| Title: The Occupational Pension Schemes (Investment) (Amendment) Regulations 2010 | Impact Assessment (IA) |
|---|---|
| Lead department or agency: Department for Work and Pensions | **Date: 02/09/2010** |
| Other departments or agencies: | **Stage:** Final |
| | **Source of intervention:** EU |
| | **Type of measure:** Secondary legislation |
| | **Contact for enquiries:** **Barry Owen 020 7449 7388** |

## Summary: Intervention and Options

### What is the problem under consideration? Why is government intervention necessary?

**The Occupational Pension Schemes (Investment) Regulations 2005 partly transposed European Union Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision[1] (IORP Directive) which includes restrictions on the amount an occupational scheme can invest in its sponsoring employer. This is intended to limit the impact on pension schemes' funding in the event of a scheme's sponsoring employer becoming insolvent. The existing regulations temporarily exempt investments made through a 'collective investment scheme' and include provisions temporarily exempting schemes that were in excess of the statutory limits when the restrictions were first introduced in 1997. In order to transpose the above Directive fully into UK domestic law, both of these exemptions now need to be repealed.**

### What are the policy objectives and the intended effects?

**To remove the transitional employer-related provisions in The Occupational Pension Schemes (Investment Regulations) 2005 in order to comply with European Union Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP Directive).**

### What policy options have been considered? Please justify preferred option (further details in Evidence Base)

**Do nothing:**

**Legal advice confirmed that there were no grounds for retaining the existing exemptions (ie to do nothing) and, if the UK Government did, it would be in breach of its EU law obligations. By retaining the existing transitional provisions, UK pensions law would be in breach of the European Directive, which could lead to infraction proceedings being taken against the UK government.**

**Consequently, the full transposition of the IORP Directive is the only option.**

### When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?

**The policy objective is to fully transpose the IORP Directive into UK domestic law. This will be achieved as soon as the changes to the Investment Regulations come into force. However we will monitor stakeholder views to ascertain whether it would be appropriate to review ways of implementing the Directive which could reduce regulatory burden in future.**

### Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?

**No – collection of monitoring data would place a disproportionate additional burden on pension schemes**

[1] (OJ No. L 235, 23.9.03, p.10)

**SELECT SIGNATORY Sign-off** For final proposal stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

**Signed by the responsible Minister: Steve Webb ........................................... Date: 01/09/10 .......................**

**Summary: Analysis and Evidence** Policy Option 1

**Description:**

| Price Base Year **2010** | PV Base Year **2010** | Time Period Years **10** | Net Benefit (Present Value (PV)) (£m) | | |
|---|---|---|---|---|---|
| | | | Low: | High: | Best Estimate: Negligible |

| **COSTS (£m)** | **Total Transition** (Constant Price) | Years | **Average Annual** (excl. Transition) (Constant Price) | **Total Cost** (Present Value) |
|---|---|---|---|---|
| **Low** | **0** | | **0** | 0 |
| **High** | **Low** | | **Low** | Low |
| **Best Estimate** | **Low** | | **Low** | Low |

**Description and scale of key monetised costs by 'main affected groups'**

**Schemes with employer-related investments in excess of 5 per cent will need to change their asset allocations. The scheme will bear the one-off cost of the transaction process. Overall, these costs are expected to be small as the transaction costs are expected to be low and only a small number of schemes will be affected. Schemes which invest in collective investment schemes will need to track the level of these investments, which will also incur a one-off cost to set up monitoring systems and a small ongoing monitoring cost. Negligible costs will be incurred by the Pensions Regulator.**

**Other key non-monetised costs by 'main affected groups'**

**Sponsors of schemes divesting themselves of a significant amount of employer-related investments may find themselves more vulnerable to takeover. However, this is unlikely since trustees are already required to invest prudently and in the members' best interest, which implies a properly diversified investment portfolio.**

| **BENEFITS (£m)** | **Total Transition** (Constant Price) | Years | **Average Annual** (excl. Transition) (Constant Price) | **Total Benefit** (Present Value) |
|---|---|---|---|---|
| **Low** | | | | |
| **High** | | | | |
| **Best Estimate** | **0** | | **Negligible** | Negligible |

**Description and scale of key monetised benefits by 'main affected groups'**

**Reducing the exposure of occupational pension schemes to investment in the sponsoring employer will improve these schemes' funding levels in the event of the sponsor becoming insolvent. This would improve funding for the Pensions Protection Fund (PPF). It is expected that this benefit will be very small, since the measure is likely to affect a small proportion of schemes, and of those only a small proportion will become insolvent and fall under the PPF regime.**

**Other key non-monetised benefits by 'main affected groups'**

**Schemes' funding positions will be less reliant on the performance of the sponsoring employer, making schemes more robust at times of low performance for the sponsor, and hence less likely to need to call for additional funding from the sponsor at these times.**

**Key assumptions/sensitivities/risks** **Discount rate** 3.5

**Given that the temporary transitional provisions were intended to give schemes with employer-related investments in excess of 5 per cent immediately before 6 April 1997 time to disinvest, it is expected that most schemes will be within the permitted limit by the time these regulations come into force. That the current investment practice for the majority of occupational pensions schemes is governed by trust law supports this assumption. This already requires schemes to invest in a prudent manner and to limit employer-related investments. Schemes that have not divested would be subject to action by the Pensions Regulator, subject to their risk based approach.**

| Impact on admin burden (AB) (£m): | | | Impact on policy cost savings (£m): | In |
|---|---|---|---|---|
| New AB: | AB savings: | Net: **NIL** | Policy cost savings: | No |

## Enforcement, Implementation and Wider Impacts

| | | | | | | |
|---|---|---|---|---|---|---|
| What is the geographic coverage of the policy/option? | | | United Kingdom | | | |
| From what date will the policy be implemented? | | | September 2010 | | | |
| Which organisation(s) will enforce the policy? | | | The Pensions Regulator | | | |
| What is the annual change in enforcement cost (£m)? | | | Negligible | | | |
| Does enforcement comply with Hampton principles? | | | Yes | | | |
| Does implementation go beyond minimum EU requirements? | | | No | | | |
| What is the $CO_2$ equivalent change in greenhouse gas emissions? (Million tonnes $CO_2$ equivalent) | | | Traded: N/A | | Non-traded: N/A | |
| Does the proposal have an impact on competition? | | | No | | | |
| What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable? | | | Costs: **N/A** | | Benefits: **N/A** | |
| Annual cost (£m) per organisation (excl. Transition) (Constant Price) | Micro | < 20 | Small | Medium | Large | |
| Are any of these organisations exempt? | No | No | No | No | No | |

## Specific Impact Tests: Checklist

**Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.**

**Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.**

| Does your policy option/proposal have an impact on…? | Impact | Page ref within IA |
|---|---|---|
| Statutory equality duties[2] Statutory Equality Duties Impact Test guidance | No | 8 |
| **Economic impacts** | | |
| Competition Competition Assessment Impact Test guidance | No | 8 |
| Small firms Small Firms Impact Test guidance | Yes | 8 |
| **Environmental impacts** | | |
| Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance | No | |
| Wider environmental issues Wider Environmental Issues Impact Test guidance | No | |
| **Social impacts** | | |
| Health and well-being Health and Well-being Impact Test guidance | No | |
| Human rights Human Rights Impact Test guidance | No | |
| Justice system Justice Impact Test guidance | No | |
| Rural proofing Rural Proofing Impact Test guidance | No | |
| Sustainable development Sustainable Development Impact Test guidance | No | |

[2] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill applies to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

References

**Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).**

| No. | Legislation or publication |
|---|---|
| 1 | **Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of Institutions for Occupational Retirement Provision (IORP) – Article 18(1) and (2) of the Pensions Directive.** |
| 2 | **Consultation: The changes were consulted upon in draft regulations - 'The Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009'** <br> **http://www.dwp.gov.uk/docs/pensions-misc-regs-2009.pdf** <br><br> **Government Response to Consultation:** <br> **http://www.dwp.gov.uk/docs/pensions-misc-regs-response.pdf** |

## Evidence Base

### Introduction

1. This impact assessment considers the effect on schemes of removing the transitional provisions in regulation 14 of The Occupational Pension Schemes (Investment) Regulations 2005: SI 2005/3378 (the Investment Regulations).

### Issue under consideration

2. Where certain employer-related investments exceeded five per cent of the market value of the assets of the scheme immediately before 6 April 1997, the transitional provisions set out in regulation14 of the investment regulations, permit those investments to be retained until disinvestment can be effected.

3. DWP consulted on the provisions in Pensions Directive 2003/41/EC during the final quarter of 2003 and again in March 2005. The 2005 consultation proposed to remove some of the existing transitional arrangements in the investment regulations but, in light of the issues raised by respondents (in particular that it may lead to a 'forced sale' of assets which could be detrimental to the members' interests), the Government decided they would permit the current transitional provisions for pre-owned investments to continue.

### Rationale for Government intervention

4. The transitional provisions cannot continue beyond the 23rd September, when the discretion available under Article 22(4) of the Directive to postpone the transposition of Article 18(1) and (2) is withdrawn.

### Objectives

5. To remove the risk of UK pensions law being in breach of the European Directive which may lead to infraction proceedings being taken against the UK Government.

### Intended effect

6. The intended effect is to ensure that those elements of Article 18(1) and (2) which are not currently found in domestic legislation are incorporated through regulations. This will also protect the Pensions Protection Fund from additional costs due to schemes which are heavily invested in the sponsoring employer.

### Main affected groups

7. The main groups affected by the proposals are as follows:

    - **Pension schemes with employer-related investments in excess of 5 per cent immediately before 6 April 1997:** The regulations withdraw transitional provisions in regulation 14 of the investment regulations. From the date the changes come into force, (with very few exceptions), pension scheme investment in a sponsoring employer will be restricted to no more than 5 per cent of the scheme's portfolio.

    - **Pension schemes which invest in collective investment schemes (CISs):** The regulations withdraw transitional provisions exempting CISs from the calculation of the level of employer-related investment. Schemes will be required to ensure that there is 'look through' into the CIS to allow them to monitor the level of employer-related investment they are making through the CIS.

    - **Government:** Government and the taxpayer stand behind private pension provision by providing tax relief on contributions to schemes. It is important, therefore, to have a regulatory regime that supports and encourages prudent investment.

- **The Pensions Regulator:** The Pensions Regulator will enforce these regulations, based on its usual risk-based approach.

- **The Pension Protection Fund:** The Pension Protection Fund provides pensions compensation to members of eligible defined benefit schemes in the UK. These regulations make a small reduction in the likelihood of the Pensions Protection Fund being called upon to provide compensation.

**Geographical extent**

8. Whilst the regulations apply to the United Kingdom, Northern Ireland will make separate, corresponding legislation.

**Implementation**

9. The Regulations will be laid before Parliament on 2nd September 2010 (coming into force on 23rd September) and will be accompanied by a Press Release. DWP will also contact major stakeholders.

**Alternative Options**

10. The only alternative to removing the current transitional provision would be to do nothing. However, this would result in UK pensions law being in breach of the European Directive which could, in turn, lead to infraction proceedings being taken against the UK Government.

**Numbers affected**

11. Given that the transitional provisions are intended to give schemes with employer-related investments in excess of 5 per cent immediately before 6 April 1997 time to divest, it is expected that most schemes will be within the permitted limit by the time the changes come into force. For the same reasons, it is anticipated that schemes with employer-related loans will have effected repayment. Consequently, it is expected that the number of schemes affected by the removal of the provisions will be low.

**SCHEMES: One-off and annual costs**

12. Where schemes have employer-related investments in excess of the 5 per cent limit, the trustees or managers of those schemes will have to instruct their investment managers to liquidate the excess employer stock and use the proceeds to purchase alternative assets. The scheme will bear the transaction costs of this process. The aggregate cost would be the sum of the per-scheme transaction cost across all the affected schemes. This is a one-off cost – there are no on-going costs. DWP has no evidence available about the size of these costs. However, since we expect the number of schemes affected to be low, we also expect the overall cost to be small.

13. Schemes investing in collective investment schemes (CISs) would bear a one-off cost in setting up systems to monitor the level of investment in the sponsoring employer through the CIS. There will be an ongoing cost of monitoring the level of employer related investment in the CIS, to ensure that the total level of employer related investment in the scheme remains below the 5% limit. Alternatively, schemes could comply by investing in CISs which commit not to invest more than 5% in any one company. DWP has no evidence available about the likely size of these costs or the number of schemes who are invested in CISs. We believe that a relatively small proportion of schemes make use of CISs, therefore we expect these costs to be negligible.

**SCHEMES: Non-monetised benefits**

14. Reducing the dependence of scheme assets on the sponsoring employer's stock is intended to provide increased financial security for schemes in the event of the sponsor suffering from adverse business conditions.

**GOVERNMENT: Annual Costs**

15. Negligible (smaller than the costs described above). The Pensions Regulator will enforce these regulations applying their usual risk based approach.

**Pension Protection Fund: Non-monetised benefits**

16. Increased financial security for trust-based defined benefit schemes reduces the risk of such schemes looking to the Pension Protection Fund (PPF) to provide compensation. Reducing the reliance of employer related investment will make a small improvement in the funding position of some schemes entering the PPF.

**KEY ASSUMPTIONS/SENSITIVITIES/RISKS**

**Key assumptions**

17. Since these transitional provisions have given schemes the opportunity to reduce their employer related investments over a number of years, it is assumed that the majority of schemes will, by 2010, have reduced employer-related investments to 5% or less. We assume that the transaction costs of disinvesting the sponsoring employer's stock will be small, and that the costs of setting up monitoring system and carrying out ongoing monitoring is also small.

**Sensitivities/Risks**

18. That the number of schemes affected by the regulations and the costs incurred by these schemes will be greater than that envisaged in the 'Key Assumptions'.

## IMPACT TESTS

## Competition

19. These regulations apply to trust based pension schemes. Schemes are employer specific and do not compete to serve a market. Therefore these regulations do not directly or indirectly affect the number or range of suppliers in a market, or alter their ability or incentives to compete.

## Small firms

20. These regulations are less likely to impact on small firms than other types of firms. This is because they are much less likely than other firms to sponsor occupational pension schemes. A small firm is very unlikely to make up a significant part of the value of a collective investment scheme. Small schemes (those with fewer than 12 members, all of whom are trustees) are already exempted from the restrictions on loans and employer-related investments. There is no scope within the IORP Directive for the exemption of small firms.

## Equality impact

21. An equality impact assessment was considered. These regulations do not impact directly on individuals. The regulations aim to change the level of exposure schemes have to investment in the sponsoring employer. In the event of the employer becoming insolvent and an eligible scheme being unable to pay benefits at the Pensions Protection Fund level, the scheme would enter the Pensions Protection Fund both before and after the introduction of this legislation and levels of compensation to individuals would not change. The level of compensation remains the same regardless of race, disability and gender.

## Annex 1: Post Implementation Review (PIR) Plan

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|---|
| Basis of the review:<br>**To review whether this aspect of implementation of the IORP Directive could be implemented in a way that reduces burdens on pension schemes.** |
| Review objective:<br>**To ensure that regulation remains proportionate** |
| Review approach and rationale:<br>**There is little hard data about costs and numbers of schemes affected by the change. Collecting data would be a disproportionate cost and an additional burden on pension schemes. Therefore review will be based on a scan of stakeholder views.** |
| Baseline:<br>**No baseline can be established, due to the lack of data and burden of collecting such data.** |
| Success criteria:<br>**Views of stakeholders, including schemes and their representative bodies, the Pensions Regulator and the Pensions Protection Fund.** |
| Monitoring information arrangements:<br>**Establishing a regular collection of monitoring information would incur a disproportionate cost and impose an additional burden on pension schemes. Therefore there is no proposal to collect monitoring information on this policy change.** |