EXPLANATORY MEMORANDUM TO

THE CONTRACTING-OUT (TRANSFER AND TRANSFER PAYMENT) (AMENDMENT) REGULATIONS 2017

2017 No. 600

1. Introduction

1.1 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 The purpose of these regulations is to enable transfers of pensioner members with contracted-out rights to take place in certain circumstances, with member consent, to schemes that have never been contracted-out.

2.2 Amendments are required to allow schemes facing financial difficulties who are in the circumstances set out in the regulations to transfer pensioner members to a new scheme, where the member consents. This will enable pensioner members to transfer into a new scheme rather than into the Pensions Protection Fund, where they would benefit from doing so.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 Until the new State Pension was introduced on 6 April 2016, sponsoring employers of salary-related or defined benefit (DB) occupational pension schemes were permitted to contract their employees out of the additional State Pension on the condition that the scheme met certain statutory requirements.

4.2 Before contracting out was abolished, it was possible for a contracted-out scheme or formerly contracted-out scheme to transfer its pensioner members, with their consent, to either a contracted-out scheme or a formerly contracted out scheme. Where a transfer was to take place to a new scheme that had never been contracted out, the new scheme could become contracted-out for a short while, thus becoming a "formerly contracted-out scheme" and satisfying the legislative requirements.

4.3 Following the abolition of contracting-out from 6 April 2016, a transfer of pensioner members with their consent to a newly established scheme was no longer possible, because the new scheme could not become a formerly contracted-out scheme.

4.4 These regulations will enable transfers of pensioner members, with their consent to new schemes (irrespective of their contracting-out status) in specified circumstances.

Transfers of contracted-out rights of deferred members (those who have ceased to be active members but have not yet reached pensionable age) to new schemes are already permitted and this change provides more parity between deferred and pensioner members

5. Extent and Territorial Application

5.1 This instrument extends to Great Britain.

5.2 The territorial application of this instrument is Great Britain.

5.3 The Department for Communities will be making corresponding provisions for Northern Ireland.

6. European Convention on Human Rights

6.1 As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 From 1978 occupational DB pension schemes were able to remove their members from the State Earnings Related Pension Scheme (additional State Pension) and provide a "guaranteed minimum pension" ("GMP") in return. These "contracting-out" provisions were widely used. The GMP was intended to provide a minimum amount of weekly pension, broadly equivalent to the amount of additional State Pension that would have built up had the member not been contracted- out. The GMP is payable for life at age 60 for a woman or 65 for a man, and a survivor benefit is payable to a widow, widower or civil partner. This system was in operation until 5 April 1997; although rights no longer accrue, those rights are, and will continue to be, protected.

7.2 From 6 April 1997, a different test, referred to in legislation as the 'statutory standard', was applied to schemes that contracted out of the state system. This was commonly known as the Reference Scheme Test and operated until 5 April 2016.

7.3 With the introduction of the new single tier State Pension from 6 April 2016 contracting-out was abolished entirely as there was no longer an additional State Pension from which to contract out.

7.4 Before contracting-out was abolished, it was possible for a scheme to transfer the contracted-out rights of its pensioner members, with their consent, to a new scheme as described at paragraph 4.2. With the ending of contracting out this ceased to be possible.

7.5 The Government has identified an urgent need for these type of transfers where schemes find themselves in financial difficulty and pensioner members could be transferred into the Pensions Protection Fund (PPF) although they would be better off if they could be transferred into a new scheme.

Permitting transfers in specified circumstances

7.6 To address this matter, the Government has decided to allow pensioner members, with their consent, to transfer into a new scheme which has never been contracted-out, where the scheme has entered into either a PPF assessment or a regulated apportionment arrangement.

7.7 All schemes go through an Assessment Period before entering the PPF. PPF must be notified when insolvency event occurs (such as the appointment of administrators) at a company that sponsors a DB pension scheme. Subsequently PPF will work with the scheme's trustees to obtain necessary information to determine if the scheme is eligible to pass into the PPF or not.

7.8 PPF pays compensation to those Defined Benefit (DB) occupational pension scheme members whose sponsoring employer has become insolvent and where the scheme is unable to secure benefits at least equal to the level of compensation the PPF provides. The PPF compensation level is based on the member's pension or accrued benefits, at:

- 100% for anyone who was over the scheme's normal pension age at the date of employer insolvency or who was paid their pension on the grounds of ill health, or who was in receipt of a spouse/dependant's pension;
- 90% for everyone else, subject to a cap (which currently produces maximum compensation of £33,678 a year at age 65; and
- the inflation protection given to PPF compensation may be less generous than the level which would have been provided by the original scheme.

7.9 A regulated apportionment arrangement (RAA) is a statutory mechanism which allows a company to free itself from its financial obligations to a pension scheme in order to avoid insolvency, provided that certain conditions are met and the RAA is approved by the Pensions Regulator and agreed by the PPF. More details can be found here[1].

Safeguarding members' pensions

7.10 To ensure that pensioners' rights are safeguarded, they must sign a statement recognising that the benefits to be provided by the receiving scheme may be in a different form and of a different amount to those which would have been payable by the transferring scheme; and there is no statutory requirement on the receiving scheme to provide for survivor's benefits. Pensioners will however be aware of benefits provided by the new scheme and must consent to the transfer. This means they will only be transferred to a new scheme if this is better for them than transferring into the PPF.

7.11 The requirement to sign a statement mirrors the current requirement for deferred members who can currently transfer their contracted-out rights to a scheme which has never been contracted-out and who are also required to sign such a statement. The change will lead to greater parity between pensioner members and deferred members. The Government intends to turn to the issue of transfers of pensioners to new schemes more generally later in the year.

7.12 Trustees of a pension scheme are under fiduciary duties in relation to the scheme and they will also need to be satisfied that they act in accordance with these duties in relation to any transfer; including acting in the best interests of the scheme beneficiaries.

[1] http://www.thepensionsregulator.gov.uk/docs/regulated-apportionment-arrangements-statement-august-2010.pdf

Consolidation

7.13 Informal consolidated text of instruments is available to the public free of charge via "the National Archives" website - legislation.gov.uk.

8. Consultation outcome

8.1 Due to the technical nature of these regulations, prior engagement with the industry regarding these issues and their request for urgent action to mitigate transfers to the PPF (where this is not in the interests of the scheme and/or its members) a short consultation was considered to be proportionate. The consultation[2] was therefore limited to 2 weeks from 10 April to 23 April 2017. There were 11 responses from experts in the pensions industry. Some respondents felt that the consultation period was too short, however, for the reasons given above, we consider the period to have been proportionate and appropriate in view of the requests for urgent action.

8.2 The consultation asked three questions:

i. whether the regulations enabled transfers of contracted-out pensions (in payment), with member consent, to schemes that have never been contracted-out in the circumstances mentioned in paragraph 7.5;

ii. whether pensioner member benefits are adequately protected; and

iii. whether the regulations work effectively for employers who form a section of a multi-employer scheme.

8.3 Respondents to question one were broadly content that the proposed amendments to the regulations achieved their intention. However, one response raised concern that under the proposed changes to the regulations it was not possible to refer to a "transfer of liability" (of GMPs or post 97 contracted-out rights). This was because, it was argued, the transfer is being applied to provide benefits in a scheme which will not be subject to the statutory restrictions and requirements which apply to a former contracted-out scheme and which are potentially of a different type in the receiving scheme. Two other respondents appeared not to have understand the distinction made between the two types of transfer. We take the view that a transfer of liability is possible although the receiving scheme has not formerly been contracted-out and the regulations should therefore enable either a transfer of liability which the receiving scheme may be able to provide, or a transfer payment in respect of the payment of a GMP or post 97 contracted-out rights. The amendments to regulation 2(3) and 7(2)(b) relate to transfers of liability and new regulations 2(3A) and 7(2A) relate to transfer payments. In the latter case, there is no distinct "transfer of liability" and this allows for the payment of the pension to be in a different form from that which would have been payable by the transferring scheme.

8.4 Question two gave rise to several responses. One respondent, without going into detail, was content that the revisions to legislation provided adequate protection for pensioner members. Other respondents suggested that the acknowledgement which pensioners must give recognising that the benefits they receive in the new scheme may be in a different form does not go far enough and that it should also recognise any differences in pension increases between the old and new scheme and any other

[2] https://www.gov.uk/government/consultations/contracted-out-pensions-enabling-transfers-to-schemes-that-have-never-been-contracted-out

changes that might result from the transfer. Another respondent however felt that the protection was sufficient because of the limited circumstances in which these transfers will apply, as the transfers will only proceed where there is active scrutiny by the PPF or the Pensions Regulator. They also added that any transfers would be likely to proceed under discretionary transfer powers in the scheme rules, in relation to which the trustees would need to be satisfied that making such a transfer would be consistent with their fiduciary duties to scheme beneficiaries.

8.5 The Government's view is that, for the reasons given by the final respondent, the regulations do provide adequate protection of pensioner members' benefits. In relation to the acknowledgement that must be provided by pensioners, the Government takes the view that this should mirror the wording of such acknowledgements which have to be given by deferred members for transfers of their contracted-out rights to schemes that have never been contracted-out. We consider this will be sufficient to protect pensioner members' rights and additional requirements could create uncertainty for deferred members.

8.6 There were also a couple of technical questions concerning whether transfers are permitted during a PPF assessment and interaction with HMRC requirements. Government confirmed that transfers during this period can be validated and that the transfers should not cause any HMRC legislation to be contravened.

8.7 Finally, regarding the last question concerning multi-employer schemes, whilst the vast majority of respondents felt that the regulations would work for employers who form a section of a multi-employer scheme, a couple of respondents raised concerns that the regulations did not adequately address the situation of these employers with one suggesting an amendment to ensure that the regulations would address their circumstances. It appears to us that whilst there are arguments for addressing this issue specifically, given most respondents agreed that the legislation would work for employers within multi-employer schemes, it is not necessary to do so. However, the Government will review this requirement as part of further changes which it will be considering in relation to contracting-out transfers place later in the year.

9. Guidance

9.1 The Government's response to the consultation on these regulations provides information for schemes on how to interpret the regulations. HMRC publish regular bulletins aimed at employers, pension scheme administrators and others in the pensions industry here:

https://www.gov.uk/government/publications/nispi-countdown-bulletins

9.2 HMRC, in collaboration with DWP, is updating guidance for schemes and pension administrators following the end of contracting-out and this should be available later this year.

9.3 Whilst guidance may not be ready before this legislation comes into force, schemes will be able to seek advice from the Pensions Regulator and the PPF who, because of the circumstances in which these transfers take place, will be involved in these transfers and ensuring appropriate procedures are followed.

10. Impact

10.1 There are no new direct impacts on business and charities or voluntary bodies as the measures are permissive. Businesses are expected to take up the transfer options if, on balance, the benefits outweigh the costs. Therefore, the impacts are assessed as zero net cost to businesses.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment is submitted with this Memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses.

11.2 No specific action is proposed to minimise regulatory burdens on small businesses. Removing small businesses (i.e. schemes sponsored by small employers) from these regulations would adversely affect members of the affected schemes because pensioner members would not be able to have their benefits transferred to a new scheme in these circumstances despite it being in their interests to do so.

12. Monitoring & review

12.1 Given the technical and permissive nature of these amendments, it would be disproportionate in these circumstances to make statutory provision for a review. The Department will, however, continue to work closely with its stakeholders, including industry bodies and employer organisations, to keep these policies under review and should any issue arise with these policies, it will assess the evidence and, if appropriate, consider whether any changes may be necessary**.**

13. Contact

13.1 Richard Jordan at the Department for Work and Pensions Telephone: 020 7449 7379; or email: Richard.jordan1@dwp.gsi.gov.uk can answer any queries regarding the instrument.