EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (EMPLOYER DEBT AND MISCELLANEOUS AMENDMENTS) REGULATIONS (NORTHERN IRELAND) 2010

S.R. 2010 No. 111

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Social Development to accompany the Statutory Rule (details above) which is laid before the Northern Ireland Assembly.

1.2 The Statutory Rule is made under Articles 68(2)(e), 75(5), (6D)(b)(i) and (10), 75A(1) to (4) and (5)(a), 116, 122(3) and 166(1) to (3) of the Pensions (Northern Ireland) Order 1995 and Articles 2(5)(a), 64(2)(a), 110(5), 280(1)(b) and (2)(b) and 287(2) and (3) of the Pensions (Northern Ireland) Order 2005 and is subject to the negative resolution procedure.

2. Purpose

2.1 These Regulations amend the Occupational Pension Schemes (Employer Debt) Regulations (Northern Ireland) 2005 ("the Employer Debt Regulations") to set out two new procedures for exempting an employer from an employer debt. They also make a number of amendments consequential on the introduction of the new procedures, and make a number of technical amendments to clarify the Employer Debt Regulations and make them easier to apply.

3. Background

3.1 When a defined benefit occupational pension scheme is being wound up and the value of the scheme assets is less than its liabilities, the shortfall is treated as a debt due from the employer. The Employer Debt Regulations set out what employers have to do to pay their debt when severing their relationship with a pension scheme. When employers cease involvement with a defined benefit occupational pension scheme, they generally have to pay a debt to top up the scheme's funds so that all liabilities are fully covered. Employers' groups have argued strongly that the current rules can force payment of such a debt unnecessarily when a company restructures but continues to stand behind its pension scheme.

3.2 The two new procedures for exempting an employer from an employer debt in the specific and limited circumstances of a corporate restructuring are –

- a "general easement" based on the exiting and receiving employer involved satisfying a restructuring test designed to guard against detriment to the members, for example, the trustees must be satisfied that the receiving employer is at least as likely as the exiting employer to meet the pensions obligations, and the assets etc must be passed over under a legally enforceable agreement; and

- a "de minimis easement" which allows for relatively small restructurings to occur without triggering the debt, where specific conditions are met.

4. Consultation

4.1 There is no requirement to consult on these Regulations as they make in relation to Northern Ireland only provision corresponding to provision contained in regulations made by the Secretary of State for Work and Pensions in relation to Great Britain.

5. Equality Impact

5.1 In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the legislative proposals for these Regulations. As the amendments are largely technical in nature or consequential, the proposals would have little implication for any of the section 75 categories. In light of this, the Department has concluded that the proposals would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

6. Regulatory Impact

6.1 The impact on business, charities or voluntary bodies is beneficial. Businesses will be able to undertake corporate restructurings without triggering an employer debt. A copy of the Regulatory Impact Assessment is attached as an annex to this Explanatory Memorandum.

7. Financial Implications

7.1 None for the Department.

8. Section 24 of the Northern Ireland Act 1998

8.1 The Department has considered section 24 of the Northern Ireland Act 1998 and is satisfied that these Regulations –

(a) are not incompatible with any of the Convention rights,

(b) are not incompatible with Community law,

(c) do not discriminate against a person or class of person on the ground of religious belief or political opinion, and

(d) do not modify an enactment in breach of section 7 of the Northern Ireland Act 1998.

9. EU Implications

9.1 Not applicable.

10. Parity or Replicatory Measure

10.1 The corresponding Great Britain Regulations are the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010 (S.I. 2010/725) which come into force on 6th April 2010. Parity of timing and substance is an integral part of the maintenance of single systems of social security, child support and pensions provided for in section 87 of the Northern Ireland Act 1998.

Annex

REGULATORY IMPACT ASSESSMENT

The costs and savings outlined in this Regulatory Impact Assessment are calculated on a United Kingdom-wide basis.

Introduction

1. This Impact Assessment considers two changes to the way employer debt is treated in the context of a company restructuring. It assesses the impact of the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations (Northern Ireland) 2010, which give effect to the Government's policy in this area.

Background

2. **Employer debt** Defined-benefit (DB) pension schemes provide pension benefits based on the individual member's salary, often his or her final salary, and the individual's length of service. DB schemes in the private sector are jointly funded by contributions from the employer and employees. The role of the employer in a defined-benefit pension scheme is very important. The employer is the scheme's "sponsor"; and, in the last resort, if the funds in the scheme are insufficient to pay benefits, it is the employer's responsibility to make good the shortfall. The ability and the willingness of the employer to support the pension scheme is known as the "**employer covenant**".

3. Where an employer's relationship with their under-funded pension scheme is ended, legislation sets out requirements for the "**employer debt**", which is the amount the employer must pay into the scheme in order to relinquish responsibility for the scheme. This is also called an "**Article 75 debt**". For a variety of reasons, it may no longer be appropriate for an employer to be the sponsor of a particular pension scheme. During a company restructure, when one company merges with or takes over another, an 'exiting employer' may sever its relationship with its pension scheme, and so trigger an employer debt.

4. The policy intention behind the employer debt legislation is to provide protection for pension scheme members after the departure of the sponsoring employer. The basis of the protection is that the scheme should be funded to the "full buy out" level with sufficient monies to fully cover the cost of securing the members' benefits with an insurance company. For larger schemes, employer debts as calculated on a full buy out basis can amount to tens of millions of pounds. Where an employer debt is triggered, it may be paid as a lump sum into the pension scheme. However, it is accepted that it may not always be feasible or necessary for the employer to fund the entire lump sum up

front, and there are several provisions[1] currently in legislation which permit the size of the debt paid up front to be safely reduced.

5. Employers and their representative bodies have made representations for further easements in the rules, in particular in relation to associated multi-employer schemes who undertake a company restructuring. “Multi-employer schemes” are pension schemes with more than one participating employer. Multi-employer schemes can be “associated” or “non-associated”. Associated means that the employers are related in some way; for example they are all directly or indirectly linked to one company, or each employer is controlled by the same party. Non-associated employers are, as the name implies, not associated with each other. These non-associated employers might be charities or voluntary organisations. The majority (around 70 per cent.) of defined benefit scheme members are in multi-employer schemes.

6. **Amendments to the Employer Debt Regulations in April 2008**. These amendments[2] (“the 2008 Regulations”) did not specifically address the restructuring issues, but instead introduced other changes to jointly protect members and assist employers. For example, loopholes on apportioning debts were tightened while easements were introduced where employers could stop debts being triggered altogether (during a 12 month “period of grace”) or else allowed more flexibility for employers paying the employer debt as triggered. An Impact Assessment was produced for the 2008 Regulations[3].

Problem under consideration

7. Whilst the pensions industry welcomed many of the changes in the 2008 Regulations, there was still concern that easements should be introduced which specifically addressed company restructurings. Such transactions are often regarded as unnecessarily triggering the employer debt provisions, requiring the employer to pay large amounts into a pension scheme which was not detrimentally affected as a result of the restructuring. This could lead to cash-flow problems for sponsoring employers and the need to tap the capital markets or borrow from banks for additional funds.

8. Concern was expressed in particular about the triggering of employer debt arising out of an internal restructuring within associated companies. This could, for example, include mergers or acquisitions between companies in the same group – usually the merging of a smaller company with a larger company in the same group and the ensuing effect of a company ceasing to have any employees. Restructurings may also involve the creation of a new employer who participates in the pension scheme.

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1 Existing provisions for reducing the size of the employer debt paid up front include withdrawal arrangements, approved withdrawal arrangements, and apportionments

2 The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations (Northern Ireland) 2008 S.R. 2008 No. 132

3 http://www.dsdni.gov.uk/ria-occpen-schemes-emp-debt.doc

9. Industry commentators and their research of employers and business practice [4] [5] have called for reform of employer debt legislation in the context of corporate restructuring and advised that such transactions ought not to be detrimental to pension schemes. Instead restructures may indeed lead to a strengthening of the employer's covenant, through the streamlining of a company's operations when efficiencies would be increased, and costs reduced. Research[6] has also highlighted the impact of the current economic climate on sponsoring employers' strategies towards pensions. The survey comments that "The relatively optimistic picture which emerged from the Annual Survey 2008 has changed significantly in the wake of the current economic downturn.".

10. **Deregulatory Review** The employer debt legislation was also considered in the deregulatory review report of private pensions, conducted by two external reviewers, Chris Lewin and Ed Sweeney[7], and two recommendations were made:

> "Where a company that participates in a DB (*defined benefit*) multi-employer scheme ceases to have employees actively participating in that scheme but the scheme continues, the debt should not be triggered if, within a period of up to one year, the employer acquires more employees who participate in the scheme."

> "Where there is a group reconstruction of employers in a multi-employer scheme, the principle should be established that the debt should not be triggered, where the original covenant was strong and if the remaining employers' covenant remains as strong, following the reconstruction, as the original covenant. The judgement as to whether the covenant remains intact should be the responsibility of the trustees, after taking appropriate professional advice. However, one of us (Chris Lewin) recommends that, where the original covenant is potentially weak, provided it remains unchanged after the reconstruction, the debt should still not be triggered."

11. The Government accepted the first of the reviewers' recommendations and the 2008 Regulations included an amendment which in specific circumstances permits a twelve month period of grace during which time an employer debt is not triggered, if an active member of the scheme is employed. In response to the second recommendation, the Government said as follows[8]:

> "The Government also accepts that the current provisions may create difficulties for employers who wish to undertake a reorganisation and believes that, in principle, there is much to be said for distinguishing

[4] NAPF Annual Survey – July 2008
[5] A view from the top – 2007. A survey of business leaders views on UK pension provision (CBI & Watson Wyatt)
[6] NAPF follow-up survey - Pension provision and the economic crisis – January 2009
[7] Deregulatory Review of Private Pensions. Chris Lewin and Ed Sweeney - July 2007 http://www.dwp.gov.uk/pensionsreform/pdfs/ReviewPaperJuly2007.pdf
[8] Deregulatory Review – Government response 22 October 2007. http://www.dwp.gov.uk/pensionsreform/pdfs/government-response.pdf

between reorganisations and complete severance of an employer from a scheme. However, this is a difficult area and it may not be easy to find a way to address this without creating loopholes within legislation. In addition to the changes already outlined in draft amending regulations, the Government intends to work with the industry over the coming months to seek a practical solution to the difficulties created by the current provisions which does not undermine the principle that employers should fully meet their pension obligations."

12. The Government has therefore been working with key stakeholders from the pensions industry to seek a practical solution to employers' concerns in the context of such company restructurings.

13. ***Informal consultation*** In November 2008, the Government undertook an informal consultation which though not confidential, was aimed at inviting views from a limited number of key stakeholders.

14. ***Formal consultation*** In the light of responses to the informal consultation, revised provisions were drawn up and these were considered as part of a formal consultation that took place between 17 September 2009 and 19 November 2009. The provisions covered by this Impact Assessment reflect the outcome of this formal consultation.

Policy objectives and intended effects

15. The objective is to reduce the circumstances in which a corporate restructuring – involving one exiting and one receiving employer – triggers unnecessary employer debts. While industry commentators have suggested that restructurings do not change the employers' commitment to the pension scheme, the Government is also keen to ensure changes should not reduce the strength of the employer covenant to support the pension scheme; should not reduce levels of member protection; and should not lead to increased calls on the PPF.

16. The employer debt provisions were intended to protect the pension entitlements of scheme members and not to hamper legitimate business practices. In the case of restructurings it is understood that debts are unnecessarily triggered even though the remaining employers' sponsorship of the pension scheme remains unchanged. For example, two associated companies within the group are "merged" to save on administration costs and the new company employs the same staff, has the same assets etc, but this nonetheless triggers an employer debt. The intended effects of current changes are therefore that employers should be able to proceed with such restructuring of their companies without unnecessarily triggering the employer debt provisions. This benefits employers by making it easier to unlock the commercial and competitive advantages that arise from corporate restructurings.

17. Without these Regulations there is a risk that employers could unnecessarily trigger debts causing them financial problems. This could

have a material impact on their business and in extreme circumstances could even threaten the viability of the group. There may be a particular need for these Regulations at the current time, since an emerging issue is the extent to which current economic conditions increase company reorganisations and merger and acquisitions activity – hence leading to the increased frequency with which the employer debt requirement has to be considered.

Groups affected

18. This section describes the **groups affected** by the Regulations.

19. **Groups affected** The groups affected by the Regulations are as follows:

- **Employer –** The employer debt requirements are a cost on employers. The requirements are based on the cost of buying out benefits with an insurance company. There are arrangements for postponing the payment of a debt, for example by apportioning it to other employers in the group. But when the debt is triggered, trustees would nevertheless usually expect some portion to be paid and employers may therefore have to borrow up front to pay such debt that would normally be paid over time. The cost of servicing any such borrowing represents the true cost to the employer of the current requirements. In a restructuring involving a multi-employer pension scheme, the relevant employers therefore have a financial and business sustainability interest in minimising or, if possible, negating any employer debt payable as a lump sum. These Regulations reduce the circumstances in which employer debts are triggered. No debt triggering is intended to reduce the pressure on, and from, trustees to exact over-cautious payments from employers.

- **Members –** The security of members' benefits is determined by the level of pension scheme funding and by the strength of the employer's covenant which supports the scheme. Members will be concerned by changes which might lead to a weakening in scheme funding or of the employer covenant backing the scheme.

- **Trustees –** Trustees have a fiduciary responsibility towards scheme members and will not welcome a position where new statutory requirements meant they were unable to protect members' interests. Trustees will also not welcome the introduction of unnecessarily complicated requirements which they found difficult to operate, or which involved them making choices between the interests of members or the ongoing sustainability of the business as a whole.

- **Pensions Regulator –** The Pensions Regulator is the UK regulator of work-based pension schemes. The Regulator's main statutory objectives include the protection of the benefits of members of work-based pension schemes; and the reduction in risk of situations arising that may lead to claims for compensation from the Pension Protection Fund ("PPF"). The Regulator will therefore be concerned if Regulations ran counter to these objectives.

- **Pension Protection Fund –** The PPF's main function is to provide compensation to members of DB pension schemes where the employer becomes insolvent and where there are insufficient assets in the pension scheme to provide at least the PPF level of compensation. The effect on the PPF depends on the extent to whether the Regulations lead to more schemes being under-funded to PPF levels and, as a result, more schemes needing to be taken on by the PPF. However the general easement in maintaining the strength of the covenant should not materially increase the likelihood of schemes having to have recourse to the PPF. Those schemes using the de minimis easement are required to be funded to at least PPF level anyway, and these will always involve small relative and absolute amounts.

- **Levy payers –** The PPF pays compensation to members of eligible DB and hybrid pension schemes when the sponsoring employer has a qualifying insolvency event and the scheme cannot afford to pay member's benefit at PPF levels of compensation. The PPF is funded in part by a pension protection levy paid by eligible schemes. The proposed options should not lead directly to any new calls for compensation on the PPF or place any material financial consequences on levy payers.

Policy options

20. Four options were initially considered in November 2008, as part of an informal consultation process with stakeholders:

Option A Scheme apportionment as the default

- o Following a corporate restructuring a debt would not be triggered where the existing *funding test*[9] was satisfied and where the employers' covenant was strong both before and after apportionment. If those conditions were satisfied, there would be automatic apportionment to other employers in the group.

Option B De minimis threshold

- o An employer debt would not be triggered on a corporate restructuring if the section 75 debt of the exiting employer was less than a de minimis limit, defined as a pre-determined proportion of the section 75 debt of the group as a whole.

Option C Lower amount of employer debt

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9 Broadly the funding test involves gauging the financial strength of the covenant for funding the ongoing scheme as specified in Regulation 2(4A) of the Occupational Pension Schemes (Employer Debt) Regulations (Northern Ireland) 2005 (S.R. 2005 No. 168), as amended in April 2008

- The employer debt would be calculated on a corporate restructuring by reference to scheme funding liabilities or PPF liabilities (rather than full buy out[10]).

Option D "Do nothing".

21. The main concern about **Option A** was the perception that trustees would adopt a cautious approach in carrying out the funding test. There was also a concern that the covenant measured by the funding test must be "strong". **Option C** attracted little support. Most respondents acknowledged that where an employer ceased to participate, the required funding level for the scheme needed to be well above the scheme funding level. **Option C** was not therefore considered an appropriate way forward. Given the current economic climate coupled with intense industry interest, and criticism of current provisions in relation to corporate restructurings, doing nothing (**Option D**) was not considered tenable.

22. Two easements (based on **Option A** and **Option B** above) were consulted on formally between 17 September 2009 and 19 November 2009. **Option A** was replaced with a "general easement" provision, whereby a debt would not be triggered in relevant cases so long as a new restructuring test was satisfied to show that the receiving employer would be **at least as likely** as the exiting employer to meet the scheme liabilities it is acquiring from the exiting employer, as well as its own liabilities. **Option B** was amended to include an absolute liability cap (based on the annual amounts of pensions that members are entitled to); a proportional cap (not more than two members, or 3 per cent. of scheme members), and to require schemes to be funded to at least Article 162 liabilities[11].

23. In light of the responses received during the formal consultation on the general and de minimis easements, some further revisions have been made to make the provisions easier to operate in practice, whilst maintaining member protection. The following provisions are therefore now included in the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations (Northern Ireland) 2010:

    1 General easement; and

    2 De minimis easement

24. **Financial consequences** – The monetised benefits shown in this Impact Assessment derive from a dataset holding funding details for PPF-eligible DB schemes as estimated at the end of February 2009, with a further estimate made of assets and liabilities at the end of January 2010. The Government is satisfied that this updated dataset more accurately reflects the impact on scheme funding in the current

10 The estimated cost of securing member benefits in full with an insurance company via annuity policies

11 See Article 162 of the Pensions (Northern Ireland) Order 2005

economic climate. Nevertheless, assumptions had to be applied as the level of detail available was limited to whole schemes, with no detail on individual employers' funding. Estimates must, therefore, be treated with some degree of caution. Further detail on the estimates and assumptions is supplied below.

25. Since the original consultation was published, many schemes have seen an improvement in their funding position (largely through higher asset prices), while employers have seen a fall in the cost of their borrowing (measured here by the yield on an AA corporate bond) as conditions in credit markets have begun to ease somewhat. As a result, the estimated financial benefits of the general easement has been lowered in comparison to the consultation Impact Assessment.

26. On the other hand, since the de minimis easement requires a scheme to be fully funded on a PPF basis before it can take advantage of the easement, the improvement in scheme funding (combined with a higher de minimis threshold than under the original proposal) means that a greater number of schemes are now able to take advantage of the easement. This has the effect of increasing the estimated benefits of the de minimis easement proposal. The net effect of the changes described in this, and the preceding paragraph is to increase the estimated benefits of the de minimis easement.

1 – General easement

27. **Formal consultation** Many respondents welcomed the Government's willingness to consider further easements to the employer debt rules. However, some expressed concern that the draft regulations were overly complex (particularly the restructuring test) and only applied to one-to-one company restructurings. The Government has revised the general easement requirements to make the provision less prescriptive and easier to operate in practice, but has also sought to maintain member protection.

28. The general easement may be used by associated employers who are undertaking a corporate restructuring. No debt is triggered provided the following conditions were satisfied:

- A restructuring test - considering the present resources and future commercial prospects of the exiting and receiving employers - must be satisfied[12]. Broadly, the test requires that the receiving employer is **at least as likely** as the exiting employer to meet the scheme liabilities it is acquiring from the exiting employer, as well as its own liabilities.

- The corporate assets, employees and scheme members of the exiting employer must be passed to another employer (the "receiving

[12] The requirements for the restructuring test are set out in the regulations which accompany this Impact Assessment.

employer"). The receiving employer also becomes responsible for the exiting employer's scheme liabilities.

29. In very limited circumstances, this option is extended to include non-associated employers. It applies where an employer changed its legal status, such that, for example an unincorporated charity changed to an incorporated company; or a partnership became a limited liability partnership.

30. To assist trustees, the Pensions Regulator is considering the need to provide guidance on behaviours that it expects, good practice, or practical advice when considering the available options when a company wishes to restructure.

Groups affected / financial consequences

31. The Government's intention is that this general easement is supported by **employers** because it should enable corporate restructuring to be managed more effectively. No debt is payable as a lump-sum, and, there is a wider benefit to employers who will find it easier to restructure their business.

32. It is estimated that the general easement could provide considerable savings for **employers**. These estimates are based on the following assumptions. There are 1,975 associated multi-employer schemes (source: Pensions Regulator). Employers expressing an interest in restructuring their businesses – from responses to CBI's survey[13] combined with knowledge of the scope of this option – suggest that around 20 per cent.[14] of medium to large employers sponsoring multi-employer DB schemes will welcome and make use of the general easement. For the purposes of calculating this estimate, it is assumed that all of these restructures occur in year 1. This gives a total of 395 schemes estimated to take advantage of this easement.

33. The median employer debt for these schemes is estimated at £3.8 million per scheme. The aggregate debt across all 395 schemes is therefore estimated to be 395 * £3.8 million = £1.48 billion.

34. For the purposes of calculating this estimate, the amount of the employer debt itself has not been counted as a saving. This is because amounts of the order of the employer debt may be paid when the scheme winds up and discharges its liabilities via an insurance company. Instead the focus has been on employers' cash flow and an assumption that employers borrow to meet the debt. On this basis, the additional cost of borrowing to employers would be the interest on the debt. This approach is consistent with that used in the Impact

[13] See footnote 5

[14] While the survey reported in excess of 40 per cent of employers to be constrained by employer debt restrictions in the event of a restructure, it is known, based on discussions with the industry, that such transactions as is proposed between two employers may only account for half of all likely restructurings.

Assessment for the amendments made to the Employer Debt Regulations in April 2008 (see footnote **3**). The saving to employers is calculated as the value of the interest payments that no longer have to be paid as a result of no debt being triggered.

35. It is assumed that companies borrow by issuing 10 year corporate bonds. The assumed nominal yield for the purposes of this estimate is 5.71 per cent. (based on the average yield on AA corporate bonds over the period 2000-2009). In each year it is assumed that only the interest is paid (with the principal being paid at maturity). In calculating the present value of the foregone interest payments, the Government is concerned only with the real interest rate since this represents the real cost to the borrower when issuing their bond. Part of the interest rate offered will contain compensation for inflation, and for the erosion of the real value of debt over time. This component leaves the borrower unaffected in real terms. Over 10 years the present value of aggregate savings will amount to around £435 million (in real terms). On the same basis the average annual savings will amount to £49 million – this is a simple average of the annual aggregate interest payments expressed in real terms.

36. Some costs and savings associated with the administration of the general easement arise. It has not been possible to estimate these costs and savings, but having had discussions with the pensions industry, it is considered that they are negligible.

37. The regulations require **trustees** to consult the employers involved in the restructuring to obtain information necessary to carry out the restructure test. However, if employers want to deal with the employer debt under existing Regulations, they also have to pass information to trustees. For example, if employers decided to enter into an agreement to apportion the debt or to enter into a withdrawal arrangement, information has to be passed across. The Regulations do not introduce any additional information requirements; rather the total amount of information provided remains broadly the same – but it is required under different headings / Regulations.

38. **Members** will benefit from their employers being able to run their business in a sustainable and competitive manner. This may lead to increased job security and continuing accrual in a DB pension sponsored by a viable employer. Since the general easement includes safeguards such as the restructure test, there is no compromise in the security of members' pensions and hence no additional costs imposed on members.

39. The **trustees' primary** duty is to the members and the security of their benefits. While the current economic climate is a testing time for trustees, explicitly different policies for restructuring transactions coupled with new guidance from the Pensions Regulator should go some way towards allaying concerns about this easement. In particular, the

safeguards inherent in the option enable trustees to have continued confidence in the strength of the overall employer covenant.

40. Concerns about the general easement are addressed in a number of ways. First, following the restructuring, the receiving employer must be **at least as likely** as the exiting employer to meet the scheme liabilities it is acquiring from the exiting employer, as well as its own liabilities. Second, the corporate assets, employees and scheme members of the exiting employer must be passed to the receiving employer. The receiving employer also becomes responsible for the exiting employer's scheme liabilities. In addition, the Regulator (via Regulatory guidance) will also be able to influence trustees i.e. to consider all the available options and decide which they think is most appropriate. This option should therefore not directly result in greater calls on the PPF and there should be no additional costs for this body.

2 – De minimis easement

41. **Formal consultation** Respondents welcomed the introduction of the de minimis easement in principle, but found it overly complex. They also commented that the levels were overly conservative – both in terms of the percentages of members and the monetary limit. The Government has therefore increased the scheme member percentages and the overall financial limit.

42. Under the de minimis easement, limits are introduced, below which, in the case of a restructuring, an employer debt is not triggered. The underlying rationale is that the interests of the exiting employer qualifying for this easement are not material to the ongoing viability of the scheme. The key features of the de minimis easement are as follows:

- The corporate assets, employees and scheme members of the exiting employer must be passed to the receiving employer. The receiving employer also becomes responsible for the exiting employer's scheme liabilities.

- The scheme members in respect of whom defined benefits have accrued as a result of service with the exiting employer must now either be (i) no more than two (this is to assist smaller employers), or (ii) no more than 3 per cent. of scheme membership, whichever is the greater.

- The total annual amount of accrued pensions of the members covered by the transaction must not exceed £20,000. The £20,000 limit will be increased by £500 each year (to broadly rise with inflation based on the Bank of England meeting its inflation target, on average).

- In order to limit the number of times the de minimis easement can be used in a multi-employer scheme, a cap is being imposed. In a rolling period of three years, de minimis transactions in a scheme must involve no more than 5 members (or 7.5 per cent. of scheme members – whichever is the larger); and the total annual amount of accrued pensions in respect of these members must not exceed £50,000.

43. **Extent of applicability** – The Government is particularly aware that applicability of this easement is very sensitive to the prevailing economic climate. It is estimated that currently around 4 per cent. of all multi-employer schemes are eligible to take advantage of the easement. Of course, as asset values recover, the proportion of schemes able to take advantage of de minimis should increase further.

Groups affected / financial consequences

44. The de minimis easement is useful to **employers** and **advisers** undertaking minor "housekeeping" restructurings – with these now easier and cheaper to manage, with no debt triggered and no assessment of the employer covenant required.

45. Where an employer debt is inappropriately triggered, it is again assumed that the employer borrows to pay this debt. As with the general easement, the direct financial benefit to the employer is the saving arising from no longer having to service the debt. As with the general easement, the estimate assumes that employers borrow by issuing debt of a maturity of 10 years[15] at a rate equivalent to that on an 'AA'-rated corporate bond – assumed to yield a nominal 5.71 per cent.[16] (based on the average AA yield over the period 2000-2009). (In reality of course, for such small amounts, employers borrow rather than issue bonds, but this approach provides a standardised approach to the estimates of savings.)

46. Using PPF scheme funding data, it is calculated that the inappropriately triggered debt in the absence of this easement as being in the region of £3.9 million. The present value of the aggregate savings to employers from their no longer having to make interest payments on this inappropriately triggered debt is estimated to be around £1.2 million over a ten year period (in real terms). While the monetary saving to employers is small, the wider benefits associated with the facilitation of such small (i.e. non-material) restructuring transactions should be welcome. There are some information requirements attached to the Regulations. However, as with the general easement, these are not regarded additional burdens but a modification of existing requirements.

47. Some costs and savings associated with administration also arise with this easement. It has not been possible to estimate these costs and savings but it is believed they are negligible.

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15 Note that it is assumed the employer simply pays off the interest on the loan in each year and then the full principal when the debt matures.

16 However, as discussed in paragraph 35, it is the real yield that is actually of concern to us.

48. It may introduce a small added risk to **members**' benefits as a scheme funded to PPF levels is permitted to undertake a restructuring exercise without the requirement to assess the covenant of the employer who now has additional obligations following the restructure. In January 2010, for example, around 5,000 members could have been in groups associated with exiting employers whose interests are near to or at 3 per cent. but not exceeding £20,000 of annual accrued pensions. However with a 7.5 per cent. limit on the proportion of interests allowed to accumulate over any rolling three year period, additional risks are not envisaged for members who continue to be supported by the strength of the wider group.

49. Overall, therefore, it is envisaged that the interests of **trustees** and **members** to be protected by the requirement that the corporate assets, employees and obligations towards the pension scheme of the exiting employer must be passed to the receiving employer, and by the limited monetary value of these transactions. While admittedly this option does not require a restructuring test and may be a concern for the Pensions Regulator and the PPF, as described in previous paragraph, only risks limited by size and number of transactions are permitted. This easement should also not lead directly to greater calls on, or additional costs for, the PPF.

OTHER TESTS

Small firms impact test

50. The regulations have a limited effect on small companies – with medium and large companies reporting the greatest need to restructure. Apart from a few cases of a change to legal status, the Regulations apply only to associated companies participating in a DB pension scheme. However, the Regulations enable employers to restructure more efficiently and should contribute to the sustainability of the overall group.

Competition assessment

51. The Regulations do not alter competitiveness with regard to any of the four questions contained in the Office of Fair Trading's guidance on completing competition assessments. In fact, by enabling companies to reorganise more efficiently, competition should be enhanced.

Enforcement

52. The Regulations are permissive and hence no compliance action is required.

Implementation and delivery plan

53. As the requirements in the Regulations are permissive, there is no requirement for a delivery plan.

Post implementation review

54. The Government will undertake a review of the Regulations in 2013. The review will be based on information and feedback provided by the Pensions Regulator, the PPF and the representative bodies from the pensions industry.

Equality

55. The Regulations have their primary effect on occupational pension schemes and their sponsoring employers. However the initial tests for the equality Impact Assessment have been considered and the results are contained in Annex A to this Impact Assessment.

Human rights

56. The Regulations are compatible with the Human Rights Act 1998.

Legal Aid

57. There is no impact on Legal Aid.

Sustainable Development, Carbon Assessment, Other Environment

58. It is not believed there are any impacts in these areas.

Health Impact Assessment

59. The Regulations have been considered against the screening questions for health impact assessments and such an assessment is not necessary.

Rural proofing

60. The Regulations have no specific impact on rural communities.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed for the Department for Social Development

Anne McCleary
16 March 2010

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