Department for Work & Pensions

Occupational Pensions: Miscellaneous Amendments Regulations 2014

Government response

March 2014

Contents

Introduction

1. This consultation ran from 26 November 2013 to 10 January 2014, seeking stakeholders' views on amendments to three sets of regulations, to simplify the administration of occupational pension schemes.

2. This document is split into three short sections, each covering an area where we planned to change Regulations. Each section introduces the Regulations which we consulted on, explains why we consulted on making changes to the Regulations; summarises the consultation responses received and outlines any changes that were made to the Regulations following responses to the consultation.

Section one: Occupational Pension Schemes (Scheme Administration) Regulations 1996

3. This section covers an exemption for very large trust-based multi-employer schemes from regulation 4(2)(d) of the Scheme Administration Regulations, to make it easer for such schemes to appoint an auditor.

Section two: Occupational Pension Schemes (Discharge of Liability) Regulations 1997

4. This section covers an amendment to clarify the circumstances in which trustees may obtain a discharge of their liability to provide pension benefits when those benefits have been secured by means of an insurance policy or annuity contract.

Section three: Occupational Pension Schemes (Employer Debt) Regulations 2005

5. This section discusses a technical amendment to update a cross-reference to primary legislation in Regulation 10 of the Employer Debt Regulations.

6. There were a total of 16 responses to the consultation. A list of respondents is included in Annex A. The Government is very grateful to all those who responded to the consultation. This part of the document outlines the main points made by respondents and provides the Government's response.

7. The regulations will be available on the UK Legislation website: http://www.legislation.gov.uk/uksi

8. This document is available on the Gov.uk website: https://www.gov.uk/government/publications?publication_filter_option=consultations

Section one: Occupational Pension Schemes (Scheme Administration) Regulations 1996 (“the Scheme Administration Regulations”)

The problem

Occupational pension schemes are, unless a scheme is exempt[1], required to appoint an auditor under section 47 of the Pensions Act 1995. There are, however, restrictions on who can be an auditor of an occupational pension scheme. These restrictions aim to ensure an appropriate degree of separation between the statutory auditor, the scheme and the employer. This is to avoid a situation where an employer or auditor can have an influence on the scheme which might be detrimental to scheme members.

These requirements are straightforward for schemes with a single sponsoring employer to comply with, and are manageable for most multi-employer schemes. However, the requirement under regulation 4(2)(d) of the Scheme Administration Regulations for trustees to appoint an auditor who is not prohibited from acting as a statutory auditor under the independence requirements in section 1214 of the Companies Act 2006 creates difficulties for very large multi-employer schemes because of their size.

The issue was first raised by NEST (the National Employment Savings Trust), but a number of large trust-based multi-employer schemes have also been set up in recent years and they have expressed concerns about this issue. There are a limited number of audit firms able to audit schemes of this size, and therefore it will become increasingly difficult for an audit firm to meet the independence requirements as these schemes grow.

Many small and medium sized businesses will turn to multi-employer pension schemes to help them fulfil their automatic enrolment requirements. Therefore it is imperative that these schemes are able to find and appoint an auditor.

The proposed solution

To address this, the Government proposed in the consultation to introduce an exemption from regulation 4(2)(d) of the Scheme Administration Regulations for, trust-based, multi-employer, occupational pension schemes where:

- at least two thirds of the employers are not associated or connected, and
- there are at least 500 participating employers in the scheme.

[1] The exemptions from the requirement to have a scheme auditor under section 47 of the Pensions Act 1995 are set out in regulation 3(1) of the Scheme Administration Regulations.

Summary of consultation responses

Questions 1.1and 1.3 asked:

Do you think that the proposed solution is sufficient to address the problem? If you do not think it would be sufficient please state why not.

As a minimum, how many employers should be involved in a scheme before this disapplication should apply? The consultation also stated that we would welcome any evidence on why the threshold for participating employers should be lower than 500.

Most respondents commented that the criterion that at least two thirds of the employers should not be associated or connected would be unworkable for schemes as they would be required to gather information that they are not empowered to collect. Respondents also stated that the definitions of ‘associated’ and ‘connected’, which are taken from the Insolvency Act 1986 and Bankruptcy (Scotland) Act 1985, are very broad and would capture connections between relatives, including distant relatives, which in the vast majority of cases the Government would not consider to be materially significant connections for scheme audit purposes. In practice this could require schemes to check hundreds, and in some cases thousands, of connections between employers in order to determine whether they were eligible for the exemption.

A large number of respondents commented that the criterion of 500 participating employers was too high, with some stating that we should not impose a minimum employer threshold on schemes at all, as difficulties complying with the auditor independence requirements were not just limited to very large schemes. Respondents were also keen to understand how the exemption criteria would be tested in practice.

A small number of respondents recommended alternative ways of exempting schemes from the auditor independence requirements. These included suggestions that:

- the Government should remove regulation 4(2)(d) from the Scheme Administration Regulations for all pension schemes; and
- schemes should be exempt from regulation 4(2)(d), providing that conflicts arising from employers represent less than 0.2 per cent of scheme members and annual contributions.

A small number of respondents questioned whether former employers should count towards the 500 participating employers threshold.

Question 1.2 asked:

Whether there were any other types of schemes affected that we have not considered?

Respondents agreed that the proposed exemption captured the main types of schemes who were affected by this issue. One respondent also suggested that if Collective Defined Contribution pension schemes were to be introduced under a Defined Ambition framework, the Government should consider whether the proposed exemption should be extended to include these schemes.

Government response

Following the evidence received on how associations and connections between employers would need to be checked in practice, the Government recognises the significant administrative burden that this would place on schemes wishing to benefit from the exemption, and has therefore decided to remove this criterion.

The Government carefully considered whether the 500 employers threshold should be set at a lower level, or removed all together. The Government also considered the suggestion that regulation 4(2)(d) should be removed from the Scheme Administration Regulations altogether. The only practical evidence received related to large multi-employer schemes, which have a number of different employers within the scheme. In practice, the risk of an employer being able to exercise control in a very large multi-employer scheme is very low, due to the number of different employers within the scheme, and trustees' duty to act in the best interests of their scheme members. Removing the 500 employers threshold from the exemption criteria, would mean that schemes with at least two employers would benefit from the exemption which is not the policy intention. Completely removing regulation 4(2)(d) from the Scheme Administration Regulations would mean that auditors of all schemes, including schemes with a single sponsoring employer, would not have to satisfy the independence requirements in the section 1214 Companies Act 2006 which is not the policy intention.

The Government considered the suggestion that former employers should count towards the 500 participating employers threshold. The policy intent is to exempt very large trust-based multi-employer schemes from the requirements of regulation 4(2)(d). Including former employers would allow smaller schemes to benefit from the exemption which is not the policy intention.

The Government therefore intends to introduce an exemption from regulation 4(2)(d) of the Scheme Administration Regulations for trust-based, multi-employer, occupational pension schemes which have at least 500 participating employers.

Respondents also requested further details of how the exemption criteria would operate in practice. The Government has decided that where a trust-based multi-employer scheme has 500 or more participating employers on the first day of the scheme year (or on the first day of the following scheme year), the scheme should be exempt from regulation 4(2)(d) in relation to the accounts and the auditor's statement for that scheme year. The reason for the reference to these documents is that, generally, trustees or managers of an occupational pension scheme are required to obtain audited accounts and an auditor's statement not more than seven months after the end of each scheme year[2].

Once in force, the Government will monitor the impacts of this exemption and any reported impacts will be considered and reviewed on an ongoing basis.

[2] Under section 41 of the Pensions Act 1995 and the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (S.I 1996/1975). The exemptions from the requirement to obtain these documents is set out in regulation 2 of these regulations."

Section two: Occupational Pension Schemes (Discharge of Liability) Regulations 1997

The problem under consideration

Section 19 of the Pension Schemes Act 1993 (the PSA), provides that trustees or managers of an occupational pension scheme may, in certain circumstances, meet their liability to provide a pension for scheme members by buying an annuity or insurance policy on their behalf. Scheme members are then paid by the insurance company, rather than the scheme, when they come to receive their pension. A common use of this provision is for schemes to bulk buy annuities or insurance policies on behalf of short-service (deferred) members in order to reduce their overall liabilities.

Where trustees choose to buy an insurance policy or annuity in order to pay benefits, they may in certain circumstances choose to include an option for members to take a proportion of those benefits as a lump sum. This is known as 'commutation'. Where a commutation option is provided, trustees or managers will only be discharged of their liability to provide pension benefits if certain conditions are satisfied. These requirements are prescribed in regulation 4 of the Discharge of Liability Regulations.

Stakeholders requested that we clarify the circumstances in which trustees may obtain a discharge of their liability to provide pension benefits by purchase of an insurance policy or annuity which includes an option to commute a proportion of those benefits to provide a lump sum on retirement. Lack of clarity in this area following changes made to the Discharge of Liability Regulations in 2006 has meant that some stakeholders were reluctant to take advantage of these provisions.

The proposed solution

To address this the consultation proposed an amendment to regulation 4 of the Discharge of Liability Regulations by inserting a new paragraph 1(c) to the regulation, to provide that an insurance policy or annuity contract may include a commutation option where benefits secured by the policy or contract have become payable, and the member is aged 55 or over and has requested or consented to the lump sum payment and the payment qualifies as a pension commencement lump sum under the Finance Act 2004.

This provision would be subject to a new regulation 4(2A) which would exclude guaranteed minimum pensions of the earner and their surviving spouse or civil partner from being taken as a pension commencement lump sum.

Summary of consultation responses

Question 2.1asked:

Do you think the proposed changes will clarify the circumstances in which trustees can obtain a discharge of their liability to provide pensions for members by buying *annuity or insurance policy? If you do not think it would be sufficient please state why not.*

Question 2.2 asked:

Whether there would be any undesirable consequences of implementing the proposed changes?

Most respondents were in favour of the proposed amendments. However, some respondents questioned the need for the requirement that an earner must have reached age of 55. They highlighted instances where a pension commencement lump sum might legitimately be taken before a member reached age 55. For example, members who have protected retirement ages under their original occupational pension scheme (which would still be valid after a buy-out) might wish to take a commencement lump sum before they were 55. A member might also wish to retire earlier than age 55 due to health reasons, and may wish to take a pension commencement lump sum.

Some respondents also highlighted that, on the basis of the current Regulations, some schemes have already discharged liabilities to provide benefits by means of insurance policies or annuity contracts which do not include an option to take a pension commencement lump sum. They suggested that the Regulations should enable trustees of these schemes to amend the terms and conditions of these contracts. Respondents stated that this could be done by backdating the proposed changes to the Discharge of Liability Regulations to April 2006.

Government response

Following evidence received, the Government has decided to remove the requirement that a person must have reached age 55 from amendment to regulation 4 of the Discharge of Liability Regulations. This will ensure that the Regulations mirror the current rules on pension tax relief, and allow eligible scheme members to take a commencement lump sum if they wish to.

The Government has carefully considered the suggestion that we should backdate the proposed amendments to April 2006. This suggestion is outside of the scope of the specific questions which formed the basis of the consultation, and the powers under the Pension Schemes Act 1993 do not allow for Regulations to be backdated.

Section three: Occupational Pension Schemes (Employer Debt) Regulations 2005

The problem under consideration

The Employer Debt requirements were introduced to prevent employers from abandoning responsibility for their occupational pension schemes, and to protect scheme members when the relationship with their employer comes to an end. This is a safeguard that scheme members expect to receive.

Regulation 10 of the Employer Debt Regulations deals with the liability of employers to pay amounts to money purchase schemes under section 75 of the Pensions Act 1995. There is a cross-reference to primary legislation (and to the fraud compensation provisions in particular) in Regulation 10(3)(b)(i). Section 81(1)(c) of the Pensions Act 1995 contained the relevant fraud compensation provision at the time that Regulation 10 of the Employer Debt Regulations came into force. However, section 81(1)(c) was subsequently repealed and re-enacted under section 182(1)(b) of the Pensions Act 2004. The consultation therefore proposed updating the cross-reference in Regulation 10(3)(b)(i) so that the fraud compensation provisions were correctly signposted.

The proposed solution

The consultation proposed a minor and technical amendment to Regulation 10 of the Employer Debt Regulations to update the reference to primary legislation in Regulation 10(3)(b)(i) so that people were signposted to sections 182 to 189 of the Pensions Act 2004 where the fraud compensation provisions are now contained.

Summary of consultation responses and Government response

All those who commented on this section of the consultation agreed that the proposed change was appropriate to address this issue. The Government therefore intends to proceed with the proposed amendment.

Other issues raised in response to the consultation

A small number of respondents also suggested some potential amendments to the automatic enrolment legislation relating to scheme staging dates and record keeping requirements. These suggestions are outside of the scope of this consultation. However, the Government will monitor these policy areas and the additional issues raised in this consultation will be considered in this context.

Next steps

The Government would like to thank all the organisations who have offered their views and advice in response to this consultation. We have noted the comments and queries raised and have made changes to the draft regulations where appropriate.

The Government intends to make amending Regulations introducing these changes which will come into force on 6 April 2014. The Regulations are subject to the negative resolution procedure.

The Miscellaneous Amendment Regulations package will also contain amendments to the Transfer of Employment (Pension Protection) Regulations 2005, to ensure that new employers, following a business transfer, are not required to make higher contributions than an employer might have to pay under the automatic enrolment phasing profile. The Government response to this consultation can be found at:

https://www.gov.uk/government/publications?publication_filter_option=consultations

HM Revenue and Customs also intend to introduce an exemption later this year from regulation 3(d) of the Registered Pension Schemes (Audited Accounts) (Specified Persons) Regulations 2005 for trust-based multi-employer, occupational pension schemes with have at least 500 participating employers. This will ensure that the requirements relating to scheme audits are consistent.

Annex A: List of those who responded to the consultation

Aon Hewitt
Association of Pensions Lawyers
Association of School and College Leaders
Aviva
Freshfields Bruckhaus Deringer
Hymans Robertson
ICAEW (Institute for Chartered Accountants in England and Wales)
L&G
Law Society of Scotland
NAPF
NEST
Pensions Management Institute
People's Pension (B&CE scheme)
Prudential
PWC
Society of Pension Consultants