Title: Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2018	Post Implementation Review
PIR No: RPC-DWP-5258(1)	**Date: 31/01/2023**
Original IA/RPC No: DWP2018_01	**Type of regulation: Domestic**
Lead department or agency: DWP	**Type of review: Statutory**
Other departments or agencies: **N/A**	**Date measure came into force:** **06/04/2018**
	Recommendation: Keep
Contact for enquiries: **pensions.review@dwp.gov.uk**	**RPC Opinion: Green**

1. What were the policy objectives of the measure?

The policy objectives for the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2018 (S.I. 2018/237)[1] (the 2018 Regulations) were to ensure that all types of employers in multi-employer occupational pension schemes were given feasible opportunities to manage their employer debt liabilities in a way that minimised the associated costs and economic distress to business, whilst keeping the interests of their pension scheme members sufficiently protected. In this way the regulations provided a cost saving measure for employers.

The intended effect was to help businesses, especially small and medium sized businesses, and non-profit organisations avoid unnecessary economic distress and prevent deterioration of their businesses. Being able to defer the payment of the employer debt means that money that may have been used to pay the debt can be used immediately within the business.

The Regulations provided for deferred debt arrangements (DDAs), which are an easement to the employer debt provisions in occupational pensions legislation. There were other easements available before the introduction of DDAs; however, DDAs can be used by non-associated employers, whereas the other easements were not available to these types of employers.

2. What evidence has informed the PIR?

The 2018 Regulations and previous related requirements in the Occupational Pension Schemes (Employer Debt) Regulations 2005 (S.I. 2005/678)[2] (the 2005 Regulations) were reviewed; together with the Impact Assessment[3] to the 2018 Regulations, as required by regulation 19 of the 2005 Regulations.

Evidence was obtained from the Pensions Regulator on the DDAs made available to schemes when the 2018 Regulations came into force. This included the number of DDAs entered into, the number of schemes who used a DDA and the date when the Regulator was notified of each DDA.

[1] The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2018 (legislation.gov.uk) https://www.legislation.gov.uk/uksi/2018/237/contents/made
[2] The Occupational Pension Schemes (Employer Debt) Regulations 2005 (legislation.gov.uk) https://www.legislation.gov.uk/uksi/2005/678/contents
[3] The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2018 - Impact Assessment (legislation.gov.uk) https://www.legislation.gov.uk/uksi/2018/237/impacts

For almost all of the DDAs, the Regulator provided information on the amount of the employer debt covered and information on the employers who had used a DDA; including the type of employer, the size of the employer, the number of employees and the status of the employer (e.g. whether still operating).

3. To what extent have the policy objectives been achieved?

The policy objectives have been fully met. However, the level of savings achieved is lower than the savings estimated in the Impact Assessment to the 2018 Regulations. This is because whilst the usage of DDAs has been higher than estimated, the value of the employer debts has been lower.

Since the introduction of DDAs an average of five have been used each year, with an average aggregate employer debt value of £4.4 million per year. This compares with the predicted three DDAs a year covering employer debt of £25 million per year.

The Impact Assessment estimated that a saving of £83.1 million would be achieved. However, on average, DDAs have saved £13 million[4]. The lower amount of employer debts and savings achieved may be due to a number of factors, which may, in part, include improved funding levels in defined benefit pension schemes over the past five years.

As demonstrated by the data from the Pensions Regulator, small and medium sized businesses and non-profit organisations have used DDAs. Where the number of people employed by employers using DDAs was known, all had fewer than 130 employees except one. The easements available before DDAs were introduced could not be used by many of these employers.

DDAs have enabled these types of employers to manage their employer debt liabilities in a way that minimises costs and economic distress and avoids deterioration of their businesses, whilst keeping the interests of pension scheme members sufficiently protected.

(See narrative below for more data.)

Sign-off for Post Implementation Review: Chief economist/Head of Analysis and Minister

I have read the PIR and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: Date: 24/01/2023

Andrew Ward, DWP Deputy Chief Economist on behalf of DWP Chief Economist

[4] While the analysis used in the IA was based on a 10-year period, as the first DDA was used in 2019 changes over the next 5 years could result in differences between the value of the current estimated figures and any future figures.

Signed: Date: ***27/03/2023***

Laura Trott MBE MP, Minster for Pensions

Further information sheet

Please provide additional evidence in subsequent sheets, as required.

4. What were the original assumptions?

The assumptions from the Impact Assessment were:

The benefits to businesses were calculated by comparing the before and after time profiles of employer debt payments using a 3.5% discount rate, in line with the Government's Green Book.

The Impact Assessment stated that the estimated impacts were highly uncertain and particularly sensitive to the following key assumptions:

- Only employers sponsoring multi-employer schemes where the employers are non-associated and the schemes have what is known as a 'last-man-standing' (NALMS) structure will benefit.
- 0.05% of all employers sponsoring schemes with a NALMS structure would have an employment cessation event (this event could give rise to an employer debt) and would make use of the proposed option every year over the next 10 years.
- On average, schemes that have an employment cessation event have the mean level employer debt across the whole NALMS population.
- Employer debt estimated on the full buy-out basis is equal to 140% of the same underlying debt, but estimated on the Statutory Funding Objective (SFO), also known as Technical Provisions, basis. This is in line with the rule of thumb that DWP and its Arms Length Bodies tend to apply when illustrating defined benefit pension scheme deficits on different bases.
- Deficit Reduction Contributions (DRCs) last for 8 years (the average length of a DRC observed across defined benefit schemes where it is used to reduce the shortfall in funding in an ongoing scheme).

(See narrative below for explanation of terms and background.)

5. Were there any unintended consequences?

Neither the Department for Work and Pensions nor the Pensions Regulator are aware of any negative unintended consequences in the use of DDAs, and none have been reported by external organisations or by schemes.

DDAs are likely to be medium to long term arrangements and therefore it is possible that any unintended consequences may not arise until later in the process. The 2018 Regulations came into force in April 2018 and the first DDA was notified to the Pensions Regulator in May 2019.

No schemes or employers that have used the process have expressed any concerns or difficulties to DWP.

6. Has the evidence identified any opportunities for reducing the burden on business?

DDAs were designed to save employers money, as they mean that employers can make payments over several years and defer having to pay all of the employer debt at once in one payment. These objectives remain appropriate.

The evidence obtained suggests that DDAs are saving employers money. Whilst the saving is lower than predicted, a total of £13 million compared to £83.1 million in the Impact Assessment, there have been more instances of use than estimated. The lower value of debts deferred may be, in part, due to improved funding levels in defined benefit schemes over the past five years.

The evidence obtained did not identify further opportunities for reducing the burden on business. There are several other types of easements to employer debt already in place, which are used by schemes. The Government has not identified other methods that could achieve the objectives in a way that is less onerous for business; however, the Government will keep this area of legislation under review.

7. How does the UK approach compare with the implementation of similar measures internationally, including how EU member states implemented EU requirements that are comparable or now form part of retained EU law, or how other countries have implemented international agreements?

The Department is not aware of any comparable measures internationally or in the EU.

Post Implementation Review of Deferred Debt Arrangements

Requirement for review

Section 19 of the Occupational Pension Schemes (Employer Debt) Regulations 2005, inserted by the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2018 (S.I. 2018/237), requires the Secretary of State to carry out a review of the statutory provisions relating to deferred debt arrangements and publish a report setting out the conclusions of that review every 5 years. The first review must be published before 6 April 2023.

Background

Where an employer, who is participating in a multi-employer[5] occupational defined benefit (DB) pension scheme, ceases to employ any active members[6] in the scheme (for example an employer's last active member in the scheme retires), at a time when at least one other participating employer continues to have employees who are active members[7], legislation sets out the requirements for what is commonly known as an "employer debt", which becomes payable by the "departing" employer to the pension scheme.

The basis of the employer debt is the difference between the value of the assets that the scheme holds and the estimated cost of buying out all of the scheme's pension liabilities with an insurance company (the "full buy-out" level). If the scheme is estimated to be in deficit on that basis the "departing" employer will be liable to pay a certain proportion (its share) of that difference. The rationale behind this requirement is to safeguard the funding of the pension scheme when the link to the employer has been broken.

Before the legislative change in the 2018 Regulations, DWP was provided with evidence that employers within non-associated[8] multi-employer schemes, who are often smaller businesses or non-profit organisations, were less likely to be able to take advantage of arrangements within the existing legislation whereby only part of the employer debt, or no employer debt, may be payable by the "departing" employer. This could be because they have no other employer (associated employer) to transfer the debt to, so could not use one of the existing arrangements or did not intend to keep any active members in the scheme, so could not make use of the period of grace arrangement.

DWP judged that legislative intervention was needed to ensure that all types of employers in multi-employer schemes were given feasible opportunities to manage their employer debt liabilities in a way that minimised the associated costs and economic distress to business, whilst keeping the interests of pension scheme members sufficiently protected.

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[5] Multi-employer scheme means a scheme in relation to which there is more than one employer.
[6] Active member – in relation to an occupational pension scheme, means a person who is in pensionable service under the scheme.
[7] The situation is called an 'employment cessation event'.
[8] Non-associated multi-employer scheme – scheme where in general the employers are from unconnected businesses or organisations.

When using a deferred debt arrangement (DDA) employers remain liable for their scheme liabilities and an associated future stream of deficit repair contribution (DRC) payments. These contributions are made by employers to make up the deficit in an underfunded scheme over a specific period of time.

DRCs have been used for shortfalls in funding in ongoing pension schemes. In this situation the funding is calculated on the Statutory Funding Objective (SFO) basis, also known as Technical Provisions basis. This funding level is noticeably lower than the full buy-out level.

DDA evidence

Number of DDAs

Since the introduction of the Regulations in April 2018 the Pensions Regulator has been notified of DDAs being used on 26 occasions by the end of October 2022, an average of five per year. Of the 26 employers that have used a DDA, they participated in eight different schemes, meaning that, on average, two different schemes used DDAs each year.

The Impact Assessment[9] published to accompany the Regulations in 2018 estimated that, on average, three employers a year would use a DDA. Based on use to date, on average, more DDAs were used per year than was predicted.

Level of employer debt

At the time of notifying the Regulator of a DDA scheme trustees estimate the amount of the employer debt that the “departing” employer owes. The value of the debts covered by the 26 DDAs varied widely ranging from £4,900 to £4,223,000, with seven employers having debts of over £1m and seven under £100,000.

The Impact Assessment to accompany the Regulations estimated that the aggregate debt size between the three employers who would use a DDA per year would be £25 million. Based on the data to date, on average, the aggregate debt value between the five employers was £4.4 million per year.

Employers using a DDA

The Pensions Regulator has provided information on the type and size of the “departing” employers using DDAs. Of these employers, 15 were private companies, one a public company, two societies, two charities and six were not known.

The annual income of these employers ranged from £500,000 to £1,166m, and the number of employees employed by them ranged from 1 to 3,531. This highest number of employees was an outlier, as, where the number of people employed was known, all had fewer than 130

[9] Whilst the analysis used in the IA is based on a 10-year period, as the first DDA was done in 2019 changes over the next 5 years could result in differences between the value of the current estimated figures and any future figures.

employees except this one. Where the status of the employer was known, 19 were active, one was in administration and one was being wound up.

There was limited information available on some of the DDAs.

The DDA provisions were introduced with the aim of particularly assisting smaller employers and non-profit organisations. From the evidence to date the provisions appear to have achieved this aim.

Saving to business

The saving to business from the DDA provisions is achieved through employers being able to defer paying the employer debt they are liable for.

Using the basis of the analysis used in the Impact Assessment accompanying the 2018 Regulations, we re-ran the calculations inputting the actual value of employer debt per year, which was lower than had been estimated in the Impact Assessment.

The saving was estimated by comparing the future value of the employer debt at the end of the DDA period with the present value of the debt (if it were to be paid right now), as per the methodology used in the Impact Assessment. We estimate that the amount saved on a cumulative basis over the appraisal period will be £13 million[10]. This assumes that the current levels of DDAs in the first 5 years were to continue over the whole 10 year period.

£13 million covers the total debt saving for employers. In order to estimate how much saving this translates to per year we divided the total debt saving of £13 million by 8. This is the average length of a recovery plan (as the earliest DDA was in 2019 we do not know how long DDAs will last, so we have used the Impact Assessment model assumptions). This gives a saving of £1.6 million per year.

Per employer - amount saved

Based on the evidence to date, the average size of the employer debt where a DDA was used was £900,000 per employer.

Whilst 26 DDAs were used, we have data on the value of the employer debt for 24 of these DDAs. The cumulative saving from using a DDA comes to £13 million. Therefore, the average saved per employer is £500,000.

The amount saved by employers per scheme averages £1.6 million.

Costs incurred

[10] We can only provide an estimate on how much schemes will have saved as the earliest DDA was in 2019.

Schemes and employers may have incurred some expenses by entering into DDAs. These would be mainly advisory costs at the point of entering a DDA, but there might also be costs incurred by the scheme in the ongoing monitoring of the employer. Trustees are under a continued obligation after entering into the DAA to monitor the “departing” employer’s covenant closely to ensure it is unlikely to weaken materially in the next year, in which case they must terminate the DDA.

This contrasts with the position in the Impact Assessment, where it was assumed that there would be no additional costs incurred by entering into a DDA.

Barriers to using DDAs

Schemes may find they have to do additional work to monitor the covenant of the employer covered by a DDA and there is possible reputational risk the trustees might assume for terminating a DDA in relation to covenant concerns. These concerns could result in the departing employer’s insolvency or could potentially deter parties from choosing the DDA mechanism. However, the Government considers these to be appropriate safeguards for the use of the DDA.

Funding position in DB pension schemes

Over the last five years the funding position of DB schemes has improved. The funding position of DB schemes reflects the relative value of their assets and liabilities. Both depend on markets and can be volatile. On a PPF-level funding basis, the aggregate funding ratio was 113.1% as at March 2022. This is a substantial improvement from five years ago, by 22.6%, as the aggregate funding ratio was 90.5% as at March 2017. The aggregate funding ratio is the level of funding in DB schemes measured using the PPF level of funding. (See table below for yearly breakdown of aggregate funding ratio.) The PPF level of funding is significantly lower than the full buy-out level used for employer debt.

Since 2018 there has been a broad improvement in scheme funding, most notably since 2021. However, there was a worsening in 2020 at the height of the impact of covid on markets.
The number of schemes in deficit as at April 2022 was 1,752, whilst 3,379 schemes were in surplus.

The total liabilities in 2017 in DB schemes on a PPF-level funding basis was £1.7 trillion. Most recently the total liabilities in these schemes was estimated at around £1.5 trillion. Therefore, many schemes have seen a noticeable reduction in the value of their liabilities. This strengthens the scheme funding position in schemes. However, it should be noted that estimates of the current value of pension liabilities can be particularly volatile, as they are sensitive to changes in inflation rates and interest rates.

Generally, the value of liabilities in DB schemes have fallen faster than the value of their assets over the last 2 years. This has improved the funding ratio in schemes. This may go some way to explaining why the levels of employer debt covered by DDAs to date are lower than was anticipated in the Impact Assessment that accompanied the 2018 Regulations. It may also account for why the savings achieved to date have been lower than anticipated in the Impact Assessment.

There are likely to be a number of factors that contribute to the levels of employer debt and savings for employers being lower than the Impact Assessment estimated. However, if the savings are lower due to lower levels of employer debt, because the funding position in schemes has improved, this is a positive outcome.

If a DDA is terminated, there are a number of instances in which an employment cessation event will be deemed to have occurred, which will trigger an employer debt. This debt could be higher or lower than the debt that had been calculated when the DDA was entered into. If the funding position in the scheme has strengthened it is likely that the level of employer debt will be lower than anticipated.

	Aggregate Funding Ratio
2018	95.7%
2019	99.2%
2020	94.9%
2021	102.8%
2022	113.1%

Source: PPF Purple Book 2022[11]

Compliance and enforcement assessment

Based on the information provided to the Pensions Regulator when schemes have notified them of DDAs, it would appear that trustees are taking professional advice before they enter into these arrangements to ensure that they comply with all of the regulatory requirements associated with DDAs.

Impacts on small and micro businesses

There has only been one DDA by an employer with more than 150 employees (excluding where the information is not available). This would indicate that the uptake of DDAs has been more prevalent with smaller employers. It would appear that small businesses are particularly benefitting from DDAs and the savings they offer.

[11] https://www.ppf.co.uk/sites/default/files/2022-11/PPF_PurpleBook_2022pdf

Views of the Government

The Government believes the DDA provisions are working as intended, as they have been used by a variety of schemes and employers since they became available, upon consideration of the various conditions attached to their use. They have been particularly beneficial for small employers and non-profit organisations.

The Government considers that DDAs have been a useful easement, particularly for schemes and employers that were unable to use the other easements that were already available. Whilst the level of saving to business achieved is lower than estimated in the Impact Assessment that accompanied the 2018 Regulations the improved funding position in DB schemes is likely to have contributed to this. This is positive as it means that the level of employer debt that employers are responsible for is lower.

Similar measure

There is a similar mechanism to DDAs available for employers in the Local Government Pension Schemes (LGPS). This can be found in regulation 64 of the LGPS Regulations 2013 (as amended) and is referred to as a 'deferred debt agreement'.

The Government introduced deferred employer status and deferred debt agreements in the LGPS in September 2020 following a consultation. Statutory guidance was also published at this time. The administering authority will use a number of key factors to consider whether to enter into a deferred debt agreement with an employer, taking account of actuarial advice, as well as any other advice the administering authority may consider necessary.

In addition, the Scheme Advisory Board has published administrative guidance for administrative authorities and their employers on the scheme website.

For the Government response to the consultation and the statutory guidance see: Local government pension scheme: changes to the local valuation cycle and management of employer risk - GOV.UK (www.gov.uk)[12]

[12] https://www.gov.uk/government/consultations/local-government-pension-scheme-changes-to-the-local-valuation-cycle-and-management-of-employer-risk