

EXPLANATORY MEMORANDUM TO
THE PENSIONS ACT 2014 (ABOLITION OF CONTRACTING-OUT FOR SALARY
RELATED PENSION SCHEMES) (CONSEQUENTIAL AMENDMENTS AND
SAVINGS) ORDER 2016

2016 No. 200

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 this Order is to make consequential amendments to secondary legislation resulting from the ending of contracting-out for salary related schemes on 6 April 2016. Amendments are required to ensure that members' accrued contracted-out rights are preserved and that schemes are able to undertake their administrative functions following the end of contracting-out. For example, the legislation governing the transfer of accrued rights is amended to account for the fact that all schemes will now be former contracted-out schemes.

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 the 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 Sponsoring employers of salary-related or defined benefit (DB) occupational pension schemes are allowed to contract their employees out of the additional State Pension on the condition that the scheme meets certain statutory requirements. Although these have changed over the years, the main requirements are contained in section 9 of the Pension Schemes Act 1993¹ ("the PSA 1993").
- 4.2 In return for the employer providing a scheme that meets the statutory standards, both the employer and employee pay reduced rates of National Insurance (NI) (employer contributions are currently reduced by 3.4% and employee contributions by 1.4%). This is known as the "NI rebate", and is set out in the PSA 1993, sections 41(1A) and (1B).
- 4.3 The introduction of the new State Pension provided by the Pensions Act 2014 means that there will no longer be an additional State Pension, and contracting-out will come to an end, as will the NI rebate, on 6 April 2016.

¹ <http://lawvolumes.dwp.gov.uk/docs/a5-1251.pdf>

- 4.4 The Occupational Pension Schemes (Schemes that were Contracted-out) (No. 2) Regulations 2015² set out the key legislative changes that are necessary as a result of the abolition of contracting-out. These regulations make further changes to other legislation as a consequence of the abolition of contracting-out.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is Great Britain. The amendment to article 25 also extends to Northern Ireland.
- 5.2 The territorial application of this instrument is Great Britain, other than article 25 which also applies to Northern Ireland.
- 5.3 Corresponding provisions, other than for article 25, will be made in 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 provisions were widely used. The GMP was intended to provide a minimum amount of weekly pension, broadly equivalent to the amount of state scheme 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, is applied to schemes that contract-out of the state system. This is still in operation, and commonly known as the Reference Scheme Test. This test requires a scheme to provide, as a minimum, for the majority of members, a pension at age 65; to have an accrual rate of 1/80th of qualifying earnings in the last three years before the end of contracted-out employment; and pay a survivor’s pension to a widow, widower or civil partner of 50 per cent of benefits that the member was being paid before death.
- 7.3 With the introduction of the new State Pension from 6 April the process mentioned above known as “contracting-out” will be abolished as the additional State Pension will no longer exist. In order to ensure that members’ accrued contracted-out rights are preserved and that schemes are able to undertake their administrative functions following abolition, it has been necessary to amend and save (allow to remain in force) certain legislation. This Order therefore makes the necessary amendments and saves certain secondary legislation as a result of the ending of contracting-out.
- 7.4 The Order provides for the legislative amendments to come into force in stages from April 2016 to April 2021. It has been necessary to delay the coming into force of certain changes in order to allow schemes to finalise arrangements following the

² <http://www.legislation.gov.uk/ukxi/2015/1677/contents/made>

ending of contracting-out, such as schemes reconciling their contracting-out records with HMRC and discharging liability to provide pensions to members.

Consolidation

- 7.5 Informal consolidated text of instruments is available to the public free of charge via ‘The Law Relating to Social Security’ (Blue Volumes) on the Department for Work and Pensions website at <http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/> or the National Archive website legislation.gov.uk. An explanation as to which instruments are maintained on each site is available [here](#).

8. Consultation outcome

- 8.1 The consultation³ ran for four weeks from 20 October 2015 to 16 November 2016. There were 22 responses from members of the public, trade union representatives and experts in the pensions industry. The consultation period was limited [to four weeks] given that the Department has already consulted during 2015 on changes to contracting-out legislation⁴ and these are simply further minor changes amending other legislation as a result of the ending of contracting-out.
- 8.2 The consultation asked two questions. Firstly, it sought agreement that the amendments were necessary as a consequence of contracting-out ending, that they protect members’ accrued rights, and ensure schemes can carry out their administrative functions post abolition. Secondly it asked whether in addition to the changes in the Order, there was any further legislation that should be revoked, amended or saved as a consequence of the ending of contracting-out.
- 8.3 There was broad agreement by most respondents to all three points raised in the first question (no responses suggested that changes were not necessary). There were, however, some concerns regarding amongst several issues:

Responses to the first consultation question – further issues

Transfer requirements for former contracted out schemes

- 8.4 Several respondents asked whether, post abolition, it would be possible to make bulk transfers of members with contracted-out rights without consent to a newly created scheme. They queried this because such a scheme cannot apply to be contracted-out – even for a short period – after the abolition date, in order to meet the criteria that such a transfer must be to a contracted-out or former contracted-out scheme. We have said in the Government response to the consultation that, because of the complexities involved in this issue, we will need to consider this once abolition has taken place.
- 8.5 Respondents also raised a question concerning individual transfers to former contracted-out schemes with the member’s consent. Whereas currently a transfer can take place to a former contracted-out scheme without the member’s accrued contracted-out rights needing to be preserved in the receiving scheme (if the member agrees to that), the proposals would have required such a transfer to preserve the member’s contracted-out rights.

³ <https://www.gov.uk/government/consultations/salary-related-pension-schemes-abolition-of-contracting-out-consequential-amendments>

⁴ <https://www.gov.uk/government/consultations/occupational-pension-schemes-abolition-of-defined-benefit-contracting-out>

- 8.6 In order to retain the current flexibilities which the member benefits from, we have amended the Order so that contracted-out rights can be transferred either to a formerly contracted-out scheme with the agreement of the receiving scheme that they will preserve contracted-out rights, or be transferred with the agreement of the member that the rights provided in the receiving scheme may be in a different form to the contracted-out rights transferred. We informally consulted with those respondents who had raised this issue to ensure that the proposed amendment would be fit for purpose when it comes into effect.

Time limits for discharging pension liabilities

- 8.7 Respondents asked whether time limits could be extended for those schemes which cease to contract out in the 12 months preceding the ending of contracting-out, and which need to discharge their pension liabilities through a transfer or pension credit benefit, given that this easement has been provided for schemes which cease to contract-out as a result of abolition. The time limit was extended for schemes which cease to contract out at abolition because they need to reconcile their records with HMRC. But it was pointed out that schemes which cease to contract out before abolition will be in the similar position of having to reconcile records. We have therefore provided for such an extension for schemes which cease to contract out in the 12 months prior to end of contracting out.

The disclosure requirements for schemes ceasing to contract-out on 6 April 2016

- 8.8 Respondents asked whether following the abolition of contracting-out, members needed to be informed that their scheme had ceased to contract-out; and whether they also need to be informed that they are “contracted-in”. The effect of the current disclosure requirements for occupational pension schemes is that the scheme will be required to inform members when employment which is contracted-out ceases to be contracted-out on 6 April 2016. This requirement will then be removed from 6 April 2017 as it will be redundant. Members who subsequently join after 6 April 2016 will not be required to be informed that they are “contracted-in”.

Responses to the second consultation question - further legislation that should be revoked, amended or saved as a consequence of the ending of contracting-out

- 8.9 With regard to the second question asked in the consultation, respondents referred to several other areas of legislation where changes or savings needed to be made. Amongst these were the following:

Impact on GMP uprating after April 2016

- 8.10 Whilst not something that could be influenced by this Order, members of the public raised the issue of changes to GMP indexation as a result of the introduction of the new State Pension and the ending of contracting-out. We explain in the response document that the Government does not pay increases on GMPs.

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

- 8.11 Respondents to the consultation 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 (the minimum standard for contracted-out schemes from 1997) 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 continue to remain in force (are saved) for schemes which operate an RST underpin.

- 8.12 We have addressed the respondents' comments in the Government's response to the consultation, published on gov.uk:

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

9. Guidance

- 9.1 The Government's response to the consultation on the Order provides information for schemes on how to interpret the Order. Her Majesty's Revenue & Customs publish regular bulletins aimed at employers, pension scheme administrators and others in the pensions industry:

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

- 9.2 Her Majesty's Revenue & Customs, in collaboration with the Department for Work and Pensions, is updating guidance for schemes and pension administrators following the end of contracting-out and should be available in spring 2016. In addition, a telephone advice line service will be available for pension scheme administrators and managers.

10. Impact

- 10.1 There is no impact on business, charities or voluntary bodies.
10.2 There is no impact on the public sector.
10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

- 11.1 The legislation applies to small businesses but does not place any additional burden on them.

12. Monitoring & review

- 12.1 It is not appropriate in the circumstances to make statutory provision for review in this Order because the Order does not place any additional burden on individuals or business. As such, the cost of conducting a statutory review and monitoring impacts would be disproportionate to the economic impact of the regulations.
12.2 The Department will, however, continue to work closely with its stakeholders, including industry bodies and employer organisations, in the period following the abolition of contracting-out and will take a keen interest in how the arrangements are working. The Department always keeps policy under review, and should any issues arise with these arrangements, 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 can answer any queries regarding the instrument. Tel: 020 7449 7379; or email:
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