

Summary: Intervention & Options

Department /Agency: DWP	Title: Impact Assessment of Amendment to Employer Debt Regulations	
Stage: Final/Implementation	Version: 12/03/08	Date: 12 March 2008
Related Publications: Amendment The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008		

Available to view or download at: <http://www.dwp.gov.uk/consultations/2007>

Contact for enquiries: Allyson Brook

Telephone: 0113 2519823

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

When employers sever links to a defined benefit (DB) scheme, the Regulations require them to pay their scheme debt at full buy out levels. For multi-employer schemes, withdrawal arrangements are allowed, but these are criticised for being too rigid and for having technical problems. There has been concern about the risk of scheme abandonment by employers abusing a third option of apportionment. The issues can only be resolved by amending the current Regulations to make withdrawal arrangements easier to use, to prevent misuse of the apportionment rule, and to resolve a number of more technical issues.

What are the policy objectives and the intended effects?

The Employer Debt Regulations have the following objectives:

- to make the Employer Debt Regulations more flexible and easier for employers and schemes with changes to the withdrawal arrangements and changes to employment cessation events specifically designed to help small employers and charities;
- to protect scheme members and the Pension Protection Fund (PPF) from the risk of employers abandoning their schemes.
- to ensure the best financial result for the PPF in the event of some insolvencies.

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

- **Withdrawal Arrangement (WA):** Simplified version with no Regulator oversight. Otherwise all WAs including those for departing employers who paid debts up to scheme funding level would unnecessarily require costly Regulator approval.
- **Apportionment:** Tighten apportionment regulation to frustrate abandonment whilst allowing corporate transactions to continue. Otherwise apportionment likely to be abused leading to scheme abandonment.
- **Introduce a 12 month period of grace:** Debt will not be triggered if an employer has no active members but expects to have one within the period. Otherwise Employment Cessation Event occurs inappropriately in period with no employee.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 2011

Ministerial Sign-off For final proposal Impact Assessments:

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

Signed by the responsible Minister:

..... Date:

Summary: Analysis & Evidence

Policy Option: Withdrawal Arrangement	Description: Withdrawal Arrangement (WA): A simplified version of the current withdrawal arrangement without reference to the Regulator
--	--

COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' The introduction of simplified Withdrawal Agreements will give trustees and employers a further option. There will, therefore, be no additional costs to the Regulator, employer or trustees.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 5px;">One-off (Transition)</td> <td style="width: 30%; text-align: center; padding: 5px;">Yrs</td> </tr> <tr> <td style="padding: 5px;">£ 0</td> <td></td> </tr> </table>		One-off (Transition)	Yrs	£ 0	
	One-off (Transition)		Yrs			
	£ 0					
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 5px;">Average Annual Cost (excluding one-off)</td> </tr> <tr> <td style="padding: 5px;">£ 0</td> </tr> </table>	Average Annual Cost (excluding one-off)	£ 0				
Average Annual Cost (excluding one-off)						
£ 0						
Total Cost (PV)		£ 0				
Other key non-monetised costs by 'main affected groups'						

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' Reduction in both the costs of complying with regulations and administrative costs are expected for both employers and trustees through a simplified process that does not involve seeking approval from the Regulator. For each WA, savings expected for employers who avoid legal costs of current WAs of between £38,000 and £58,000, and actuarial reporting costs of £10,000. Regulatory reductions could not readily be quantified. Total savings per case £13,800 - £15,800 x 38 cases.				
	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 5px;">One-off</td> <td style="width: 30%; text-align: center; padding: 5px;">Yrs</td> </tr> <tr> <td style="padding: 5px;">£ 0</td> <td></td> </tr> </table>		One-off	Yrs	£ 0	
	One-off		Yrs			
	£ 0					
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%; padding: 5px;">Average Annual Benefit (excluding one-off)</td> </tr> <tr> <td style="padding: 5px;">£ 520,000-600,000</td> </tr> </table>	Average Annual Benefit (excluding one-off)	£ 520,000-600,000				
Average Annual Benefit (excluding one-off)						
£ 520,000-600,000						
Total Benefit (PV)		£ 4.3 million				
Other key non-monetised benefits by 'main affected groups' The key 'other' benefits from these simplified WAs which do not involve the Regulator will be that employers sponsoring DB pension schemes are likely to perceive this legislation as more flexible and possible to use. Difficulty in using had been a complaint often levelled against current WAs.						

Key Assumptions/Sensitivities/Risks The overall savings expected from using the proposed regulations assume that 75% of the average historical number of around 50 withdrawals per year will take advantage of these simplified withdrawal arrangements.

Price Base Year 2007	Time Period Years 10	Net Benefit Range (NPV) £ 4.0-4.6 million	NET BENEFIT (NPV Best estimate) £ 4.3 million
-------------------------	-------------------------	---	---

What is the geographic coverage of the policy/option?	UK								
On what date will the policy be implemented?	6 April 2008								
Which organisation(s) will enforce the policy?	Pensions Regulator								
What is the total annual cost of enforcement for these organisations?	£ not available								
Does enforcement comply with Hampton principles?	Yes								
Will implementation go beyond minimum EU requirements?	N/A								
What is the value of the proposed offsetting measure per year?	£ 0								
What is the value of changes in greenhouse gas emissions?	£ 0								
Will the proposal have a significant impact on competition?	No								
Annual cost (£-£) per organisation (excluding one-off)	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%; text-align: center;">Micro</td> <td style="width: 15%; text-align: center;">Small</td> <td style="width: 15%; text-align: center;">Medium</td> <td style="width: 15%; text-align: center;">Large</td> </tr> <tr> <td style="padding: 5px;">Are any of these organisations exempt?</td> <td style="text-align: center;">No</td> <td style="text-align: center;">No</td> <td style="text-align: center;">N/A</td> </tr> </table>	Micro	Small	Medium	Large	Are any of these organisations exempt?	No	No	N/A
Micro	Small	Medium	Large						
Are any of these organisations exempt?	No	No	N/A						

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	Net Impact £ 0

Key: Annual costs and benefits: (Net) Present

Summary: Analysis & Evidence

Policy Option:
Apportionment

Description: Apportionment: Make changes to apportionment regulation to frustrate abandonment whilst allowing

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' The aim is to not increase costs. The changes suggested bring the regulatory framework in line with current good practice. There are no anticipated additional regulatory costs as many of the new requirements are already good practice.
	One-off (Transition)	Yrs	
	£ 0		
	Average Annual Cost (excluding one-off)		
	£ 0		Total Cost (PV) £ 0
Other key non-monetised costs by 'main affected groups' The new requirements are in line with the requirements already set in current guidance. No further regulatory costs are expected.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' The typical debt of a pension scheme likely to be at risk of abandonment was estimated at £60million, with potential for one such abandonment every three years, and costs usually borne by the PPF. The likely PPF savings from proposed changes are thus around £20m per year. This annual estimate should, however, only be considered as indicative as costs depend on scheme size.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 20 million		Total Benefit (PV) £ 154 million
Other key non-monetised benefits by 'main affected groups' The main benefit is that the regulations will make it more difficult for employers to abandon their schemes. This will be beneficial to scheme members and also to the Pension Protection Fund. It will benefit all Pension Protection Fund levy payers. Abandonment is regarded as evasion and as such any cash saved by employer is not considered a social benefit.			

Key Assumptions/Sensitivities/Risks Estimates of increased regulatory or administrative costs have not been made in relation to the changes to apportionment as many of the requirements are already good practise. The costs for the risk of abandonment can only be seen as indicative as this practise would be unethical and difficult to robustly quantify.

Price Base Year 2007	Time Period Years 10	Net Benefit Range (NPV) £ -	NET BENEFIT (NPV Best estimate) £ 154 million
-------------------------	-------------------------	---------------------------------------	---

What is the geographic coverage of the policy/option?		UK	
On what date will the policy be implemented?		6 April 2008	
Which organisation(s) will enforce the policy?		Pensions Regulator	
What is the total annual cost of enforcement for these organisations?		£ not available	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£ 0	
What is the value of changes in greenhouse gas emissions?		£ 0	
Will the proposal have a significant impact on competition?		Yes/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 £ 0	Decrease of £ 0	Net Impact	£ 0

Key: Annual costs and benefits: Constant Pr

Summary: Analysis & Evidence

Policy Option: Cessation Event

Description: Allow 12-month grace period triggered if employer has no active members within the period.

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' The regulations offer an option for some employers and will therefore not add further costs. The cost to trustees should be negligible as the debt is delayed and there could be some savings in not chasing very small debts.
	One-off (Transition)	Yrs	
	£ 0		
	Average Annual Cost (excluding one-off)		
	£ 0		Total Cost (PV) £ 0
Other key non-monetised costs by 'main affected groups' There may be the risk that the period of grace would be abused by employers. It is believed that the limited 12-month timescale should prevent this.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Following the new proposals, employers will not have to pay the debt up front, that is accidentally triggered. Normally this debt would be due over the course of time and would be covered by employer and employee contributions, and investment returns. When the debt is triggered accidentally, it is assumed that employers have to borrow up front to pay the debt that would normally be paid over time. The additional cost to the employer is the interest on this loan and the benefit (as estimated here) represents the value of this interest, which no longer needs to be paid as a result of the proposals.
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 94,000-125,000		Total Benefit (PV) £ 840,000
Other key non-monetised benefits by 'main affected groups' There would be a legal right for the employer to remain part of the scheme for a period of twelve months after ceasing to have active members. This would be particularly useful among small employers and charities, where it is often usual for pension schemes to have only one or two active members. Under the current rules, even though the only additional cost to the employer is the interest on the debt, having to pay the debt up-front could cause significant cash flow problems for some employers; these problems are eased by the proposed regulations			

Key Assumptions/Sensitivities/Risks The number of unintentional and unnecessary cessation events triggered annually by small employers was estimated to be between 150 and 200, with the overall debt triggered by each such event estimated to be around £10,000. Employers are assumed to borrow money to pay this debt, at a rate of interest of 6.25%, one percentage point above the current Bank of England base rate There is a risk that the provision could be used as a loophole to avoid the debt. However, it is believed that the time-limiting provisions in the legislation combined with the scrutiny of trustees will minimise this risk.

Price Base Year 2007	Time Period Years 10	Net Benefit Range (NPV) £ 720,000-960,000	NET BENEFIT (NPV Best estimate) £ 840,000
-------------------------	-------------------------	---	---

What is the geographic coverage of the policy/option?		UK	
On what date will the policy be implemented?		6 April 2008	
Which organisation(s) will enforce the policy?		Pensions Regulator	
What is the total annual cost of enforcement for these organisations?		£ not available	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£ 0	
What is the value of changes in greenhouse gas emissions?		£ 0	
Will the proposal have a significant impact on competition?		Yes	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium
Are any of these organisations exempt?	No	No	N/A
			Large

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of £ 0	Decrease of £ 0	Net Impact	£ 0

Key:

Annual costs and benefits: Constant Prices

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Background

Current regulations

The Employer Debt Regulations, which came into force in two stages in 2005, set out requirements for employers of both single and multi-employer Defined Benefit (DB) schemes to pay their debt when severing their relationship from such schemes. The employer debt is calculated at full buy out level but with the facility for withdrawal arrangements from multi-employer schemes to be put in place provided The Pensions Regulator (TPR) approved. These arrangements allow an amount less than full buy out to be paid by the exiting employer supported by a guarantee that the balance up to the full buy out level will be paid if required at a future date. In many multi-employer schemes, which have the appropriate rule, there is the third option of apportionment. In such cases the employer exits a multi-employer scheme with that employer's debt apportioned (i.e. shared amongst) to the remaining employers. In some instances this may be apportioned to a nominal or nil amount.

Reason for proposed changes

Pension schemes and employers have told us that some aspects of the current rules create unnecessary *difficulties* for multi-employer schemes. At the same time, TPR has been concerned that other aspects of the current rules make it too easy for employers to avoid their debts. The amendments detailed in this document are intended to effect a balance between these opposing camps – so both facilitating legitimate corporate activity and protecting members' pension expectations. Without the proposed regulations current rules on apportioning pension scheme debts could be exercised in ways that endanger members' pension entitlements.

Other adverse influences on provision of DB Pension Schemes

It is the Department's policy to put in place legislation which supports employers in providing DB pension schemes for their employees. These proposals for amendments to Employer Debt regulations go some way towards facilitating employers to continue supporting such schemes. However there are other demographic and regulatory issues which could adversely impact on real or perceived liabilities of these DB pension schemes. These issues are likely to be seen as detractors for employers from maintaining their DB schemes. They include revised mortality / longevity assumptions which will extend the average life expectancy of members thereby increasing the average time and costs for schemes funding members' pensions. Additionally, if adopted, recent proposals from the Accounting Standards Board are expected to have a net effect of increasing the liabilities recorded in both corporate and pension scheme accounts. The impacts here – while more perceptual – are also likely to detract from employers' willingness to continue their DB provision.

Policy Options and Financial Consequences

The proposals for replacing the current arrangements would have a positive financial impact on the pensions industry. There is very limited information on which to base reliable estimates of the costs and benefits of these proposals, and estimates must therefore be regarded with considerable caution. As introduced above, such estimates would also be affected by revised economic assumptions of investment type, and by demographic factors (such as revised mortality expectations). Other relevant issues impacting DB scheme costs include future

changes in economic conditions (such as stock market movements), and by changes in the membership of defined benefit schemes.

Consultation

On 7 August, the Government undertook a consultation exercise on the draft Employer Debt (Amendment) Regulations. Over 60 written responses to the consultation were received. These were mainly from pension scheme advisers such as lawyers, actuaries, benefit consultants and insurance companies. Comments were also received from employers sponsoring pension schemes and trustees in relation to pension schemes. The Government's response will be available shortly to view or download at <http://www.dwp.gov.uk/resourcecentre>.

The majority of the responses received were broadly welcoming of the substantive changes, such as clear rules on powers to apportion debts and the introduction of more options for managing a debt arising when an employer – for whatever reason – stops sponsoring a pension scheme.

It is believed however, that some stakeholders may find the prospect of restructuring even more regulated than before because of the additional safeguards that have been put in place regarding apportionments. Additionally, in certain circumstances (particularly those where there is no appropriate guarantor available) the debt on the employer will continue to be a major hurdle to be overcome in transactions and corporate restructurings. It is intended to further consider these issues in 2008 together with the recommendations made in the Deregulatory Review.

Withdrawal Arrangements(WA) and Approved Withdrawal Arrangements (AWA)

Currently, an exiting employer in a multi-employer scheme must meet its share of the full buy-out deficit unless a "withdrawal arrangement" is put in place, which is approved by the Regulator. These arrangements allow an amount less than full buy out to be paid (amount A), based on the scheme funding level (using the minimum funding requirement level or scheme specific funding). This allowance has to be supported by a guarantee up to the full buy out level (amount B).

The Withdrawal Arrangement (WA), which is a simplified version of the earlier withdrawal arrangement, will be introduced as the preferred option. The proposed WA should reduce the costs for employers of withdrawing from a scheme as trustees and employers could now enter into a WA without reference to the Pensions Regulator where:

- the exiting employer agrees to pay an amount (Amount A) equal to the difference between what is actually in the scheme and the scheme specific funding requirement; and
- the exiting employer puts in place a guarantor (agreed by the trustee) who will pay the difference (Amount B) between Amount A that the employer pays, and full buy-out level; and
- the trustees are satisfied that the remaining employers are able to fund the scheme so that it has sufficient assets to cover technical provisions.

There will also be flexibility for trustees to agree an amount A *lower* than meets the full scheme funding level. Such an agreement is now called an Approved Withdrawal Arrangement (AWA), because in such cases the approval of TPR will be required. This provision would be particularly helpful to ongoing organisations with low levels of liquidity such as charities.

Technical changes are also being made to the test TPR has to apply to be able to approve an AWA (currently TPR has to be satisfied that the debt is more likely to be paid by the guarantor than by the employer whose debt they are guaranteeing). This will resolve what stakeholders have identified as a significant barrier to using the existing withdrawal arrangements.

Financial Consequences

Costs to Industry

As proposed WAs will operate effectively in a similar way to current withdrawal arrangements there will be, for most employers, no savings in terms of the level of debt or the employer's cashflow. The savings lie in reduced administrative and regulatory costs for the process itself, as the proposed WAs should reduce the number of withdrawal arrangements requiring clearance from the Pensions Regulator.

It is understood that the legal costs for a withdrawal arrangement can vary between £15,000 and £90,000 depending on the advisors employed, the size of the employer/scheme, and the complexity of the arrangement. Collating and presenting all necessary figures to the Pensions Regulator incurs around £10,000 in actuarial costs. However, again, the complexity of the case and the relationship between trustees and employer can greatly influence the overall costs, which can range from £25,000 to £100,000.

Anecdotal evidence suggests a wide range of circumstances and ensuing costs for withdrawal arrangements. A feasible range for total legal costs was so estimated from £38,000 to £58,000. While only rough estimates can be made for costs incurred specifically for Regulator approval, it is understood these are around £10,000 for actuarial costs and about 10% of legal costs. This

would suggest savings of between £13,800 and £15,800 for the average withdrawal arrangement.

In 2006/07 the Pensions Regulator granted approval for 40 withdrawal arrangements to proceed. This was around a third lower than the previous recorded period (when there were 61 such approvals in the last 6 months of 2005/06). However, these higher figures in 2005/06 may reflect pent up demand as the withdrawal arrangement was then new having been introduced in September 2005.

Averaging TPR's approvals data over the period suggests around 50 Withdrawal Arrangements are entered into each year. Based on the nature of WAs seen by the Regulator, 75 per cent of all employers currently using Withdrawal Arrangements will be able to opt for the less costly version which no longer involves the Regulator. Overall annual savings to employers are therefore likely to range from £520,000 to £600,000.

Another change in these regulations involves easements to the Guarantor test where guarantors are no longer required to be more able to pay their guarantee than does the employer they are guaranteeing. This change will enable employers to find appropriate guarantors and so make better use of Withdrawal Arrangements than previously.

However, it is difficult to estimate what overall monetary savings would accrue from this change to the Guarantor's test. It is expected that this effect when combined with lower costs of WAs would lead to a further increase in the number of these arrangements not requiring Regulator approval. The real benefits are therefore likely to be higher than the range estimated above.

Costs to the Pensions Regulator

Schemes are currently required to be funded up to the Minimum Funding Requirement, but proposals will change this to the higher scheme specific funding level. This may generate some short-term increase in volumes for the Pensions Regulator as schemes reduce their deficits to meet this new higher level of funding. In so doing they may seek agreement from the Pensions Regulator for AWAs, but the Regulator intends to minimise this risk through its guidance. However, in the longer term there is expected to be less demand for Regulator involvement and some operational savings may even be gained.

Changes to apportionment regulation to frustrate abandonment whilst allowing corporate transactions

Turning to the second objective, proposals aim to provide maximum protection for scheme members and the PPF, whilst minimising the impact on employers pursuing their legitimate business. Whilst the vast majority of apportionments represent legitimate corporate restructurings and the pragmatic distribution of debt, there is a real risk that the process can be used for the unethical abandonment of a pension scheme.

Proposals are suggested which tighten the permitted use of the apportionment rule, thereby frustrating the ability of employers to abandon schemes while ensuring that corporate restructurings would not be negatively affected. This will be achieved by:

- overriding scheme rules so that apportionments can only take place in line with the scheme rules *and* with the trustees' applying a covenant test – so stopping principal employers having the sole power; and

- obliging trustees to ensure that they are satisfied that the remaining employers are able to fund the scheme so that it has sufficient assets to cover its technical provisions or liabilities.

While permitting legitimate business activity, proposed policy also prevents a debt being apportioned to weak employers or shell employers. Additional checks proposed in the apportionment process, add a requirement for trustees to be satisfied that the remaining employers are able to meet the costs of the scheme going forward. Proposals will however continue to allow debts to be apportioned to a nil or nominal amount as long as the covenant test can be met.

Changes also provide a series of checks in the apportionment process to better protect the interests of both scheme members and the PPF, as their respective interests are not necessarily the same, or even complementary. To this end Regulated Apportionments are proposed.

Regulated Apportionment

It is recognised that there are circumstances where it is in the best interests of scheme members and the Pension Protection Fund (PPF) for an apportionment to take place outside of the usual parameters. The current regulations permit debt to be apportioned in accordance with scheme rules, but without the Pensions Regulator involvement. There is thus no provision within current rules to allow for a regulated apportionment to happen. Changes suggested allow that a regulated apportionment (which involves the Pensions Regulator) will take place where a scheme:

- is in an assessment period; or
- where an assessment period is about to commence; and
- the Pension Protection Fund consider that the apportionment will result in a higher level of funding for the scheme than if an employer became insolvent.

These amendments are necessary because under changes proposed for apportionments the trustees cannot agree to these if the employer is unable to stand behind the scheme. The fiduciary duties of trustees do not currently protect the PPF and there could be cases where it is in the employees' interest for the scheme to go into the PPF if that will save their jobs.

In introducing regulated apportionments The Pensions Regulator (working closely with the PPF) is enabled to approve this type of apportionment. The PPF is a funding body rather than a regulatory authority, and such collaboration with the Pensions Regulator allows for a better financial outcome from the scheme than there would otherwise have been when the employer is insolvent. Such examples are rare but do cover LVM-type cases and therefore provide best value for the PPF. In such cases the PPF can reach an agreement with a company on the brink of insolvency in return for an equity share in this company. Normally when a debt has been re-apportioned in this way it could be construed that a compromise agreement has been reached by the trustees and the scheme is normally rendered ineligible for entry to the PPF. However, amendment to the entry rules allow regulated apportionments not to be considered as compromises for the purposes of the PPF. This represents best value for the PPF, and so is important to the PPF and to the schemes who will continue to be eligible for the PPF.

Following consultation, other conditions originally proposed for regulated apportionment have been simplified

Costs to Industry

The aim of the changes to the apportionment rules is to ensure that trustees are satisfied that the apportionment would not lead to abandonment. The aim is to do this while ensuring that regulatory and administrative costs are not increased. There would be no further costs imposed on schemes in calculating the actual level of debt or any new effect on cashflow.

The Pension Regulator's code of practice currently advises trustees that an early valuation might be appropriate "...particularly when a recovery plan is in place...". Similarly trustees are advised to revisit the funding documents where there is "...a significant improvement or decline in the employer's covenant." A valuation would normally cost around £40,000. Updating the check on the employer covenant (assuming it has already been completed for scheme funding purposes) would cost around £5,000. However, if a completely new valuation is needed the costs would be higher and could be in excess of £50,000.

The regulations do not force trustees to undertake a further valuation or to instigate a full scrutiny of the employer covenant. Indeed where the apportionment is a small adjustment and clearly does not have any material effect it is unlikely trustees would need formal reassurance. Where there is a significant change they should, in line with the code of practice, be checking the covenant and if necessary commissioning a valuation.

However, it is possible that the legal costs of an apportionment would increase initially as trustees and employers seek further advice in line with the new duties on trustees. However any extra costs are expected to be temporary.

Benefits

It is very difficult to quantify the risk of scheme abandonment with any certainty. It is difficult to estimate how often employers may seek to abandon their schemes and what their deficits may be. If a large scheme, with a large deficit at full buy out level was abandoned by its sponsoring employer, then the costs to the PPF could be very large. The deficit (at full buy-out level) of a typical pension scheme is estimated to be around £60 million. Abandonment is rare and it is assumed that such a scheme may potentially be abandoned once every three years, with an annual cost of £20 million to the PPF.

However, it should be stressed that the true impact would be dependant on a number of factors and subject to wide variation. Any change, for example, in the frequency of abandonment would have a large effect on the average annual costs. Furthermore, the size of the scheme and the size of its deficit would impact directly on costs with scheme debts ranging from thousands to hundreds of millions. The figure of £20 million can therefore only be taken as an indicator with caveats.

Period of grace

Proposals also seek to create a more flexible framework for employers as to whether they do trigger a cessation event. Currently when an employer ceases to have active members in a multi-employer scheme this counts as a cessation event and the employer is obliged to exit the scheme with the associated costs. A grace period of 12 months is proposed when a debt would not be triggered if an employer has no active members but expects to have one within the period. This would be helpful to some very small employers in multi-employer schemes, who have only one or two active scheme members due to their small payroll. The other advantage of this approach is that there would also be a legal right for the employer to remain part of the scheme for a period of twelve months after ceasing to have active members.

There are two main disadvantages of this approach which need to be balanced against each other. Firstly, there is some possibility that the twelve month period of grace would not give small employers enough flexibility in finding new employee who also joins their pension scheme. However, it is believed that 12 months should provide a reasonable period for most. There is

also the risk that the period of grace could be abused by employers. It is believed that the measures put in place protect against such abuse.

Financial Consequences

The measure should not entail further regulatory costs for trustees or employers as this would simply delay the triggering of the employer debt by 12 months. However, in cases where the debt would have been triggered inappropriately the regulations would result in savings to the employer. Ultimately the employer is liable for the debt; the problem with the current rules is that they could lead to the debt being brought forward unnecessarily, which may cause cash flow problems for the employer. Assuming employers borrow to fund this debt, the *additional* cost to them of doing so is the interest payments on the debt. Under the proposed regulations, the employer would have no interest to pay since the debt would no longer be accidentally triggered. This would have a positive effect on cash flow for the employer. Even in the case where the employer does not borrow (in which case there is no net cost to them, as all that is happening is that the debt is being brought forward), the employer might face significant cash flow problems in the short term. The proposed regulations will alleviate this problem. They will also relieve the trustees from the need to chase a small debt, which may lead to some small administrative savings for schemes. However, there is no information available to quantify these.

It is difficult to estimate the benefits of such a measure to employers in terms of removing the need to pay the debt. However, it is estimated there are around 150-200 occasions each year when a debt on a small employer is unnecessarily triggered because that employer has temporarily ceased having an active member of his pension scheme. The debts involved are usually small with the average probably around £10,000. Assuming an interest rate of 6.25% (one percentage point above the current Bank of England base rate) on this debt, the value of the savings arising from no longer having to pay these interest payments are expected to be around £94,000 to £125,000 per annum.

Equality and Fairness

It is not believed that there will be an impact on the equality strands as the proposals are not concerned with individuals, but with occupational pension schemes and their sponsoring employers. It has, however, considered each of the initial tests for the equality impact individually and are confident that this concern is not relevant here.

Human Rights

These regulations amend existing rules establishing how a debt is calculated and triggered for employers who have ceased sponsoring a defined benefit occupational pension scheme. These regulations would therefore have no direct effect on members. No effect on human rights is anticipated.

Small Firms Impact Test

The appropriate guidance has been consulted and these regulations will not have a negative effect on small firms. Indeed, the easing of the ways employers may generally make use of withdrawal arrangements and the introduction of the new (Regulator-free) Withdrawal Arrangement is expected have a positive impact on such employers (especially as some of the costs are fixed). The introduction of a period of grace before the triggering of the cessation event, where an employer ceases to have active members, is intended to benefit small employers. Thus any overall effect on small firms offering defined benefit pension schemes would be positive. There would be no effect on small firms not offering defined benefit pension schemes.

Competition Assessment

After looking at the four questions on the initial test no impacts on competition are foreseen, either directly or indirectly. Employers sponsoring defined benefit pension schemes would be affected by the amendments to the Regulations. The primary objective of the Regulations is to safeguard members' benefits. At the same time regulations will not place additional costs on the sponsoring employers which may be detrimental to their competitiveness when compared with other employers not offering defined benefit pension arrangements. An analysis of the effect of the preferred amendments to the Regulations suggests that the overall burden on sponsoring employers and schemes would be reduced.

On the other hand the option of completely removing the right for schemes to apportion their debts would have a detrimental effect on company restructurings and thus their competitiveness. This option to completely disallow apportionment of debts has also been previously rejected by Ministers. It is not therefore a currently recommended proposal.

Legal Aid

There will no impact on Legal Aid.

Sustainable Development, Carbon Assessment, Other Environment

It is not believed that there will be any impacts on these areas. The initial tests have been looked at and do not apply.

Health Impact Assessment

Having gone through the initial assessment, it is believed that there is no health impact.

Enforcement and Sanctions

The changes to the regulations would be regulated by The Pensions Regulator in accordance with its current powers.

Rural Proofing

Having looked at the initial test on rural proofing, it is believed there is no 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	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
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