

**EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (CONTRACTING-OUT)
(AMENDMENT) REGULATIONS 2009**

2009 No. 846

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 This instrument applies when scheme trustees seek to convert the guaranteed minimum pension (GMP) element of an individual's occupational pension entitlement into actuarially equivalent scheme benefits. It sets out how actuarial equivalence is to be determined for the GMP element and the new scheme benefits. This instrument also sets out the circumstances in which a survivor's benefit must be payable from the converted GMP benefits.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

- 3.1 None.

4. **Legislative Context**

- 4.1 Section 14 in the Pensions Act 2007 requires regulations to be made for the purposes of:

- Specifying how actuarial equivalence must be determined in order to convert the GMPs of members into scheme benefits, and
- Setting out the conditions under which, and period for which, survivors benefits must be provided post-conversion.

Section 14 comes into force on 6 April 2009. This instrument sets out the provisions that are permitted to be made under section 14.

5. **Territorial Extent and Application**

- 5.1 This instrument applies to Great Britain.

6. **European Convention on Human Rights**

The Minister of State for Pensions and the Ageing Society, Rosie Winterton, has made the following statement regarding Human Rights:

In my view the provisions of the Occupational Pension Schemes (Contracting-out) (Amendment) Regulations 2009 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

- 7.1 Between 6 April 1978 and 5 April 1997, defined benefit occupational pension schemes could be contracted out of the State system if they promised that the pension they provided would not be lower than a specified minimum, calculated in a given manner – the GMP. This aimed to ensure that members of contracted-out schemes did not lose out by no longer getting a full state pension.
- 7.2 Although GMPs ceased to accrue from April 1997, schemes have had to continue to administer the rights already accrued.
- 7.3 Section 24B of the Pensions Schemes Act 1993 sets out the conversion conditions which schemes have to meet in order to convert GMPs into scheme benefits. Condition 1 sets out that post-conversion benefits must be actuarially equivalent to the pre-conversion benefits. Actuarial equivalence is a method which is used to compare the value of a member's rights before and after a proposed change to occupational pension scheme benefits. The purpose of it is to ensure that the value of the members' benefits does not fall as a result of the change.
- 7.4 Currently a GMP must be used to provide for a survivor benefit where a scheme member has a spouse or civil partner. A scheme choosing to convert GMPs would still have to meet that requirement from the converted benefits. This instrument sets out the period for and circumstances in which a survivor benefit is payable from the converted benefits.

Consolidation

- 7.5 The Government accepts the need for consolidation in due course. Most users of pensions legislation are pensions professionals who will have access to their own online resource materials. In addition the Department for Work and Pensions publishes the "Blue Volumes", which can be accessed by members of the public on the internet. The Blue Volumes contain the legislation for which the Department is responsible. The legislation is presented in a consolidated format and is updated regularly. The weblink is:
http://www.dwp.gov.uk/advisers/docs/lawvols/bluevol/pdf/c_0031.pdf.

8. Consultation outcome

- 8.1 Because of the technical nature of this instrument the consultation period was limited to 8 weeks. The consultation period ran from 2 September 2008 to 28 October 2008.
- 8.2 Thirty-four responses were received on the draft regulations. Most were broadly supportive of the concept of GMP conversion as set out in Section 14 of the Pensions Act 2007. Many respondents have indicated that schemes would not wish to disturb current administrative procedures, so were unlikely to adopt the GMP conversion facility in the near future.
- 8.3 One respondent suggested that we require an actuary to provide a certificate to trustees within a set timescale (3 months suggested), we have taken this comment on board and amended the regulations accordingly.

- 8.4 Twenty respondents commented on the GMP “conversion date” as this was not set out in the draft regulations. Because the date is defined in the Pensions Act 2007 as “the date on which that amendment takes effect” the regulations did not seek to mirror this definition.
- 8.5 Twenty-one respondents considered whether restrictions should be put on onward transfers from schemes which have converted their GMP liabilities. All respondents were unanimous in stating that there should be no onward transfer restrictions on the ‘converted benefits’. The Government decided not to impose restrictions on the onward transfer of scheme benefits derived from converted GMPs.
- 8.6 Several comments were received asking for clarification of the role the Pensions Regulator and the Board for Actuarial Standards would adopt. The published consultation response therefore clarified the roles of both bodies. A copy of the consultation document has been published on the Government’s website at www.dwp.gov.uk/consultations/2008/.

9. **Guidance**

- 9.1 This instrument is of interest to pension scheme trustees and actuaries and the regulations are technical. It is therefore inappropriate to issue specific guidance. This SI sets out, that for the purposes of seeking to determine actuarial equivalence, trustees are responsible for obtaining advice from an actuary about what assumptions should be used.
- 9.2 The Board of Actuarial Standards is proposing to set pensions standards for actuaries.
- 9.3 Guidance on the notification procedures will be available on HM Revenue & Customs website.

10. **Impact**

- 10.1 This instrument imposes no new costs on business, charities or voluntary bodies. The new regulations set out how actuarial equivalence should be determined if scheme trustees choose to convert GMPs into scheme benefits. The regulations also set out the circumstances under which a survivor benefit needs to be payable. Estimated costs and savings for schemes wishing to convert GMPs are shown in Annex A.
- 10.2 This instrument imposes no new costs on the public sector. The new regulations set out for contracted out occupational pension schemes, the considerations which need to be taken into account prior to a GMP conversion exercise being undertaken. If scheme trustees adopt this voluntary measure, estimated costs and savings for schemes are shown in Annex A.
- 10.3 An assessment of the impact of the provisions in these regulations is included in the regulatory impact assessment that accompanied the Pensions Act 2007, the relevant extract of which is attached at Annex A; the figures remain up to date.

11. **Regulating small business**

11.1 The GMP conversion facility imposes no new regulations or costs on small businesses.

12. **Monitoring & review**

12.1 The legislation will remain in place as an optional facility for schemes and will be kept under regular review.

13. **Contact**

Maureen Rafferty at the Department for Work and Pensions Tel: 020 7962 8742 or email: Maureen.rafferty@dwp.gsi.gov.uk can answer any queries regarding the instrument.

GMP conversion

4.41 GMP conversion would be an option for schemes; no scheme would be required to convert. The proposal would only affect DB occupational pension schemes that were contracted-out prior to April 1997.

4.42 The proposed legislation includes a requirement for trustees to obtain the prior agreement of the scheme's sponsoring employer before undertaking a conversion exercise.

4.43 There would be a one-off cost for a scheme to go through the conversion procedure, resulting from the need to modify IT software and incur legal, actuarial and other administrative costs. Once converted, a scheme will be able to benefit from ongoing administrative economies as a result of having adopted a unified benefit structure. These savings would arise through no longer having to purchase actuarial advice for GMP calculations, no longer having to deal with queries from members on their GMPs, simpler awards of benefit when members reach pensionable age and simpler uprating of pensions in payment.

4.44 Whilst costs and benefits will vary significantly according to the circumstances of the particular scheme, for the purposes of making a broad indicative estimate of the possible effects of this reform, we have assumed an average initial cost of £7,000 for smaller schemes and £12,000 for larger schemes. Using an assumption that 25-50 per cent of schemes may choose to convert their GMPs, the total initial cost across all schemes is estimated to be between £11m and £22m, with a total annual cost saving of £6m to £13m.