

**EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (WINDING UP, WINDING UP
NOTICES AND REPORTS ETC) (AMENDMENT) REGULATIONS 2007**

2007 No. 1930

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. **Description**
 - 2.1 The regulations enable trustees and administrators of defined benefit (DB) occupational pension schemes and hybrid schemes that are in the process of winding up to:
 - (a) discharge pension entitlements by the payment of a winding up lump sum, or a trivial commutation lump sum, even if members did not have a right to the lump sum under the scheme's rules; and
 - (b) discharge their liability to pension credit members¹ by way of a winding up lump sum.
 - 2.2 The regulations also require schemes which commence winding up on or after 1 October 2007 to report to the Pensions Regulator two years after winding up started, instead of the current three years.
3. **Matters of special interest to the Joint Committee on Statutory Instruments**
 - 3.1 None
4. **Legislative Background**
 - 4.1 The Parliamentary and Health Service Ombudsman's report "Trusting in the Pensions Promise" recommended that the Government review the time taken to wind up final salary schemes. This recommendation was accepted by the Government.
 - 4.2 DWP worked closely with the Pensions Regulator, Her Majesty's Revenue and Customs (HMRC) and the pensions industry to review the main reasons for delays in the winding up process under the current regulatory framework. The review resulted in the publication of the Secretary of State's report "Speeding up winding up of occupational pension schemes"² on 2 November 2006, which put forward proposals (administrative, regulatory and legislative) to speed up the process. The legislative proposals are contained within this Explanatory Memorandum.

¹ Members with pension rights (known as a "pension credit") arising from the sharing of pension rights on divorce; not to be confused with the state benefit Pension Credit.

² <http://www.dwp.gov.uk/publications/dwp/2006/pensions/speedup-windup-pens.pdf>

- 4.3 The Regulations amend regulation 8(6)(b)(i) of the Occupational Pension Scheme (Winding up) Regulations 1996 (S.I. 1996/3126). This enables trustees to discharge small accrued pension entitlements by way of winding up lump sum or trivial commutation lump sum payments regardless of whether the member had a right under the scheme rules to the lump sum.
- 4.4 The Regulations add a new sub-paragraph (c) to regulation 3(2) of the Pension Sharing (Pension Credit Benefit) Regulations 2000 (SI 2000/1054) to allow pension credit benefits to be paid as winding up lump sums.
- 4.5 Further, Regulation 3 is amended so that pension credit benefit may be paid as a lump sum where that payment qualifies as a winding up lump sum under paragraph 10 of Schedule 29 of the Finance Act 2004.
- 4.6 The Regulations also add a new paragraph (6) to regulation 9 of the Occupational Pension Schemes (Winding up Notices and Reports etc) Regulations 2002 (S.I. 2002/459). This requires schemes which start to wind up on or after 1 October 2007 to report to the Pensions Regulator after two years, instead of the current three years.

5. Extent

- 5.1 This instrument applies to England, Wales and Scotland.

6. European convention on Human Rights

As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

Winding Up Lump Sum Payments

- 7.1 Section 74 of the Pensions Act 1995 and the Occupational Pension Scheme (Winding up) Regulations 1996 set out a number of ways in which trustees can discharge liabilities in respect of scheme members when a DB or hybrid occupational pension scheme winds up. One of these ways is to pay a cash lump sum to members. Currently, these are where the member has a right under the scheme rules to a lump sum and where that sum is authorised by Her Majesty's Revenue and Customs (HMRC). In order to be authorised by HMRC the relevant conditions in the Finance Act 2004 must be complied with.
- 7.2. The regulations enable trustees to discharge small accrued pension entitlements by way of winding up lump sum or trivial commutation lump sum payments, even if members did not have a right to the lump sum under the scheme rules. The trustees will still need a general power under the scheme to pay lump sums.

Pensions on Divorce

- 7.3. As part of the financial settlement on dissolution of a marriage, the Court may order that a member's pension be shared with his former spouse. The former spouse's share of the pension is held in a pension scheme as a pension credit.
- 7.4. An amendment has been made to pension sharing legislation so that pension credit benefit can be paid as a winding up lump sum, where the pension credit member satisfies the conditions for such a payment.

Reports to the Pensions Regulator

- 7.5. Trustees or managers of both DB and Defined Contribution (DC) occupational pension schemes are currently required to report to the Pensions Regulator after three years from the date the scheme starts winding up, and then to make yearly progress updates until the winding up is complete.
- 7.6. The regulations reduce the current requirement from three years to two years, to give the Pensions Regulator evidence at an earlier stage to support any action it may decide to take.

Consultation

- 7.7 A four week consultation exercise was carried out that sought comments on the draft regulations. Seventeen responses to the consultation were received. There is a brief summary below of the responses:
 - (a) One respondent suggested the use of winding up lump sums might help some trustees in some cases, but in others it could possibly, in some cases generate another difficult decision (whether to pay lump sums rather than secure pension benefits and what conversion term to use), and as a consequence, increase administrative.
 - (a)(i) However, the use of winding up lump sums will be optional for schemes. We are not compelling trustees to pay trivial lump sums, but rather making this facility available to them. We are therefore not convinced that administrative costs will increase as a result of the introduction of this measure.
 - (b) Three respondents suggested that the case for the change in reporting from three years to two had not been made, and that the proposal will increase the cost burden on trustees.
 - (b)(i) Once the requirement to make a report applies to a scheme, the Pensions Regulator may use its powers under section 72B of the Pensions Act 1995 to issue directions to facilitate winding up. The requirement to report after two, rather than three years, will give the

Pensions Regulator evidence at an earlier stage to support any action it may decide to take.

- (b)(ii) The proposal to require trustees to make their first report to the Pensions Regulator after two years instead of three years will bring forward the cost of the first report by one year. The first report is the most expensive, however, subsequent reports are less expensive.
- (b)(iii) If the time taken for a scheme to wind up remains the same, then the proposal will add the cost of one subsequent (less expensive) report for schemes. However the objective of the proposal, along with the full package of administrative and regulatory measures announced in the Secretary of State's report "*Speeding Up Winding Up Of Occupational Pension Schemes*", is designed to shorten the length of time taken to wind up a scheme. The earlier report will alert the Pensions Regulator earlier to any barriers to winding up quickly. In addition, we understand that significant charges are payable as retainer fees (for example that of an actuary, legal advice and administrator) for each year the scheme continues winding up and that measures to speed up wind up could therefore lead to savings. That is why the Government believes the proposed changes to legislation will have a negligible net cost to business.
- (c) A number of respondents suggested extending the application of draft Regulation 2 to permit other types of schemes, primarily defined contribution schemes, to pay winding up lump sums and trivial commutation lump sums irrespective of whether the scheme rules contain the necessary provision, when discharging liabilities on winding up. We have considered this change but have concluded that we do not have the powers to extend the regulations to money purchase schemes.
- (d) Another respondent suggested that the winding up lump sum rules should be extended to allow pensions in payment to be commuted, where the value of the member's current pension is less than one percent of his lifetime allowance. We think this suggestion merits further consideration, and have therefore said in the consultation response that the Government will look into it further

- 7.8 A detailed analysis of the responses are discussed in the Government's response to the consultation, available at:
<http://www.dwp.gov.uk/consultations/2007/index.asp>

Guidance

- 7.9 These regulations are of interests to pension lawyers, pensions scheme actuaries and trustees and the amendments are minor and technical. It is therefore inappropriate to issue specific guidance.

Consolidation

- 7.10 The Occupational Pension Scheme (Winding Up, Winding Up Notices and Reports etc) amends three statutory instruments. We recognise the case for consolidation however, we await the outcome of a deregulatory review which may recommend a complete overhaul of the regulations.

8. Impact

- 8.1 A full regulatory impact assessment has not been produced for these Regulations as only a negligible impact on the private or voluntary sectors is foreseen.

- 8.2 There are no public sector costs.

9. Contact

- 9.1 Olu Abe at the Department for Work and Pensions (Tel: 020 7962 8500) or e-mail: olu.abe@dwp.gsi.gov.uk can answer any queries regarding the instrument.