Regulatory Policy Committee

The Pensions Act 2014 (Contributions Equivalent Premium) (Consequential Provision) and (Savings) (Amendment) Order 2016

Department for Work and Pensions

RPC rating: validated

The IA is now fit for purpose as a result of the Department's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of proposal

Currently, managers of a contracted-out salary-related occupational pension scheme have to pay a contributions equivalent premium (CEP) to Government when a member of such a scheme leaves the scheme with less than two years' pensionable service. The original purpose of the CEP was to buy the individual back into the secondary state pension. However, contracting out is being abolished in 2016. Current legislation is likely to be interpreted as requiring managers of affected schemes to pay a CEP for each member with less than two years' pensionable service when this occurs, even though this was not the original intention of the contracting out reforms.

The Department proposes to amend the legislation to clarify that a CEP is not required as a result of contracting-out ending. A CEP will only be required if a member of a current affected scheme leaves with less than two years pensionable service.

Impacts of proposal

The Department estimates that there are currently 130,000 individuals in affected pension schemes with less than two years of pensionable service and that 41,125 of these individuals will leave the schemes before achieving two years of pensionable service. Schemes would have to pay CEPs for these individuals under the baseline scenario and the proposal. Therefore, the employers of up to 88,875 individuals who will not leave the scheme before accruing 2 years' service may interpret current legislation to mean that a CEP must be paid for these employees simply as a result of the abolition of contracting-out. These figures are taken from a Departmental model, which is explained below. However, the Department expects that, in the baseline scenario, managers will only interpret the law in this way in 87.5% of these

cases. Therefore the proposal would lead to 77,765 fewer CEPs than in the baseline scenario.

The Department estimates that the average value of a CEP is approximately £928 and the value of the time spent completing the administrative tasks accompanying paying a CEP is worth approximately £24. These figures are calculated using data from ASHE, consultation with industry and Government data. Therefore schemes will save approximately £74 million over two years.

The Department states that there will be one-off familiarisation costs of £4,000. These are based on an administrator in each of the 768 affected pension schemes reading two pages of guidance.

The RPC validates the estimated equivalent annual net cost to business (EANCB) of -£35.3 million. This will be a qualifying regulatory provision that will score under the business impact target.

Quality of submission

This measure qualifies as a beneficial change for the Business Impact Target, as it removes an unintended cost to business that will result from the implementation of the abolition of contracting out. In the last parliament, when the abolition of contracting out was appraised, the Department treated the measure as a spending decision so did not submit an impact assessment to the RPC or include any impacts in the One in One out (OIOO) account. The RPC believes that all of the impacts to business as a result of changes to CEPs paid should have been included in the OIOO account.

The Department has responded to a number of issues that the RPC raised in its initial review. The Department has now:

- corrected an error in the value of administrators time, which has changed the EANCB from -£37 million to -£35.3 million;
- checked the assumed percentage of cases in which managers will interpret the law to mean they have to pay a CEP with the Government Actuary Department, who agreed with the percentage used;
- explained that the estimated figures are based on a ‘Pensim2’, a dynamic micro-simulation model of pensions in Great Britain estimated with data from the Family Resources Survey, the British Household Panel Survey and the Lifetime Labour Market Database; and
- shown that the familiarisation costs are trivial.

The IA would still be improved by additional justification of the assumed percentage of cases in which managers will interpret the law to mean they have to pay a CEP. However, the RPC notes that businesses may be unwilling to provide estimates given the legal consequences of doing so.

The Department appraises the policy over two years. This appears appropriate as all the impacts of the policy will occur before April 2018. The RPC therefore validates a BIT score of -£70.6 million as this proposal should be scored in the same manner as a time-limited proposal.

The Department could improve the IA by presenting its calculations in a clearer manner and including explanations of the technical terms used in the IA. For example, terms such as accruing rights in a DB scheme should be defined and figures on the number of individuals affected and the administrative costs should be rounded consistently.

Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net cost to business (EANCB)	-£37 million (initial estimate) -£35.28 million (final estimate)
Business net present value	£72.95 million

RPC assessment

Classification	Qualifying regulatory provision (OUT)
EANCB – RPC validated[1]	-£35.3 million
Business Impact Target (BIT) Score[1]	-£70.6 million
Small and micro business assessment	Not required (deregulatory)
RPC rating (of initial submission)	Not fit for purpose

[1] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.

Michael Gibbons CBE, Chairman