EXPLANATORY MEMORANDUM TO

THE PUBLIC SERVICE (CIVIL SERVANTS AND OTHERS) PENSIONS (CONSEQUENTIAL AND AMENDMENT) REGULATIONS 2015

2015 No. 372

1. This explanatory memorandum has been prepared by HM Treasury and the Cabinet Office and is laid before Parliament by Command of Her Majesty.

2. Purpose of the Instruments

The Public Service (Civil Servants and Others) Pensions (Consequential and Amendment) Regulations 2015 ("the Regulations") make consequential provision in relation to the new public service pension scheme under the Public Service Pensions Act 2013 (c.25). They modify the effect of other statutory provisions in their application to pension schemes for civil servants and others. The Regulations also make minor amendments to a previous instrument.

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

The Regulations make modifications to provisions in primary legislation.

4. Legislative Context

4.1 The Regulations implement reforms under the Public Service Pensions Act 2013 ("the 2013 Act") in respect of pensions for civil servants and other public service workers.

4.2 The 2013 Act was enacted in response to the recommendations of the Independent Public Service Pensions Commission led by Lord Hutton of Furness. The Commission reported on 10 March 2011. Under the 2013 Act, new pension schemes ("new schemes") are being established for persons in public service, by regulations ("scheme regulations") made under section 1.

4.3 To date, scheme regulations have been made to establish pension schemes for teachers in England and Wales: the Teachers' Pension Scheme Regulations 2014 (S.I. 2014/512); for civil servants and other Crown employees: the Public Service (Civil Servants and Others) Pensions Regulations 2014 (S.I. 2014/1964); for the armed forces: the Armed Forces Pension Regulations (S.I. 2014/2336); and for firefighters in England: the Firefighters' Pension Scheme (England) Regulations 2014 (S.I. 2014/2848).

4.4 This instrument is being laid with the Armed Forces Pension (Consequential Provisions) Regulations 2015, the Police Pensions (Consequential

Provisions) Regulations 2015, the Teachers' Pension Scheme (Consequential Provisions) Regulations 2015, the Firefighters' Pension Scheme (England) (Consequential Provisions) Regulations 2015, and the National Health Service Pension Scheme (Consequential Provisions) Regulations 2015.

5. Territorial Extent and Application

The Regulations extend to the United Kingdom.

6. European Convention on Human Rights

Francis Maude, Minister for the Cabinet Office has made the following statement regarding human rights:

In my view the provisions of the Public Service (Civil Servants and Others) Pensions (Consequential and Amendment) Regulations 2015 are compatible with the Convention Rights.

7. Policy background

- **What is being done and why**

Certification provisions for contracting-out

7.1 Some employers choose to set up company pension schemes to provide a pension which replaces all, or part, of the additional State Pension provided the scheme meets minimum standards known as the Reference Scheme Test. This is known as "contracting-out" of the additional State Pension. Individuals who are members of a contracted-out scheme and their employers pay lower National Insurance contributions. This arrangement is known as the National Insurance rebate. The Government intends that the new schemes, like the existing schemes, should be contracted-out of the additional State Pension, until contracting-out ends in April 2016. Part 2 of the Regulations deals with contracting-out under the Pension Schemes Act 1993 (c.48) ("the 1993 Act") for the period from 1 April 2015 to 5 April 2016, inclusive. Certain procedural requirements are disapplied that would otherwise apply by virtue of the Occupational Pension Schemes (Contracting-out) Regulations 1996 (S.I. 1996/1172): for example, formal notices to earners. New schemes must still meet the requirements in section 9 of the 1993 Act: in particular, they must satisfy the Reference Scheme Test.

Provisions about pensionable service and early leavers

7.2 The effect of the 2013 Act and scheme regulations is that existing schemes must close, and current members (except for specific protected groups) transfer into new schemes. However, these transferring members will retain certain benefits in their existing scheme (described in the Regulations as their "old scheme”). Although they will accrue new service related benefits in the new scheme only, the member will, strictly speaking, belong to both schemes at once. In certain cases such a member will have a “final salary link” (see Schedule 7 to the 2013 Act) which means that the final salary in their new scheme will be used to determine their final salary for the purposes of their old scheme. Members will also continue to accrue benefits under pre-existing contracts to buy added pension or added years.

7.3 Part 3 of the Regulations reflects the policy intention that those with ongoing service in an old scheme and a new scheme should generally (subject to certain conditions) be treated as if they remained active members for particular purposes or in “pensionable service” for their old schemes until their pensionable service in their new scheme is terminated. The objective is to prevent them from becoming deferred members and triggering rights that are inconsistent with them remaining in service with the same employer in a successor pension scheme.

7.4 The 1993 Act contains provisions about occupational pension schemes – not only public service schemes – including as to their contracting-out of the additional State Pension (see Part 3 of the 1993 Act); and as to members who leave their scheme before retirement age (“early leavers”) (Part 4 of the 1993 Act).

7.5 For the purposes of the 2013 Act and scheme regulations, a number of those provisions need to be modified in relation to a member of an old scheme who transfers to a new scheme. The modifications described below (paragraphs 7.6 to 7.12) affect only this category of members, and not those who remain fully active members of an old scheme (primarily, those near to normal pension age at the time of the reforms). It does not affect those who have become fully deferred members of the old scheme, nor brand new members who join the new scheme on or after 1 April 2015.

7.6 One reference to “pensionable service” in Part 3 of the 1993 Act, which concerns certification requirements for contracted-out pension schemes, is modified so that the person is treated as having a single period of pensionable service in one scheme.

7.7 There are further provisions in Part 4 of the 1993 Act, which concerns the rights of early leavers. Chapter 1 provides for preservation of benefits and sets out the principle of short service benefit for those persons. The Regulations provide that a person will not have access to short service benefit until pensionable service terminates in the new scheme, rather than when the person transfers into the new scheme. Certain provisions will apply as though the old scheme and the new scheme were a single scheme.

7.8 Chapter 2 of Part 4 concerns revaluation of benefits during the period between the person leaving their occupational scheme and reaching normal pension age. The requirements of that Chapter should not apply to someone's old scheme benefits when the person transfers into the new scheme but remains in service. Instead the amount of their old scheme benefits will be determined in accordance with the scheme rules and (if applicable) the member's final salary in the new scheme. This is to ensure that their old scheme benefits are not effectively revalued twice.

7.9 Chapter 3 of Part 4 concerns "anti-franking", or the protection of increases in guaranteed minimum pensions ("GMPs") which contracted-out schemes had to provide until 1997. For this purpose, the Regulations provide that the "cessation date" when a person ceases to be in contracted-out employment under the old scheme (and from which point GMPs may need to be increased) is treated as the date when the person leaves their new scheme, and not the date when they transfer from the old scheme to the new scheme. The Regulations include a subsequent modification of the definition of "cessation date" in section 87 of the 1993 Act, which will take effect when that definition is amended by the Pensions Act 2014 (c.19) as part of the abolition of contracting-out.

7.10 Chapter 4 of Part 4 concerns cash equivalent transfers for early leavers. The Regulations provide that a person will not acquire the statutory right to a cash equivalent under the old scheme until pensionable service terminates in the new scheme, rather than when the person transfers into the new scheme.

7.11 There are also modifications to the Occupational Pension Schemes (Transfer Values) Regulations 1996 (S.I. 1996/1847) which were made under that Chapter, to enable scheme managers in certain circumstances to delay transfers of preserved benefits until the transition member has left new scheme employment. This is designed to restrict transfers out (from either scheme) by a person who has voluntarily opted out of membership of the new scheme, but remains in employment.

7.12 Chapter 5 of Part 4 concerns cash transfer sums or contribution refunds for those who leave a scheme after 3 months but within 2 years or before their rights have vested. The Regulations provide that a person will not acquire rights under Chapter 5 until pensionable service terminates in the new scheme, rather than when the person transfers into the new scheme. The statutory time periods are also measured as though the person had one continuous period of service.

Ill-health benefits

7.13 The Government has chosen to adopt a 'single source model' for the payment of ill-health pensions in the new schemes. Under the single source model, all payments of ill-health pension will be made from the new pension scheme during the period between retirement and the scheme member reaching normal pension age in the old scheme. This model delivers certainty over the ill-health pensions that are payable to members with service in both schemes, and prevents the administrative difficulty of performing two parallel ill-health calculations.

7.14 Accordingly, the pension payable to the scheme member from the new scheme will contain 3 elements:

(1) An element in respect of the lower tier ill-health pension entitlement in respect of service in the old scheme;

(2) A pension in respect of service in the new scheme; and

(3) In the case of upper tier ill-health pensions, an uplift.

7.15 When the person receiving an ill-health pension from the new scheme reaches their normal pension age in the old scheme, then the first element will cease to be paid out of the new scheme and the element in respect of the lower tier ill-health pension entitlement under their old scheme pension will come into payment from the old scheme. They will see no difference in the amount that they receive.

7.16 Part 4 of the Regulations modifies the tax regime in order to correct some unintended consequences.

7.17 Under the current legislation, element (1) would count as an increase in the value of the pension over the pension input period. If that increase meant that the amount of the annual allowance for the pension input period was exceeded, then a tax charge would arise. Regulation 15 modifies the application of the current legislation to remove element (1) from the calculation of the pension input period during the pension input period in which the member takes ill-health retirement.

7.18 Under the current legislation, the initial value of the ill-health pension – elements (1), (2), and in cases of serious ill-health, (3) – would be measured against the lifetime allowance. However, when the member taking ill-health retirement reaches the normal pension age under the new scheme, the current legislation would measure the element in respect of the lower tier ill-health pension entitlement from the old scheme coming into payment against the member’s remaining lifetime allowance, notwithstanding that element (1) will cease to be paid from the new scheme. If that second measurement results in the total amount of pension exceeding the lifetime allowance, then a tax charge will arise. Regulation 14 modifies the application of the current legislation to ensure that the payment of the element in respect of the lower tier ill-health pension entitlement paid from the old scheme will not count against the lifetime allowance.

7.19 Accordingly, both regulations operate so that a member will not suffer any unexpected tax consequences as a result of the way the Government has chosen to structure the ill-health provisions of the new scheme.

Amendments to the new civil service pension regulations

7.20 Part 5 of the Regulations makes minor amendments to the Public Service (Civil Servants and Others) Pensions Regulations 2014 (S.I. 2014/1964). These amendments correct some of the provisions and also make sure that the regulations properly reflect the policy regarding transitional arrangements for members of the old scheme who become members of the new scheme. The procedure for free issue is being applied as the corrections to the original are not the result of subsequent changed circumstances but further consideration as to whether the instrument produced the intended result.

- **Consolidation**

7.21 There are no plans to consolidate these Regulations.

8. Consultation outcome

The Cabinet Office consulted on the draft Public Service (Civil Servants and Others) Pensions (Consequential and Amendment) Regulations 2015 with the relevant Trades Unions. The nationally recognized unions were provided with copes of the draft regulations and an explanation of the how they delivered the policy intent previously discussed as part of the Public Service (Civil Servants and Others) Pensions Regulations 2015 on 20 October 2014 and given until 24 November 2014 to reply. The consultation received no responses beyond acknowledgements of receipt and the opportunity to comment.

9. Guidance

There are no plans to produce formal guidance relating to these Regulations.

10. Impact

An Impact Assessment has not been prepared for these Regulations as they have no impact on business, charities or voluntary bodies. An impact assessment was produced for the Public Service Pensions Bill. See: http://www.parliament.uk/documents/impact-assessments/IA12-023.pdf

11. Regulating small business

The Regulations do not apply to small businesses.

12. Monitoring & review

There are no plans for any formal mechanism for monitoring and reviewing the Regulations.

13. Contact

Michael Watkins at the Cabinet Office (telephone 020 7276 6379 or email michael.watkins@cabinetoffice.gov.uk) or Catherine Stewart at the Treasury (telephone 0207 270 1219 or email Catherine.stewart@hmtreasury.gsi.gov.uk) can answer any queries regarding the Regulations.