EXPLANATORY MEMORANDUM TO

THE PENSION PROTECTION FUND AND OCCUPATIONAL AND PERSONAL PENSION SCHEMES (MISCELLANEOUS AMENDMENTS) REGULATIONS 2016

2016 No. 294

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 These regulations introduce a set of miscellaneous amendments to six sets of regulations governing occupational and personal pension schemes and the Pension Protection Fund.

2.2 The amendments have two broad purposes: first, to make various changes required to ensure that the new pension flexibilities operate as intended, and, secondly, to make changes to ensure that relevant schemes whose sponsoring employer cannot have an insolvency event are able to enter the Pension Protection Fund.

2.3 The sets of regulations amended are the:

- The Occupational Pension Schemes(Winding Up) Regulations 1996 (SI1996/3126)
- The Occupational Pension Schemes (Assignment, Forfeiture, Bankruptcy etc.) Regulations 1997 (SI1997/785)
- The Pension Protection Fund (Compensation) Regulations 2005 (SI2005/670)
- The Pension Protection Fund (Entry Rules) Regulations 2005 (SI2005/590)
- The Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 (SI2006/580)
- The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (SI2013/2734)

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 The Taxation of Pensions Act 2014("the 2014 Act") gave pension scheme members with money purchase benefits (as defined in tax legislation) greater choice about how and when they can access their pension savings. The changes included the introduction of a new type of lump sum payment called an "uncrystallised funds pension lump sum" (UFPLS), and the relaxation of restrictions on the payment of a "drawdown pension" (the withdrawal of income directly from a pension pot while the remainder stays invested within the scheme). These changes allowed individuals with money purchase pension savings to access those savings as cash, rather than being required to buy an annuity, in most cases for the first time.

4.2 As the definition of "money purchase benefits" under taxation of pensions legislation is different from that used in other pensions legislation, the Pension Schemes Act 2015 ("the 2015 Act") introduced the concept of "flexible benefits", which covers the types of benefits to which the pension flexibilities apply.

4.3 The Pension Protection Fund and Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2016 make amendments to secondary legislation governing the operation of occupational and personal pension schemes and the Pension Protection Fund (PPF), in light of the changes introduced by the 2014 and 2015 Acts.

4.4 These include changes in relation to the winding up of occupational pension schemes, the availability of the flexibilities in limited circumstances where a scheme is being assessed for entry into the PPF, and the provision of risk warnings by occupational pension schemes to members who wish to take their benefits flexibly.

4.5 The regulations also make amendments to secondary legislation in relation to eligible schemes whose sponsoring employer cannot have an insolvency event in order to trigger entry to the PPF.

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 Northern Ireland will be making separate parallel provisions.

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

Occupational Pension Schemes: Winding-Up etc.

7.1 The Occupational Pension Schemes(Winding Up) Regulations 1996 allow schemes which are winding up to discharge their liability in respect of members' accrued benefits in specified ways, including by paying certain types of lump sums if conditions under tax legislation are satisfied. These amendments update the list of specified lump sums in light of the pension freedoms to include UFPLSs, subject to a requirement to obtain the member's consent to the payment.

7.2 The Occupational Pension Schemes (Assignment, Forfeiture, Bankruptcy etc.) Regulations 1997 specify the circumstances in which a pension can be paid as a lump sum by an occupational pension scheme, subject to conditions. The conditions for payment of certain lump sums can be read as requiring the member to still be employed by the scheme's sponsoring employer. It was unclear what purpose this requirement served, since a member may have moved jobs by the time they come to receive their pension, so these regulations remove it.

Pension Protection Fund and Pension Flexibilities

7.3 The Pension Protection Fund (PPF) is a statutory fund that protects members of eligible defined benefit and hybrid occupational pension schemes by paying them pension compensation in certain circumstances.

7.4 These minor amendments are intended to update the PPF regulations in the light of the new pension flexibilities.

7.5 The amendments provide an exception to the restriction that non-money purchase benefits cannot be converted into or replaced with money purchase benefits during the period when the scheme is being assessed for entry into the PPF. The exception applies where, before the start of the assessment period, a member has applied to convert such flexible benefits into money purchase benefits for the purpose of designating a drawdown fund under the scheme.

7.6 Similarly, where a member has applied to be paid an UFPLS in respect of flexible benefits, other than money purchase benefits, prior to the start of the assessment period, the payment of the UFPLS will now be permitted, subject to certain restrictions.

7.7 The amendments make a minor modification to provisions governing members' entitlement to PPF compensation, as they apply to cash balance benefits (a type of flexible benefits which are not money purchase benefits, and which therefore give rise to an entitlement to PPF compensation), in order to make it clear following the introduction of the flexibilities that a right to an UFPLS under scheme rules does not give rise to an entitlement to lump sum compensation from the PPF. The amendments do this by clarifying how references to lump sums which result from commuting part of a pension apply in relation to cash balance benefits.

7.8 The amendments also provide that where a member has money purchase benefits and their scheme has transferred into the PPF, they will be signposted towards the Pension Wise[1] guidance service, if they are within 6 months of normal minimum pension age or meet the ill health conditions.

7.9 The amendments also change the earliest age at which a member can take their compensation from age 55 to normal minimum pension age, and reduce the lower age limit on PPF trivial commutation lump sums to normal minimum pension age, bringing the PPF age limits into line with those for pension schemes. Trivial commutation allows a member with pension rights worth £30,000 or less in total to give up these rights in exchange for a cash lump sum.

Pension Protection Fund Entry Rules

7.10 Some schemes which are eligible for the PPF have sponsoring employers who are unable to have a qualifying insolvency event in order to trigger access to the PPF. Where such an employer is unlikely to continue as a going concern, the scheme trustees can instead apply to the PPF for it to assume responsibility for the scheme. This is known as "the alternative route". The Pension Protection Fund (Entry Rules) Regulations 2005 ("the Entry Regulations") specify the conditions a scheme's

[1] Pension Wise is the government's free and impartial pensions guidance service.

employer must satisfy in order for the scheme to utilise this route, by listing the relevant types of employers. However, over the years the Government has had to expand the list to cover more types of employers.

7.11 These amendments revise the relevant provisions in the Entry Regulations with the aim of covering all employers that cannot have an insolvency event.

7.12 The amendments will make it possible for the eligible UK pension schemes of certain overseas employers to enter the PPF via the alternative route. As a result of the application of EU legislation (EC Regulation No. 1346/2000, the Insolvency Regulation), there are circumstances in which an employer which is based in an EU member state other than the UK and does not carry out business operations in the UK cannot have an insolvency event in order to trigger entry to the PPF. The amendments provide that, where these circumstances arise so that a scheme's sponsoring employer cannot have an insolvency event, the scheme will be able to use the "alternative route" into the PPF. The PPF covers schemes which have their main place of administration registered in the United Kingdom.

7.13 A related amendment ensures that Regulation 10 of the Entry Regulations (confirmation of scheme status by Board), which sets out the requirements governing the issuing of scheme failure notices by the Board of the PPF, covers all schemes to which the alternative entry route applies. A similar amendment ensures that Regulation 9 (confirmation of scheme status by insolvency practitioner), which sets out the circumstances in which an insolvency practitioner must issue a scheme rescue or failure notice, covers all schemes which can enter the PPF via the insolvency event route.

Occupational Pension Schemes: Retirement Risk Warnings and the Advice Requirement

7.14 The pension flexibilities, introduced in April 2015, give members more choice over how to take their retirement benefits. To take advantage of this choice, it is important that they understand the risks associated with the different options for taking their benefits which are now available to them.

7.15 In April 2015, the Financial Conduct Authority (FCA) introduced a clause into their Conduct of Business Sourcebook which obliged personal pension schemes to provide personalised risk warnings to members who have decided to access their benefits flexibilities. However, there was no legislative obligation on occupational pension schemes to provide any type of risk warnings.

7.16 The Government's policy position is that all members of pension schemes, whether they are occupational or personal pension schemes, should have the appropriate information regarding the risks of the options which are open to them for accessing their flexible benefits.

7.17 The amendments to The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 ("the Disclosure Regulations") introduce a new Regulation 19A, which places an obligation on trustees and managers of occupational schemes to provide generic retirement risk warnings to members at the point that they give members application forms or other methods of access, so that they can require the trustees and managers to allow them to access their flexible benefits. There is no requirement to send members risk warnings before they have been sent information about their retirement options; risk warnings will be issued before members access their benefits and are not tailored to the member's individual circumstances.

7.18 The amendments also require schemes to send members a statement alongside the risk warnings to highlight the importance of reading the risk warnings and accessing pensions guidance or independent advice.

7.19 Regulation 19A does not require trustees or scheme managers who provide more personalised risk warnings to members to send generic retirement risk warnings as well. For example, trustees or scheme managers who choose to provide risk warnings in line with the FCA requirements would not be required to send retirement risk warnings under regulation 19A as this would be an unnecessary additional burden.

7.20 Provisions in the Disclosure Regulations require trustees or managers to provide members with a statement setting out that the member may have to take independent advice before transferring safeguarded benefits out of the scheme in order to access flexible benefits. However, provisions in the 2015 Act prevent members of unfunded public sector defined benefit schemes from transferring out of these schemes in order to obtain flexible benefits. The Government is therefore amending the Disclosure Regulations so that there is no requirement to provide this statement to members of such schemes.

Consolidation

7.21 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 from http://www.dwp.gov.uk/docs/lawvolnews.pdf.

8. Consultation outcome

8.1 Consultation on the amendments to the regulations included in this package took place between 23 November 2015 and 15 January 2016. 28 responses were received to the areas covered by these regulations, from pension providers, pension professionals, legal advisers, industry bodies and consumer bodies. The government response to the consultation can be found at: https://www.gov.uk/government/consultations/occupational-and-personal-pension-schemes-miscellaneous-amendments-regulations-2016

Occupational Pension Schemes: Winding-Up etc.

8.2 Eleven responses were received regarding the proposed changes to The Occupational Pension Schemes (Winding Up) Regulations 1996. While all were supportive of the general change, some were concerned over the requirement for member consent before discharge by way of an UFPLS could occur. However, others said that, in practice, member co-operation was needed and thought the consent requirement was an important safeguard, particularly given that the tax consequences for the member of receiving an UFPLS can be significant. The government has therefore decided to retain the consent requirement.

8.3 Four responses were received to the question on) The Occupational Pension Schemes (Assignment, Forfeiture, Bankruptcy etc.) Regulations 1997, all of which supported the deletion of the requirement that a member must be employed by the scheme's sponsoring employer before they could be paid certain types of lump sums.

8.4 No changes were needed to the draft regulations in response to these comments.

Pension Protection Fund (PPF) and Pension Flexibilities

8.5 Eight respondents commented on the changes to PPF legislation in relation to the pension flexibilities. Respondents generally agreed with the proposed changes.

8.6 The draft regulations proposed changing the age from which members could take compensation early from 55 to normal minimum pension age. One respondent said that this change would mean that those members who had an earlier protected minimum pension age (subject to a lower limit of age 50) would lose this. However, the Government's view is that members will retain any earlier protected pension age with the new wording.

8.7 One respondent pointed out that an amendment was needed to The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 in relation to schemes in a PPF assessment period where members have cash balance benefits. At present, their scheme is required to direct them to Pension Wise in certain circumstances; however, these members are not generally able to transfer or take their benefits flexibly during the assessment period. The Government agrees with the respondent and is amending the Disclosure Regulations accordingly.

PPF Entry Rules

8.8 Nineteen responses were received to the questions on the changes to the Entry Regulations in relation to employers which cannot have an insolvency event. Of these, 13 welcomed the change (although 4 of these suggested that further changes were needed), 3 made general comments neither in support nor opposition, and 3 agreed that a change was needed, but disagreed with the government's approach in the proposed amendments.

8.9 Three respondents were concerned about eligible schemes with sponsoring employers outside the EU. However, the restrictions under the Insolvency Regulation which prevent an insolvency event in relation to certain EU employers do not apply to non-EU sponsoring employers, and the Government did not consider that a significant problem had been demonstrated in relation to non-EU employers.

8.10 Four respondents thought that there might still be cases in which a scheme with a sponsoring employer based in an EU member state might not be able to gain entry to the PPF. However, the Government did not consider that there was significant enough evidence of risk to require further legislative changes.

8.11 The Government is concerned about protecting the PPF, and would not want the PPF to be opened up to circumstances where an effectively solvent employer was able to get the PPF to take responsibility for its scheme. The Government considers it is reasonable to put in place proportionate conditions to protect the PPF from possible abuse. The Government intends to keep the position under review, particularly considering that (as three respondents commented) a revised EU Insolvency Regulation will come into effect in June 2017.

8.12 Four respondents queried the 28-day time limit for trustees to use the "alternative route" of applying to the PPF, as they thought it could cause difficulties, particularly where the employer was outside the UK.

8.13 The Government was persuaded by this argument, and will therefore retain 28 days as the default period, but provide that the PPF have discretion to extend this to a maximum of 3 months where they consider this reasonable.

Occupational Pension Schemes: Retirement Risk Warnings and the Advice Requirement

8.14 Twenty-two respondents had a view on the disclosure provisions set out in the draft regulations. Most of the respondents agreed that there was a need for risk warning set out in legislation warnings, with only 2 respondents favouring a principles-based approach.

8.15 However, more than three-quarters of the respondents who commented on disclosure were sceptical that the original approach set out in the draft regulations would be workable and cost effective. A majority expressed concerns about the prospective extra cost to schemes, and suggested that many schemes, rather than following guidance from the Pensions Regulator, provided the application forms at the same time as the "wake up pack". Eleven respondents explicitly suggested that the risk warnings should be given at the same time as the member receives their retirement options.

8.16 Two respondents argued that those firms which meet the FCA requirements for risk warnings, but also administer trust-based schemes should be deemed to have fulfilled their obligation to members of occupational schemes if they follow the FCA process. Respondents also raised concerns that the proposed trigger for sending out risk warnings was open to interpretation and might therefore require schemes to take legal advice.

8.17 The Government considered the policy in the light of the responses to the consultation and decided that the important feature of the new risk warnings is not the timing but rather the fact that it cannot be ignored, and that every member has information on risk factors when applying to make decumulation decisions.

8.18 The final regulations now ensure that risk warnings should be provided at the same time as the scheme gives the member the means by which they can apply to take their benefit. This could be an application form, an online portal or verbal information. In this way they can be given either at the same time as the retirement options or subsequently.

8.19 The Government intends the regulations to be permissive. The final regulations therefore also ensure that schemes can meet their obligations by giving their members personalised risk warnings using information supplied by the member on their preferred option and personal circumstances.

8.20 Where risk warnings are given, they can be tailored to the options available to the member, so a member only needs to be given risk warnings in relation to those options to which they are being given access. As a result schemes shouldn't need to put in place an additional communication point with members, while members are still given an appropriate level of protection.

8.21 Five respondents questioned why trust-based schemes would be required to give risk warnings on transfers, when such an obligation does not appear in FCA rules. They emphasised that a transfer was not a decumulation decision and that the Government should not slow down the transfer process when the member would generally retain the same options after they had transferred.

8.22 The Government accepts this argument and has therefore dropped the requirement for risk warnings on transfer.

8.23 Respondents unanimously agreed that the obligation to explain the advice requirement should be disapplied for members of unfunded public sector defined benefit schemes.

9. **Guidance**

9.1 These regulations introduce straightforward amendments, and no separate guidance is considered necessary. Trustees and managers may find the Pensions Regulator's existing *Essential Guide to communicating with members about pensions flexibilities* useful in meeting their obligations to provide retirement risk warnings, as this guide contains examples of risk warnings.[2]

10. **Impact**

10.1 There is no other impact on business, charities or voluntary bodies from these Regulations.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment covering the amendments to The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 is submitted with this memorandum and will be published alongside it on www.legislation.gov.uk. The amendments have been designed to minimise the burdens on schemes whilst providing more protection to members considering their retirement options. We expect total one-off costs of around £122,000 to occur in 2015/16 as a result of providers amending their communications. But we expect no other ongoing costs. The Equivalent Annual Net Cost to Business (EANCB) based on a 10-year appraisal period rounds to £0.01m.

11. **Regulating small business**

11.1 This legislation applies to activities that are undertaken by small businesses

11.2 No specific action is proposed to minimise regulatory burdens on small businesses

11.3 The pension providers and administrators affected by the amendments to The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 are typically large businesses, but not exclusively so. The government does not believe it would be appropriate to provide an exemption from the new signposting requirements for any small businesses because:

- failure to ensure that all trust-based pension providers clearly and prominently signpost all of their eligible customers to the guidance service at all of the key communication points listed further above risks consumer detriment;
- this may create an unfair playing field (in terms of lower regulatory compliance costs for smaller firms and, more significantly, in terms of these firms having a greater likelihood of remaining as benefiting from consumer inertia if their customers don't seek guidance); and
- it is not likely that the costs will pose a significant burden on even the smallest providers.

[2] http://www.thepensionsregulator.gov.uk/docs/essential-guide-pension-flexibilities-april-2015.pdf

12. **Monitoring & review**

12.1 No formal post-implementation review of these amendments is planned, but Department for Work and Pensions monitors all new pensions legislation on an ongoing basis by means of representation and feedback from the pensions community and the Pensions Regulator.

13. **Contact**

13.1 Any queries regarding this instrument should be directed to the following officials at the Department for Work and Pensions:

Winding-up: Pam Bryson, pam.bryson@dwp.gsi.gov.uk, tel. 020 7449 7406

Pension Protection Fund: Gabrielle Park, gabrielle.park@dwp.gsi.gov.uk, tel. 020 7449 7427

Retirement Risk Warnings: Mark Rogers, mark.rogers2@dwp.gsi.gov.uk, tel. 020 7449 7528