

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL AND PERSONAL PENSION SCHEMES (AUTOMATIC ENROLMENT) (AMENDMENT) (NO. 3) REGULATIONS 2012

2012 No. [XXXX]

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 This instrument amends regulations setting out the practical arrangements associated with automatic enrolment into workplace pensions. In particular it amends the prescribed features of an average salary scheme which would otherwise exclude it from being a qualifying workplace pension scheme.

2.2 A pension scheme which provides for average salary benefits is excluded from being a qualifying scheme for the purposes of the workplace pension reforms if the scheme does not revalue the benefits of members whilst in pensionable service by a minimum rate. This instrument gives schemes greater flexibility in the ways in which they can provide for this minimum level of revaluation and so not be excluded from qualifying.

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

None

4. Legislative Context

4.1 The Pensions Act 2008 introduces new duties for employers: principally to enrol automatically eligible jobholders into a qualifying workplace pension scheme and to maintain active scheme membership for those already enrolled into qualifying provision. A qualifying scheme is one that meets:

- the basic requirements set out in the Pensions Act 2008 (the Act) and the supporting regulations; and
- other specified quality requirements, in accordance with scheme type in sections 20-27 of the Act and the supporting regulations.

4.2 The quality requirements in relation to a defined benefit scheme providing average salary benefits are that it either is contracted-out of the State Second Pension or that it satisfies the test scheme standard. In addition (as per regulation 36 of the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 the scheme is excluded from being a qualifying scheme unless it revalues the benefits of members in service at the minimum rate specified in regulation 36(4).

4.3 In the run up to the start of automatic enrolment in October 2012, the Department and The Pensions Regulator (TPR) are engaging closely with employers to help them prepare for the onset of their new duties under the reforms. In the course of this, it emerged that the way that the quality requirements for average salary pension schemes are currently

specified interact in an unintended way with the scheme rules for some pension schemes as described in paragraph 7.4 below.

5. Territorial Extent and Application

This instrument applies to Great Britain.

6. European Convention on Human Rights

The Minister for Pensions has made the following statement regarding human rights:

“In my view the provisions of the Occupational and Personal Pension Schemes (Automatic Enrolment) (Amendment) (No. 3) Regulations 2012 are compatible with the Convention rights.”

7. Policy background

What is being done and why

7.1 The Government’s intended policy on schemes providing average salary benefits is to allow them to be used as qualifying schemes and for the purposes of automatic enrolment so long as they provide for the accrued rights to benefits under the scheme to be revalued at, or above, a prescribed minimum rate (as set out in regulation 36) at any time when the jobholder’s pensionable service is continuing. (Current legislation would prevent a jobholder being treated less favourably once the jobholder has left pensionable service).

7.2 Revaluation can be achieved either by the scheme providing for guaranteed revaluation or providing for funded discretionary revaluation. The current minimum set out in regulation 36 (as amended) is the increase in CPI or 2.5 per cent, whichever is lower. The policy intent is to ensure that individuals’ pensions keep pace with inflation so it is important that benefits accruing in average salary schemes are increased in line with inflation in service as well as in deferral.

7.3 A scheme, set up after 1 July 2012, which revalues benefits by the increase in RPI would not qualify as it is possible that this could be lower than CPI or 2.5% in some years. Given the expectation that revaluation by RPI is likely to be more generous in most years, it is proposed that schemes should not be excluded from qualifying if they revalue in this way (also capped at 2.5%).

7.4 Currently, regulation 36 of the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 does not allow an average salary scheme that has a mix of guaranteed revaluation below the minimum rate and a discretionary power to revalue at a higher rate to meet the minimum to qualify. The Regulations are revised to allow schemes which provide for discretionary increases or a mix of guaranteed and discretionary increases to qualify, provided that the revaluation is funded for and included in the statement of funding principles.

7.5 These amendments reduce the level of prescription about how revaluation in average salary schemes is achieved while ensuring that the benefits of members of these types of schemes remain protected.

Consolidation

7.7 Automatic enrolment became effective on 1 July 2012 and the largest employers will be subject to the employer duty to automatically enrol their eligible workers into a qualifying workplace pension from 1 October 2012. The Secretary of State will give consideration to consolidation as the reforms gather pace.

8. Consultation outcome

8.1 Consultation on a draft of the proposed changes took place for a period of six weeks between 30 April and 11 June 2012. A six week period consultation was considered appropriate because of the minor and technical nature of the proposed amendments and because of the need to bring in the changes in time for employers being staged into the reforms from November. The Department received 17 responses from employers, pension advisers, accountants, lawyers, and individuals. The Government response to the consultation is available here: <http://www.dwp.gov.uk/consultations/2012/>

8.2 The proposed change to allow schemes that have a mix of guaranteed revaluation below the minimum rate and a discretionary power to revalue at a higher rate to meet the minimum to qualify was supported by the overwhelming majority of respondents to the consultation.

8.3 Several respondents felt that further flexibility could be afforded to schemes regarding how they provide for revaluation at the minimum rate. They proposed that:

- schemes established after 1 July 2012 should be able to qualify if they choose to revalue benefits by the increase in the RPI without the need for a CPI underpin;
- schemes which revalue by reference to the increase in average earnings should also be able to qualify without having to track prices to ensure they met the minimum rate; and
- a wider and more flexible test should be built into regulation 36 enabling a scheme to qualify where the scheme actuary is able to certify that the benefits under the scheme are at least as good as those provided by the test scheme (assuming benefits are revalued at the minimum rate).

8.4 The regulations make amendments in respect of the first of these suggestions. Revaluation is designed to protect benefits from the effects of inflation and revaluing by the increase in RPI is likely to do this as well or better than CPI. This fits within the original policy intention of allowing employers and schemes flexibility on how they provide for revaluation while protecting members' benefits. The Government will consider further the suggestions that schemes be allowed to revalue by reference to the increase in average earnings and to allow an even more flexible test. Careful consideration would need to be given to the detail of how such proposals might be achieved to ensure that members' benefits will continue to be appropriately protected.

9. Guidance

The Department will update the statutory guidance on the certification of defined benefit and hybrid schemes for employers and actuaries when the regulations are made.

10. Impact

10.1 These regulations have a zero net impact on business and civil society organisations. The changes being made are minor and will give effect to the Government's original policy intention. Overall the changes merely put schemes back in the position they were intended to be in from the start. The amendments to the regulations will allow qualifying pension schemes more flexibility about how they meet the minimum quality requirements of the workplace pension reforms.

10.2 The impact on the public sector is negligible.

10.3 A full impact assessment has not been published for this instrument.

11. Regulating small business

11.1 The legislation applies to small business in the same way as it does to larger business.

12. Monitoring & review

12.1 The effects of the reforms will be fully evaluated against the policy objective of getting more people to save more for retirement. The impact of the reforms on employers and the pensions industry will be assessed to evaluate the extent to which this policy objective is met, whilst minimising burden on employers and maintaining current good pension provision.

13. Contact

Jeremy Over at the Department for Work and Pensions Tel: 01900 828272 or email: Jeremy.over@dwp.gsi.gov.uk can answer any queries regarding the instrument.

Annex – Keeling schedule for the proposed amendments to regulation 36 of The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 as amended by Regulation 6 of the 2012 regulations

PART 10

Exclusion as a qualifying scheme

Certain schemes providing average salary benefits excluded from being qualifying schemes

36.—(1) For the purposes of section 16(3)(c) (qualifying schemes) of the Act, a pension scheme which provides for average salary benefits to be provided to or in respect of a jobholder is not a qualifying scheme if, subject to paragraph (3), the scheme has any of the features specified in paragraph (2).

(2) The specified features are that, in relation to any jobholder who has accrued rights to benefits under the scheme (“accrued benefits”)—

- (a) there is no provision for revaluation of such benefits;
 - (b) such benefits are to be revalued at less than the minimum rate; or
 - (c) a discretionary power may be exercised in the revaluation of such benefits;
 - ~~(c) such benefits are to be revalued only on the exercise of a discretionary power,~~
- at any time when the jobholder’s pensionable service is continuing.

(3) Paragraph (1) does not apply to a scheme with the feature specified in paragraph (2)(c) if—

- (a) the funding of the scheme takes account of the exercise of the discretionary power and does so on the assumption that accrued benefits would be revalued at or above the minimum rate; and
- (b) such funding is provided for in the scheme’s statement of funding principles under section 223 (statement of funding principles) of the Pensions Act 2004 or, if the scheme is not required to have such a statement, in an equivalent statement of the scheme’s funding plan.

(4) For the purposes of this regulation, the “minimum rate” on a revaluation of accrued benefits is an annual increase by —

- ~~(a) in relation to a scheme which has members on 1st July 2012 the percentage increase in the retail prices index for the year by reference to which the increase is made;~~
- ~~(b) in relation to any scheme, the percentage increase in the general level of prices for the year by reference to which the revaluation is made; or~~
- (c) 2.5 %

whichever is the lesser or the least.

(5) In paragraph (4) –

- (a) “retail prices index” means—
 - (i) the general level index of retail prices (for all items) published by the Statistics Board; or
 - (ii) where that level index is not published for any month, any substituted level index or figures published by the Board;
- (b) “general level of prices” means the general level of prices in Great Britain determined in such manner as the Secretary of State thinks fit.

(6) The Secretary of State shall publish from time to time the manner in which the general level of prices is to be determined.