

Summary: Intervention & Options

Department /Agency:

1. Department for Work and Pensions

Title:

2. Impact Assessment of the statutory overrides introduced by The Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009

Stage: Implementation

Version:

Date: 26 February 2009

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

Available to view or download at:

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

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

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

What are the policy objectives and the intended effects?

The aim is to enable trustees to amend scheme rules to take advantage of the reduced statutory indexation and revaluation caps. This will provide significant savings for defined benefit (DB) schemes, thus helping to maintain high quality DB provision. RPI inflation is currently well below 2.5% so there won't be benefits to employers and costs to employees in the short run - but pensions are a long term business and the changes are still appropriate. Changes to the revaluation cap are estimated to allow possible savings to schemes of between £250 million and £400 million over the long term.

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

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

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

2013

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

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

Signed by the responsible Minister:

William D McKenzie Date: 11 March 2009

Summary: Analysis & Evidence

Policy Option: Introduce override with reduction to revaluation cap

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

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

| | | | |
|--|--|------------|--|
| BENEFITS | ANNUAL BENEFITS | | Description and scale of key monetised benefits by 'main affected groups' Analysis suggests that if employers took advantage of the reduction in the cap to 2.5% it could lead to possible average savings of the order of £250 million per year (2007/08 prices), although savings could reach as much as £400 million in the long term. |
| | One-off | Yrs | |
| | £ 0 | | |
| | Average Annual Benefit (excluding one-off) | | |
| | £ 250million | | Total Benefit (PV) £ 4.4 billion |
| Other key non-monetised benefits by 'main affected groups' Employers sponsoring schemes- increased flexibility for schemes and sponsoring employers which might be expressed through improved scheme viability, higher wages and/or higher profits. | | | |

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

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

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

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

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

Summary: Analysis & Evidence

Policy Option: Introduce override for LPI

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

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

| | | | |
|--|--|---------------------------|--|
| BENEFITS | ANNUAL BENEFITS | | Description and scale of key monetised benefits by 'main affected groups' Employers will benefit from reduced scheme costs |
| | One-off | Yrs | |
| | £ 0 | | |
| | Average Annual Benefit (excluding one-off) | | |
| | £ 20 million | Total Benefit (PV) | £ 0.9 billion |
| Other key non-monetised benefits by 'main affected groups' Employers sponsoring schemes- increased flexibility for schemes and sponsoring employers which might be expressed through improved scheme viability, higher wages and/or higher profits. | | | |

Key Assumptions/Sensitivities/Risks

Long term inflation 2.9%

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

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

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

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

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

Evidence Base (for summary sheets)

Introduction

1. The Government announced a rolling deregulatory review of private pensions legislation in May 2006. As part of the review it appointed Chris Lewin and Ed Sweeney in December 2006 to act as external reviewers and to make recommendations for change. Their report, "Deregulatory Review of Private Pensions" containing recommendations for change, was published on 25 July 2007.
2. This impact assessment is an abridged and slightly amended version of the impact assessment published in conjunction with the Government's response to the reviewers' report which was published on 22 October 2007. The outcomes of the consultation on the Government's response to the reviewers' recommendations were published on 5 December 2007. This amended version of the impact assessment considers the following changes to legislation applying to occupational pension schemes:
 - Introduction of a power for trustees to modify scheme rules by resolution, where the employer consents, to enable rates or amounts (or ways of determining rates or amounts) in scheme rules to be changed following the reduction in the revaluation cap from 5% to 2.5% for future accrued rights (referred to as a "statutory override") as provided for in the Pensions Act 2008. This impact assessment considers the impact of the override alongside the introduction of the lower revaluation cap.
 - Introduction of a power for trustees to modify scheme rules by resolution, where the employer consents, to enable amounts (or ways of determining amounts) in scheme rules to be changed following the reduction in the cap on increases to pensions in payment (LPI) from 5% to 2.5% (referred to as a "statutory override") which came into effect from April 2005. The override would only apply for pensions accrued from a future date.

Background to the legislation on private pensions

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

Government objective

4. The Government are committed to reducing legislative burdens on employers but recognise that there needs to be a balance between reducing legislative complexity and making legislation simpler, and protecting pension scheme members' interests.
5. The Government also recognise that it is important there should be scope, where appropriate, for scheme rules to be amended to reflect any legislative easements.
6. Scheme rules set out the circumstances and conditions in which benefits may be paid to members. Some scheme rules allow very limited scope for amendment and may not provide for either employers or trustees of schemes to make amendments to reflect any subsequent changes to the legislative requirements which have already been incorporated into scheme rules. This leads to a form of "one way valve" where legislation imposes cost requirements with which schemes must comply but does not provide an override where the legislative requirements are relaxed. This means that some employers are not always able to take advantage of any legislative easements introduced to reduce burdens on them.
7. As a balance to the legislative override which imposes certain requirements on schemes, the Government want to provide those schemes with the scope to make amendments to reflect relaxations in the statutory requirements.

Change being taken forward

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

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

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

9. Schemes are required to increase any pension rights earned on or after 6 April 1997 when those pension rights come into payment. Until April 2005 schemes had to increase those rights by RPI or 5% whichever is less. The reduction in the LPI cap from 5% to 2.5% was introduced in April 2005 to reduce burdens on business. However, a number of employers have not been able to take advantage of the flexibility because of restrictions in their scheme rules.
10. Anecdotal evidence is that around a quarter of occupational pension schemes are unable, because of constraints on amendments to scheme rules, to make changes to reflect the reduction in the LPI cap from 5% to 2.5% from April 2005.
11. The power in regulations for trustees to modify scheme rules by resolution, where the employer agrees, will introduce flexibility that some employers will like. It will enable scheme rules to be amended in relation to future accruals to reflect the legislative easement which was introduced in 2005. It could result in savings for employers and might provide them with an incentive to continue to provide defined benefit schemes for their employees.

Financial consequences

Impact on schemes/employers

“Statutory override” together with the reduced revaluation cap

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

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

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

13. Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits.
14. A potential benefit resulting from the savings for employers might be increased business profits which may lead to improved scheme viability.

“Statutory override” -change in LPI cap

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

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

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

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

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

Impact on individuals

“Statutory override” together with the reduced revaluation cap

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

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

**2.5% cap - 100% deferred
pension affected by
change**

| | |
|-------------|------|
| 2020 | 0.2% |
| 2030 | 0.5% |
| 2040 | 1.1% |
| 2050 | 1.6% |

Source: DWP estimates

19. Deferred pensioners are likely to have a number of different sources of pension income so any impact on one part of their overall income might not necessarily bear so heavily on the individual's total pension income. However, there is a risk that a reduction in the cap accompanied by high inflation could result in a significant reduction in defined benefit pension incomes and a consequent increase in income related state benefits.
20. The measure is likely to affect more female scheme members than male scheme members as women tend to have more breaks in their employment and therefore are more likely to have deferred pension entitlement. No concrete evidence exists as to what proportion of deferred pension entitlement relates to women as opposed to men.
21. Increased business profits arising from the savings for employers from such a change could result in benefits for members of schemes and employees. For example by way of higher wages for employees; increased employment opportunities within the business and improved scheme viability.
22. In addition, there is also a redistribution of pension income from the best-off DB scheme members (under current revaluation rules) to the group who are able to join DB schemes following the change and who would otherwise be worse off (because they would otherwise have been in DC schemes which tend to have lower employer contribution rates). This is expected to raise overall social welfare.
23. It is very difficult to estimate the size of these benefits but one approach would be to consider the scenario whereby the employer chooses to channel these savings back into pension provision. Assuming all the savings from the change were spent by employers on expanding the coverage of their DB schemes, it is estimated that an upper bound of 165,000-265,000 additional DB members in the medium to long term. In practice the actual impact will certainly be lower than this since employers are unlikely to choose to spend savings on expanding the coverage of their DB schemes.
24. Whilst positive, such figures must be seen in the context of the total number of active DB scheme members, estimated to be 2.7 million in 2007, and the rate of change of membership, with a net decrease in membership of around 200,000 between 2006 and 2007 and 210,000 between 2005 and 2006.

"Statutory override" -change in LPI cap

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

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

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

Source: DWP estimates

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

Summary of costs and savings

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

Competition assessment

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

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

Small firms impact test

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

Legal aid

30. There will be no impact on legal aid.

Sustainable Development, Carbon Assessment, Other Environment.

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

Health impact assessment

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

Race Equality, Disability Equality

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

Gender equality

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

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

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

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

Human Rights

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

Rural proofing

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

Specific Impact Tests: Checklist

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

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

| Type of testing undertaken | <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 |

Annexes

No Annexes

