

**EXPLANATORY MEMORANDUM TO**  
**THE PENSIONS ACT 2014 (CONTRIBUTIONS EQUIVALENT PREMIUM)**  
**(CONSEQUENTIAL PROVISION) AND (SAVINGS) (AMENDMENT) ORDER 2016**

**2016 No. 252**

**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 the Pensions Act 2014 (Contributions Equivalent Premium) (Consequential Provision) and (Savings)(Amendment) Order 2016 (“the Order”) is to clarify the legislation at the point when contracting-out is abolished on 6 April 2016, in order to prevent a contributions equivalent premium<sup>1</sup> (CEP) payment being made when contracting-out ends and the member remains in the scheme.

2.2 The Order will clarify that a CEP is required only where a scheme member remains in pensionable service after the abolition of contracting-out and ceases to be a member with less than two years’ service and without accruing any rights in the scheme. It also makes provision allowing for payment of a CEP where a member who has accrued rights in the scheme has less than two years’ service upon ceasing to be a member or upon wind-up.

2.3 This Order amends the savings provision for sections 55 to 68 of the Pension Schemes Act 1993<sup>2</sup> - The Pensions Act 2014 (Savings) Order 2015<sup>3</sup> (S.I. 2015/1502) - and modifies some of the primary legislation to make sure it works with the provisions of the Order.

**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 the 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 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. These have changed over the years: the

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<sup>1</sup> A Contributions Equivalent Premium (CEP) may be paid where an individual has served less than two years in a salary-related contracted out scheme and then leaves the scheme (leaves contracted out employment). In such circumstances, the scheme may (and where there are no accrued rights in the scheme must) pay an amount to the National Insurance Fund so that the member is reinstated in the State Pension

<sup>2</sup> <http://www.legislation.gov.uk/ukpga/1993/48>

<sup>3</sup> <http://www.legislation.gov.uk/uksi/2015/1502/contents/made>

main requirements are contained in Part 3 of the Pension Schemes Act 1993 (“the PSA 1993”).

- 4.2 In return for the employer providing a scheme that meets the statutory minimum both the employer and employee pay lower levels of National Insurance (NI) (employer contributions are currently reduced by 3.4 per cent and employee contributions by 1.4 per cent). This is known as the “NI rebate”, and is set out in the PSA 1993, section 41(1A) and (1B).
- 4.3 The introduction of the new State Pension on 6 April 2016 means that there will no longer be an additional State Pension and consequently contracting-out will come to an end as will the NI rebate.
- 4.4 Section 24(1) of and Schedule 13 to, the Pensions Act 2014<sup>4</sup> plus the provisions in the Occupational Pension Schemes (Schemes that were Contracted-out) (No.2) Regulations 2015<sup>5</sup> (S.I. 2015/1677), set out the key legislative changes that are necessary as a result of the abolition of contracting-out for salary-related occupational pension schemes.
- 4.5 This Order provides for further amendments to contracting-out legislation that will enable trustees or managers of a scheme, following abolition, to correctly carry out a key administrative function, namely the payment of CEPs.

## **5. Extent and Territorial Application**

- 5.1 The extent of this instrument is Great Britain.
- 5.2 The territorial application of this instrument is Great Britain.
- 5.3 Subject to the agreement of the Northern Ireland Assembly, the Department for Social Development in Northern Ireland will be making corresponding provisions for Northern Ireland to the provisions which extend only to Great Britain.

## **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 salary-related occupational pensions schemes were able to remove their members from the state earnings related pension scheme and provide a “guaranteed minimum pension” (“GMP”) in return. The GMP was intended to provide a minimum amount of weekly pension broadly equivalent to the amount of additional State Pension that the member would have been entitled to had the member not been contracted-out. This 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.

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<sup>4</sup> <http://www.legislation.gov.uk/ukpga/2014/19/contents>

<sup>5</sup> <http://www.legislation.gov.uk/uksi/2015/1677/contents/made>

- 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 benefits broadly equivalent to the reference scheme, which provides: 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 2016 the process mentioned above known as "contracting-out" will be abolished as the additional State Pension will no longer exist.
- 7.4 Trustees or managers of a contracted-out salary-related occupational pensions scheme may and, subject to prescribed exceptions, where there are no accrued rights in the scheme, must make a CEP payment to Government when a member of a contracted-out scheme leaves their employment with less than two years' service. The purpose of a CEP is to buy the member back into the additional State Pension. The member is then effectively treated as if they had not been contracted-out of the State system. Trustees or managers are required to notify Her Majesty's Revenue and Customs (HMRC) where a CEP is appropriate so that they can recalculate the correct amount of State Pension entitlement.
- 7.5 It is possible that current legislation could be interpreted as requiring trustees or managers of a pension scheme to pay a CEP at the point that contracting-out is abolished (6 April 2016) where a member has less than two years' service at that point. This is contrary to the policy intention as the member may remain a member of the scheme after abolition, pass the two years' pensionable service point and accrue rights in the scheme.
- 7.6 The policy intention is that a CEP should only be required to be paid in respect of a member who ceases to be a member of a scheme with less than two years' service and without accruing any rights. The amendments contained in the Order will clarify the legislation to ensure that a CEP is not required to be paid at abolition where the member remains in pensionable service; that it is only required where the member ceases to be a member after abolition without having accrued rights in the scheme. The Order makes provision allowing for payment of a CEP where a member who has accrued rights in the scheme has less than two years' service upon ceasing to be a member or upon wind-up.
- 7.7 The Order also makes provision in relation to the detail and practicalities of CEP payments. For example, it provides detail of the time limits for notification and payment of a CEP to HMRC and for refund of a CEP following abolition of contracting-out. The Order makes provision for a de minimis so that where the amount of the CEP is £17 or less, the payment does not have to be made. The Order provides that a CEP must be paid out of the resources of the scheme or, where appropriate, the Pension Protection Fund. These provisions and others will ensure that the payments of CEPs under this Order are practically workable.
- 7.8 In addition, the Order amends the savings provision for sections 55 to 68 of the Pension Schemes Act 1993 - The Pensions Act 2014 (Savings) Order 2015<sup>6</sup> (S.I.

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<sup>6</sup> <http://www.legislation.gov.uk/ukxi/2015/1502/contents/made>

2015/1502) - and modifies some of the primary legislation to make sure it works with the provisions of the Order.

### ***Consolidation***

- 7.9 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](http://www.legislation.gov.uk). An explanation as to which instruments are maintained on each site is available from <http://www.dwp.gov.uk/docs/lawvolnews.pdf>.

## **8. Consultation outcome**

- 8.1 In 2014 we consulted for eight weeks on the draft Occupational Pension Schemes (Schemes that were Contracted-out) Regulations 2014<sup>7</sup>, a package of legislative changes, which were needed to support the ending contracting-out for salary-related schemes. A stakeholder asked for clarification of the transitional arrangements for the payment of CEPs following abolition. After investigating the details of the issue, we decided to save and modify the relevant legislation to ensure that CEPs are not made by trustees or managers of a scheme contrary to the policy intention. We informally consulted with an industry specialist stakeholder on the draft Order. The stakeholder suggested structural changes to the draft Order and some technical drafting points. We have amended the draft Order to reflect the stakeholder’s comments.

## **9. Guidance**

- 9.1 In relation to this provision, HMRC, in conjunction 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 The impact on business, charities or voluntary bodies is a saving of £74 million spread over two years.
- 10.2 The impact on the public sector is negligible.
- 10.3 An Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on [www.legislation.gov.uk](http://www.legislation.gov.uk).

## **11. Regulating small business**

- 11.1 The legislation applies to activities that are undertaken by small businesses, but does not place any additional burden on them.

## **12. Monitoring & review**

- 12.1 It is not appropriate in these circumstances to make statutory provision for review of this Order. This is because CEPs payable under this Order can only arise a maximum of two years after the abolition of contracting-out on 6 April 2016. As such, the cost

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<sup>7</sup> <https://www.gov.uk/government/publications/government-response-to-the-consultation-on-the-occupational-pension-schemes-schemes-that-were-contracted-out-regulations-2015>

of conducting a statutory review and monitoring impacts would be disproportionate to the economic impact of the provision in the Order. On balance of the benefits versus adverse effects, the Department's view is that it would not be appropriate to conduct a review.

- 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 keep policy under review, and should any issue arise with these arrangements, it will assess the evidence and, if appropriate, consider whether any changes may be necessary.

### **13. Contact**

- 13.1 Lillian Coulson at the Department for Work and Pensions Telephone: 0207 449 7232 or email: [lillian.coulson@dwp.gsi.gov.uk](mailto:lillian.coulson@dwp.gsi.gov.uk) can answer any queries regarding the instrument.