



Occupational pension schemes draft
amendments to contracting out
regulations

Occupational pensions legislation
subject to review

A proposed methodology for
equalising pensions for the effect of
GMPs

Public consultation

November 2016

Contents

Introduction	2
How to respond to this consultation.....	4
How we consult	5
Chapter 1: Commentary on the draft The Occupational Pension Schemes and Social Security (Schemes that were Contracted-out and Graduated Retirement Benefit) (Miscellaneous Amendments) Regulations 2017	7
Chapter 2: Reviews	17
Chapter 3: GMP Equalisation	23
Annex A: List of consultation questions.....	34

Introduction

Following the introduction of the new State Pension, salary-related contracting out was abolished on 6 April 2016. Legislation was introduced to enable trustees and managers to administer former contracted out schemes effectively¹. Further changes to that legislation are now needed to help improve scheme administration and provide clarity. We are consulting on the changes contained in the draft Occupational Pension Schemes and Social Security (Schemes that were Contracted-out and Graduated Retirement Benefit) (Miscellaneous Amendments) Regulations 2017 (“the 2017 Regulations”) – Annex C. Chapter 1 of this consultation provides a commentary on the 2017 Regulations.

The consultation also deals with secondary legislation which has been introduced in the past where the Department committed to review the provisions. Chapter 2 outlines the context for two reviews: firstly, in relation to the transitional arrangements following the abolition of defined contribution contracting-out in April 2012²; secondly, for regulations 3 and 4 of the Occupational and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2013³.

Chapter 3 seeks views on a new methodology for equalising pensions for the effect of inequalities caused by Guaranteed Minimum Pensions (GMPs), and potential changes to GMP conversion legislation that may be needed to enable equalisation to take place.

We looked at issues raised by respondents in previous consultations. We were, however, unable to tackle all the points raised. For example, the issue of bulk

¹ Principally, the “Occupational Pension Schemes (Schemes that were Contracted-out)(No 2) Regulations 2015” - <http://www.legislation.gov.uk/ukxi/2015/1677/contents>

² The Pensions Act 2007 (Abolition of Contracting-out for Defined Contribution Pension Schemes (Consequential Amendments) (No 2) Regulations 2011 - <http://www.legislation.gov.uk/ukxi/2011/1724/contents/made>

³ The Occupational and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2013 - <http://www.legislation.gov.uk/ukxi/2013/459/contents/made>

transfers without member consent to schemes that have never been contracted-out. We are working with stakeholders on this issue but any changes to legislation will not be introduced before autumn 2017. We expect to consider this and other issues in future consultations.

About this consultation

Who this consultation is aimed at

This consultation is mainly aimed at pension administrators and employers who sponsor formerly contracted-out defined benefit occupational pension schemes. However, the Government also welcomes the comments from the pension industry, professionals, pension schemes, trustees, pension scheme members and member representative organisations and any other interested organisations.

Purpose of the consultation

The consultation seeks views on:

- the draft Pensions (Schemes that were Contracted-out) (Miscellaneous Amendments) Regulations 2017;
- reviews of legislation introduced previously; and
- a proposed methodology for equalising for the effect of inequalities caused by guaranteed minimum pensions.

Scope of consultation

The Regulations apply to England and Wales and Scotland, except for regulations 4(9) and (10) and relevant provision in regulation 1, which extend to Northern Ireland.

Duration of the consultation

The consultation period begins on 28 November 2016 and runs until 15 January 2017.

How to respond to this consultation

Please send your consultation responses preferably by email to:

Email: contracting.outteam@dwp.gsi.gov.uk

Or by post to:

Department for Work and Pensions

Contracting-out policy Team

First Floor

Caxton House

Tothill Street

London

SW1H 9NA

Please ensure your responses reaches us by: 15 January 2017

When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents, and where your applicable, how the views of members were assembled.

Any queries about the subject matter of this consultation should be addressed to:

contracting.outteam@dwp.gsi.gov.uk

Government response

We will aim to publish the government response to the consultation on the [GOV.UK](https://www.gov.uk) website. The [consultation principles](#) encourage Departments to publish a response within 12 weeks or provide an explanation why this isn't possible. Where consultation is linked to a statutory instrument responses should be published before or at the

same time as the instrument is laid. The report will summarise the responses and say what the Government intends to do as a consequence.

How we consult

Consultation principles

This consultation is being conducted in line with the revised [Cabinet Office consultation principles](#) published in January 2016. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator

2nd Floor

Caxton House

Tothill Street

London

SW1H 9NA

Email: caxtonhouse.legislation@dpw.gsi.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:

Email: freedom-of-information-request@dwp.gsi.gov.uk

The Central Fol team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the [Freedom of Information Act](#).

Chapter 1: Commentary on the draft The Occupational Pension Schemes and Social Security (Schemes that were Contracted-out and Graduated Retirement Benefit) (Miscellaneous Amendments) Regulations 2017

Regulation 1 Citation, commencement and extent

Commentary

1.1. The Regulations come into force on 6th April 2017. The Regulations apply to England and Wales and Scotland, except for regulations 4(9) and (10) and relevant provision in regulation 1, which extend to Northern Ireland.

Regulation 2 Amendment of the Contracting Out (Transfer and Transfer Payment) Regulations 1996

Revaluation of a Guaranteed Minimum Pension after transfer from another scheme.

Background

1.2. Between 6 April 1978 and 5 April 1997 employers sponsoring salary-related schemes could contract their employees out of the additional state pension as long as the scheme paid a 'guaranteed minimum pension' (GMP) calculated according to the legislation.

- 1.3. GMPs were no longer required from 6 April 1997 and contracting-out for salary-related schemes was abolished from 6 April 2016. Technical rules set out in the legislation governed the revaluation of GMPs, including when the member's rights are transferred to another scheme and the provisions differ according to whether the member's contracted-out employment ended before or on the abolition date.

Commentary

- 1.4. Regulation 2 makes a minor change to regulation 13(B)(1) of the Contracting-out (Transfer and Transfer Payment) Regulations 1996. Regulation 2 amends those rules to clarify that those particular provisions only apply where the member's contracted-out employment ended on the abolition date, and not before.

Amendment of the Social Security (Graduated Retirement Benefit) Regulations 2005

Regulation 3

- 1.5. Regulation 3 concerns State Pensions and is included in this package for procedural reasons. The heading is given but the text of the provision is not provided. This is because state pension provisions have a separate scrutiny process. The text for the provision will appear in the published final version of the Regulations.

Amendment of the Occupational Pension Schemes (Schemes that were Contracted-out) (No2) Regulations 2015 ("the 2015 Regulations")

Regulation 4(2)

Background

1.6. Regulation 4(2) inserts a number of definitions used in the 2017 Regulations.

Commentary

1.7. The terms 'Bereavement Support Payment' and 'Scheme Reconciliation Service' are defined.

Regulation 4(3)

Contributions equivalent premium

Background

1.8. The payment of a contributions equivalent premium (CEP) enables a scheme manager to buy a member of a contracted-out scheme into the additional State Pension. CEP payments are usually made when an employer's scheme is wound up or an individual has left employment with less than two years' service. The legislation permits or requires trustees of formerly contracted-out schemes to notify and make a CEP payment to HM Revenue and Customs (HMRC). The CEP payment ensures that the member is placed back into the State scheme for the period during which they were originally contracted-out. The member is then effectively treated as if they had not been contracted-out of the State system. The employer's scheme is no longer responsible for paying a pension for the period in question.

1.9. The time limits for notifying and paying such payments are set in legislation. Where a CEP is required to be paid in respect of a scheme member, the scheme is then required to notify HMRC no later than six months after the member ceased contracted-out employment. HMRC can extend this period if it

appears that notification could not reasonably have been given within this period.

1.10. Where a CEP is required or trustees have elected to pay a CEP, the timeframe is either six months after termination of contracted-out employment or one month after HMRC payment notice, whichever is the later. For a Pension Protection Fund case, the six month period is in relation to the date the assessment period ended. There are currently two ways the timeframe can be extended: (i) by up to six months, if payment could not reasonably be required within above period; and (ii) by such further reasonable period, if earlier payment would prejudice the earner's interests.

1.11. HMRC's data reconciliation service⁴ has revealed short periods of service in the past for which a CEP is due but the current time limits in legislation for notification and payment of the CEP do not cover this scenario. The legislation needs to be modified so that HMRC also has the discretion to extend the notification and payment periods to allow late CEPs identified as a result of the scheme reconciliation service.

Commentary

Regulation 4(3): Notification of requirement to pay a contributions equivalent premium

1.12. Regulation 4(3) makes further provision for the Commissioners of HMRC to extend the time limit for notification provided for in regulation 9 of the 2015 Regulations where notification is made through a scheme reconciliation service route.

⁴ An HMRC service to reconcile scheme data with data held by HMRC

Regulation 4(4): Amendments relating to payment of a contributions equivalent premium

1.13. Regulation 4(4) allows for the Commissioners to extend the time period to pay a CEP provided for in regulation 12 of the 2015 Regulations where payment of a CEP follows from use of the scheme reconciliation service.

Consultation Question

- 1. Do you agree that the draft changes to give HMRC discretion to extend the notification and payment periods for contributions equivalent premiums will deliver the policy intent?**

Regulation 4(5)

Alteration of scheme rules

Background

1.14. In formerly contracted-out schemes members' accrued rights are protected so that certain adverse changes cannot be made when scheme rules are altered. Regulation 17 of the 2015 Regulations sets out the relevant requirements⁵. It also protects benefits to accrue in the future and survivor benefits when scheme rules are changed.

1.15. The draft amendments strengthen these protections as outlined in the commentary.

⁵ Section 9(2B) rights are contracted-out rights which accrued from April 1997 to April 2016.

Commentary

1.16. Draft regulation 4(5) amends regulation 17 of the 2015 Regulations in two ways. Firstly, by amending the ‘after’ alteration position in paragraph (1)(a) of regulation 17. Secondly, in paragraph (2) of regulation 17, by requiring both elements (concerning the amount of the pension and the circumstances in which it will be paid) to be satisfied. This increases the requirements in relation to benefits to accrue in the future and survivor benefits, and thus serves the policy intent which is to protect pension benefits, following a change to scheme rules.

Consultation Questions

2. **Do you agree that the proposed changes will now correctly reflect the policy intention as outlined in paragraph 1.14 above?**

Regulation 4 (6) - (7): Introduction of the new Bereavement Support Payment and impact on circumstances in which an inheritable Guaranteed Minimum Pension (GMP) must be paid

Background

1.17. Section 17 of the Pension Schemes Act 1993 and regulations 21 and 22 of the Occupational Pension Schemes (Schemes that were Contracted-out) (No 2) Regulations 2015 require that in certain circumstances, usually where a State Bereavement Benefit such as Widowed Parents Allowance, or Bereavement Allowance is payable, an inheritable GMP is also payable to any surviving spouse or civil partner.

1.18. From April 2017 these benefits will be replaced by the Bereavement Support Payment (“the BSP”), thereby requiring consequential changes to regulations 21 and 22. Without these changes it would be unclear to *some* pension

schemes whether they are required to pay an inheritable GMP where the survivor is entitled to the BSP or where entitlement to the BSP comes to an end. (We are aware that some pension schemes provide in their scheme rules for an inheritable GMP to be paid regardless of circumstances).

Commentary

1.19. Regulation 4(6)-(7) amends regulations 21 and 22 to clarify that an inheritable GMP is payable where the survivor is entitled to the BSP and to continue where the survivor has reached age 45 and BSP ceases to be paid.

1.20. Where the member was under age 45 when payment of the BSP ceases, the regulations will continue to require that an inheritable GMP be payable where the survivor is residing with a child or entitled to child benefit in respect of: (i) a child from the relationship; or (ii) a child for whom the earner was entitled to child benefit before the earner's death.

Consultation questions

3. **Do you agree that the changes we have made to regulations 21 and 22 make it clear in which circumstances an inheritable GMP should be paid following the introduction of the new BSP?**

4. **It would be helpful to know, from your experience, approximately what proportion of schemes are likely to provide an inheritable GMP regardless of the survivor's circumstances (for example as their scheme rules require that this is paid to everyone), and what proportion will provide an inheritable GMP by following the statutory requirements of section 17 of the 1993 Act (for example by checking that the appropriate State benefit is in payment or that the survivor has reached the appropriate age). We believe**

that the latter approach will represent a minority of schemes but we are seeking some quantification:

- (i) For a scheme that provides an inheritable GMP regardless of the survivor’s circumstances (the former approach), will there be any costs associated with the change to regulations? These costs can be expressed in financial terms or in terms of staff time (e.g. 1 hour for 12 admin staff).**

- (ii) For a scheme that provides an inheritable GMP by following the statutory requirements for each member (the latter approach), what additional costs might the scheme incur from updating their administrative processes to take account of the change, e.g. changing guidance, making staff aware of the new requirements? These costs can be expressed in financial terms or in terms of staff time (e.g. 1 hour for 12 admin staff).**

Regulation 4(8): review of fixed rate revaluation of guaranteed minimum pension (GMP) for early leavers

Background

1.21. Where a member of a formerly contracted out pension scheme leaves the scheme before pensionable age (an “early leaver”), the scheme must revalue their GMP until it becomes payable at pensionable age. Where a scheme has chosen to revalue the GMPs of early leavers using the “fixed rate method”, the GMP is revalued each year by the same percentage. The percentage is provided for in legislation⁶ by the rate relevant to the time they left the scheme.

⁶ Regulation 24(2) of the Occupational Pension Schemes (Schemes that were Contracted-out) (No 2) Regulations 2015 (2015/1677) and regulation 62 of the Occupational Pensions Schemes (Contracting-out) Regulations 1996 (1996/1172) as saved by the Pensions Act 2014.

1.22. The revaluation rate is reviewed every 5 years and a new rate needs to be applied for those who leave pensionable service on or after 6 April 2017. DWP has always undertaken this review having taken the advice of the Government Actuary's Department (GAD) on the rate that should apply. GAD has prepared the report at **Annex B**.

Commentary

1.23. Regulation 4(8) amends regulation 24(2) to apply a new fixed rate percentage for early leavers from 6 April 2017. It is our intention to apply the rate in the GAD report (4%), a rate based on a medium term view on earnings assumptions being applied given the assumption that most individuals leaving pensionable service between 6 April 2017 and 5 April 2022 (when the next review takes place) will be less than 10 years from their GMP age.

1.24. The rate, also in accordance with previous reviews, continues to apply a premium of 0.5% for the certainty that employers get from revaluing in line with a fixed rate.

Consultation questions

5. **Do you agree with the underlying earnings increase assumption proposed by GAD?**
6. **Is it correct to adopt a medium term view on earnings assumptions?**
7. **Do you agree that DWP should continue to apply the 0.5% premium for fixing the rate or are there good arguments to remove or adjust the premium?**

Provision for Northern Ireland

Regulation 4 (9)-(10)

1.25. These Regulations include provisions for Northern Ireland which mirror the provisions for England, Wales and Scotland.

Commentary

Regulation 4(9): Notification of requirement to pay a contributions equivalent premium): Northern Ireland

1.26. Regulation 4(9) replicates the provisions relating to the notification of a CEP as a result of scheme reconciliation service, and as they apply to England, Wales and Scotland.

1.27. For commentary on regulation 4(9), see commentary on regulation 4(3).

Regulation 4(10): Payment of a contributions equivalent premium: Northern Ireland

1.28. Regulation 4(10) replicates the provisions relating to the payment of a CEP as a result of the scheme reconciliation service, as they apply to England, Wales and Scotland. For an explanation of regulation 4(10), see commentary on regulation 4(4)

Chapter 2: Reviews

Introduction

2.1. This chapter considers two areas of contracting out where the Department has committed to review legislation. It looks specifically at the Occupational and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2013 – “the 2013 Regulations”, and the transitional arrangements that were put in place following the abolition of defined contribution contracting-out in April 2012. Our purpose in reviewing is to determine whether or not the arrangements put in place are effective and the policy aim is still valid. The chapter sets out the context in which the provisions were made. Stakeholders’ comments will help inform the reviews.

Review No. 1: The Occupational and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2013 – “the 2013 Regulations”

2.2. The Department committed to review regulations 3 and 4 of the 2013 Regulations⁷.

Regulation 3. Amendment of the Occupational Pension Schemes (Contracting-out) Regulations 1996

Background

2.3. From 6 April 1997 contracted out pension schemes had to meet a statutory test in relation to benefits from the scheme - the Reference Scheme Test (RST)⁸ -

⁷ Explanatory Memorandum to the 2013 regulations - http://www.legislation.gov.uk/ukxi/2013/459/pdfs/ukxiem_20130459_en.pdf

⁸ Since 6 April 1997 schemes have been required to satisfy a test of overall scheme quality in respect of future service – the reference scheme test.

carried out every three years by an actuary. In relation to schemes that ceased to contract out, the policy aim is to ensure that member's accrued rights are not reduced when a scheme changes its rules. Certain legislative safeguards are placed on those schemes to ensure that accrued rights are not affected. One requirement is that any scheme rule changes that take place after the scheme has ceased to contract-out must not affect the members' rights accrued while the scheme was contracted-out; any changes to accrued rights must still meet the RST. The scheme actuary is required to certify that this is the case before the scheme rule is changed. The requirements that schemes had to follow were set out in the Occupational Pension Schemes (Contracting-out) Regulations 1996⁹ ("the 1996 Regulations").

- 2.4. Industry stakeholders told us it was not possible to provide the certification set out in the legislation because the RST is prospective, looking at the coming three years, so cannot be applied to a past period. Another concern was that pension schemes generally would not hold the relevant historical data to provide the certification. Schemes also said that in attempting to meet the legislative requirements, pension schemes had to seek and pay for additional legal advice and, in doing so, incurred delays to making changes to scheme rules.
- 2.5. So, in order to address these issues, changes were made to the legislation. Regulation 3 amended regulation 42 of the 1996 Regulations, providing clarification of the policy intent for the actuary responsible for assessing the effect of proposed scheme rule changes on the benefits payable to members. The amendment enabled the actuary to undertake suitable tests of the effect of any proposed rule changes to contracted-out rights accrued and future accruals. In relation to the latter, the test remained the RST.
- 2.6. In relation to amendments to accrued contracted-out rights, the RST is not appropriate. Regulation 3 meant that retrospective scheme rule changes cannot proceed if a member's accrued contracted-out rights were replaced with a money purchase benefit and would - or might - result in a reduction of

⁹ <http://www.legislation.gov.uk/uksi/1996/1172/contents>

pension payment. Neither could 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 1995¹⁰ is met (that is the change would have little effect on the overall value of the pension benefits). There was also a new requirement to preserve the value of survivors' benefits, and the circumstances in which benefits are payable to survivors.

2.7. Regulation 42, which regulation 3 amended, has now been incorporated into regulation 17 of the 2015 Regulations. In relation to the review, we are aware that stakeholders have already raised some issues relating to regulation 3, specifically:

- That it could potentially result in more generous benefits being provided by the altered scheme than were originally provided in the scheme in accordance with the RST; and
- Certification of changes by the actuary.

The first issue is considered in Chapter 1 of this consultation – see paragraph 1.14. The second needs further development work and any changes to the legislation would be not be implemented before autumn 2017.

Consultation question

8. Do you have any concerns relating to regulation 3 of the 2013 Regulations which the Department is not already aware of?

¹⁰ <http://www.legislation.gov.uk/ukpga/2004/35/section/262>

Regulation 4. Amendment of the Contracting-out (Transfer and Transfer Payment) Regulations 1996

Background

2.8. Where the accrued rights in a defined benefit pension scheme do **not** include contracted-out rights, legislation permits a bulk transfer of a member's rights to another defined benefit scheme without member consent provided the employers involved in the transfer are "connected" - broadly:

- The two schemes must apply to employment with the same employer, or
- Where the schemes apply to employment with different employers, the proposed transfer must be a bulk transfer of members, and the employers must be either involved in a takeover or merger, or be part of the same group of companies.

Where the rights include contracted-out rights, the transfer (at that time) must also be to a receiving scheme which is an active contracted-out scheme.

2.9. Stakeholders informed us that the legislation governing these types of bulk transfers was inconsistent, causing additional administrative cost and burdens for schemes wanting to consolidate pension provision. There was also uncertainty whether bulk transfers could take place between schemes where both schemes have the same sponsoring employer, but one scheme has no active members. Consequently, we made changes to the Contracting-out (Transfer and Transfer Payment) Regulations 1996¹¹ by virtue of regulation 4 of the Occupational and Stakeholder Pension Schemes (Miscellaneous Amendments) Regulations 2013.

Regulation 4

2.10. Regulation 4 made changes to remove this inconsistency and alleviate administrative burdens. Stakeholders, however, have since alerted us to a

¹¹ <http://www.legislation.gov.uk/uksi/1996/1462/contents>

further problem with bulk transfers without member consent to schemes that have never been contracted-out. Their concern is how such transfers can take place now that contracting-out has ended. Before contracting-out was abolished if a scheme wished to receive a bulk transfer but could not because, as the receiving scheme, it had never been contracted out, it could adopt a workaround by becoming contracted-out for a short period, thereby becoming a formerly contracted-out scheme. With the ending of contracting-out, schemes are no longer able to use this workaround. Some stakeholders have asked whether, because the workaround is no longer possible, we could make changes to enable this type of transfer to take place. We are working with stakeholders on this issue but any changes to legislation will not be introduced before autumn 2017.

Consultation question

9. **Apart from the issues mentioned, do you have any concerns about regulation 4 and bulk transfer arrangements?**

Review No. 2: Abolition of Contracting-out on a defined contribution basis

Background

2.11. The Department introduced secondary legislation providing a detailed framework for the abolition of defined contribution (DC) contracting-out in 2012. The legislation includes provision for transitional arrangements that are necessary for administrative 'tidying-up' of 'late' National Insurance rebates.¹² The impact assessment accompanying the legislation committed the Department to reviewing the transitional provisions.¹³

¹² Part 2 of The Pensions Act 2007 (Abolition of Contracting-out for Defined Contribution Pension Schemes (Consequential Amendments) (No 2) Regulations 2011 - <http://www.legislation.gov.uk/ukxi/2011/1724/contents/made>

¹³ <http://www.legislation.gov.uk/ukxi/2011/1724/impacts>

2.12. National Insurance (NI) rebate payments were made by HM Revenue & Customs (HMRC) to contracted-out DC schemes at the end of each tax year by automated payments. From time to time, HMRC needs to amend an individual's NI record because of changes notified after the end of a tax year – for example, an error in the amount of earnings paid to an employee in an earlier tax year is identified or an incorrect date of birth. These adjustments to the NI records can sometimes result in an additional contracted-out rebate payment (or overpayment) becoming due to a scheme. Analysis shows that the bulk of late rebate payments fall to be paid in the three tax years following the tax year to which the rebate relates. The transitional arrangements ensure that adjustments to rebates for periods prior to April 2012 are paid to individuals' pension schemes up to April 2015 by an automated process. Following the end of the 3 year transitional period, the intention was for payment to be made from 6 April 2015 to individuals, subject to a minimum amount. The minimum amount (£15) is the limit below which HMRC will not make a rebate payment. It corresponds broadly to HMRC meeting the cost of paying the rebate clerically.

2.13. The Department committed to review the transitional arrangements in 2013 but on further reflection we considered this timescale too short and a longer period would be needed to understand better the impacts. HMRC report that there have been no issues relating to payments to schemes. In relation to payments to individuals, HMRC report that due to a technical problem, there has been a delay in making such payments. However, the problem has been rectified and HMRC expect payments to begin shortly.

Consultation questions

10. Are there any issues that you think the Department needs to be aware of in relation to the transitional arrangements?

Chapter 3: GMP Equalisation

Consultation on a new methodology for equalising pensions for the effect of GMPs

Introduction

- 3.1. In January 2012 DWP published draft regulations for consultation. These draft regulations amended the Equality Act 2010 by removing the need for a comparator to be required to provide equal pension benefits. The industry had also asked for guidance on a standard methodology for equalisation, so draft guidance was published alongside the draft regulations.
- 3.2. However, because of concern from the industry that the proposed methodology would be particularly onerous to implement, the Government withdrew the draft regulations whilst DWP investigated with the pensions industry whether equalising pensions for the effect of unequal GMPs might be achieved through a less onerous process that would be acceptable to both the Government and to the pensions industry. We are aware that since then pension schemes have been awaiting further advice from DWP on equalisation.
- 3.3. Following the withdrawal of the regulations, in 2013 a working group was set up comprising of leading practitioners from across the industry. The remit of the group is to establish whether GMP conversion would allow schemes to provide equal pension benefits, but without imposing overly onerous burdens on those schemes. The purpose of this consultation is to provide an update on the work that has been taking place within the working group and to seek views on a

new proposed methodology for achieving equal pensions through GMP conversion.

- 3.4. The group have investigated various methods by which schemes might achieve equal pensions. The proposed method involves a one-off calculation and actuarial comparison of the benefits a man and woman would have, with the greater of the two converted into an ordinary scheme benefit under sections 24A to 24H of the Pension Schemes Act 1993.
- 3.5. In tandem with this and to address calls from the industry that the GMP conversion legislation does not work in certain respects, the group has come up with a number of suggested amendments to the primary legislation on which we will also be seeking views. Further detail on the proposed methodology and the proposed changes to legislation are provided later in this consultation.
- 3.6. The consultation also seeks to clarify the position on the requirement to provide equal pensions following the UK's decision to leave the EU.

Background

- 3.7. On 17 May 1990 the Court of Justice of the European Union ruled that occupational pensions were a form of deferred pay. As such, Article 157 of the Treaty on the Functioning of the European Union applies, and it is unlawful to discriminate between men and women in relation to occupational pensions (the *Barber* judgment). It was subsequently decided by that Court that the *Barber* judgment applied to any pension that accrued from the date of the judgment going forward.
- 3.8. The Government reflected this judgment in domestic legislation – Section 62 of the Pensions Act 1995. That section imported an equal treatment rule into a scheme, requiring any rule that treated one sex less favourably than another to be read as though it did not treat that sex less favourably. The obligations on schemes formerly contained in section 62 of the Pensions Act 1995 have since been replaced by equivalent provisions in the Equality Act 2010.

3.9. In line with equal pay requirements, these equal treatment rules applied only where there was an opposite sex comparator: an individual of the opposite sex who is in like work, or work rated as equivalent, who was treated more favourably.

The Guaranteed Minimum Pension (GMP)

3.10. The GMP is the minimum pension that a scheme that was contracted out of the Additional State Pension between 6 April 1978 and 5 April 1997 has to provide to its members. GMP rules were abolished for post 5 April 1997 contracted out service. However past accruals remain subject to them and a scheme must still provide a pension at least as good as the GMP for any time a person was a member of that scheme, up to and including 5 April 1997.

3.11. Legislation requires GMPs to be determined on an unequal basis: under the Pension Schemes Act 1993 (“PSA93”), a woman’s GMP accrues at a greater rate than that of a man in recognition that a woman’s working life for State pension purposes was five years shorter than that of a man. As a result, where a woman and a man have an identical work history, the woman’s overall GMP will be greater than that of the man.

3.12. As a woman is also entitled to receive her GMP at an earlier age (age 60) than a man is entitled to receive his (age 65), further differences can arise for a GMP in payment. This is through the operation of the revaluation provisions of PSA93 applicable up to this GMP pension age and of the indexation provisions of PSA93 after GMP pension age. Whilst the rates of revaluation or indexation do not differ on the basis of sex, a woman will be entitled to indexation in periods during which a man is entitled to revaluation, due to the differing GMP pension ages, and the rate of indexation differs from the rate of revaluation.

3.13. The requirement that GMPs are calculated and paid on an unequal basis flows through to result in an inequality of the overall scheme pension in payment.

This is compounded by the requirements for preservation, revaluation and anti-franking legislation in PSA93 that benefits above GMP (“excess benefits”) be determined with reference to this unequal GMP and the fact that revaluation and indexation provided on the excess benefit can and usually differs to that on the GMP element (depending on the legislation and the rules of the scheme).

3.14. As a result, it can become far from clear which sex receives the greater total scheme benefit. It is also possible for the position to change over the course of a lifetime so that an individual who is advantaged on the basis of sex when the GMP is first paid becomes disadvantaged later. In other words, which sex is advantaged may fluctuate over the course of a lifetime.

3.15. Successive Governments have maintained the position that schemes are under an obligation to equalise overall scheme benefits accruing from 17 May 1990 including, in respect of accruals from 17 May 1990 to 5 April 1997, any inequality resulting from the GMP rules, where an opposite sex comparator existed in the scheme.

The Allonby judgment

3.16. Since *Barber* the Court of Justice of the European Union has reconsidered the issue of equal treatment between the sexes in a line of case law including the case of *Allonby*. The Government understands the Court’s conclusion in those cases to mean that, as inequality resulting from the GMP rules results from state legislation, the requirement to remove any unfavourable treatment resulting from those rules *is not subject to the requirement that an opposite sex comparator exists*.

3.17. Following the Allonby judgement, in 2012 DWP published draft regulations for consultation. These draft regulations amended the Equality Act 2010 by removing the need for a comparator to be required to provide equal pension benefits. The industry had also asked for guidance on a standard methodology

for equalisation, so draft guidance was published alongside the draft regulations. The method proposed by DWP required schemes to compare on a year by year basis the position of a male against a female and pay the better of the two.

3.18. However, this methodology was not well received by the industry. They pointed out that the approach would not only be administratively expensive, but would also result in both men and women receiving equalised pensions that would be higher than either a man or a woman would otherwise have received.

3.19. Sympathetic to the industry's concerns, the Minister for Pensions at the time then decided to withdraw the draft regulations whilst DWP investigated with the pensions industry whether equalising pensions for the effect of unequal GMPs might be achieved through a less onerous process that would be acceptable to both the Government and to the pensions industry.

The Guaranteed Minimum Pension (GMP) conversion working group

3.20. In 2013 a working group was set up comprising leading practitioners from across the industry. The remit of the group is to see how the GMP conversion process might be used to equalise scheme benefits for the effects of unequal GMPs, and to seek a solution that would allow schemes to provide equal benefits, but without imposing overly onerous burdens on those schemes.

Proposed methodology

3.21. The Government is aware that there are challenges as to how schemes should amend their benefits in order to equalise where a GMP entitlement exists. It wants to offer as much help to pension schemes as is possible and therefore is putting forward a new possible method of equalising pensions that schemes could choose to use.

- 3.22. The method put forward by the group is one which compares the value of the future expected cash flows for the member in the period that needs to be adjusted for GMP inequalities (i.e. during the period from 17 May 1990 to 5 April 1997) with that for the opposite sex comparator, allowing for contingent benefits. If the opposite sex comparator has the greater discounted value of expected cash flow, then that greater value is delivered. (Schemes will have to consider whether it is appropriate to use the cash equivalent transfer value method, or whether another method would be more appropriate).
- 3.23. In order to avoid having to then comply with the unequal requirements of the GMP legislation, the GMP is also converted into a benefit that is not subject to the requirements of the GMP legislation. Because of the benefits that simplification provide, it is likely that all the GMP will be converted; not just that which accrued between 1990 and 1997. The pension that accrued alongside the GMP that is to be converted may also be put through the conversion process. All of this is achieved through the GMP conversion legislation set out in sections 24A to 24H of the Pension Schemes Act 1993.
- 3.24. The Government is not placing any obligation on schemes to use this method nor does it comprise legal advice to schemes on how to equalise: it should not be treated as a definitive statement of how equalisation should be effected. It simply describes one way of equalising for the effect of the GMP legislation which the Government believes meets the equalisation obligation derived from EU law. The Government does not assert this is the only way that equalisation can be achieved.
- 3.25. Where trustees are content that they are providing equal pension benefits, they need take no further action. Further, if a scheme believes it needs to take action, it is for the trustees to decide what action is needed and this may not be equalising in the way described in this document.

How the proposed methodology is expected to work in practice

3.26. The methodology for equalising pensions for the effect of inequalities caused by the GMP is described in greater detail in a paper which has been drafted by individual members of the working group (attached as Annex D to this consultation). The paper describes some of the practical difficulties that schemes may face when using this methodology and how these might be addressed. This is provided for illustrative purposes only and again, is not a definitive view or advice from Government about how equalisation might be addressed.

GMP Conversion – legislation that needs to be amended

3.27. Whilst the working group has indicated that the proposed methodology should enable schemes to equalise pensions for the effect of inequalities created by GMPs in a manner which is less burdensome than under that proposed in 2012, given that under its proposals conversion is a key part of the equalisation process, they have also requested that certain changes should be made to the conversion legislation to make it easier to use.

3.28. We have set out below some of the key changes we've agreed with the group we think need to be made. We've also sought to clarify one or two other points raised by the group as regards the legislation where we don't think changes are required (because the legislation should still achieve the desired effect). We also explain what we are doing regarding issues where we still have not reached agreement with the group.

Potential changes to legislation agreed with the group

Definition of "GMP conversion" (section 24A(1)(b) of the Pension Schemes Act 1993 (PSA))

3.29. The group argued that GMP conversion will take place not only in respect of earners, but also in respect of survivors of earners who are entitled to GMP benefits. The definition needs to include these survivors. We agree a change needs to be made to the definition to make it clear that conversion is also possible in respect of survivors as well as earners.

Requirement to consult in advance of any conversion (section 24E(3) PSA)

3.30. It was suggested that the requirement to consult members before the conversion and notify them after it was not necessary, as it was not clear what purpose was being served by consultation with earners in advance. The group thought that this requirement should be replaced with one simply notifying them after it has taken place. We think this requirement could be replaced with one which simply requires the member to be notified *before and after* the conversion takes place.

Restrictions on transfers under a GMP converted scheme (section 24F(1)(a) and (b))

3.31. The group argued that further restrictions on transfers should not be necessary after conversion. No restrictions have been imposed under section 24F(1)(a) and (b) since the primary legislation was put in place. We agree that further restrictions should not be imposed following conversion, hence we propose to remove these provisions in the future.

Clarification of specific terms etc.

Definition of and references to “GMP converted scheme” and “the converted scheme” should be removed.

3.32. The group felt that use of the term “GMP converted scheme” is likely to be interpreted to require that all of the GMP benefits in the scheme must be converted if any are to be converted. However, our view is that the term does not need to be removed because the definition “converted scheme” allows for individual conversions. Appropriate advice could be provided through guidance.

The identity of the members to be converted and the conversion date must be identified and agreed between the trustees and the employer and provision should be made for how to proceed when there is no employer. (Sections 24E(2) and (2A) PSA 1993)

3.33. It was argued that a general consent on the part of the employer to the conversion process would be unlikely and that legislation should set out that employer consent must be given to which individuals are to be included in the conversion, the methodology to be applied and the assumptions to be used. There should also be a power under secondary legislation to allow for conversions where there is no employer.

3.34. We think that putting definitive requirements in legislation is unnecessary and can be left up to schemes to decide on the process, however some advice on the process could be provided in guidance. Where there is no employer, there is no need to gain employer agreement.

Issues still to be addressed by the group

3.35. There are a number of issues which the group is still considering where additional changes might be desirable or necessary. For example, the requirements under conversion to provide a survivor benefit, and to notify HMRC that conversion has taken place, definitions of pre and post conversion benefits, treatment of pensions in payment, and certain pensions tax issues which may arise where GMP inequalities are addressed. No decisions have

been reached as far as these issues are concerned and discussions with the group are ongoing.

Guidance

3.36. DWP intends to issue guidance to clarify some of the details of the GMP conversion process once the legislation has been amended. For the time being however, this won't be possible until a legislative vehicle becomes available and the necessary changes to the primary legislation have taken place.

Impact of UK's decision to leave the EU

3.37. We are aware that within the pensions industry there has been some uncertainty as to whether the UK's decision to leave the EU in the future would impact on pension schemes' requirement to provide equal pensions.

3.38. Following the EU referendum on 23 June where the people of the United Kingdom voted to leave, the Government's position is that, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will continue to negotiate, implement and apply EU legislation.

3.39. With regard to the regulations which were previously withdrawn, this consultation focuses only on the new methodology as this could potentially benefit all schemes. DWP will consider these regulations further in the light of this consultation and will consult on them again in due course if necessary.

Consultation Questions

11. Is the proposed methodology the best approach? What, if any, other methods should we consider?

- 12. Is there anything about the proposed process that raises concerns or might not work – if so, what needs to be done?**

- 13. What are the potential administration costs from using the proposed methodology? How might these costs be reduced?**

- 14. What do you think of the proposed changes to the GMP conversion legislation? (We would be particularly interested to hear from schemes that have already converted GMPs using the current legislation)**

Annex A: List of consultation questions

Chapter 1: The draft Pensions (Schemes that were Contracted-out) (Miscellaneous Amendments) Regulations 2017

1. Do you agree that the draft changes to give HMRC discretion to extend the notification and payment periods for contributions equivalent premiums will deliver the policy intent?
2. Do you agree that the proposed changes will now correctly reflect the policy intention as outlined in paragraph 1.14 above?
3. Do you agree that the changes we have made to regulations 21 and 22 make it clear in which circumstances an inheritable GMP should be paid following the introduction of the new BSP?
4. It would be helpful to know, from your experience, approximately what percentage of schemes are likely to provide an inheritable GMP regardless of the survivor's circumstances (for example as their scheme rules require that this is paid to everyone), and what percentage will provide an inheritable GMP by following the statutory requirements of section 17 of the 1993 Act (for example by checking that the appropriate State benefit is in payment or that the survivor has reached the appropriate age). We believe that the latter approach will represent a minority of schemes but we are seeking some quantification:
 - (i) For a scheme that provides an inheritable GMP regardless of the survivor's circumstances (the former approach), will there be any costs associated with the change to regulations? These costs can be expressed in financial terms or in terms of staff time (e.g. 1 hour for 12 admin staff).

(ii) For a scheme that provides an inheritable GMP by following the statutory requirements for each member (the latter approach), what additional costs might the scheme incur from updating their administrative processes to take account of the change, e.g. changing guidance, making staff aware of the new requirements? These costs can be expressed in financial terms or in terms of staff time (e.g. 1 hour for 12 admin staff).

5. Do you agree with the underlying earnings increase assumption proposed by GAD?
6. Is it correct to adopt a medium term view on earnings assumptions?
7. Do you agree that DWP should continue to apply the 0.5% premium for fixing the rate or are there good arguments to remove or adjust the premium?

Chapter 2: Reviews

8. Do you have any concerns relating to regulation 3 of the 2013 Regulations which the Department is not already aware of?
9. Apart from the issues mentioned, do you have any concerns about regulation 4 and bulk transfer arrangements?
10. Are there any issues that you think the Department needs to be aware of in relation to the transitional arrangements?

Chapter 3: GMP Equalisation

11. Is the proposed methodology the best approach? What, if any, other methods should we consider?

12. Is there anything about the proposed process that raises concerns or might not work – if so, what needs to be done?

13. What are the potential administration costs from using the proposed methodology? How might these costs be reduced?

14. What do you think of the proposed changes to the GMP conversion legislation? (We would be particularly interested to hear from schemes that have already converted GMPs using the current legislation).

Annexes B, C and D are published on GOV.UK alongside this consultation document

Annex B – Government Actuary’s Department report: Fixed revaluation rate for Guaranteed Minimum Pensions

Annex C – Draft regulations: Occupational Pension Schemes and Social Security (Schemes that were Contracted-out and Graduated Retirement Benefit) (Miscellaneous Amendments) Regulations 2017

Annex D – A ten-stage possible process for resolving the GMP inequalities issue: for comment

ISBN: 978-1-78425-870-2