EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL, PERSONAL AND STAKEHOLDER PENSIONS (MISCELLANEOUS AMENDMENTS) REGULATIONS 2009

2009 No. 615

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 contain amendments to various sets of Regulations relating to occupational, personal and stakeholder pensions. They make a number of changes to current Regulations, and introduce amendments to help schemes implement the recommendations of the "Deregulatory Review of Private Pensions" on:

- Reducing the cap on the amounts by which schemes are required to revalue rights in a pension scheme or increase pensions in payment, and
- Simplifying the payment rules for benefits payable as the result of a pension sharing order.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 These Regulations contain a number of provisions that are intended to make pensions schemes easier to run, and a number of provisions that change or update existing legislation. They make a number of unconnected changes to existing regulations, and are intended to:

a. Help occupational pension schemes wind up more quickly and efficiently,
b. Enable trustees to take full advantage of changes to existing statutory requirements on increasing pensions in payment and revaluing accrued rights,
c. Tidy up some out of date legislation,
d. Incorporate provisions of the EU pensions Directive relating to investments in the sponsoring employer into UK legislation,
e. Provide a power for the Pensions Regulator to impose a financial penalty on a person who has not complied with certain requirements to consult about future changes to a pension scheme,
f. Make it easier to apply the scheme funding requirements in specific situations, and

g. Make it easier for members of occupational pension schemes with benefits payable as a result of a pension sharing order to take a pension before normal benefit age in line with other scheme benefits.

4.2 A transposition note in respect of regulation 19 is attached to this memorandum

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain

6. European Convention on Human Rights

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

7. Policy background

- **What is being done and why**

The purpose of each of the provisions contained in the Regulations is outlined below:

7.1 We are changing a number of Regulations containing references to the Pensions Regulator's powers to impose a financial penalty. The changes:

a. remove any references to the "Occupational Pensions Regulatory Authority" (which became the Pensions Regulator in 2004), and
b. ensure the Regulator is required to give notice of a financial penalty in writing in every case.

7.2 The changes are made to the:

a. Occupational Pension Schemes (Preservation of Benefit) Regulations 1991
b. Occupational Pension Schemes (Disclosure of Information) Regulations 1996
c. Occupational Pension Schemes (Transfer Values) Regulations 1996
d. Occupational Pension Schemes (Age-related Payments) Regulations 1997
e. Pensions on Divorce etc. (Provision of Information) Regulations 2000.
f. Pensions on Divorce etc. (Charging) Regulations 2000
g. Pension Sharing (Implementation and Discharge of Liability) Regulations 2000
h. Pension Sharing (Pension Credit Benefit) Regulations 2000
i. Stakeholder Pension Schemes Regulations 2000
j. Occupational Pension Schemes (Independent Trustee) Regulations 2005
k. Occupational Pension Schemes (Fraud Compensation Levy) Regulations 2006

7.3 In the Pensions Act 2004, Parliament reduced from 5% to 2.5% the cap on the amount by which pension schemes are required to increase pensions in payment. The Pensions Act 2008 made a similar change to the amount by which pension schemes are required to revalue past rights. The Government agreed in response to the Deregulatory Review Report submitted by the independent reviewers in July 2007 to introduce a "statutory override" so that pension schemes with restricted powers of amendment could take advantage of these changes (Deregulatory review – Government Response to consultation published 5 December 2007).

7.4 Regulation 3 makes this change by amending the Occupational Pension Schemes (Revaluation) Regulations 1991 and Regulation 7 makes the equivalent change to the Occupational Pension Schemes (Indexation) Regulations 1996. Where a pension scheme wants to change the rate or amount by which it revalues accrued pension benefits or increases pensions in payment, these new powers can be used provided the employer agrees. In particular, it will allow changes to be made where the scheme rules do not allow that change.

7.5 When an occupational pension scheme ceases to contract-out, it would normally be required to consult with trade unions. If the scheme is winding up, however, such consultation is of little/no benefit to the scheme and has the effect of delaying the winding up process. Regulation 4 amends the Occupational Pension Schemes (Contracting-out) Regulations 1996 to remove the requirement for schemes to consult with trade unions about contracting-out certificates if they are in the process of winding up.

7.6 Where a scheme is contracted-out, it can sometimes transfer certain pensions to other schemes. Regulation 5 makes an amendment which allows a scheme that used to be contracted-out to make the same transfers

7.7 Regulation 10 amends the Personal Pension Schemes (Appropriate Schemes) Regulations 1997. The change will bring the regulations in line with the Upper Accrual Point being introduced in April 2009 by the Pensions Act 2007.

7.8 Regulation 15 prescribes when members of occupational pension schemes with rights derived from a pension sharing order can take the benefit before normal benefit age. The amendments will allow benefits payable as a result of divorce or dissolution of a civil partnership to be paid in the same circumstances as apply to other pension scheme members in most pension arrangements. Regulation 15(6) changes a cross reference, and regulation 9 makes a consequential amendment to the Occupational Pension Schemes (Winding Up) Regulations 1996.

7.9 Regulation 18 amends the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (“the Scheme Funding Regulations”) to ensure that the modification in paragraph 9(5),(6) and (7) of Schedule 2, which applies to the extent that the actuary in a particular scheme has the sole power under the scheme rules to set the contribution rate, also applies where the actuary has the power under the scheme rules to set any, but not necessarily all, of the contributions rates.

7.10 There are a small number of pension schemes in which the actuary alone determines the contributions payable to the scheme. The intention in this area was that the legislation should not, as far as possible, override the essential balance of power where scheme rules give the scheme actuary the sole power to determine the contribution rate. The modification in paragraph 9(5),(6) and (7) of Schedule 2 to the Scheme Funding Regulations therefore provides for the actuary to certify that the level of contributions in these cases to be no less than that which the actuary would have provided for.

7.11 Regulation 18 also amends regulation 17 of the Scheme Funding Regulations so that Part 3 of the Pensions Act 2004 does not apply to a section of a multi-employer scheme which is winding up, but only where a specified part or proportion of the assets of the scheme is attributable to that section and cannot be used for the purposes of any other section of the scheme. The amendment is intended to cover those sections of multi-employer defined benefit occupational pension schemes which are winding up at a time when contributions to the scheme were no longer payable by the employer.

7.12 Regulation 19 amends the Occupational Pension Schemes (Investment) Regulations 2005 (“the Investment Regulations”) to transpose requirements of Article 18(1)(f) of the EC Pensions Directive 2003/41/EC (“the IORP Directive”) on the activities and supervision of institutions for occupational retirement provision. This requires Member States to impose, by September 2010, a 5% limit on the amount of its resources an occupational pension scheme can invest in the sponsoring employer. The amendments have been included in this Statutory Instrument in order to give schemes with investments currently in excess of 5%, sufficient time to comply with the Directive. The Investment Regulations already impose this restriction in most circumstances, but the changes made by regulation 19 ensure that the majority of the remaining exemptions which are prohibited by Article 18(1)(f) are removed. Regulation 19 also introduces a provision to permit employer-related loans (currently prohibited by the Investment Regulations) and, for employer-related investments purposes, requires that they comply with the 5% limit.

7.13 Regulation 13 of the Investment Regulations currently allows unlimited employer-related investment of resources in an account with a person who has permission to accept deposits. Regulation 19(3)(b) of these Regulations adds the Bank of England as an institution with which such deposits can be made from April 2009. The Bank of England is a financial institution which is permitted under Financial Services Authority rules to provide banking services to its pension scheme but whose scheme is currently prohibited by regulation 13 from using those banking services. The exemption in regulation 13 will be brought in line with the requirements of 18(1)(f) of the IORP Directive when the other changes to the Investment Regulations made by regulation 19 come into force in September 2010.

7.14 Larger employers are required to consult the affected members (or their representatives) of some pension schemes before making certain changes. Regulation 20 amends the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 to allow the Pensions Regulator to impose a civil penalty on a person who has failed, without reasonable excuse, to comply with these requirements to consult. This ensures the Pensions Regulator has the full range of regulatory options available.

7.15 Regulation 22 amends the Occupational Pension Schemes (Member-Nominated Trustees and Directors) Regulations 2006 in cases where the trustee structure involves two (or more) corporate trustees, at least one of which is an independent corporate trustee performing a professional function. It ensures the independent trustee company is not required to appoint member-nominated directors. Government policy is that the member-nominated trustee and director requirements do not apply to independent trustees.

- ***Consolidation***

7.2 Informal consolidation of the instrument will be included in due course in the Department's "The law relating to Social Security" (the Blue Volumes), which are available at no cost to the public on the internet at http://www.dwp.gov.uk/advisers/docs/lawvols/bluevol/

8. Consultation outcome

8.1 This SI was subject to an 8 week consultation exercise which ran from 8th December 2008 to 30th January 2009. A shortened consultation period was chosen:

a. as most of the regulations are technical,
b. as the important issues had already been discussed with key stakeholders, and
c. to ensure the Regulations would come into force on the April common commencement date.

8.2 Thirty four responses were received. Most respondents welcomed the package. A number of responses included helpful points, which are reflected in the finalised version of the Regulations.

8.3 As a result of consultation comments, changes were made to the statutory overrides provisions in regulations 3 and 7 to provide that:

- the provisions cannot be used retrospectively.
- the modification power can only be used if the employer agrees.
- any modification made under the power cannot provide for **increases** in the rates of indexation or revaluation.

8.4 Changes were also made to regulation 18. Most of these comments outlined potential problems to specific schemes if the draft regulation was not reworded. The regulation has been redrafted to address these concerns.

8.5 The consultation draft included amendments to the Occupational Pension Schemes (Investment) Regulations 2005 to fully transpose the requirements of Article 18(1)(f) of the IORP Directive. These requirements imposed restrictions on the proportion of a scheme's resources that may be invested in the sponsoring employer. As a result of the consultation, some amendments have been withdrawn from these Regulations in order for further discussions to take place about the impact on business. These amendments are now being taken forward on a separate track and may be included in a future Statutory Instrument.

8.6 We consulted separately on some of the amendments in regulation 15 as the draft Pension Sharing (Pension Credit Benefit) (Amendment) Regulations 2008 and published the response to the consultation in August 2008 (http://www.dwp.gov.uk/consultations/2008/govt-resp-pspcb-amdt-regs08.pdf).

9. Guidance

9.1 The Department publishes guidance on the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 (which are amended by regulation 20) at http://www.dwp.gov.uk/publications/dwp/2005/occ_pen_schemes/occ_personal_pens_schemes_regs06.pdf

10. Impact

10.1 This instrument imposes no new costs on business, charities or voluntary bodies, and regulations 3 and 7 enable some pension schemes to reduce costs.

10.2 This instrument has negligible impact on the public sector.

10.3 A full impact assessment for regulations 3 and 7 which estimates the benefits to business of enabling pension schemes to take advantage of the reduced indexation and revaluation caps without having to gain the approval of scheme members is attached to this memorandum.

11. Regulating small business

11.1 Most of these Regulations apply to small business.

11.2 Where the Regulations make minor and technical changes to existing statutory requirements the impact of these Regulations on small businesses is negligible. The Financial penalty introduced in regulation 20 only applies to larger employers, and the changes to the scheme funding regulations only apply to larger schemes with defined benefit arrangements.

12. Monitoring & review

12.1 The provisions relating to statutory overrides in regulations 3 and 7 are permissive powers being made available to pension scheme trustees. The Department for Work and Pensions ("DWP") will review the effectiveness of these changes in 2013.

12.2 The effectiveness of the changes relating to scheme funding, scheme investment, and payment of benefits to pension credit members will be monitored through existing stakeholder engagement arrangements. DWP seeks regular feedback through groups such as the Joint Working Group on occupational pensions and the Deregulatory Review Advisory Group, and has regular discussions with the Pensions Regulator.

12.3 The remaining regulations make minor and technical changes to existing statutory requirements. Monitoring and review of these regulations is not, therefore, appropriate.

13. Contact

Michelle Boreland at the Department for Work and Pensions Tel: 020 7712 2530 or sft@dwp.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Intervention & Options

Department /Agency: 1. Department for Work and Pensions	Title: 2. Impact Assessment of the statutory overrides introduced by The Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009	
Stage: Implementation	**Version:**	**Date: 26 February 2009**

Related Publications: Deregulatory Review - Government Response, Deregulatory Review - response to consultation; The Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009-consultation draft

Available to view or download at:

http://www.dwp.gov.uk/pensionsreform/deregulatory_review.asp: http://www.dwp.gov.uk/consultations/2008

Contact for enquiries: Michelle Boreland **Telephone: 020 7712 2530**

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

Inability to amend scheme rules following reductions to the statutory revaluation and indexation caps (reductions to the statutory caps were introduced by the Pensions Act 2008 and Pensions Act 2004 respectively). Restrictive provisions in scheme rules sometimes preclude, or restrict, employers negotiating for changes for example to reflect the current cap on indexation (reduced from 5% to 2.5%in 2005) and the reduction in the statutory revaluation cap from 5% to 2.5% from 6 April 2009.

What are the policy objectives and the intended effects?

The aim is to enable trustees to amend scheme rules to take advantage of the reduced statutory indexation and revaluation caps. This will provide significant savings for defined benefit (DB) schemes, thus helping to maintain high quality DB provision. RPI inflation is currently well below 2.5% so there wont be benefits to employers and costs to employees in the short run - but pensions are a long term business and the changes are still appropriate. Changes to the revaluation cap are estimated to allow possible savings to schemes of between £250 million and £400 million over the long term.

What policy options have been considered? Please justify any preferred option.

The Government response to the recommendations from the independent reviewers to the Deregulatory Review (Chris Lewin and Ed Sweeney) published on 22 October 2007 considered the options of removing the revaluation requirement and the alternative of reducing the cap from 5% to 2.5% for future accruals together with a statutory override to introduce more scope for scheme rules to be amended to reflect the legislative change. The first option had the potential to have a significant impact on individuals. The preferred option was to reduce the cap to 2.5% which still provides members with a measure of protection against inflation but also has the potential to deliver savings to employers.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

2013

Ministerial Sign-off For final proposal / implementation stage Impact Assessments:

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

Signed by the responsible Minister:

William D McKenzie .... Date: 11 March 2009

Summary: Analysis & Evidence

Policy Option: Introduce override with reduction to revaluation cap	**Description: Introduce a power for scheme rules to be amended by trustees so that scheme rules can be amended following the reduction of the statutory revaluation cap**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits. Public sector estimates indicate that costs of increased payments of income related state benefits are negligible
£ 0		
Average Annual Cost (excluding one-off)		**Total Cost** (PV) **£ 4.4 billion**
£ 250million		

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

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Analysis suggests that if employers took advantage of the reduction in the cap to 2.5% it could lead to possible average savings of the order of £250 million per year (2007/08 prices), although savings could reach as much as £400 million in the long term.
£ 0		
Average Annual Benefit (excluding one-off)		**Total Benefit** (PV) **£ 4.4 billion**
£ 250million		

Other **key non-monetised benefits** by 'main affected groups' Employers sponsoring schemes-increased flexibility for schemes and sponsoring employers which might be expressed through improved scheme viability, higher wages and/or higher profits.

Key Assumptions/Sensitivities/Risks All employers sponsoring defined benefit schemes will implement the new requirement. Long term inflation is 2.9%

Price Base Year 2007	Time Period Years 43	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			Great Britain	
On what date will the policy be implemented?			6 April 2009	
Which organisation(s) will enforce the policy?			Pensions Ombudsman	
What is the total annual cost of enforcement for these organisations?			£ Negligible	
Does enforcement comply with Hampton principles?			N/A	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ N/A	Decrease of £ N/A	**Net Impact** £ N/A

Key:	**Annual costs and benefits: Constant Prices**	**(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: Introduce override for LPI	Description: Introduce a power for scheme rules to be amended by trustees so that scheme rules can be amended following the reduction of the indexation cap

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits. Public sector - estimates indicate that costs of increased payments of income related state benefits are negligible.
£ 0		
Average Annual Cost (excluding one-off)		
£ **20 million**		**Total Cost** (PV) £ **0.9 billion**

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

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Employers will benefit from reduced scheme costs
£ 0		
Average Annual Benefit (excluding one-off)		
£ **20 million**		**Total Benefit** (PV) £ **0.9 billion**

Other **key non-monetised benefits** by 'main affected groups' Employers sponsoring schemes- increased flexibility for schemes and sponsoring employers which might be expressed through improved scheme viability, higher wages and/or higher profits.

Key Assumptions/Sensitivities/Risks

Long term inflation 2.9%

Indexation rules governing about 25% of schemes are changed as a result of this measure.

Price Base Year 2007	Time Period Years 43	**Net Benefit Range** (NPV) £ **0**	**NET BENEFIT** (NPV Best estimate) £ **0**

What is the geographic coverage of the policy/option?			Great Britain	
On what date will the policy be implemented?			6 April 2009	
Which organisation(s) will enforce the policy?			Pensions Ombudsman	
What is the total annual cost of enforcement for these organisations?			£ Negligible	
Does enforcement comply with Hampton principles?			N/A	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			N/A	
What is the value of changes in greenhouse gas emissions?			N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ N/A Decrease of £ N/A **Net Impact** **£** N/A

Key:	Annual costs and benefits: Constant Prices	(Net) Present Value

Evidence Base (for summary sheets)

Introduction

1. The Government announced a rolling deregulatory review of private pensions legislation in May 2006. As part of the review it appointed Chris Lewin and Ed Sweeney in December 2006 to act as external reviewers and to make recommendations for change. Their report, "Deregulatory Review of Private Pensions" containing recommendations for change, was published on 25 July 2007.

2. This impact assessment is an abridged and slightly amended version of the impact assessment published in conjunction with the Government's response to the reviewers' report which was published on 22 October 2007. The outcomes of the consultation on the Government's response to the reviewers' recommendations were published on 5 December 2007. This amended version of the impact assessment considers the following changes to legislation applying to occupational pension schemes:
   - Introduction of a power for trustees to modify scheme rules by resolution, where the employer consents, to enable rates or amounts (or ways of determining rates or amounts) in scheme rules to be changed following the reduction in the revaluation cap from 5% to 2.5% for future accrued rights (referred to as a "statutory override") as provided for in the Pensions Act 2008. This impact assessment considers the impact of the override alongside the introduction of the lower revaluation cap.
   - Introduction of a power for trustees to modify scheme rules by resolution, where the employer consents, to enable amounts (or ways of determining amounts) in scheme rules to be changed following the reduction in the cap on increases to pensions in payment (LPI) from 5% to 2.5% (referred to as a "statutory override") which came into effect from April 2005. The override would only apply for pensions accrued from a future date.

Background to the legislation on private pensions

3. The present regulatory system governing occupational pensions has grown incrementally over the course of the past thirty years. It is now, by common consent, lengthy, complicated and hard to understand. Although each successive layer usually had the aim of protecting scheme members or simplifying the regulatory structure, there have been unintended consequences, leading to undesirable outcomes. Whilst by no means wholly attributable to the growth of regulatory burdens, there is little doubt that the weight of regulation has contributed to a belief by some employers that the costs and risks of having their own pension schemes are becoming too great.

Government objective

4. The Government are committed to reducing legislative burdens on employers but recognise that there needs to be a balance between reducing legislative complexity and making legislation simpler, and protecting pension scheme members' interests.

5. The Government also recognise that it is important there should be scope, where appropriate, for scheme rules to be amended to reflect any legislative easements.

6. Scheme rules set out the circumstances and conditions in which benefits may be paid to members. Some scheme rules allow very limited scope for amendment and may not provide for either employers or trustees of schemes to make amendments to reflect any subsequent changes to the legislative requirements which have already been incorporated into scheme rules. This leads to a form of "one way valve" where legislation imposes cost requirements with which schemes must comply but does not provide an override where the legislative requirements are relaxed. This means that some employers are not always able to take advantage of any legislative easements introduced to reduce burdens on them.

7. As a balance to the legislative override which imposes certain requirements on schemes, the Government want to provide those schemes with the scope to make amendments to reflect relaxations in the statutory requirements.

Change being taken forward

A power for trustees to modify scheme rules by resolution, with employer consent, to reduce rates of revaluation in scheme rules at the same time as a reduction to the statutory revaluation cap from 5% to 2.5%

8. The statutory cap on revaluing deferred pensions will be reduced to 2.5% for all pension rights which accrue from 6 April 2009. This will provide savings for employers sponsoring occupational pension schemes and demonstrates that the Government are committed to making changes which will reduce burdens on employers. The savings and costs of the reduction of the revaluation cap together with the "statutory override" provided by these regulations will build up over time as the change to the cap will only apply to rights built up from a future date - pension rights which accrue until 6 April 2009 or until scheme rules reflect a lower rate will have to be revalued in accordance with the 5% statutory cap regime.

A power for trustees to modify scheme rules by resolution, with employer consent, to reduce rates of increases to pensions in payment following the reduction in the cap on increases to pensions in payment (LPI) from 5% to 2.5% which came into effect from April 2005

9. Schemes are required to increase any pension rights earned on or after 6 April 1997 when those pension rights come into payment. Until April 2005 schemes had to increase those rights by RPI or 5% whichever is less. The reduction in the LPI cap from 5% to 2.5% was introduced in April 2005 to reduce burdens on business. However, a number of employers have not been able to take advantage of the flexibility because of restrictions in their scheme rules.

10. Anecdotal evidence is that around a quarter of occupational pension schemes are unable, because of constraints on amendments to scheme rules, to make changes to reflect the reduction in the LPI cap from 5% to 2.5% from April 2005.

11. The power in regulations for trustees to modify scheme rules by resolution, where the employer agrees, will introduce flexibility that some employers will like. It will enable scheme rules to be amended in relation to future accruals to reflect the legislative easement which was introduced in 2005. It could result in savings for employers and might provide them with an incentive to continue to provide defined benefit schemes for their employees.

Financial consequences

Impact on schemes/employers

"Statutory override" together with the reduced revaluation cap

12. A reduction in the cap will deliver potential savings for employers. These are estimated to be around £250 million a year on average although in the long term they could rise to as much as £400 million a year. The key assumption in this is a long term inflation rate of 2.9%, in line with HM Treasury forecasts. All private sector defined benefit pension schemes will be able to take advantage of the reduction in the cap. As most defined benefit pension schemes are provided by medium/ large enterprises the proposal is more likely to be of benefit to organisations of those sizes.

Option	Overall costs for employers	Overall savings
Reduce the cap to 2.5%	None	£4.4 billion (PV)

Note: The savings in the table are present value figures covering the period to 2050. Savings will build up over time and in the early years will be lower but in the later years will be higher - the average falls somewhere between.

13. Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits.

14. A potential benefit resulting from the savings for employers might be increased business profits which may lead to improved scheme viability.

"Statutory override" -change in LPI cap

15. Estimates are that around a quarter of defined benefit occupational pension schemes were unable to amend their scheme rules to reflect the reduction in the LPI cap from 5% to 2.5%. On the assumption that all of those employers choose to override their schemes rules to reflect the relaxed statutory requirement, annual savings are estimated to be in the region of £20 million (2007/08 prices) but over time savings will be greater in the long run. Total estimated savings are as follows:

Option	Overall costs for employers	Overall savings
Statutory override introduced	None	£0.9 billion (PV)

Note: Assumes average annual savings of £20 million (at 2007/08 prices).

16. Savings for employers are generated from a corresponding reduction in the level of inflation protection provided to pensions in payment.

17. A further potential benefit resulting from the savings for employers might be increased business profits which may lead to improved scheme viability.

Impact on individuals

"*Statutory override" together with the reduced revaluation cap*

18. Analysis indicates that given the current forecasts for long term inflation a reduction in the cap on revaluation will have very little effect on average private sector incomes from defined benefit schemes as illustrated below.

Percentage reductions in average private sector DB pension income compared to the base case, long term inflation rate of 2.9% and reduction in the cap from 2009

	2.5% cap - 100% deferred pension affected by change
2020	0.2%
2030	0.5%
2040	1.1%
2050	1.6%

Source: DWP estimates

19. Deferred pensioners are likely to have a number of different sources of pension income so any impact on one part of their overall income might not necessarily bear so heavily on the individual's total pension income. However, there is a risk that a reduction in the cap accompanied by high inflation could result in a significant reduction in defined benefit pension incomes and a consequent increase in income related state benefits.

20. The measure is likely to affect more female scheme members than male scheme members as women tend to have more breaks in their employment and therefore are more likely to have deferred pension entitlement. No concrete evidence exists as to what proportion of deferred pension entitlement relates to women as opposed to men.

21. Increased business profits arising from the savings for employers from such a change could result in benefits for members of schemes and employees. For example by way of higher wages for employees; increased employment opportunities within the business and improved scheme viability.

22. In addition, there is also a redistribution of pension income from the best-off DB scheme members (under current revaluation rules) to the group who are able to join DB schemes following the change and who would otherwise be worse off (because they would otherwise have been in DC schemes which tend to have lower employer contribution rates). This is expected to raise overall social welfare.

23. It is very difficult to estimate the size of these benefits but one approach would be to consider the scenario whereby the employer chooses to channel these savings back into pension provision. Assuming all the savings from the change were spent by employers on expanding the coverage of their DB schemes, it is estimated that an upper bound of 165,000-265,000 additional DB members in the medium to long term. In practice the actual impact will certainly be lower than this since employers are unlikely to choose to spend savings on expanding the coverage of their DB schemes.

24. Whilst positive, such figures must be seen in the context of the total number of active DB scheme members, estimated to be 2.7 million in 2007, and the rate of change of membership, with a net decrease in membership of around 200,000 between 2006 and 2007 and 210,000 between 2005 and 2006.

"Statutory override" -change in LPI cap

25. Paragraphs 6 and 7 set out the rationale for introducing a statutory override to scheme rules. Analysis indicates that given the current forecasts for long term inflation (2.9%) the impact of a reduction in the cap on indexation from 5% to 2.5% will build up over time to a reduction of 1.2% in the average private sector defined benefit pension income by 2050. The long term impact is likely to be greater on pensioners who live longer. However, pensioners in receipt of defined pension benefits tend to belong to the best-off socio-economic groups who are most likely to have access to other assets or sources of income.

Percentage reductions in average private sector DB pension income compared to the base case

	2.5% cap from 2009-100% pension affected by the change
2020	0.5%
2030	0.9%
2040	1.1%
2050	1.2%

Source: DWP estimates

26. Savings to employers of such a change could result in non-monetised benefits for members of schemes and employees as outlined in paragraphs 21 and 22. It is estimated that there could be an upper bound increase in DB membership of 13,000 members if employers were to use all the savings in expanding coverage of their DB schemes. Again, the caveats in paragraphs 22 to 24 apply.

Summary of costs and savings

Change	***Overall costs (to employees)***	***Overall savings (to employers)***
Reduction in the revaluation cap		
Reduce the cap to 2.5%	£4.4 billion (PV)	£4.4 billion (PV)
Statutory override-change to LPI cap		
Statutory override introduced	£0.9 billion (PV)	£0.9 billion (PV)

Competition assessment

27. The regulations do not affect any particular market sector. Nor will they have an impact on suppliers. Instead they will affect any company which has a salary related pension scheme.

28. The reduction in the revaluation cap from 5% to 2.5% will entail some minor one-off costs to administration systems, but these costs will have no impact on competitiveness.

Small firms impact test

29. These proposals will impact on employers who operate defined benefit pension schemes. Smaller companies are less likely to provide salary related occupational pension schemes for their employees than medium to larger enterprises. The reduction in the revaluation cap from 5% to 2.5% has the same impact on the costs of providing members' benefits regardless of the size of the employer.

Legal aid

30. There will be no impact on legal aid.

Sustainable Development, Carbon Assessment, Other Environment.

31. It is not expected that these proposals will have any impact in these areas.

Health impact assessment

32. The options have been considered against the screening questions for health impact assessments and a full health impact assessment is not necessary.

Race Equality, Disability Equality

33. These proposals do not have any consequences for race equality or disability equality.

Gender equality

34. Defined benefit pension schemes have traditionally been established in male dominated industries at a time when female participation in the labour force was far lower than it is today. Consequently any change to the regulatory framework for defined benefit schemes is likely to impact more on men than women.

35. The introduction of a "statutory override" alongside the lower revaluation cap however may have a particular impact on female scheme members because women tend to earn pension benefits early in their careers and then leave the work force for periods of time to undertake caring responsibilities. However, as already outlined in paragraph 19, the impact on any individual member is likely to be small.

36. On the introduction of a statutory override to enable employers to change their rules to reflect the reduction in the LPI cap from 5% to 2.5% the position is as follows. Changes in indexation rights will apply to all individual members equally, irrespective of gender, and it is an intrinsic feature of pension schemes that the aggregate amounts of pension paid vary according to how long each pensioner lives. The introduction of a statutory override will have an impact on a higher proportion of female than male scheme members as they tend to live longer. However, indications are that male life expectancy is now increasing faster than female life expectancy and, assuming this continues, the impact on men and women should move towards becoming equal in the future.

37. The proposals for both overrides are designed to encourage continued provision of defined benefit schemes and that will be of equal benefit to men and women.

Human Rights

38. These proposals are compatible with the Human Rights Act 1998.

Rural proofing

39. These proposals have no specific impact on rural communities.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

No Annexes

Transposition Note

<u>The Occupational Pension Schemes (Investment) Regulations 2005</u>

Transposing those parts of the European Union Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision[1] (IORP Directive) which concern the investments of private sector occupational pension schemes

Article	Requirements	Implementation
18(1)(f)	Investment by schemes in the sponsoring undertaking shall to be no more than 5% of the portfolio as a whole.	This requirement is already satisfied in part by section 40 of the Pensions Act 1995 and Regulations 10 to 16 of The Occupational Pension Schemes (Investment Regulations) 2005 (the Investment Regulations), which restrict the proportion of the market value of a scheme's resources that may be invested in the sponsoring employer. Such investments are called employer related investments. Regulation 19 of The Occupational, Personal and Stakeholder Pensions (Miscellaneous) Regulations 2009 amends regulations 12,13,15 and 16 of the Investment Regulations and inserts new regulation 15A with effect from 25 September 2010 to bring a number of additional employer related investments within the limits required by Article 18(1)(f) of the IORP Directive.

Scrutiny history

Doc Ref 13420/00, COM(200)507: *Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, Regulations and administrative provisions relating to institutions for occupational retirement provisions*.

The Government submitted explanatory memoranda to Parliament dated 11 December 2000 and 16 May 2001.

The House of Commons European Scrutiny Committee reported on the proposal and the Government's explanatory memoranda in report no.2, Session 00/01 and in report no. 31, Session 01/02.

The proposal and explanatory memoranda were sifted to Sub-Committee A of the House of Lords European Union Committee and were cleared by that committee following correspondence with Ministers on 17 June 2002.

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