

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (SCHEMES THAT WERE
CONTRACTED-OUT) (NO. 2) REGULATIONS 2015

2015 No. 1677

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 revoke and replace the Occupational Pension Schemes (Contracting-out) Regulations 1996¹ (S.I. 1996/1172) (“the 1996 Regulations”). Much of the provision made by the 1996 Regulations is revoked as a consequence of the abolition of contracting-out when the new State Pension is introduced in April 2016. Some provisions of the 1996 Regulations will remain in force until 6th April 2019. For example, provisions relating to the issue, variation and surrender of contracting-out certificates remain in force to enable the Commissioners for Her Majesty’s Revenue and Customs to issue certificates relating to a period before the abolition date, and to deal with any variation or surrender of such a certificate which is to take effect prior to that date.
3. **Matters of special interest to the Joint Committee on Statutory Instruments**
 - 3.1 These Regulations are made to correct a defect in an earlier instrument (The Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2015 (S.I. 2015/1452)).
 - 3.2 The Department discovered an error in the Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2015 (S.I. 2015/1452) which were made on 14th July 2015 and were laid before Parliament on 16th July 2015. The Department realised that regulation 28, and the provision in regulation 32 which revokes regulation 69B of the Occupational Pension Schemes (Contracting-out) Regulations 1996 (“the 1996 Regulations”), of S.I. 2015/1452, which is made under section 24B(5) of the Pension Schemes Act 1993, can only be made after a draft of the regulation has been laid before, and approved by a resolution of, each House of Parliament (see s.186(3)(a) of that Act). S.I. 2015/1452 re-makes the 1996 Regulations to take account of the abolition of contracting-out on 6th April 2016; regulation 28 replaces regulation 69B of the 1996 regulations, which is the only provision of those regulations subject to the affirmative Parliamentary procedure. Regulation 28 and the revocation of regulation 69B of the 1996 Regulations therefore has not been made according to the correct Parliamentary procedure.
 - 3.3 Regulation 45 revokes The Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2015 (S.I. 2015/1452) (except regulation 28, and part of regulation 32) and this instrument re-makes the provisions in that instrument without the provisions contained within regulation 28 of that instrument.

¹ <http://lawvolumes.dwp.gov.uk/docs/a5-4941.pdf>

3.4 In due course we will include the provisions contained in regulation 28, and to revoke regulation 28, and regulation 69B of the 1996 Regulations, within a suitable affirmative set of regulations, to be debated before both Houses of Parliament. We aim to make this provision well before it must come into force on 6th April 2016. Both new sets of regulations will be issued free of charge to persons who bought S.I. 2015/1452.

4. **Legislative Context**

4.1 Sponsoring employers of salary-related or defined benefit (DB) 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. These have changed over the years; the main requirements are contained in Part 3 of the Pension Schemes Act 1993² (“the PSA 1993”).

4.2 In return for the employer providing a scheme that meets 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 is set out in the PSA 1993, sections 41(1A) and (1B).

4.3 The introduction of the new State Pension means that there will no longer be an additional State Pension, contracting-out will come to an end, as will the NI rebate, on 6 April 2016.

4.4 Section 24(1) of, and Schedule 13 to, the Pensions Act 2014³ (“the 2014 Act”) provide for the abolition of contracting-out for salary-related occupational pension schemes. Section 24(2) and Schedule 14 of the 2014 Act, and the regulations made under these provisions, 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 key consequential legislative changes that are necessary as a result of the abolition of contracting out. Further legislative changes consequential on the abolition of contracting-out are to be consulted upon in the autumn.

5. **Territorial Extent and Application**

5.1 This instrument (except Part 8) extends to Great Britain. Part 8 (Contribution Equivalent Premium) and Part 9 (Revocation of the Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2015) extend to Northern Ireland.

5.2 Subject to agreement of the Northern Ireland Assembly, the Department for Social Development in Northern Ireland will be making corresponding provisions for

² <http://lawvolumes.dwp.gov.uk/docs/a5-1251.pdf>

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

Northern Ireland, except for Contribution Equivalent Premium (CEP), where the powers are vested in the Secretary of State for Work and Pensions.

6. **European Convention on Human Rights**

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

7. **Policy background**

- **What is being done and why**

7.1 From 1978 occupational DB pension schemes were able to remove their members from the state earnings related pension scheme and provide a “guaranteed minimum pension” (“GMP”) in return. These provisions were widely used. The GMP was intended to provide a minimum amount of weekly pension, broadly equivalent to the amount of additional state scheme pension that would have built up had the member not been contracted-out. The GMP is payable for life at age 60 for a woman or 65 for a man, and a survivor benefit is payable to a widow, widower or civil partner. This system was in operation until 5 April 1997; although rights no longer accrue, those rights are, and will continue to be, protected.

7.2 From 6 April 1997, a different test, referred to in legislation as the statutory standard, is applied to schemes that contract-out of the state system. This is still in operation, and commonly known as the Reference Scheme Test. This test requires a scheme to provide for the vast majority of members a pension at age 65; to have an accrual rate of 1/80th of qualifying earnings in the last three years before the end of employment service; and pay a survivor’s pension to a widow, widower or civil partner of 50 per cent of benefits that the member was being paid before death.

7.3 These Regulations set out the rules with which schemes that were contracted-out will need to comply following the abolition of DB contracting-out. The Regulations aim to ensure that members’ entitlements derived from contracted-out employment continue to be preserved, and make other provisions to ensure the appropriate operation of formerly contracted-out DB schemes.

- **Consolidation**

7.4 Informal consolidated text of instruments is available to the public free of charge via ‘The Law Relating to Social Security’ (Blue Volumes) on the Department for Work and Pensions website at <http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/> or the National Archive website legislation.gov.uk. An explanation as to which instruments are maintained on each site is available [here](#).

8. **Consultation outcome**

8.1 During the development of these Regulations, a formal public consultation was held and ran for 8 weeks, from 8 May until 2 July 2014. The Department consulted over a shorter period than the 12 week period because it had engaged extensively with stakeholders prior to the consultation. The consultation sought views on the

legislative changes which are needed as a result of the abolition of contracting-out for salary related schemes. Meetings with stakeholders were held to consider some issues raised in the feedback.

- 8.2 The Department received 20 written responses to the consultation from a wide range of organisations, including employer organisations, pension providers, lawyers, actuaries and trade unions. The consultation invited views on a number of specific issues: for example, whether consultees agreed that the proposed changes would achieve the intended effect of preserving accrued contracted-out rights. Overall, respondents thought that these regulations would preserve accrued rights.
- 8.3 A number of substantive changes were made to the Regulations as a result of the consultation feedback. For example, for the purposes of determining the revaluation applicable to GMPs, respondents asked that DWP clarify that all remaining DB contracted-out employment will be treated as having terminated on 5 April 2016. Their concern was to ensure that the abolition of contracting-out will not trigger the early leaver rules for those who cease contracted-out employment at the abolition date but remain in pensionable service.
- 8.4 We re-assured respondents that amendments made to sections 16 and 87 of the PSA 1993 by Schedule 13 of the 2014 Act (the revaluation requirements for GMPs for early leavers and the anti-franking rules) will ensure that the abolition of contracting-out does not trigger the early leaver rules for those who cease contracted-out employment at the abolition date but remain in pensionable service. However, in looking at this issue we became aware that for some members, whose contracted-out employment ended before 6 April 2016 but who remain active members of their scheme, the amendments to section 16 of the PSA 1993 do not achieve the policy intention that such members should be entitled to fixed rate revaluation from the date contracted-out employment ended. To address this we have provided for section 16(2) of the PSA 1993, and the regulations made under it, to be saved in the Pensions Act 2014 (Savings) Order 2015 (S.I. 2015/1502), and in regulation 33 of these Regulations, in order to avoid this unintended retrospective change to the member's rights.
- 8.5 A number of respondents asked for clarification of the drafting: for example why it was necessary to have two separate provisions for GMPs and section 9(2B) rights in relation to forfeiture of benefits. The reason for this is that provisions relating to forfeiture of section 9(2B) benefits, (regulation 19), and the suspension and forfeiture of GMP benefits (regulation 26) are separately provided for because they are made under separate powers, and provide for forfeiture in different ways. Regulation 19 describes an exception to the general rule in section 92(1) Pensions Act 1995⁴ relating to forfeiture of accrued rights. Section 92(1) and the general regulations made under that power also apply to section 9(2B) rights (see regulation 6(1)(a) of the Occupational Pension Schemes (Assignment, Forfeiture, Bankruptcy, etc.) Regulations 1997⁵ (S.I. 1997/785) ("the Forfeiture Regs 1997")). Regulation 26 provides for a comprehensive set of circumstances in which a GMP can be forfeited in accordance with section 21(2) of the PSA 1993. The existing GMP provision (regulation 61 of the 1996 Regulations), does not allow forfeiture of an occupational pension for murder or manslaughter of the earner by the survivor, as is

⁴ <http://lawvolumes.dwp.gov.uk/docs/a5-1801.pdf>

⁵ <http://www.legislation.gov.uk/uksi/1997/785/made>

the case for other accrued rights. We have therefore taken the opportunity presented by these Regulations to update the legislation to reflect forfeiture of a GMP for murder and manslaughter in regulation 26(2)(e).

- 8.6 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>.

9. **Guidance**

- 9.1 The Government's Response to the consultation on the Regulations provides information for schemes on how to interpret these Regulations. 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>

- 9.2 Her Majesty's Revenue & Customs, in collaboration with the Department for Work and Pensions, is updating online guidance for schemes and pension administrators for use from April 2016. In addition, a telephone advice line service will be available for pension scheme administrators and managers.

10. **Impact**

- 10.1 This legislation is about ensuring we have regulations which are appropriately worded in order to protect the previously accrued rights of individuals and, therefore, they do not place any additional burden on individuals or business, nor do they lead to any savings.

- 10.2 The impact of the abolition of contracting-out on employee and employer NI contributions is considered in the Impact Assessment for the new State Pension Bill, updated in July 2014⁶. Copies of these Impact Assessments are available in the libraries of both Houses of Parliament. Copies may also be obtained from the Better Regulation Unit of the Department for Work and Pensions, 2D, Caxton House, Tothill Street, London SW1H 9NA. The costs and benefits associated with the provision of the employer amending power were set out in an Impact Assessment which was produced in March 2015⁷.

- 10.3 An Impact Assessment has therefore not been prepared for this instrument.

11. **Regulating small business**

- 11.1 The legislation applies to small businesses but does not place any additional burden on them.

⁶ <https://www.gov.uk/government/publications/single-tier-pension-updated-impact-analysis-july-2014>

⁷ <http://www.legislation.gov.uk/ukxi/2015/118/impacts>

12. **Monitoring & review**

- 12.1 It is not appropriate in the circumstances to make statutory provision for review in these Regulations. This is because the purpose of the Regulations is to ensure that legislation is appropriately worded to protect the previously accrued rights of individuals and does not place any additional burden on individuals or business. As such, the cost of conducting a statutory review and monitoring impacts would be disproportionate to the economic impact of the regulations.
- 12.2 The Department will, however, continue to work closely with its stakeholders, including industry bodies and employer organisations, in the period following the abolition of contracting out 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 changes may be necessary.

13. **Contact**

- 13.1 Lillian Coulson, Department for Work and Pensions, can answer any queries regarding the instrument. Tel: 020 7449 7232; or email: Lillian.Coulson@dwp.gsi.gov.uk