

The Pensions Act 2014 (Abolition of Contracting- out for Salary Related Pension Schemes) (Consequential Amendments) Order 2016

Government response

March 2016

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Chapter One: Introduction

1. DWP consulted on the draft Pensions Act 2014 (Abolition of Contracting-out for Salary Related Pension Schemes) (Consequential Amendments) Order 2016 – the “2016 Order” - on 20 October 2015. The 2016 Order sought views on technical changes to other secondary legislation to take account of the abolition of contracting-out from 6 April 2016.
2. The proposed changes in the 2016 Order follow on from the regulations published in September 2015, (the Occupational Pension Schemes (Schemes that were Contracted-out) (No.2) Regulations 2015)¹ and the draft State Pension and Occupational Pension Schemes (Miscellaneous Amendments) Regulations 2016 that will come into force in April 2016. Both sets of Regulations ensure that all rights accrued by employees in contracted-out defined benefit schemes before abolition are fully protected.
3. The consultation on the 2016 Order ended on 16 November 2015. There were 22 written responses from individuals, pension industry bodies and pension professionals (actuaries, lawyers). We are grateful to everyone who replied. A list of the individuals and organisations that responded is at **Annex A**.
4. This response addresses most of the issues raised by respondents. A number of the responses, however, concerned issues that could not be addressed by changes to the 2016 Order, such as changes that respondents felt still needed to be made to the anti-franking legislation. We explain in Chapter Two either how we will deal with these issues or that they will need to be set aside for future consideration.
5. There were certain other issues which did fall within the remit of possible changes that could be made to the Order (some transfer issues) but there was insufficient time to address them before the Order is due to come into force. We have however outlined in this consultation response how we intend to address these issues in the near future.
6. The 2016 Order is available on the UK Legislation website:

<http://www.legislation.gov.uk/>

7. This consultation document is available on the GOV.UK website:

<https://www.gov.uk/government/consultations/salary-related-pension-schemes-abolition-of-contracting-out-consequential-amendments>

¹ Due to a procedural error the original set of regulations published in July 2015 had to be re-laid on 16 September 2015. A full explanation can be found at:

<https://www.gov.uk/government/consultations/occupational-pension-schemes-abolition-of-defined-benefit-contracting-out>

Impact Assessment

8. An analysis of the impact of the abolition of contracting out was made as part of the analysis of the Pension Act 2014. Full details of the potential impacts of the reforms are to be found in Chapter 5 of the Impact Assessment:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/310896/pensions-act-ia--summary-of-impacts.pdf

9. An update of the analysis for the new State Pension reforms was published in July 2014. This includes impacts on the ending of contracting out:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332996/single-tier-pension-impact-assessment-update-july-2014.pdf

Chapter Two: Government's response to the feedback received on the consultation questions

Introductions

10. The consultation posed two questions concerning the draft regulations. This Chapter summarises the feedback received and sets out the Government's response.

Question 1: “Do you agree that:

- a) the amendments in the 2016 Order are necessary as a consequence of contracting-out ending on 5 April 2016?**
- b) they protect members' accrued rights?**
- c) they ensure schemes are able, post abolition, to carry out their administrative functions?"**

Respondents' views

11. There was broad agreement by most respondents that the provisions in the Order are necessary as a consequence of contracting out ending, that they protect members' rights and that they will ensure schemes are able, post abolition, to carry out their administrative functions. There were, however, some concerns regarding:

- the transfer requirements for formerly contracted out schemes, particularly those involving bulk transfers without member consent. (Articles 4 and 5)
- Whether time limits could be extended for those schemes which need to discharge their pension liabilities; or make payment of a cash equivalent transfer value, and which cease to contract out in the 12 months preceding the ending of contracting-out (new articles 35,36 and 37) (previously draft Articles 29,30(3) and 31).
- The Transfer of Employment (Pension Protection) Regulations – what the new arrangements should be following the removal of the requirement for the receiving scheme to meet the Reference Scheme Test. (Article 21)
- The disclosure requirements for schemes ceasing to contract out on 6 April 2016(Article 32) Four issues were raised:
 - (i) whether it was necessary to place a specific requirement on schemes that they should inform members that the scheme had ceased to be a contracted out scheme;
 - (ii) whether new joiners up until April 2017 will need to be told that they are “contracted-in”;

- (iii) whether the Department would confirm that no further changes are envisaged to the Disclosure of Information Regulations in respect of informing members of the scheme's contracted-out status;
- (iv) DWP were advised that it would be helpful to communicate that a formal advance election to surrender a contracting-out certificate is not required where cessation occurs at 6 April 2016.
- The amended definition of section 9(2B) rights (new article 28)(previously draft article 2).

Government Response

12. Given the technical nature of all these issues, we deal with them in Chapter Three.

Question 2: “In addition to the amendments to the legislation set out in this consultation, is there any further legislation that you consider should be revoked, amended or saved as a consequence of the ending of contracting-out?”

Respondents' views

13. Although not directly relevant to this Order, several respondents commented on the impact that the ending of the additional State Pension (AP) would have on individuals. This is because the current AP calculation for the period 6 April 1978 – 6 April 1997 takes into account the Guaranteed Minimum Pension (GMP) payable by the scheme, and the individual receives the difference between the gross AP and the GMP calculation as net AP. This calculation means that where the GMP is less than the AP, the individual is not worse off than if they had not contracted-out. There were a number of other changes to legislation that respondents still felt needed to be made to ensure a smooth ending to contracting out. These are listed as follows:

(i) **Internal transfers of contracted-out rights to defined contribution (DC) sections within the same scheme.** It is currently not possible to make a transfer between a section of a scheme that was formerly contracted-out on a defined benefit basis and a defined contribution section within the same scheme.

(ii) **Anti-franking** – Two respondents pointed out that we should save the current anti-franking legislation (section 87(1)(a)(i) of the Pension Schemes Act 1993) for members of schemes who cease to contract out before abolition takes place in line with the savings already made for section 16(2) of that Act. Otherwise the new requirements, which apply to members who remain in pensionable service under the scheme after the scheme has ceased to contract-out would have the unintended consequence of re-setting the fixed rate revaluation start date for members of schemes who ceased contracted-out service whilst remaining in pensionable service before abolition took place.

- (iii) **Request for clarity around the wording related to the saving of section 16(2) of the Pension Schemes Act 1993** – Two respondents queried the wording used in the saving. They felt that there was some potential ambiguity in the wording and that it could be misinterpreted. It was pointed out that whilst the intention was to allow individuals who ceased contracted out service before 5 April 2016 but remained in pensionable service to retain fixed rate revaluation, even those who cease contracted out service at the end of the day on 5 April 2016 (as a result of abolition) technically end service before the second abolition date. So the saved legislation could also apply to those members of schemes which cease to contract out at abolition but whose members remain in pensionable service, which was not the intention.
- (iv) **How best to preserve the Reference Scheme Test (RST) for RST underpin schemes** – Respondents asked us to advise on the position for these schemes as soon as possible.
- (v) **Alteration of scheme rules where there are section 9(2B) rights; and HMRC rules on trivial commutation** – respondents also wanted to know when an update would be provided on these two issues which were mentioned in the consultation document.

Government Response

The effect of GMP uprating after April 2016

14. GMPs accrued between 1978 and 1987 are not required to be uprated by contracted-out schemes and GMPs accrued between 1988 and 1997 are only required to be uprated by schemes up to 3% price inflation. In contrast, additional State Pension (AP) for these periods is fully uprated. At the moment contracted-out people do not lose out because of this. An amount of AP is calculated for them each year including price indexation together with a contracted-out deduction to recognise the GMP. The overall calculation is such that the State, as part of the State Pension, pays the difference between the individual's uprated GMP and their additional State Pension so they do not lose out (we call this the 'uprating difference calculation'). These arrangements will end for people reaching State Pension age from 6 April 2016.
15. However, most people who have been contracted out will be able to benefit from transitional arrangements that will be introduced from 2016. As part of the arrangements people's National Insurance records up to 2015/16 are used to calculate a "Starting Amount" using the old State Pension rules, and the new State Pension rules, and the better of the 2 calculations becomes the Starting Amount. Both calculations include a deduction made to reflect periods of contracted out employment. This deduction is made in 2016 rather than at someone's State Pension age. Once an individual's Starting Amount is calculated, they are able, if they continue to pay NICs after April 2016 to add more new State Pension until they reach State Pension age or they have the maximum amount of new State Pension.

16. As an example, someone who has been contracted-out all of their working life may have a new State Pension Starting Amount in 2016 of just the old basic State Pension (£115.95). For every year (after April 2016) they pay National Insurance contributions (or have National Insurance credits) they will add 1/35th of the full rate of the new State Pension (£151.25 illustrative amount for 2015/16). This means they will have an additional £4.32 for each year they pay or have credited national insurance on top of their Starting Amount.
17. We recognise that not everybody will benefit from this approach. However, it is worth noting in the context of the ending of the uprating difference calculation (in paragraph 14 above) that an individual would not benefit from the uprating difference calculation until their AP exceeded their GMP which is often many years into their retirement. Depending on earnings and the time when someone left their scheme some people's GMP will always exceed the AP.
18. In addition, the triple lock uprating, where the basic State Pension will be increased annually by the higher of price or earnings inflation or 2.5% is intended to secure the real value of the basic State Pension, so that more people live in dignity and security in retirement. This means the full basic State Pension will be around £560 a year higher in 2015/16 than had it been uprated just by earnings since the start of this Parliament.
19. The benefits of the triple lock uprating will feed through to the new State Pension. This means that people with 30 National Insurance qualifying years or more will start off in the new system with at least the £560 boost. People with less than 30 qualifying year will see a pro rata gain as well.

(i) Internal transfers of contracted-out rights to defined contribution (DC) schemes.

20. We understand that this may be an issue for schemes. We do not have the appropriate powers in primary legislation to make the changes that would be necessary in this Order. But we do plan to keep this on our agenda and to consider potential changes to the transfer legislation in due course.

(ii) Anti-franking

21. We agree that we need to save the current section 87(1)(a) of the Pension Schemes Act for members of pension schemes who ceased to contract out before abolition of contracting out so that the fixed rate revaluation start date for these members is not unintentionally re-set to the date they leave the scheme. We have done this in the Pensions Act 2014 (Commencement No.7) and (Savings)(Amendment) Order 2015 (SI. 2015/2058).

(iii) Request for clarity around the wording related to the saving of section 16 of the Pension Schemes Act 1993

22. The legal position is that schemes which cease to contract-out as a result of the abolition legislation coming into force on 6 April 2016 will cease to contract out on the second abolition date, as the legislation comes into force at the beginning of that day. A scheme will not cease to contract-out at the end of the day on 5 April 2016 as the legislation providing for abolition won't be in force on 5 April 2016.
23. It flows from that that all references in legislation to an earner whose contracted-out employment ended “before the second abolition date” means any earner who left contracted-out employment before 6 April 2016 or whose scheme ceased to contract-out before that date, and not as a result of the legislation providing for abolition.
24. References in legislation to “immediately before the second abolition date” are used in specific situations in the secondary legislation where the legislation refers to a provision of the 1993 Act “as it had effect immediately before the second abolition date” – that is, we are referring to that provision as it had effect at the end of the day on 5 April 2016. If we simply said “before the second abolition date” that would be confusing in that context because some provisions have been amended at least once, and we have to refer to the provision at a specific point in time so it is clear which version of the provision we are referring to.

(iv) How best to preserve the Reference Scheme Test (RST) for RST underpin schemes

25. Respondents explained that schemes that operated on a defined contribution basis but provided members with, as a minimum, benefits that they would have accrued under the RST would no longer be able to operate after April 2016 if we were simply to remove the RST requirements from legislation. To address this we have, under article 3 (2)(b) of the Pensions Act 2014 (Commencement No 7) and (Savings) (Amendment) Order 2015 (SI 2015/2058) made an amendment to the Pensions Act 2014 (Savings) Order 2015 to ensure that the RST requirements are saved for schemes which operate an RST underpin.

(v) Alteration of scheme rules where there are section 9(2B) rights; and HMRC rules on trivial commutation

26. Whilst we are aware that these issues have been on-going for some time, because these are fairly complex issues, we've decided that we won't put forward any potential solutions to address them before we have amended the key legislation which needs to be changed from 6 April 2016. However, we will revisit these issues at a later date and consult on any possible legislative solutions.

Chapter Three: Detailed issues raised by respondents

27. This Chapter deals with detailed issues raised by respondents in relation to the draft Order.
28. Please note the article numbers in the headings refer to the numbering of the final Order and, where appropriate, are followed by the draft article number in brackets.
29. Readers may find it helpful to refer to the original consultation for an explanation of the broader context.

Issue – The Transfer requirements for formerly contracted-out schemes - Articles 4 and 5

30. There were three specific issues that were raised which concerned how transfers of contracted-out rights will operate once contracting out has ended:
 - (i) Bulk transfers made without member consent
 - (ii) Changes to the definition of “connected employer” in the new regulation 12(2A) of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991
 - (iii) Individual transfers to a former contracted out scheme and preservation of contracted out rights
- (i) Bulk transfers made without member consent
 31. A number of respondents were concerned that as a result of changes we propose to make to the Contracting-Out (Transfer and Transfer Payment) Regulations 1996 (S.I. 1996/1462), it will only be possible to make a bulk transfer of contracted-out rights without members’ consent to a scheme that was formally a salary-related contracted-out scheme. In the past, new schemes have been set up with a few contracted-out members in order to be able to receive such transfers but that will not be possible when contracting-out ceases. So in the future, it will not be possible to set up a new scheme to receive bulk transfers in this way
 32. It was suggested that schemes which were not formerly contracted-out should be able to receive bulk transfers provided sufficient safeguards and protections were put in place. Whilst this seems like a reasonable suggestion, given the complexity that would be involved in drafting these protections, there is insufficient time to draft such changes in this Order. We will therefore be considering this under a further package of changes that we expect to make to legislation in 2017.

(ii) Changes to the definition of “connected employer” in the new regulation 12(2A) of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991

33. Several respondents questioned the wording of the definition of “connected employer” provided by article 3(2) of the draft Order (article 2(2) of the final Order), and whether it exactly replicated the current provision. Some respondents thought it widened the definition, and others thought it imposed new restrictions.
34. Our view is that the definition of “connected employer” has not changed, we have simply amended it to remove the cross reference to regulation 64(2) of the Occupational Pension Schemes (Contracting-out) Regulations 1996 which will cease to exist.
35. Respondents also questioned whether there was any need to amend regulation 12 of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 as regulation 64(2) is not in the list of revocations in the Occupational Pension Schemes (Schemes that were Contracted-out) Regulations (No 2) 2015. However, regulation 64 will fall away as a result of the repeal of section 35 of the Pension Schemes Act 1993 by Schedule 13 of the Pensions Act 2014 under which it is made. So no separate provision needs to be made for it to be revoked. Consequently we do not need to amend regulation 12 of the Preservation of Benefit Regulations to take account of this.

(iii) Individual transfers to a former contracted out scheme and preservation of contracted-out rights

36. Several respondents mentioned that the proposed changes in the Contracting-Out (Transfer and Transfer Payment) Regulations 1996 (S.I. 1996/1462) to regulations 3 and 8 would mean that whereas currently when a scheme makes a transfer to a formerly contracted-out occupational pension scheme, it must follow the requirements of regulations 5 and 10, after abolition of contracting out it will need to comply with regulations 3 and 8.
37. So whereas currently the receiving scheme simply needs to ensure that the member has signed a statement that they understand that the benefits they receive may be in a different form and different amount to those which would have been payable by the transferring scheme, post abolition of contracting out, the receiving scheme will have to provide the benefits the member would have received from the transferring scheme. So the member and scheme are tied into preserving accrued contracted out rights.
38. The policy intention is to ensure that members’ accrued rights are protected, however, we don’t want to remove the flexibilities which the member benefits from in the current legislation. We are therefore, now providing in the final Order that contracted-out rights can be transferred either to a formerly contracted-out scheme under regulations 3 and 8, or to any scheme (that isn’t an overseas scheme or arrangement) (which can include a former contracted-out scheme) in accordance with regulations 5 and 10. A transfer under regulations 3 and 8 will require the scheme to preserve the contracted-out rights. A transfer under

regulations 5 and 10 will allow the scheme to agree with the member that the rights provided in the receiving scheme may be of a different nature to the contracted-out rights transferred.

Issue – Whether time limits could be extended for those schemes which need to discharge their pension liabilities; or make payment of a cash equivalent transfer value, and which cease to contract out in the 12 months preceding the ending of contracting out. Articles 35,36 and 37 (draft Articles 29,30(3) and 31).

39. Several respondents pointed out that the proposed new time limits for schemes to complete such arrangements as discharging their liability to provide a pension or make payment of a cash equivalent transfer value would be limited to one year for those schemes which ceased to contract out before abolition. This contrasted with schemes that ceased to contract out at abolition who are provided with a time extension of up to 5 years following abolition to complete these tasks where they have not reached agreement with HMRC as to the scheme's contracted out liabilities.
40. We considered that whether or not a scheme ceased to contract out at abolition or in the 12 months preceding it, the requirement to reconcile scheme records is as a direct consequence of the ending of contracting out and the reduced service that HMRC will provide in the longer term, and all schemes wishing to take advantage of the service need to register for reconciliation before 6 April 2016. It seems reasonable therefore that because reconciliation affects all schemes discharging their pension liabilities or making payment of a cash equivalent, whether ceasing to contract out shortly before or at abolition, that all such schemes should benefit from an extension in the time limits for completing these arrangements which is linked to completion of scheme reconciliation.
41. We have therefore amended the wording in articles 35, 36 and 37 in the final order so that the extended time limits apply to schemes that ceased to contract out in the 12 month period ending on the second abolition date who have not yet completed reconciliation.
42. As a consequence of this change, we have revised the Discharge of Liability requirements which required schemes to discharge their liabilities by 5 April 2017 (previously article 29 (2)(b)) so that they must be completed by 5 April 2021(changes are now provided for under article 35(2)(b)). We have also tidied up article 12(4) so that regulation 9(3) of the Occupational Pension Schemes (Discharge of Liability) Regulations 1996 (1996/987) refers from 6 April 2016 to a scheme that has ceased to contract out rather than one that one “which is to cease” which would no longer be possible after 6 April 2016.
43. Finally, one respondent was unsure what was meant at articles 29, 30 and 31 of the draft Order by schemes not having yet “reached an agreement with HMRC as to the scheme's liabilities for guaranteed minimum pensions or section 9(2B) rights” but presumed this meant reference to the Scheme Reconciliation Service. This is correct and to clarify this we have amended the wording of these articles so that this is more easily understood.

Issue – The Transfer of Employment (Pension Protection) (TUPE) Regulations – what the new arrangements should be following the removal of the requirement for the receiving scheme to meet the Reference Scheme Test. (Article 21)

44. Under the proposals in the draft Order, when an individual's employment is being transferred, they must be transferred to a pension scheme the quality of which is based on factors relating to the contributions being made to that scheme. That is the requirement now if the pension scheme they are being transferred into is not a contracted-out scheme. One respondent suggested that this might open the door to misunderstandings and even fraud and that to address this, the receiving scheme should have to meet the circumstances for qualifying schemes under auto-enrolment.
45. We do not consider that to be necessary. Employers in relation to a TUPE arrangement will always have to meet the automatic enrolment requirements for employees who are jobholders when transferring current employees to a new scheme; there is no need to duplicate that requirement elsewhere. For those employees who are not jobholders, the requirements provided by the current TUPE arrangements for schemes that are not contracted-out will apply from April 2016, as now.

Issue – The disclosure requirements for schemes ceasing to contract out on 6 April 2016. (Article 32) Four issues were raised:

- (i) Whether it is necessary to place a specific requirement on schemes to inform members that the scheme had ceased to be a contracted-out scheme.
 - (ii) Whether new joiners up until April 2017 will need to be told that they are “contracted-in”.
 - (iii) Whether DWP would confirm that no further changes are envisaged to the Disclosure of Information Regulations in respect of informing members of the scheme’s contracted-out status.
 - (iv) DWP were advised that it would be helpful to communicate that a formal advance election to surrender a contracting out certificate is not required where cessation occurs at 6 April 2016.
- (i) Whether it is necessary to place a specific requirement on schemes that they should inform members that the scheme had ceased to be a contracted out scheme.
46. We considered placing a specific requirement on schemes so that they should inform members that the scheme had ceased to be a contracted out scheme. However, we decided against this because the existing legislation already places a requirement on schemes to notify members which employment is contracted out and which is not – Schedule 2, Part 1, paragraph 12 of the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 – and to notify them when that position changes. This means that schemes are already required to inform members – under those Regulations – when employment

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which is contracted-out ceases to be so at the second abolition date. In addition, the Department's communications strategy for the new State Pension emphasises the importance of communicating the changes to scheme members. The link can be accessed here:

<https://www.gov.uk/government/collections/state-pension-toolkit>

(ii) Whether new joiners up until April 2017 will need to be told that they are “contracted in”.

47. New joiners from 6 April 2016 will not need to be told whether they are contracted-in because paragraph 12 of Schedule 2 (Basic information) of the Disclosure of Information Regulations (which remains in force until 6 April 2017) begins “Except where the scheme has no relevant employment which is contracted-out employment within the meaning of section 8 of the 1993 Act.” Therefore, because of the exception, from 6 April 2016 there will be no need for formerly contracted-out schemes to inform members that they are contracted-in.

(iii) Whether DWP would confirm that no further changes are envisaged to the Disclosure of Information Regulations in respect of informing members of the scheme’s contracted-out status.

48. We can confirm that no such changes are envisaged to the Disclosure of Information Regulations. Furthermore a number of communications (including employer packs) will be published before contracting out ends informing schemes of their statutory requirements as far as making members aware of the ending of contracting out and the change in the amount of national insurance they will pay.

(iv) DWP were advised that it would be helpful to communicate that a formal advance election to surrender a contracting out certificate is not required where cessation occurs at 6 April 2016.

49. We have mentioned in several previous publications concerning the ending of contracting out that it will not be necessary for schemes to formally make an election to surrender their contracting out certificates. We are happy to re-iterate that message here again and will also ensure that it is reiterated in HMRC bulletins concerning the ending of contracting out.

Issue – The amended definition of section 9(2B) rights. Article 28 (draft article 2)

50. It was mentioned that the Order does not appear to change the definition of “section 9(2B) rights” in the Occupational Pension Schemes (Contracting-out) Regulations 1996. It was suggested that this was an omission as the consultation paper on the Order says that the same definition of section 9(2B) rights is to be used throughout secondary legislation.

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51. We realise there is a mis-match between the definitions of section 9(2B) rights in the 1996 Regulations (as amended by reg 28(2)(c) of the Occupational Pension Schemes (Schemes that were Contracted Out) (No2) Regulations 2015) and the definition of section 9(2B) rights in the Occupational Pension Schemes (Schemes that were Contracted Out) (No2) Regulations 2015 which is amended by this Order. The final Order further amends both definitions to take account of the changes to the contracting-out transfer provisions, and to ensure they are the same.

Annex A: Consultation respondents

Aon Hewitt
Association of Consulting Actuaries (ACA)
Association of Pension Lawyers (APL)
Association of School and College Leavers
Rosemary Buckler
Eversheds LLP
Hogan Lovells International LLP
Hymans Robertson LLP
JLT Benefit Solutions
Marji Loquet
Mercer UK (a subsidiary of Marsh & McLennan)
Jane Northam
D.Parish
Payroll Alliance
Pensions and Lifetime Savings Association (formerly NAPF)
The Pensions Administration Standards Association
The Pensions Trust
Prospect (Union for Professionals)
The Society of Pension Professionals (SPP, formerly the Society of Pension Consultants)
Dawn Scott
Isaque Sousa
Mr and Mrs Strong
Christopher Thompson
Towers Watson
Wragge Lawrence and Graham