

EXPLANATORY MEMORANDUM TO

**THE OCCUPATIONAL PENSION SCHEMES AND SOCIAL SECURITY
(SCHEMES THAT WERE CONTRACTED-OUT AND GRADUATED
RETIREMENT BENEFIT) (MISCELLANEOUS AMENDMENTS) REGULATIONS
2017**

2017 No. 354

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 make amendments to secondary legislation relating to the abolition of contracting-out of the additional State Pension for salary related pension schemes; make amendments to the Social Security (Graduated Retirement Benefit) Regulations 2005¹; to add ‘entitlement to bereavement support payment’ to the circumstances in which survivor Guaranteed Minimum Pensions (GMP) can be paid; and to provide a new fixed rate of revaluation of GMP for those leaving pensionable service after 5 April 2017.
- 2.2 Amendments are required to ensure that members’ accrued contracted-out rights are preserved, schemes are able to undertake their administrative functions, and that legislation provides for the calculation of a lump sum payment by an individual who deferred receipt of their Graduated Retirement Benefit.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to the 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 Until the new State Pension 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 the additional State Pension on the condition that the scheme met certain statutory requirements.
- 4.2 Following the abolition of contracting-out from 6 April 2016, The Occupational Pension Schemes (Schemes that were Contracted-out) (No. 2) Regulations 2015² and the Pensions Act 2014 (Abolition of Contracting-out for Salary Related Pension

¹ <http://www.legislation.gov.uk/uksi/2005/454/contents>

² <http://www.legislation.gov.uk/uksi/2015/1677/contents/made>

Schemes) (Consequential Amendments) Order 2016³ set out the key legislative changes that are necessary as a result of the abolition of contracting-out for DB schemes. These regulations make further changes to contracting-out and other legislation as a consequence of the abolition of DB contracting-out including:

- extending the period for which Contributions Equivalent Premiums (CEPs) may be paid where a scheme has reconciled their records through HM Revenue and Custom's scheme reconciliation service (SRS);
- consequential changes to add entitlement to bereavement support payment to the circumstances in which a GMP can be paid to an earner's survivor following the introduction of the new bereavement support payment; and
- revising the fixed rate of revaluation of GMPs for those leaving pensionable service after 5 April 2017.

4.3 The regulations also make an addition to the legislation that provides for the calculation of a lump sum payment for individuals, who between April 1961 and April 1975 gained entitlement to Graduated Retirement Benefit under the old State Pension and who deferred claiming their State Pension. The calculation set out in the Social Security (Graduated Retirement Benefit) Regulations 2005 relies on the payment arrangements provided by the Social Security (Claims and Payments) Regulations 1987.

5. Extent and Territorial Application

- 5.1 This instrument (except regulation 4 (9), (10) and (11)) extends to Great Britain.
- 5.2 Regulation 4(9), (10) and (11) extend to Northern Ireland.
- 5.3 The territorial application of this instrument is Great Britain
- 5.4 The Department for Communities will be making corresponding provisions for Northern Ireland, except for CEPs, 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 (additional State Pension) 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 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.

³ <http://www.legislation.gov.uk/ukxi/2016/931/contents/made>

- 7.2 From 6 April 1997, a different test, referred to in legislation as the ‘statutory standard’, was applied to schemes that contracted out of the state system. This was commonly known as the Reference Scheme Test and operated until 5 April 2016. This test required a scheme to provide, as a minimum, a pension at age 65 for the majority of members; to have an accrual rate of 1/80th of qualifying earnings in the last three years before the end of contracted-out employment; 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 With the introduction of the new single tier State Pension from 6 April 2016 the process mentioned above known as ‘contracting-out’ was abolished entirely as there was no longer an additional State Pension from which to contract out of. In order to ensure that members’ accrued contracted-out rights are preserved and help schemes undertake their administrative functions following abolition, it has been necessary to make further amendments to certain legislation. These amendments will:
- i. Concern Contributions Equivalent Premiums (CEPs). These payments serve to restore the State Pension rights of members in contracted-out employment and broadly apply if a member was in contracted-out employment for less than 2 years.
 - ii. The legislative changes will allow HMRC to extend the deadline for late notifications and payments of CEP where outstanding payments come to light as a result of HMRC’s scheme reconciliation process (one through which pension scheme administrators may reconcile their membership and GMP dates against records held by HMRC).
 - iii. Add ‘entitlement to bereavement support payment’ to the circumstances in which a GMP can be paid to an earner’s survivor. Inheritable GMPs are paid to survivors if they receive certain benefits such as Bereavement Allowance. Following the reform of these benefits, consequential changes are required to clarify for schemes the circumstances in which and the period for which survivor GMP is payable where the survivor is entitled to a bereavement support payment.
 - iv. Revise the fixed rate of revaluation of GMPs for those leaving pensionable service after 5 April 2017. The fixed rate of revaluation was part of the review of National Insurance (NI) rebates for contracted-out employers and their members which took place every five years. With the ending of contracting-out, and notwithstanding the removal of the NI rebate review requirement, we nevertheless still intend to review the fixed rate every five years to ensure that it reflects ongoing expected increases in earnings.
- 7.4 In addition, these regulations provide for an addition to the legislation governing the calculation of entitlement, under the old State Pension, to a Graduated Retirement Benefit. The change ensures that those who deferred receipt of their Graduated Retirement Benefit may receive a lump sum payment calculated in line with the changes, introduced from 6 April 2010, to the regulations providing for the payment of State Pension. This amendment was not made at the time and the need for it was only recently identified.

Consolidation

- 7.5 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 Archives website legislation.gov.uk. An explanation as to which instruments are maintained on each site is available [here](#).

8. Consultation outcome

- 8.1 A consultation *Occupational pensions: draft regulations, legislative review and Guaranteed Minimum Pensions equalisation methodology*⁴ ran for 7 weeks from 28 November 2016 to 15 January 2017. This accords with previous consultation periods on similar topics within the contracting-out field. There were 43 responses from members of the public and experts in the pensions industry. The consultation asked seven questions mostly seeking to ensure that the proposed changes to the contracting-out legislation would achieve the policy intent, and also seeking views on the proposed new fixed rate of GMP revaluation for those leaving pensionable service. The State Pension amendment was considered separately by the Social Security Advisory Committee.
- 8.2 There was broad agreement for the proposed changes in regulations with one exception concerning alteration of scheme rules. Here, some respondents raised concerns that the changes being suggested were unnecessary or that we had not sufficiently explained the implications of the changes we were proposing. We have therefore decided not to take these forward at this time, but to reflect further on what, if any, additional provision is required in this area going forward and to consult further with industry.
- 8.3 Several responses to the review of fixed rate revaluation of GMPs for early leavers suggested that the new rate proposed by the Government Actuary's Department (GAD) might be somewhat high taking into account current economic factors and that the premium added by DWP for achieving certainty was unnecessary given recent changes to State Pensions. In addition, it was suggested that historically those who have had fixed rate revaluation applied to their GMPs have generally done much better than those who have had revaluation linked to average weekly earnings. Other respondents argued recent heightened inflation expectations supported the underlying average earnings increase assumption, and others still supported retaining the premium to fix the rate. DWP considered the points raised and as a result the Minister for Pensions has decided to retain the proposed average earnings increase assumption but remove the premium so that the final rate will be reduced from the 4.00% set out in the consultation to 3.5%.
- 8.4 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-pensions-draft-regulations-legislative-review-and-guaranteed-minimum-pensions-equalisation-methodology>

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 publish regular

⁴ <https://www.gov.uk/government/consultations/occupational-pensions-draft-regulations-legislative-review-and-guaranteed-minimum-pensions-equalisation-methodology>

bulletins aimed at employers, pension scheme administrators and others in the pensions industry here:

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

- 9.2 HMRC, in collaboration with DWP, is updating guidance for schemes and pension administrators following the end of contracting-out and this should be available in spring 2017.

10. Impact

- 10.1 The impact on business, resulting solely from the introduction of the new Bereavement Support Payment is estimated to be about £0.5 million in year one resulting from familiarisation, administration and implementation costs. We do not expect any costs in later years. The vast majority of schemes provide an inheritable GMP regardless of the member's circumstances, including their entitlement to bereavement benefits, and thus are not affected by the regulations. The majority of the rest of the provisions in the regulations are technical in nature and do not have an impact on business, charities or voluntary bodies.
- 10.2 The process enabling Contributions Equivalent Premiums resulting from the SRS process, to be extended beyond April 2016, will incur additional public expenditure as a result of paying increased State Pension. However, this will be wholly offset by the additional National Insurance (NI) the NI Fund will receive. So there will be no overall impact on public expenditure.
- 10.3 Most public sector schemes will pay an inheritable GMP to a survivor regardless of their circumstances, hence the introduction of the bereavement Support Payment should not impact significantly on these schemes.
- 10.4 An Impact assessment is submitted with this Memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 No specific action is proposed to minimise regulatory burdens on small businesses. Removing small businesses (i.e. schemes sponsored by small employers) from these regulations would adversely affect members of the affected schemes because their bereavement benefits would not be protected with the introduction of the Bereavement Support Payment.

12. Monitoring & review

- 12.1 Given the technical nature of these amendments and the limited level of impacts, it would be disproportionate in these circumstances to make statutory provision for a review. The Department will, however, continue to work closely with its 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 Richard Jordan at the Department for Work and Pensions can answer any queries regarding the instrument. Tel: 020 7449 7379; or email: Richard.jordan1@dwp.gsi.gov.uk