



Department
for Work &
Pensions

Pensions Bill Delegated Powers

Supplementary memorandum from DWP to the
Delegated Powers and Regulatory Reform
Committee

January 2014

Introduction

1. This Memorandum is prepared by the Department for Work and Pensions, and is supplementary to the Memoranda dated 31 October 2013. It identifies new or amended delegated powers conferred in the Government amendments to the Pensions Bill that have been tabled on 13 January 2014 for consideration at Lords Committee stage. It explains the purpose of the powers, the reasons why they are left to delegated legislation, the Parliamentary procedure selected for the exercise of these powers and why that procedure has been chosen.

Background and summary

2. The Pensions Act 2008 ('the Act') (sections 20 to 28) sets out the quality requirements to be met by a pension scheme if it is to be used to meet an employer's enrolment duties under automatic enrolment.
3. The Act sets out separate requirements depending on the type of benefits offered:
 - for money purchase arrangements the scheme rules must provide a total contribution of 8% of qualifying earnings with at least 3% contributed by the employer (set out in section 20 of the Act);
 - for defined benefit ('DB') arrangements either the jobholder must be in contracted-out employment or the scheme must satisfy the 'test scheme standard' (set out in section 21 of the Act).
4. The Act provides that the 'test scheme standard' is satisfied in relation to a jobholder if the benefits provided by the scheme are broadly equivalent to, or better than, those provided under a test scheme. The current test scheme is a hypothetical DB scheme which can provide either a pension or lump sum to provide a pension.
5. In March 2013 the Government issued a consultation paper *Technical Changes to Automatic Enrolment* on a number of proposals to improve the automatic enrolment process. As part of this consultation the Government asked whether there is a simpler way to determine whether a DB scheme is good enough to be used for automatic enrolment as the existing way is considered by many to be overly complicated.
6. In addition, the end of contracting out in April 2016 (as a result of reforms to the State Pension) will mean that those schemes which currently satisfy the quality requirement on the basis of being contracted-out of the State Pension (and therefore providing benefits of a certain level) will instead need to satisfy the test scheme standard. This is seen as unnecessarily burdensome for schemes that have previously satisfied a

higher standard in the form of the Reference Scheme Test. The Government is therefore keen to find a way for a scheme to demonstrate it is of sufficient quality to be used for automatic enrolment without the burden of demonstrating it meets the test scheme standard.

7. As a result of responses to that consultation and further discussions with stakeholders, the Government is proposing to introduce alternative quality requirements for DB schemes. The new alternatives are:
 - to allow DB schemes of a prescribed description to satisfy the money purchase quality requirement (set out in section 20 of the Act); and
 - to introduce two new tests based on the cost of funding future accruals. One would apply at scheme level, the other at scheme member level.
8. These amendments will support the continuation of DB schemes by providing increased flexibility for employers whilst ensuring adequate protection for members' benefits across all automatic enrolment qualifying schemes.

Extent

9. The provisions relating to the proposed alternative DB quality requirement extend to England and Wales and to Scotland. Pensions are a transferred matter in respect of Northern Ireland and, as such, legislation is the responsibility of the Northern Ireland Assembly.

Analysis of delegated powers by clause

New clause after Clause 37: Alternative quality requirements for UK defined benefits schemes

Powers conferred on: Secretary of State

Powers exercised by: Regulations (Statutory Instrument)

Parliamentary Procedure: Negative

10. The new clause provides for regulations to be made setting out the details of the alternative quality requirements. Paragraph 2 of the clause inserts new section 23A into the Pensions Act 2008, which sets out the current quality requirements for DB schemes. Subsection 23A(1) provides that the Secretary of State can, by regulations, prescribe that a defined benefits scheme satisfies the quality requirements in one of three ways, as set out in subsections (a), (b) and (c).

Allowing DB schemes of a prescribed description to satisfy the money purchase quality requirement (power under new section 23A(1)(a))

11. Some schemes which are not money purchase schemes under the definition in section 99 of the Act nevertheless operate with a defined contribution structure. For example this could be a scheme with a defined contribution structure but which provides guarantees over the fund size or investment performance therefore preventing it from being classified as a money purchase scheme. Such a scheme might find it easy to demonstrate it meets the money purchase qualifying scheme requirements because of the contribution rate, but would find it difficult or impossible to show it satisfies the test scheme standard because of the lack of certainty over the benefits being accrued.
12. Subsection (1)(a) of new section 23A therefore provides a power for the Secretary of State to prescribe that a DB scheme of a specified type or description satisfies the quality requirement for automatic enrolment if it satisfies the quality requirement set out under section 20 of the Act. That is, that the scheme provides a total contribution of 8% of qualifying earnings with at least 3% contributed by the employer.
13. We intend to consider further which schemes should be included taking account of responses to the recent consultation on regulations under sections 30 to 32 of the Pensions Act 2011 regarding the clarification of the definition of money purchase benefits following the Supreme Court judgement in *Bridge Trustees v Houldsworth and another (2011)*.

Alternative test based on cost of funding future accruals (powers under section 23A(1)(b) and (c))

14. The consultation on technical changes to automatic enrolment suggested that simplifications could be made and the most commonly suggested alternative was a test based on equivalence between the cost of funding future DB accruals and the minimum contributions due under the money purchase quality requirements.
15. Subsections (1)(b) and (1)(c) of new section 23A therefore provide for two alternative quality requirement tests for DB schemes relating to the cost to the scheme of funding the future accrual of active members' benefits. In order to satisfy the quality requirement the cost must be at least a prescribed rate. The rate is to be expressed as a prescribed percentage of members' relevant earnings over a relevant period either on an aggregate (scheme) level (subsection (1)(b)) or, if the scheme cannot satisfy the test at that level, at an individual level for at least 90% of the relevant members (subsection (1)(c)).

16. The Government intends to undertake a full consultation with stakeholders and the Government Actuary to determine the appropriate rate in order to ensure that a balance is struck between achieving the increased simplicity that is intended and ensuring that an adequate level of protection for the level of members' benefits is provided across all qualifying schemes. The Government expects the rates will be different for the aggregate and individual test and might also be different depending on the definition of earnings used. However, subsection (3) of new section 23A provides that the prescribed percentage must be at least 8%, in line with the minimum level for total contributions into a qualifying money purchase scheme.
17. Subsections 23A(2) and (4) then provide further powers to prescribe relevant details for these alternative tests in regulations as follows:
 - *the description of 'relevant earnings'*. The Government wants the provision to be simple to use, so it has to recognise the different definitions of earnings used by defined benefit schemes – which could for example be “qualifying earnings”, “pensionable earnings” or “total earnings. The intention is to determine the appropriate definitions following the consultation with stakeholders and the Government Actuary.
 - *the description of 'relevant members'*. The Government wants the provision to apply broadly to the jobholder concerned and all active members who are jobholders of the same employer but wishes to consider in consultation whether the alternative tests should apply separately to members in different sections or benefit categories of the scheme.
 - *the 'relevant period' in which the benefits accrue under these tests and in which the contributions would be required to be made*. The Government wants the provision to be simple to operate. In practice this means it needs to be as easy as possible for schemes to demonstrate that they meet the alternative requirement. For example, a starting point might be to use existing valuations provided by the scheme actuary for the purpose of Part 3 of the Pensions Act 2004 (scheme funding) as evidence. These valuations will routinely include a calculation of the cost of future benefits over a three year period. Not all schemes are, however, covered by the scheme funding requirements and it may be necessary to prescribe a separate period as an alternative. Again, the intention is to consult with stakeholders and the Government Actuary on the detail.
 - *how to calculate whether the requirement in section 23A(1)(b) or (c) is satisfied and whether that must involve certain methods or assumptions*. The intention is to leave these matters to schemes as

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far as possible, on the basis that most schemes likely to be attracted to these alternative requirements will already be carrying out valuations. However, the Government has taken the power in order to cater for schemes not covered by the scheme funding requirements or if there is evidence the provisions are being misused (for example through the use of inappropriate assumptions).

- *the description of certain benefits which must be disregarded when determining whether the requirement in section 23A(1)(b) or (c) is satisfied.* It may be appropriate to exclude certain contingent or ancillary benefits from any assumptions about future costs.
 - *whether and in what circumstances a scheme can only be treated as satisfying the alternative quality requirement if a scheme actuary certifies that it does.* This mirrors provision for the test scheme standard in section 22(6) of the Act. The Government expects that in many circumstances an actuary will not be required to certify that the scheme satisfies the test, for example if the basis of the evidence is the latest scheme valuation undertaken by the scheme actuary. However in some circumstances the nature of the calculations, comparisons or assessments involved may make it necessary to prescribe that a scheme actuary would be required to certify.
 - *the meaning of 'scheme actuary' for the purposes of certification in this context.* This is similar to the provision for the test scheme standard in section 22(7) of the Act. The intention is for regulations under this provision to specify an appropriately qualified actuary, such as a fellow of the Institute and Faculty of Actuaries. Specifying this in regulations provides the flexibility to reflect any changes to the definition of an appropriately qualified actuary if necessary.
18. The Government believes it is appropriate to make these provisions in regulations as the provisions setting out the detail on the alternative quality requirements for DB schemes and how they are to be satisfied will be very technical and complex and therefore more suited for secondary legislation. This will also allow for full consultation with all interested parties, i.e. representatives of employers and their advisers, employees and the pensions industry as well as the Government Actuary, to ensure that the proposed alternative requirements deliver the simplicity they are intended to whilst still affording a sufficiently high quality of benefit for members automatically enrolled into such schemes. This is particularly important in setting the prescribed percentages under sections 23A(1)(b) and (c) which are sensitive to a range of assumptions.
19. Schemes currently as part of their three yearly valuation cycle for scheme funding purposes calculate the cost of the accrual of benefits for current service and we wish to explore with stakeholders the extent to which the proposed alternative tests under section 23A(1)(b) and (c)

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could be based upon or build upon that existing actuarial work. Setting out the detail in regulations will also allow the Government to respond quickly to changes in the future, for example in scheme design.

20. Regulations made under section 23A(1) will be subject to the negative resolution procedure which is consistent with the procedure under which the regulations that govern the way in which schemes currently determine whether they have satisfied the test scheme standard are made (under section 22(4)). It is also consistent with the procedure under which regulations are made (under section 23(6) in which the detail of the test scheme requirements for lump sum schemes is provided for. In the analogous context of these other Regulations, this procedure has enabled us to respond swiftly and flexibly to ensure that members have continued to enjoy good quality DB provision by preventing schemes from failing to satisfy the test scheme standard for technical reasons and may prove equally valuable in the context of alternative DB quality requirements

21. Section 23A(3) provides that the prescribed percentage cannot be set below 8%, which is the minimum total contribution required in a qualifying money-purchase scheme at section 20 of the Act. This ensures a baseline value, in the primary legislation, for the alternative DB quality requirements below which a scheme could not be a qualifying scheme for automatic enrolment purposes.

Department for Work and Pensions
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