices Index (CPI) and pay increases based on that

for any year that CPI is higher. This easement will also apply to pension credit benefits following this change.

Indexation of pension credit benefit held in cash balance schemes (regulation 7)

7.16 Cash balance schemes are schemes which provide a lump sum, with which the member can purchase an annuity but, unlike a pure money purchase scheme, there is some form of promise or guarantee as to how the lump sum is calculated. The Pensions Act 2011 removed the requirement from 3 January 2012 for annuities bought with cash balance schemes to be indexed and the intention is to bring pension credit benefits held in cash balance schemes into line with the requirement for cash balance schemes generally. This will allow pension credit members to take advantage of a wider choice of retirement income at no cost or savings to schemes since the starting rate of an indexed annuity is lower than a flat rate annuity to reflect the indexation.

Stakeholder pensions – removal of employer and employee exemptions (regulation 8(3)(c) and (d))

7.17 The requirement for employers to designate a stakeholder pension scheme has been removed. Therefore, there is no need to exclude certain employees or employers from the requirement, so these provisions are being revoked.

Stakeholder pensions – existing employees (regulation 8(5))

7.18 The removal of the requirement for employers to designate a stakeholder pension also removes the obligation on employers to comply with any new requests for contributions to be deducted and paid over to the designated scheme. However, employers are still required to continue deducting contributions in respect of employees who had already made a request before 1 October 2012, until the employee leaves or ceases contributing. They are not required to implement any new requests, but must allow an employee to vary the amount of the contribution as long as the new level is acceptable to the scheme.

7.19 It is possible that the employer's existing designated scheme may wind up or become unavailable for reasons beyond the employer's control, while employees' requests for deductions are still valid. In these circumstances, these Regulations provide that the employer will not have to continue deducting contributions, or wait until the employee formally withdraws his request.

Amendments consequential on tax changes (regulations 8(2)(a)(b)(e), (3), (4), and 10)

7.20 There are references in the regulations to the Income and Corporation Tax Act relating to permitted reductions or to people who may set up stakeholder schemes which have been superseded by the Finance Act 2004. The Department is taking this opportunity to update the references.

Consolidation

7.21 Consolidation of the regulations included within this instrument will be included in due course in the Department's "The Law Relating to Social Security" (the Blue

Volumes), which are available at no cost to the public on the internet at - <http://www.dwp.gov.uk/advisers/docs/lawvols/bluevol/>

8. Consultation outcome

Contracting out and bulk transfers

8.1 Following the approaches by industry, in winter last year the Department undertook a targeted, informal six-week consultation with key stakeholders on the changes relating to contracting-out. On this basis, the Minister for Pensions agreed that a shorter public consultation period would be appropriate. The eight-week formal public consultation⁴ began on 20 July and ended on 13 September 2012.

8.2 There were 16 responses to the consultation. Where respondents made comments on the draft regulations relating to rule changes for contracted-out pension schemes, they concentrated on four main areas. They wanted clearer definitions of “accrued section 9(2B) rights” and “rights which are to accrue in the future under a contracted-out scheme”; they questioned why changes to accrued contracted-out rights should be restricted in ways over and above the existing “subsisting rights” rules in section 67 of the Pensions Act 1995; they wanted to know why existing legislative provisions requiring member consent to make changes involving accrued contracted-out rights could not be used; and questioned the protection for survivor benefits.

8.3 As a result of the comments, the regulations now contain a clearer definition of accrued rights and rights which are to accrue in the future. As for the need for additional restrictions placed on changes to accrued contracted-out rights, when a scheme is contracted out of the state additional pension, members give up entitlement to state additional pension, and receive contracted-out benefits from the scheme instead. At the time of accrual, those rights would have been certified as meeting the statutory standard, and it is important that any contracted-out accrued rights are protected and remain at that standard. The subsisting rights legislation does allow retrospective rule changes to be made to non-contracted out schemes with member consent. But in this case, the policy intention is that the changes should only be allowed if they are actuarially equivalent, ensuring that there will be little change in the overall value of pension benefits paid by the scheme should the rule change take place. And the intention for survivor benefits is that the benefits from the scheme should be in accordance with those rules in place at the time of accrual, even if a rule change has taken place. This requirement has been clarified in the amendments following comments made during the consultation.

8.4 For the other two amendments in this area (reinstating the policy intention in relation to bulk transfer of accrued rights without member consent to non-UK pension schemes within the EEA and allowing bulk transfer of scheme membership, without member consent, from contracted-out schemes to formerly contracted-out schemes and clarifying the definition of “connected employer”), of those who made comments, the majority agreed with the proposals. However, there were requests for clarification of

⁴ The Occupational Pension Schemes (Miscellaneous Amendments) Regulations 2013: <http://www.dwp.gov.uk/docs/occ-pension-schemes-misc-amend-regs-2013.pdf>

definitions and to include some requirements of the existing regulations in the draft legislation. Where appropriate, these requests have been met and the legislation amended.

Indexation and Pension Credit Benefit changes

8.5 These changes are either consequential on previous changes to legislation or Government decisions or technical changes to the regulations. The Minister for Pensions therefore agreed that a short public consultation period would be appropriate, and a six-week consultation⁵ took place between 4 October and 11 November 2012. This was a separate consultation to that at 8.1.

8.6 Ten responses were received, although none made substantive comments. There was concern that the change from the Retail Prices Index (RPI) to “general level of Prices” in the Transfer Values regulations might give those whose schemes had retained uncapped RPI-based revaluation the right to a transfer. However, the actual wording in the regulations refers to a rate which is equivalent to, **or exceeds**, the general level of prices so will continue to exclude those receiving RPI revaluation.

8.7 Responses regarding the pension credit provisions comprised drafting suggestions where the respondent thought that the draft regulations did not meet the policy intent or needed clarification. Many of these were helpful, and have been accepted and the legislation amended.

Stakeholder Pension changes

8.9 There is no obligation on the Secretary of State to consult on these changes. However, the Department engaged with key stakeholders, representative bodies and companies who had responded to an earlier consultation about removing the employer designation, or who had contacted the Department recently about the changes, and offered the opportunity to comment on a draft of the regulations. Four responses were received, two of which offered helpful drafting suggestions which were accepted.

9. Guidance

No additional guidance is necessary as all the information will be contained in the regulations.

10. Impact

10.1 There is no impact on business and civil society organisations.

10.2 There is no impact on the public sector.

⁵ The Occupational Pension Schemes (Miscellaneous Amendments No.2) Regulations 2013
<http://www.dwp.gov.uk/consultations/2012/occ-pen-misc-regs-2013.shtml>

10.3 Two Impact Assessments are attached to this memorandum and published on www.legislation.gov.uk . An assessment of the impact of regulation 8 was made when the changes to the Stakeholder designation requirement were made by section 87 of the Pensions Act 2008. A copy of that assessment is on www.legislation.gov.uk/ukxi/2012/2480/resources.

11. Regulating small business

11.1 The legislation does apply to small business, although very few small and medium employers use contracting-out on a defined benefit basis.

11.2 It is not possible to minimise the impact of the requirements on firms employing up to 20 people without an adverse effect on scheme members.

12. Monitoring & review

Regulations 3 and 4 of this instrument will be reviewed in October 2017.

13. Contact

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