EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (WINDING UP, DEFICIENCY ON WINDING UP AND TRANSFER VALUES) (AMENDMENT) REGULATIONS 2005

2005 No.72

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 Current legislation provides that a debt is due from a sponsoring employer if they become insolvent at a time when their pension scheme, which is subject to section 75 of the Pensions Act 1995, is underfunded. The Regulations amend existing Regulations to increase the debt owed by such an employer to its salary-related occupational pension scheme, which is subject to section 75, by stipulating that "full buy-out" is used as the basis for calculating the value of the scheme's liabilities. This increases any debt due from the employer, and thereby increases the claim the pension scheme will have as an unsecured creditor of the employer. "Full buy-out" is the funding level that would enable all scheme members to purchase an annuity or deferred annuity, and may mean that the members receive more of the entitlement that they have accrued than they are presently able to.

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

None

4. Legislative Background

4.1 The Regulations amend existing Regulations which set the level of debt due from a sponsoring employer to its pension scheme, should the scheme wind up or the employer become insolvent. These are the Occupational Pension Schemes (Deficiency on Winding Up etc.) Regulations 1996 (SI 1996/3128) and the Occupational Pension Schemes (Winding Up) Regulations 1996 (SI 1996/3126).

4.2 The Occupational Pension Schemes (Winding Up and Deficiency on Winding Up etc) (Amendment) Regulations 2004 (SI 2004/403), which came into force on 15 March 2004, changed the method of valuing schemes' liabilities, and therefore the debt due to schemes, so that "full buy-out" is used for schemes that are winding up with a solvent sponsoring employer.

4.3 The Regulations bring the valuation method for liabilities of schemes with an insolvent sponsoring employer into line with those on a solvent employer whose scheme is winding up. This change was suggested by many respondents to the consultation on the draft Regulations on solvent employers (which became SI 2004/403). It will mean that the pension

scheme will have an appropriate claim as a creditor of that employer, and that scheme members may receive more of the entitlement that they have accrued than they are presently able to.

4.4 The Regulations also amend the Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847). The amendment places a disclosure requirement on trustees should a member request a guaranteed cash equivalent whilst their scheme is winding up.

5. Extent

This instrument applies to Great Britain.

6. European Convention on Human Rights

Not applicable

7. Policy Background

7.1 Section 75 of the Pensions Act 1995 currently states that any deficiency in a pension scheme becomes a debt on the employer should a salary-related occupational pension scheme wind up or its sponsoring employer become insolvent. This is designed to provide protection to scheme members should these events occur. Regulations SI 1996/3128 and SI 1996/3126 provide the basis for calculations of the liabilities and, therefore, the amount of the debt on the employer.

7.2 The Government's policy view is that wherever possible employers should ensure that there are sufficient funds in schemes which are winding up to meet the full costs of the rights accrued by scheme members. Regulation SI 2004/403 changes the valuation method so that the value of a scheme's liabilities is calculated on a "full buy-out" basis, should the scheme wind up whilst its sponsoring employer is solvent.

7.3 The Government's objective for the Regulations is that pension schemes have an appropriate claim as creditors of sponsoring employers that become insolvent. The Regulations align the method of calculating the debt owed from an insolvent employer to that brought in by SI 2004/403 for debts owed by solvent employers.

7.4 The Regulations also place disclosure requirements on trustees should a member request a guaranteed cash equivalent whilst their scheme is winding up.

7.5 A consultation was held on draft Regulations, to which 19 responses were received. There was general approval of the Regulations aligning the debt level for schemes with an insolvent sponsoring employer with that for schemes winding up with a solvent sponsoring employer. As a result of comments received during the consultation changes were made to the disclosure requirement on trustees. These changes were to the wording in the disclosure requirement and to make this provision apply to schemes winding up with an insolvent sponsoring employer, as well as those winding up with a solvent employer.

8. **Impact**

   A Regulatory Impact Assessment is attached to this memorandum.

9. **Contact**

   Gabrielle Park at the Department for Work and Pensions Tel.: 020 7712 2122 or email: Gabrielle.Park@dwp.gsi.gov.uk can answer any queries regarding the instrument.

REGULATORY IMPACT ASSESSMENT

The Occupational Pension Schemes (Winding Up, Deficiency on Winding Up and Transfer Values) (Amendment) Regulations 2005

Purpose and intended effect of measure

Objective

1. The objective of the Occupational Pension Schemes (Winding Up, Deficiency on Winding Up and Transfer Values) (Amendment) Regulations 2005 ("the Regulations") is to amend current Regulations to ensure that where the sponsoring employer of a salary-related occupational pension scheme, which is subject to section 75 of the Pensions Act 1995, becomes insolvent, the pension scheme will have an appropriate claim as a creditor of that employer.

2. The Regulations will align the method used for calculating the value of the liabilities for schemes with an insolvent employer with that used when an occupational scheme is winding up with a solvent sponsoring employer.

3. The change may mean that, depending on the level of funding in the pension scheme and the assets available for creditors of the insolvent employer, the members may receive more of the entitlement that they have accrued than they are presently able to.

4. The Regulations stipulate that "full buy-out" is used as the basis for calculating the value of the liabilities for a relevant scheme whose sponsoring employer becomes insolvent. This method of valuing the liabilities is used to calculate the amount of the debt on the employer under section 75. Where the sponsoring employer becomes insolvent the debt due from the employer to the scheme will be calculated on the basis that pensioner members should receive their full benefits through an annuity, and non-pensioner members should receive their full

accrued benefits either through a deferred annuity or, for non-pensioner members who consent, a transfer value of the same amount as would have been used to purchase a deferred annuity.

5. The Regulations cover both solvent employers and insolvent employers. They amend Regulations currently in place. Once the new Regulations come into force the status of the sponsoring employer, solvent or insolvent, would not be part of the equation, the calculation of a scheme's liabilities would be the same on wind up or employer insolvency.

6. The Regulations also place disclosure requirements on trustees should a member request a guaranteed cash equivalent whilst their scheme is winding up.

Background

7. The current legislation covering the debt on the employer is contained in the Pensions Act 1995 ("the Act"), the Occupational Pension Schemes (Deficiency on Winding Up etc.) Regulations 1996 (SI 1996/3128) ("the Deficiency Regulations") and the Occupational Pension Schemes (Winding Up) Regulations 1996 (SI 1996/3126) ("the Winding Up Regulations").

8. Section 75 of the Act provides that if the sponsoring employer of an occupational pension scheme, which is not a money purchase scheme[1], becomes insolvent and at the applicable time[2] its assets are less than its liabilities, an amount equal to the difference shall be treated as a debt due from the employer to the trustees or managers of the scheme. Section 75 also makes similar provision for relevant schemes that wind up whilst their sponsoring employer is solvent.

9. Where the sponsoring employer becomes insolvent, regulation 3 of the Deficiency Regulations and regulation 4 of the Winding Up Regulations provide for a calculation of the value of scheme liabilities and assets based on provisions within the Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996 (SI 1996/1536).

10. The definition of insolvency used to determine whether the sponsoring employer is insolvent, for the purposes of the debt on the employer provisions, is set out in section 75(4) of the Act. This subsection defines relevant insolvency events in relation to the employer.

11. The Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847) covers legislation on guaranteed cash equivalents and includes provisions for the disclosure of information by trustees. Trustees must ensure that a statement of entitlement to a guaranteed cash equivalent is accompanied by information that is set out in the Regulations.

[1] With other prescribed exemptions in regulation 10 of the Deficiency Regulations
[2] see Section 75(3) of the Act

Risk Assessment

12. The risk of doing nothing is that should the sponsoring employer of a salary-related occupational pension scheme go into insolvency, members are less likely to receive the pension they were expecting at retirement.

13. Also, it means that should otherwise solvent companies go into members' voluntary liquidation (MVL), the level of debt due to the scheme would continue to be the lower minimum funding requirement (MFR) amount. This could mean that scheme members in this situation receive less of their accrued benefits, when compared to scheme members whose schemes wind up with solvent sponsoring employers.

14. The current use of the minimum funding requirement (MFR) basis to calculate the debt in relation to non-pensioner members means that members are unlikely to receive the pension income they were expecting. The amounts available would almost certainly be insufficient to buy out their full accrued rights with deferred annuity contracts from an insurance company.

15. If non-pensioner members transfer the funds into money purchase arrangements, the resulting amounts at retirement are likely to be too small to reproduce the pensions that they were expecting. In addition, they will bear the investment risk, being dependent on the investment returns achieved on the funds.

16. In March 2004 the Government introduced Regulations that raised the debt on solvent employers whose occupational salary-related scheme is winding up, so that payment of the increased debt would bring the schemes' funding up to the "full buy-out" level.

17. During the consultation on the draft Regulations that increased the debt on solvent employers, respondents expressed concern about methods employers could use to avoid the higher debt.

18. Currently the definition of an insolvent employer in the relevant pension legislation for employers who are companies in England and Wales is that they are in liquidation. This definition includes MVL, which is a liquidation method for solvent employers. It is possible for companies in MVL to be in a healthy financial position. However, the debt attributable under the current legislation would be the lower debt, based on the MFR.

19. Regulations that increase the employer debt due from the sponsoring employer to the "full buy-out" level should that employer become insolvent, would severely limit the ability of companies to use MVL to avoid the higher debt requirement. Employers would have to be able to meet the "full buy-out" cost. If they were unable to meet the "full buy-out" debt, it would be more difficult to put the company into MVL.

20. Should companies go into other types of liquidation, whilst the higher debt would be due, in most cases this debt would not be recoverable. Pension schemes (except for a very specific, small area of contributions

due to the scheme) are unsecured creditors and are therefore at the bottom of the list of creditors. Therefore, only a fraction of the debt, perhaps a few pence in every pound, is likely to be collected.

21. As can be seen from the table below, the number of companies that go into MVL is lower numbers than those that go into compulsory liquidations (CL), or particularly creditors' voluntary liquidations (CVL).

Corporate Insolvencies in England, Wales and Scotland in 2003:

Liquidations:	
Compulsory Liquidations	5,670
Creditors Voluntary Liquidations	9,145
Other proceedings:	
Members Voluntary Liquidations	2,620

Source: Insolvency Service

Note: Some companies were subject to more than one form of proceeding.

22. Unsecured creditors of companies in CL or CVL usually receive small proportions of the amounts they are owed. In these types of insolvencies, even secured and preferential creditors normally receive quite low proportions of the amounts owed to them.

23. Some commentators to the consultation on the draft Regulations on solvent employers considered it an anomaly that there are significantly different levels of debt applicable, depending on whether the sponsoring employer is solvent or insolvent. Their view was that there is no rational basis for this, it is difficult to justify a scheme's claim being less if the employer is in liquidation and that different levels of debt add complication and therefore loopholes. They said that the difference in debt levels could affect companies' choice of procedure if they want to reorganise, and may push companies into liquidation rather than administration.

24. Several respondents suggested increasing the debt on companies in liquidation to "full buy-out". As this would increase the proportion of assets paid to pension schemes and would make the amount received by the pension scheme members proportionate with that received by other unsecured creditors. They said that this was fairer and might mean that members received more of the pension income that they expected. The responses to the consultation on the draft Regulations on insolvent employers in autumn 2004 were generally in favour of aligning the level of debt in all cases.

25. Provisions in Part 3 of the Pensions Act 2004 will replace the MFR with new scheme funding requirements. A new basis for calculating schemes' liabilities for debt on the employer purposes would therefore be needed once the MFR has been replaced.

26. From April 2005 the Government is introducing the Pension Protection Fund (PPF) to provide improved protection for members of eligible pension schemes whose sponsoring employer becomes insolvent and which can not afford to buy out at least the level of benefits offered by the PPF.

27. With the expected introduction of the PPF it would be advisable to increase the level of employer debt in the near future. This would allow the PPF to take in additional assets in respect of the schemes whose liabilities it was taking on. Thus it may mean improved funding for the PPF. It also means that any incentive for employers to dispose of pension scheme liabilities on to the PPF, once it is in place, is made more difficult.

Disclosure

28. Another issue raised in the consultation on the draft Regulations on solvent employers in 2003 was concern about the level of guaranteed cash equivalents that members might receive if their scheme was winding up. This is why the draft Regulations on insolvent employers included a provision for trustees to make a statement to a member if they requested a guaranteed cash equivalent whilst their scheme was winding up and the sponsoring employer was solvent. Not including such a disclosure provision could mean that members were more at risk of accepting a low guaranteed cash equivalent without giving careful consideration to the decision.

Options

The following options were considered:

Option 1: "Do nothing"

29. Under the "do nothing" option, the debt on an insolvent employer would continue to be an amount to bring the scheme's assets up to the MFR level. This option would only be applicable for the period leading up to the replacement of the MFR; at that time a new measure would be needed.

Option 2: "Partial buy-out"

30. Under the "partial buy-out" option, the debt would be the amount needed to bring a scheme's assets up to a level sufficient to meet:

- the trustees' estimate of all expenses likely to be incurred when winding up the scheme;

- the actuary's estimate of the costs of buying annuities with an insurance company for pensioners;
- the actuary's estimate of the costs of buying deferred annuities for non-pensioners who are, say, within 10 years of pension age; and
- transfer values based on the MFR for other members who have not retired.

31. Similarly to option 1, part of this option would only be applicable for the period leading up to the replacement of the MFR, when a new measure would be needed. A different method would be needed for transfer values for younger non-pensioners in the longer term.

Option 3: "Full buy-out" (option in the Regulations)

32. Under the "full buy-out" option the debt would be the amount needed to bring a scheme's assets up to a level sufficient to meet:

    - the trustees' estimate of all expenses likely to be incurred when winding up the scheme;
    - the actuary's estimate of the costs of buying annuities for pensioner members; and
    - the actuary's estimate of the costs of buying deferred annuities for non-pensioner members.

Further options

33. Another option that was considered was to base the debt calculation on the new scheme funding requirements which will replace the MFR. Under this option the debt could be calculated on the basis of the statutory funding objective to which each scheme will be subject under the provisions of Part 3 of the Pensions Act.

34. Under the new requirements the trustees of each scheme will be responsible for determining the appropriate actuarial method and assumptions to be used in actuarial valuations of their scheme for the purposes of the statutory funding objective. The debt calculation would therefore vary from scheme to scheme, and as a result some scheme members would be treated less favourably than others.

35. Such an approach would not ensure that the debt was sufficient to secure all members' benefits in full. An additional consideration is that the new scheme funding requirements are not expected to come into force before September 2005.

36. An alternative option was to use non-regulatory routes, but this option was not considered able to deliver the change required. The change that is being proposed

is to provisions that are set out in Regulations, so the current position is set out in legislation and therefore the change required is a legislative one.

37. The higher debt level needs to be capable of being recognised as legitimate by other creditors and the claim of the pension scheme needs to be enforceable.

Benefits

Option 1: "Do nothing"

38. Members have limited protection with the current provisions. However, if their employer goes into insolvency they can find the benefits they receive fall far short of what they might have expected.

Option 2: “Partial buy-out”

39. Under option 2 it is possible that a proportion of the members of underfunded salary-related occupational pension schemes whose sponsoring employer went into insolvency across all business sectors might benefit.

40. Option 2 would raise the level of debt due to schemes above that under option 1, meaning that some members might receive more of the pension benefits they had expected and benefit from this extra protection. However, there would continue to be a group of non-pensioners, albeit a smaller group than under option 1, only afforded the lesser protection offered by the current arrangements. This is because the debt would be calculated on the basis that the liabilities for these members would be based on transfer values using the MFR, rather than the cost of deferred annuities.

41. Also, if option 2 were adopted it would mean that schemes whose sponsoring employer entered MVL would have a lower debt due to them than that due to schemes in wind up with solvent sponsoring employers. This could appear unequal as companies in MVL may be regarded as solvent, as they should be able to pay all of their liabilities.

42. It is possible that with the change in the valuation of liabilities, schemes’ assets would be likely to be distributed differently amongst non-pensioner members in comparison with the current distribution method. Also, with option 2 there is an issue of a cliff-edge; where two members with the same accrued pension, one 9 years and 364 days from pension age and the other 10 years and 1 day from pension age, receive very different benefits from the scheme.

Option 3: “Full buy-out” (option in the Regulations)

43. Under option 3 all members of underfunded salary-related occupational pension schemes whose sponsoring employer went into insolvency might benefit.

44. Option 3 would raise the level of debt due to schemes above that in options 1 and 2. More members than under options 1 and 2 might receive more of their pension benefits, and therefore benefit from the extra protection. The benefit of option 3 over option 2 is that the scheme is due the amount that would broadly enable

them to purchase a deferred annuity for all non-pensioners. If non-pensioner members were to benefit from this measure they would receive the same proportion of the cost of their deferred annuity.

45. Much would depend on how much additional funding was received from the employer. It is possible that all non-pensioners could benefit, as the debt would be calculated on a basis that all of them would be entitled to deferred annuities.

46. It is recognised that should the amount received by a scheme fall considerably short of that owed to it, it is possible that, because of the different method of valuing each member's entitlement which these new Regulations introduce, some non-pensioners could receive less than they would currently. This is because of the change in valuing benefits, from one based on the MFR to one based on the cost of deferred annuities, which is necessary to maintain consistency between the possible value of the assets and the valuation of the liabilities. The change in the valuation method is likely to distribute assets differently amongst non-pensioner members when compared to the current valuation method. This would result in the position for younger non-pensioner members being improved more than that for older non-pensioner members.

47. Valuing the liabilities at "full buy-out" brings the relevant debt calculations applicable to schemes that wind up with a solvent sponsoring employer and schemes whose sponsoring employer becomes insolvent back into line. It halts any advantages that could be gained by employers from having a lower debt level should they go into liquidation, particularly MVL, or other type of qualifying insolvency. It would make the pension scheme's claim as a creditor more realistic when compared with members' expectations.

Costs

48. There are no additional administration costs. The costs of the calculation of the debt should be the same as under the current legislation.

49. How much pension schemes receive depends upon the level of assets employers have at the time of their insolvency and the other creditors in addition to the pension scheme.

50. The cost of the "partial buy-out" option is estimated at £10 million a year (before taking any Corporation Tax effects into account).

51. The cost of the "full buy-out" option is estimated at £20 million a year (before taking any Corporation Tax effects into account).

52. Generally, costs for measures which impose additional burdens on employers would be higher before taking any corporation tax effects into account, and lower once corporation tax effects are taken into account. This is because employers can usually offset additional payments into their pension funds against their profits assessed for corporation tax, thus lowering their tax bills. However, this depends on the employers involved having profits which costs could be offset against. This does not apply for debts imposed on insolvent companies.

53. The relevant definition of insolvency in pension legislation is very restrictive, covering mainly companies which go into liquidation. Raising the level of debt due to pension schemes from companies that are in either compulsory or creditors' voluntary liquidation could be regarded as fairly academic because unsecured creditors of companies in these situations usually receive very small proportions of what they are owed.

54. Whether the debt is based on MFR or "full buy-out", the chances of pension schemes receiving all that is due to them from an insolvent employer is highly unlikely.

55. Once the Pension Protection Fund is in place, in April 2005, we would expect the schemes of companies that fall into in these situations on or after 6 April 2005 to enter a PPF assessment period.

56. The main practical impact of the change in the debt level is likely to be upon companies in MVL. This type of liquidation is much less common than the other two types. Companies in MVL will still have options open to them once the debt is increased to "full buy-out". They can pay the increased debt, decide not to go into MVL or if their debts are higher than they can afford use an alternative insolvency procedure. It is possible that if they choose an alternative procedure this could trigger a PPF assessment period.

57. The cost estimates in paragraphs 47 and 48 have been calculated by the Government Actuary's Department (GAD). They are calculated by considering the total deficits against "full buy-out" costs of all private sector salary-related occupational schemes, allowing for schemes run by insolvent companies to be worse funded than average. They assume that a certain proportion of all schemes (weighted by scheme size) enter wind up each year with an insolvent employer, and that 5% of the debt placed on the insolvent company from the pension scheme is actually collected from the assets of the company.

58. In calculating the figures GAD have made a number of assumptions and used information from a wide variety of sources. Information on the funding status of all schemes is derived from data collected by the actuarial profession from consulting actuaries and insurance companies on the MFR funding levels of just over 1000 schemes that had an MFR valuation with an effective date between April 1997 and April 2000. The funding levels of the schemes were rolled forward to the current time in line with returns on assets and changes to the calculation of the values of MFR liabilities, and then the value of the MFR liabilities for each scheme was adjusted from an MFR basis to the "full buy-out" cost based on information from insurance companies as to the costs of annuities and deferred annuities. The data base may under-represent underfunded schemes and consequently this figure may underestimate slightly the likely level of underfunding. An allowance for further underfunding of between 5% and 10% for schemes run by insolvent employers was made.

59. It was assumed that around 0.25% of all private sector salary-related occupational pension schemes start to wind up each year (weighted by scheme size), based on data from the Occupational Pensions Regulatory Authority (Opra) Pension Schemes Registry database, and that a little over half of these winding up

schemes are associated with insolvent employers. It was further assumed that unsecured creditors, as pension schemes are, can secure on average 5 pence in the pound from the assets of insolvent companies in the situations in which these Regulations apply - this is based on information from "Corporate insolvency in the UK 12th survey" published by the R3 organisation on 5th July 2004.

60. The estimates of cost are sensitive to, among other assumptions, the assumptions about the cost of buying out pension benefits with insurance companies. Should these be 5% or 10% higher than assumed (for instance because increased allowance for longevity is now being made by insurance companies in pricing annuities and deferred annuities) the costs quoted above would be between £3 million and £7 million higher for the "full buy-out" option and between £3 million and £5 million higher for the "partial buy-out" option.

61. The costings are based on financial market conditions as at 31 December 2004.

Example 1

62. This is a small scheme, with an employer who is in creditors' voluntary liquidation. The scheme has 50 members, and the value of its liabilities on an MFR basis is £1.25 million. 50% of its liabilities on the MFR basis relate to pensions-in-payment; and 50% of its liabilities for non-pensioners on the MFR basis relate to those with less than 10 years to retirement.

63. If the scheme is 80% funded (on the MFR basis) its assets will be £1 million.

Current situation

64. Currently the debt on the employer would be that required to bring the scheme's assets up to the 100% level on the MFR, which is £250,000. However, the scheme, like other unsecured creditors, is unlikely to be paid the full debt that it is owed. If the total amount of assets available to unsecured creditors is £50,000, and the unsecured creditors other than the pension scheme have claims of £250,000, then the pension scheme and the other unsecured creditors will be paid 10p in the pound, and the pension scheme will secure £25,000.

"Partial buy-out"

65. The extra liability of the pension scheme under the "partial buy-out" option would be £250,000, so the total claim on the assets of the insolvent employer would be £500,000. Assuming the same level of assets and other unsecured creditors as before, the unsecured creditors would be paid 6.67 pence in the pound, and the total available for the pension scheme would be £33,333, an increase of £8,333.

"Full buy-out"

66. The extra liability of the pension scheme under the "full buy-out" option would be £625,000, so the total claim on the assets of the insolvent employer would be £875,000. Assuming the same level of assets and other unsecured creditors as before, the unsecured creditors would be paid 4.44 pence in the pound, and the

total available for the pension scheme would be £38,888, an increase of £13,888 over that available under the current rules.

Example 2

67. This is a medium-sized scheme, with an employer who is in members' voluntary liquidation. The scheme has 800 members, and the value of its liabilities on a MFR basis is £25 million. As with example 1, 50% of this scheme's liabilities on the MFR basis relate to pensions-in-payment; and 50% of its liabilities for non-pensioners on the MFR basis relate to those with less than 10 years to retirement.

68. If the scheme is 90% funded on the MFR level its assets will be £22.5 million.

Current situation

69. Currently the debt on the employer would be that required to bring the scheme's assets up to the 100% level on the MFR, which is £2,500,000. As the employer is in members' voluntary liquidation, this amount should be paid in full. However, this is sufficient only to bring the scheme up to 100% funding on the MFR basis, which is likely to secure through purchase of deferred annuities from an insurance company only a small fraction of benefits for those who are some years from retirement.

"Partial buy-out"

70. The extra liability of the pension scheme under the "partial buy-out" option would be £5,000,000, so the total claim on the assets of the employer would be £7,500,000. This extra amount, if paid in full, should ensure that all those scheme members who are already retired or who are within 10 years of retirement should see their benefits fully secured by the purchase of annuities and deferred annuities from insurance companies.

"Full buy-out"

71. The extra liability of the pension scheme under the "full buy-out" option would be £12,500,000, so the total claim on the assets of the employer would be £15,000,000. If this amount was met in full, it would ensure that all pension scheme members would receive all of their accrued pension benefits by having them secured with annuities and deferred annuities from insurance companies.

Impact on different business sectors

72. The options considered would only affect salary-related occupational pension schemes whose sponsoring employer became insolvent after these Regulations come into force.

73. Whilst there are particular industries where proportionately more companies provide salary-related occupational pension schemes than others, the impact would primarily be on the other unsecured creditors of those companies that became insolvent. These creditors could be from a variety of industries.

74. The industries which tend to have proportionately higher levels of final salary scheme provision amongst companies are the energy and water industry and the manufacturing sector.

Issues of equity and fairness

75. Section 75 of the Pensions Act, the Deficiency Regulations and the Winding Up Regulations as they apply to insolvent employers, ensure that where the sponsoring employer of a salary-related occupational pension scheme becomes insolvent a debt is placed on the sponsoring employer, to bring the amount of the scheme's funding up to a level to meet its liabilities. Options 2 and 3 raise the level of the debt. Depending on the employer's situation this may mean that members receive more of the benefits they were expecting.

76. In many cases of insolvency there are very limited assets available from the employer. In practical terms, this usually means that all unsecured creditors only receive a small proportion of the money they are owed. Where the insolvent employer does have assets that will be shared amongst the unsecured creditors, the effect of increasing the claim of one of those creditors may result in other unsecured creditors receiving proportionately less than they would have previously. However, as most unsecured creditors of employers who had experienced a relevant insolvency event receive very small proportions of the amounts they are owed, any change to the debt owed to the pension scheme is likely to have a limited effect.

77. The amount that creditors higher up the order of creditors would receive would not be affected by this proposal.

78. The situation would be different for schemes of companies that went into MVL, as these companies should be able to meet all their liabilities.

Impact on different racial groups

79. The intention behind the options is to help members of salary-related occupational pension schemes with insolvent sponsoring employers. These members could work for a variety of companies in a variety of different industries. And the employers could be located anywhere in Great Britain.

80. This means that there should not be a disproportionate impact on any particular racial group and the consequences for members will not differ according to their racial group. Members would not be affected differently by the policy or be discriminated against due to their racial group. Nor are the Regulations likely to affect relations between certain racial groups. Members of a particular scheme are likely to have the same expectations from a measure that increases the debt due to their scheme.

81. Much of the impact of the measure would depend upon the particular employer the member was employed by and the funding position of their scheme. If there were any difference in treatment between members this would be on the status of membership they held in the scheme; i.e. whether the person was a pensioner member or a non-pensioner member.

Impact on small business

82. Options 2 and 3 would impact on all insolvent employers, whatever their size, if they provide a salary-related occupational scheme. However, most small businesses do not run such schemes. Only about 4% of employees with organisations who have between 2 and 19 employees are members of final salary schemes.

83. The table below shows the percentage of employers with final salary schemes by number of employees in those companies.

Occupational Pension scheme provision in 2000 by size of organization	
Number of employees in organisation	Percentage of employers with final salary scheme (%)
2-5	Less than 0.5%
6-12	2
13-19	8
20-49	6

Source – DWP Employers Pension Provision Survey 2000

84. Small businesses are more likely to be affected if they are unsecured creditors of larger employers who become insolvent. Presently, unsecured creditors receive a small proportion of the money they are owed in this situation. Any change to the pension scheme's claim on the employer's assets is likely to have a limited impact because the assets to be shared are already so limited.

Competition assessment

85. Companies in a wide range of industries and business sectors operate final salary pension schemes.

86. The options would affect employers who have salary-related occupational pension schemes, subject to section 75 of the Pensions Act 1995, that become insolvent; and the unsecured creditors of those employers. The cost arises on the insolvency of the sponsoring employer. The effects upon companies who enter CL or CVL are likely to be very limited, because of the level of assets usually available.

87. Companies have a choice about the type of pension scheme they provide (and in some cases whether they provide a scheme), so this change will not impose additional costs on new entrants into markets that do not apply to existing companies in that market.

88. Companies with salary-related occupational pension schemes, subject to section 75 of the Pensions Act 1995, are found in a variety of industries and markets. The unsecured creditors of those companies will also come from a number of industries and markets.

Securing compliance - enforcement and sanctions

89. Where a debt is established under section 75 of the Act and the Regulations, it is for the trustees or managers of the scheme to pursue the debt from the employer.

The debt is not a preferential debt for the purposes of the Insolvency Act 1986 or a preferred debt for the purposes of the Bankruptcy (Scotland) Act 1985.

90. Under trust law pension scheme trustees have to act in the interests' of all the members and beneficiaries of the pension scheme. Failure to comply with pension legislation is sanctionable by Opra. Members also have recourse to the Pensions Ombudsman, and ultimately to the courts.

Consultation

Within Government

91. Ministers and officials within the Department for Work and Pensions sought the views of Ministers and officials within HM Treasury, the Department of Trade and Industry and the Insolvency Service and obtained advice from the Government Actuary's Department in drawing up these proposals and the Regulations.

Public consultation

92. The Department sought the views of the CBI and the IoD on this proposal prior to issuing draft Regulations.

93. Draft Regulations based on option 3 were developed. These draft Regulations were published on 3 September 2004, and a six week consultation was held.

94. There were 19 responses to the consultation. Of these, two people wrote in an individual capacity and 17 respondents had some professional pension knowledge or are involved in the pensions industry.

Monitoring and review

95. This measure is one of a number of measures that the Government is introducing to increase protection for members of pension schemes. These measures need to be monitored and reviewed as a complete package. Therefore, there will not be specific monitoring arrangements put in place solely for this individual measure; the monitoring of this measure will be covered by the arrangements made for the improved member protection measures as a whole.

96. The Department for Work and Pensions has an ongoing programme of economic analysis and social research covering pension provision and public knowledge, attitudes and behaviour towards pensions and saving for retirement.

Summary

97. The Government considered the views expressed in the responses to the consultation on the draft Regulations. As a result, slight adjustments were made to the Regulations as they appeared in draft.

98. Specifically, amendments were made to the disclosure requirement being inserted into the Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847). This disclosure requirement has been extended to cover those schemes in wind up whose sponsoring employer is insolvent. The draft Regulations made this provision applicable only to schemes in wind up with solvent sponsoring employers.

99. The disclosure requirement now says that members requesting a guaranteed cash equivalent whilst their scheme is winding up should be informed that the value of their guaranteed cash equivalent may be affected by the scheme's winding up; a decision to take a guaranteed cash equivalent should be given careful consideration; and the member should consider taking independent financial advice before deciding whether to take the guaranteed cash equivalent.

100. An amendment has also been made to the note at the end of the Actuarial Certificate shown in schedule 1 of the Deficiency Regulations. This changes the note, so that it now reads: "The valuation of the amount of the liabilities of the scheme *may* not reflect the *actual* cost of securing all of those liabilities by the purchase of annuities, if the scheme were to have been wound up on the date as at which the valuation is made."

101. The other changes made were minor and technical, and do not change the effect of the Regulations.

<u>Recommendation</u>

102. The Government wants to improve the protection afforded to members of salary-related occupational pension schemes, whilst taking care not to place unnecessary burdens on employers.

103. It is the Government's view that option 3 will achieve this objective and the objectives set out at the beginning of this RIA. The Regulations reflect option 3.

Declaration

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

Signed ....

Date: 19 January 2005

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