

Automatic enrolment: career average schemes as qualifying schemes

Government response to consultation

July 2012

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1. Introduction

1. On 30 April 2012 we published the consultation document ‘Automatic enrolment: career average schemes as qualifying schemes’. The consultation closed on 11 June 2012, and we received 17 formal written responses.
2. The consultation proposed amendments to Regulation 36 of the Occupational and Personal Pensions Schemes (Automatic Enrolment) Regulations 2010 and draft regulations were published alongside the consultation.
3. We consulted formally for a period of six weeks. This will allow for the amending regulations to be laid before Parliament before the summer recess and for the parliamentary procedure to be completed, and if Parliament approve, for them to come into force on 1 November 2012. It will provide certainty to employers, pensions industry professionals and external suppliers who will be responsible for delivering different elements of the workplace pension reforms.
4. This document summarises the responses to the consultation and the Government’s response and final proposals.
5. It also provides us with the opportunity to provide clarification on issues raised which fall outside the scope of this consultation, but which we recognise are important to enable wider understanding of the reforms or legislation.
6. We are grateful to all those who took time to consider the issues and share views, thoughts and suggestions. A list of organisations and individuals that responded to the consultation is at Section 5.
7. The proposed draft regulations are subject to the affirmative resolution procedure and will be laid in draft before Parliament on 2 July 2012.
8. This document is available on the DWP website at:
<http://www.dwp.gov.uk/consultations/2012/auto-enrol-career-ave-qual-sch.shtml>
9. A paper copy of this document can be obtained from:

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2. Background and summary of changes

10. In the run up to the start of automatic enrolment in October 2012, DWP 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 has emerged that the way that the quality requirements for Career Average Revalued Earnings (CARE) pension schemes are currently specified in The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 interact in an unintended way with the scheme rules for some (CARE) pension schemes.
11. To address this, the Government is proposing to amend Regulation 36 of the Occupational and Personal Pension Schemes (Automatic) Regulations 2010. The consultation document described the proposed changes and what they are intended to achieve and provided commentary on a draft amending Regulation. We were keen to hear views on whether the proposals would achieve the intended effect. We were also keen to hear from employers intending to use CARE schemes as qualifying schemes and their advisers about whether there were other practical issues relating to revaluation which could prevent good quality schemes from qualifying.
12. The Government is proposing to take forward the proposed amendments as well as to allow for further flexibility for schemes to meet the original policy intention to allow good quality CARE schemes to qualify while protecting the interests of workers. We propose to amend the regulations as quickly as possible and before the onset of the employer duties for those organisations that are likely to be affected.

3. Stakeholders' responses to the consultation and the Government's response

What the draft regulations said

13. 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 Pensions Act 2008 and the supporting regulations.
14. The Government's intended policy on CARE pension schemes 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. (Section 72 of the Pension Schemes Act 1993 would prevent a jobholder being treated less favourably once the jobholder has left pensionable service).
15. Revaluation can be achieved either by the scheme providing for guaranteed revaluation or providing for funded discretionary revaluation. The minimum set out in Regulations (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 a career average scheme are increased in line with inflation in service as well as in deferral.
16. As currently drafted, regulation 36 of the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 does not allow a CARE 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. We are now proposing to revise the Regulation to allow schemes which provide for a mix of guaranteed and discretionary increases to qualify, provided that the revaluation is funded for and included in the statement of funding principles.
17. These minor technical amendments will reduce the level of prescription about how revaluation in CARE schemes is achieved while ensuring that the members of these types of schemes remain protected.

18. In amending Regulation 36, we propose to set out the minimum required outcome and to provide appropriate flexibility for schemes and employers providing CARE schemes so that these can be used for the purposes of automatic enrolment.

What stakeholders said

19. Almost all respondents to the consultation welcomed the proposals to allow more flexibility for good quality career average defined benefit schemes to be used as qualifying schemes. Furthermore they agreed that the draft amendments would achieve the desired outcome.
20. Two respondents questioned the need for a revaluation requirement for CARE schemes as qualifying schemes at all.
21. Respondents who were not supportive of the proposals thought that no discretion should be allowed and that a benefit promise should be given to ensure that any discretion is actually applied in practice at the minimum rate required.
22. Some respondents commented that the amendment should come into force earlier than the proposed date of 1 November 2012 to ensure that all employers, including those who choose to bring forward their staging dates, will benefit from the amendment.
23. While respondents agreed with the additional flexibility proposed, they also felt that the revaluation requirement could be more flexible. Two respondents felt that a CPI underpin should not be required for schemes established after 1 July 2012 that revalue by reference to the Retail Prices Index (RPI). One respondent felt that a scheme which revalued by reference to the increase in average earnings should also be allowable as a qualifying scheme.
24. Given the wide range of career average schemes which exist, it was suggested by three respondents that rather than attempt to legislate for every possible type of career average benefit structure, it would be preferable to include a more flexible test. The suggestion was that a scheme should be able to qualify if the scheme actuary certifies 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). Rather than dealing with revaluation in isolation, it should be taken into account in the context of the overall benefits provided by the scheme.
25. One respondent questioned whether it was possible to revalue above the minimum requirement and offset that excess increase against the statutory minimum in the following year. They also questioned whether it was possible for negative revaluation to be applied in a year when inflation was negative.
26. There were two queries about the interpretation of the wording in Regulation 36 “for the year by reference to which the revaluation is made”. These were whether revaluation must be applied in the final year of service where this is a part year only, and whether the revaluation could be calculated by reference to a period other than one year.

27. One respondent felt that the flexibility for discretionary revaluation should be extended to the revaluation requirements for schemes that provide a cash sum to be available for the provision of benefits in Regulation 39A.
28. As well as meeting the revaluation requirements, a CARE scheme must also meet the test scheme standard. Section 23(4)(a) of the Pensions Act 2008 requires that the rate of the pension derived from a test scheme must be '1/120th of average qualifying earnings in the last 3 tax years preceding the end of pensionable service'. One respondent was concerned that CARE schemes would need to do precisely this in order to qualify and that as a result schemes will have to undergo changes as they won't at present work by reference to the narrow definition of qualifying earnings.
29. The regulations on certifying defined benefit schemes allows employers to certify under certain conditions, but in more complex cases the certification must be carried out by the scheme actuary. One respondent felt that this was a process which should always be carried out by an actuary.
30. Some respondents were keen to know when DWP would publish final guidance on the certification of Defined Benefit Schemes including CARE schemes.
31. Lastly, where an individual's benefits are revalued at a higher rate than the increase in CPI, the excess must be included in the individual's "pension input amount" for the purposes of Section 234(5C) of Finance Act 2004. This could have tax consequences for the member and one respondent felt that this showed an inconsistent approach between DWP and HMRC.

The Government's response to stakeholders

32. The policy on qualifying schemes has always been to create a broadly equivalent minimum quality requirement to the money purchase requirements, regardless of the type of scheme that is being used. Without revaluation in an average salary scheme the minimum quality requirement would have been significantly lower than other types of scheme. Revaluation ensures that the value of the benefits accrued is not eroded over time by inflation.
33. Where an employer is using a DB scheme to meet their employer duties, we want there to be flexibility in the regulations. This is important to ensure that the wide diversity of good quality existing provision can continue without requiring expensive changes to pension schemes. In order for a scheme with a discretionary power to revalue to qualify:
 - a. the funding of the scheme must take account of the exercise of the discretionary power on the assumption that accrued benefits will be revalued at or above the minimum rate; and
 - b. this funding must be provided for in the scheme's statement of funding principles.

34. The Government believes that this provides appropriate safeguards for individual members' benefits to be revalued. If evidence is found that this is not the case, then this position would be subject to review.
- 35. We therefore propose to proceed to make the amendments that we consulted on and allow for a mixture of guaranteed and discretionary revaluation in average salary schemes.**
36. We agree that it would be preferable for the proposed amendments to come into force as early as possible and before the proposed coming into force date of 1 November. However, these regulations are subject to the affirmative Parliamentary procedure and therefore must be debated and approved by both Houses of Parliament before they can be made. There is no power in the Pensions Act 2008 to make these regulations with retrospective effect and it is not possible to complete the required procedures for an earlier coming into force date.
37. Furthermore, the Government agrees with respondents that where a scheme provides for revaluation at a level that will usually be better than CPI, for example RPI or the increase in average weekly earnings (AWE), that this should be allowed without the need for a CPI underpin.
- 38. We propose to amend Regulation 36 further to allow for revaluation by CPI or RPI in average salary qualifying schemes.** We propose to allow for a scheme to revalue by the increase in CPI or RPI, and to cap the required revaluation at 2.5%.
39. We will give further consideration to how revaluation by the increase in average earnings could be allowed for, including working through the detail of how the regulation would then work to ensure that the value of members' benefits remain protected.
40. The suggestion that schemes should be able to qualify if the scheme actuary certifies 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) would give schemes further flexibility over how they design their scheme. It would also mean a slight reduction in the quality requirements for average salary schemes however. We believe this suggestion should be kept under review for the present.
41. The word "increase" in regulation 36 cannot be interpreted as "decrease". As a matter of statutory interpretation, we adopt the ordinary English meaning unless there is provision to the contrary and therefore increase cannot mean decrease. So in a year of deflation, no increase is required but obviously benefits cannot be decreased. This is seen as a trade off for not having to account for the entire rate of inflation in revaluation.
42. We believe that the wording of Regulation 36: "for the year by reference to which the revaluation is made" can be interpreted widely and we have provided our interpretation in the final guidance for the certification of defined benefit schemes.

This guidance was published on 2 July 2012 and is available at [workplace pension reforms guidance](#)

43. A scheme that provides for a cash sum to be available for the provision of benefits can be a qualifying scheme if it meets the test scheme standard and the revaluation requirements set out in Regulation 36. Schemes do not need to meet every requirement of the test scheme standard exactly.
44. More broadly, the features specified for DB schemes are the features of the test scheme. For a qualifying scheme to meet the test scheme standard it is only necessary for the benefits provided under the scheme to be as good as or better than the benefits that would have been payable under the test scheme, i.e. as per Regulation 39(5) they must be at least as valuable for 90% or more of relevant members.
45. The Government wants to minimise the burdens on employers wherever possible. Therefore, if it is clear that a defined benefit scheme will satisfy all of the requirements of the test scheme without the need for calculations, then it is disproportionate to require the certification to be carried out by the scheme actuary.

5. List of respondents

Association of Consulting Actuaries

Association of Pension Lawyers

AON Hewitt

Brian Fleetwood

BT

Elcena Jeffers Foundation

JLT Benefit Solutions Ltd

The Law Society of Scotland

Mayer Brown

Mercer

Neil Fallon

Pensions Management Institute

Sackers

Sainsbury's

Society of Pension Consultants

Towers Watson

Wragge & Co.