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Dear Colleagues,

### **Pension Schemes Bill: Committee debate**

I am writing to you in relation to matters raised during the Lords Committee of the Pension Schemes Bill.

#### 1 Definition of a Master Trust

Lord Flight and Lord Naseby sought to clarify the position of Non-Associated Multiple Employer Schemes (NAMES) under the Master Trust authorisation regime that will be introduced by the Pensions Schemes Bill.

As explained during the committee debates we have had to strike a balance with the definition to ensure that we capture those risks which the policy is aimed at mitigating, whilst not opening up the door to avoidance activity. This is why we have intentionally drawn the definition as it stands, which captures mixed benefit schemes.

But I would like to take this opportunity to again offer my reassurances that our policy intent is to dis-apply some or all of the measures in relation to schemes with certain characteristics by using the regulation making power at clause 39. This power enables Secretary of State, subject to Parliamentary approval, to dis-apply all or some of the provisions in Part 1 of the Bill for schemes with certain characteristics. To be clear, these Regulations will specify particular types of schemes as opposed to naming specific schemes which do not have to meet relevant requirements.

Further, Ministers and the department are committed to working closely with the industry to develop the right balance in those regulations, based

on detailed examination of the various structures and schemes which exist in the landscape already. We will need to hold the measures in those regulations in balance with the risk of creating avoidance loopholes, which a simpler provision of only capturing money purchase schemes or for profit schemes would have created.

More specifically, with references to some of the scheme characteristics mentioned during the debate:

- (a) *AVCs*: as I referred to in the debate, we do intend to consult on creating regulations under clause 39 to create exemptions for schemes which only have money purchase benefits as a result of Additional Voluntary Contributions of non-money purchase members, but we will also be considering carefully the need to avoid creating any avoidance loopholes as we go through that process.
- (b) *Profit/not for profit*: - we do not see that the risks to members or the need to protect them should alter depending on whether the scheme is for profit or not – but we are sympathetic to the different pressures and dynamics between for profit and not for profit structures.
- (c) *Centralised schemes*: - the definition of centralised schemes was not developed with the risks in mind that the Master Trust authorisation regime is in place to mitigate. Simply exempting all centralised schemes under that definition may give rise to avoidance activity by new schemes in the future. Under the regulations under clause 39 we can explore what characteristics those schemes have and whether these characteristics mitigate the key risks we want to address and could therefore be exempted from part or all of the Master Trust authorisation regime.
- (d) *Regulatory requirements on hybrid schemes*: - Lord Naseby and Lord Flight both raised the protections under the funding regime that hybrid schemes must comply with under current legislation. Those funding requirements apply to the non-money purchase benefits in the scheme, not to the money purchase elements. I appreciate that some existing schemes are in a fairly stable state and may have adequate provision or protections in scheme rules. However, we cannot legislate on the basis that as particular schemes are secure in some respects, all schemes of the same structure in the future will always be so. But we can identify where certain scheme characteristics mean the risks we are focused on are mitigated already and use these characteristics and the clause 39 power to develop regulations to dis-apply some or all of the requirements as appropriate.

In addition, we have power under clause 8 of the Bill to require the Pensions Regulator to take certain things into account in determining whether or not the scheme is financially sustainable. This might include certain structures or arrangements being in place to provide suitable protection to ensure that the scheme is able to meet the costs of running the scheme, including additional costs arising from duties during triggering event periods.

## 2 Master Trusts that are not trusts

Later in the debate, Lord McKenzie and Baroness Drake asked about the circumstances in which a Master Trust could be set up other than as a Trust.

The reference to Master Trusts which are not set up under a Trust is to cater for the very small number of occupational pension schemes which are not required to be set up under trust. These are set out in the Occupational Pension Schemes (Trust and Retirement Benefits Exemption) Regulations 2005 and at present comprise public service pension schemes, schemes with fewer than 2 members and certain schemes with fewer than 100 members.

While these exemptions are restricted and we are not aware of any Master Trusts which are not set up under Trust we want to ensure that the Bill provisions would work equally well for such schemes should any fall within the exemption and the definition. Such schemes would as Master Trusts continue to run on the basis on which they are set up. They would not be required to evolve into trust based schemes. In such cases, the person akin to the trustee is the scheme manager. This is the case in many public service pension schemes for example. The definition of trustee incorporates references to managers of schemes.

## 3 Mixed benefit schemes

Following what I believe was a helpful debate on how the Master Trust Authorisation regime will apply to schemes that provide both money purchase benefits (defined contribution) and defined benefits to members, Baroness Drake asked how the regime will deal with schemes where those funds are not held separately. On a related point she later asked if I would clarify how the existing legislative protections for defined benefit schemes fits with the defined contribution protections and will fit with the Master Trust authorisation regime.

Under the scheme funding provisions, schemes which include non-money purchase benefits must meet the scheme funding requirements (subject to

some exceptions such as public service pension schemes). These require schemes to have sufficient and appropriate assets to meet the scheme's technical provisions – i.e. the amount required on an actuarial calculation to meet the scheme's liabilities. Assets which relate to money purchase benefits cannot be double-counted against both those benefits and non-money purchase benefits regardless of how the assets are actually held in the scheme. Where a scheme goes into wind-up, assets and liabilities relating to money purchase benefits are treated separately to the other benefits.

If decumulation products are offered by the scheme and are non-money purchase – these will be protected by the funding requirements that bite on non-money purchase benefits. Those Master Trust schemes which provide decumulation benefits as a money purchase benefit will need to comply with the new Master Trust authorisation regime requirements – including financial sustainability requirements, and systems and processes requirements – which we expect to cover making sure the records are sufficiently accurate to identify how assets match to member pots.

Under clause 8 schemes are required to hold sufficient financial resources to cover the costs of the setting up and running of the scheme, as well as to pay for the costs arising under the triggering events requirements and activities, and also to run the scheme on for a period of time. We intend to consult on regulations under clause 8.

The consultation will explore how schemes will be able to demonstrate that they have allocated resources for these purposes. The Regulations would require the Pensions Regulator to take into account the transparency of that allocation and potentially could provide for schemes to hold them separately from other resources (including, in the case of a mixed benefits scheme, resources employed in the provision of non-money purchase benefits). The consultation will need to further explore the costs, benefits and security for members of any such separation.

#### 4 Implications of tax administration arrangements for those earning < £11,000

Baroness Altmann asked about the provision of information to those earning less than £11,000 whose pension scheme operates a net pay arrangement.

The Pensions Regulator provides guidance to employers on choosing a pension scheme for their staff in order to discharge their statutory obligations under automatic enrolment. This guidance covers the choice

between net pay and relief at source processes, and the implications of using the net pay process for employees who do not pay income tax.

During a later debate, but on a related point, Lord McKenzie asked me to write about the availability of data on the operation of the net pay arrangements tax regime. I should explain that the Government does not collect data on the number of workers earning less than the personal allowance who are also members of pension schemes that operate net pay arrangements. Neither does Government hold employee level data on employees enrolled in schemes, as such schemes are not obliged to report pension contributions to HM Revenue and Customs. I cannot therefore provide information on the value of tax reliefs paid out to employees in schemes which use the net pay process.

#### 5 Bulk transfers of members' rights

Baroness Altmann asked if the Government intends to consider introducing measures that will facilitate bulk defined contribution pension transfers.

There are two separate areas of legislation to mention here. Firstly, current bulk transfer provisions in current legislation and, secondly, new measures for bulk transfers which have been provided in the Bill under Option 1 where a Master Trust has experienced a triggering event. Option 1 transfers do not operate under the current bulk transfer provisions. This is because of the different circumstances in which these types of transfer occur and the structure of the current legislation.

On the current bulk transfer provisions, we intend to publish a Call for Evidence soon on the current provisions for scheme-initiated voluntary defined contribution to defined contribution (DC to DC) bulk transfers – principally between occupational pension schemes. This is separate to the measure in the Bill. An example where these regulations could be used is where a single employer scheme wishes to transfer members to a master trust. This call for evidence will consider whether there is scope to simplify the current arrangements whilst not compromising member protection. We recognise that the existing provisions were originally designed for a defined benefit, rather than a DC landscape. The information and views gathered will inform a consultation and more industry engagement on firmed up policy proposals during 2017.

You will be aware that the existing requirements are for the transferring and receiving schemes to have a certain relationship, and for an actuarial certificate to be produced certifying that the members' rights in the receiving scheme are broadly no less favourable than those in the ceding scheme. We intend to seek evidence on how each of these tests is

working. The current certificate covering the rights in each scheme may well not be the most appropriate measure for DC.

This Call for Evidence will give us the opportunity to revisit the transfer provisions as a potential barrier to allowing scale to develop. Some smaller occupational schemes will have weaker governance and they tend to have higher charges. Improving bulk transfer arrangements should help the market to develop scale, by enabling small schemes to exit the market or consolidate.

#### 6 Transfer process for a Master Trust under Option 1

I will now turn to the related questions asked during the debate on day two of Committee by Baroness Drake as to how the transfer process will work for a Master Trust that has experienced a triggering event and is, under Option 1, moving to transfer out its members and wind up the scheme. The process will be set out under the regulations provided for in clause 24 which are subject to the affirmative procedure.

This is an entirely separate process from the provision in current legislation relating to bulk transfers, which requires an actuarial certificate as set out above. We do not intend to require an actuarial certificate as it currently stands for the transfers under option 1, but instead to provide alternative provision appropriate to the context of this type of bulk transfer.

#### 7 Duty to report a significant event

Lord Kirkwood asked about the operation of the duty to notify a significant event under clause 16.

The clause is structured so that the duty applies to all the people in the list who become aware of the significant event. This may mean that the Pensions Regulator is notified by several different people, but we considered this preferable to creating a situation in which the Pensions Regulator was not notified because of confusion over who the duty applied to or a misunderstanding of whether others had already notified or not.

The decision to issue a civil penalty for breach is a power of the Determinations Panel and is subject to appeal in the same way as all other Determinations Panel decisions.

The power to issue a civil penalty is a power, not an obligation, and the Pensions Regulator, as a public body, must exercise its powers in a way which is reasonable.

#### 8 Pause orders – automatic enrolment

Baroness Altmann and Baroness Drake asked about how a pause order related to an employer's auto-enrolment duties.

Pause orders will not put employers in breach of their automatic enrolment duties to ensure that qualifying jobholders are and remain active members of a qualifying scheme. Section 31 of the Pensions Act 2008 makes provision in relation to freezing orders so that, in the event of such an order being made, the employee is still considered to be an active member of the scheme and the scheme is still a qualifying scheme notwithstanding that contributions are not being made into it. Schedule 3, paragraph 13 of the Pension Schemes Bill will amend section 31 of the Pensions Act 2008 to include reference to pause orders made under the Bill.

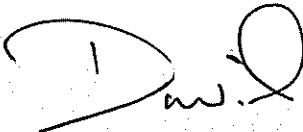
In relation to the follow up question as to whether this puts the employer in breach of their contractual obligation to the employee to make the contributions to the scheme. Under schedule 1 paragraph 1 (3)(b) contractual obligations are treated as if they do not arise, so employers will not breach their contractual obligation to the employee to make contributions to the scheme when a pause order directs that they should not do so.

#### 9 Pause orders - tax

Lord McKenzie also asked about the treatment of tax contributions during a pause order.

Tax contributions paid under Relief at Source arrangements would be covered by clause 31 (6)(a) in so far as this allows for contributions that are due into the scheme before the order takes effect to continue to be paid to the scheme. Tax relief can only be paid on contributions that are collected to be paid to the scheme – tax relief does not apply where contributions are not collected and paid in to the scheme.

I hope you find this letter helpful. I have copied it to all Peers who spoke during Committee and will place a copy in the House Library.

*Yours sincerely*  


**Lord Freud**  
**Minister of State for Welfare Reform**

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