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|--|---|
| <b>Title:</b><br><b>The Occupational Pensions Schemes (Employer Debt) Regulations 2011</b><br><b>Lead department or agency:</b><br>Department for Work and Pensions<br><br><b>Other departments or agencies:</b> | <b>Impact Assessment (IA)</b>                 |
|  | <b>IA No:</b> DWP 0018                        |
|  | <b>Date:</b> 06/06/2011                       |
|  | <b>Stage:</b> Consultation                    |
|  | <b>Source of intervention:</b> Domestic       |
|  | <b>Type of measure:</b> Secondary Legislation |
| <b>Contact for enquiries:</b><br>declan.montgomery@dwp.gsi.gov.uk<br>0207 449 7385   |   |

## Summary: Intervention and Options

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

When an employer who is participating in a multi-employer defined benefit pension scheme ceases to employ any active members of the scheme (for example where all the employees of one company are moved to another), the employer may be required to pay an amount of money into the scheme - an "employer debt". The basis of the debt is the difference between the assets that the scheme has and the cost of buying out all of the scheme's pensions with an insurance company (the "full buy-out" level). The employer will be liable to pay a proportion of that difference. The employer debt is a means of safeguarding the funding of the pension scheme when the link to the employer has been broken.

The existing legislation contains various easements whereby an employer debt is not payable or payment can be deferred where there are other employers in the same group of companies who are willing to accept responsibility for it. However employers' groups say these can be difficult and cumbersome to use and can have a detrimental effect on beneficial company restructurings. The Government considers that some changes can be made which will help employers to deal with an employer debt without materially increasing the risk to scheme funding or members' benefits.

The employer debt requirements are contained in primary and secondary legislation. Any changes to introduce further flexibility into the arrangements could only be done by amending secondary legislation.

### What are the policy objectives and the intended effects?

Commentators say that employer debts are often triggered inappropriately, for example when a corporate restructuring is being undertaken and no value leaves the group. The policy objective is to avoid a debt triggering where an employer ceases to **permanently** or **temporarily** employ an active member of the scheme, but without any detriment to members or the ongoing funding of the scheme.

The intended effects are to increase the flexibility of employers to deal with employer debt whilst maintaining member protection.

### What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Four options have been considered - **1.** Group Guarantees – no employer debt would be payable if a group of companies entered into guarantee arrangements for the payment of the debt. **2.** Apportionment Arrangements – the arrangements that already exist for one employer to take over responsibility for the debt of another employer would be made more flexible. **3.** Extended Period of Grace – the existing period would be extended so no employer debt would be payable for up to 36 months (instead of the current 12 months) where the employer intended to re-employ an active member of the scheme within that period. **4.** No Change – which does not meet employer concerns.

Options **1** and **2** are alternative options for dealing with cases where the employer ceases **permanently** to employ an active member of the scheme. For example this may occur where two companies are merged into one. Of these two, the preferred option is option **2**, because it is a simplification of existing procedures which are already familiar to employers and pension scheme trustees. Option **3** is the preferred option where an employer ceases **temporarily** to employ an active member of the scheme. The preferred options will increase flexibility for employers without materially increasing the risk to members' benefits. The introduction of further easements will require regulatory changes.

**Will the policy be reviewed?** It will be reviewed. **If applicable, set review date:** N/A

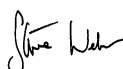
**What is the basis for this review?** Ongoing review. **If applicable, set sunset clause date:** N/A

**Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?**

No

**Ministerial Sign-off** For consultation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***



**Signed by the responsible Minister:**

**Date:** 07/06/2011

# Summary: Analysis and Evidence Policy Option 1: Group Guarantees

**Description:** The option would mean that instead of paying an employer debt to the pension scheme immediately, the other employers in the pension scheme would act as guarantors, to pay the debt at some future point, if appropriate.

| Price Base Year 2011 | PV Base Year 2011 | Time Period Years 10 | Net Benefit (Present Value (PV)) (£m) |           |                     |
|----------------------|-------------------|----------------------|---------------------------------------|-----------|---------------------|
|                      |                   |                      | Low: N/A                              | High: N/A | Best Estimate: 56.6 |

| COSTS (£m)    | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|--|----------------------------|
| Low           | Optional                                | Optional   | Optional                   |
| High          | Optional                                | Optional   | Optional                   |
| Best Estimate | 0                                       | 0  | 0                          |

**Description and scale of key monetised costs by 'main affected groups'** None.

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

Where an employer debt triggers for payment, various administrative, legal and actuarial costs arise. These costs arise whether the employer debt is paid or whether one of the existing easements is used to defer the payment. The costs vary from scheme to scheme, but are estimated to fall in the range of £40 - 60,000 for each case. These costs would also be incurred if employers choose to use this option - so in effect the additional one-off cost of the policy option is nil.

At some future date, when the guarantee is called in for payment, it is possible that some employers might be unable to honour the guarantee, in which case scheme funding and members' benefits might be affected. Ultimately a scheme might have to enter the Pension Protection Fund which ensures that members' benefits are protected to a prescribed level (and is funded by a compulsory levy on defined benefit schemes). However, given the long periods over which pension schemes exist and over which the guarantees might apply, it is not possible to quantify how many of them might fail to meet their obligations. A mitigation to reduce this risk is that the trustees would be able to end the guarantee arrangements where a "material adverse change" occurred.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|--|-------------------------------|
| Low           | Optional                                | Optional   | Optional                      |
| High          | Optional                                | Optional   | Optional                      |
| Best Estimate | N/A                                     | 6.5  | 56.6                          |

### Description and scale of key monetised benefits by 'main affected groups'

The employers who would benefit from this option are those involved in company restructurings who would otherwise have paid the employer debt, rather than make use of the existing easements. These are therefore counted as **new cases**. When a debt is triggered it is assumed that employers have to borrow up front to pay the debt that would normally be paid over time as the scheme discharges its liabilities. The saving from no longer having to service this debt is a benefit to employers. However, there is also a cost of not paying off the debt early, as the (unpaid) debt increases over time as discounting unwinds. This cost needs to be netted off from the savings arising from the foregone interest payments after the policy has been enacted. The benefit to the employer is therefore interest on the loan net of the increase in liabilities over time as a result of the debt not being paid off immediately. The estimate of these savings to employers under this option is a net present value of £56.6 million over a 10 year period.

### Other key non-monetised benefits by 'main affected groups'

It is expected that some of the employers who would otherwise use one of the existing easements to defer the payment of the debt would instead use this option. For example they might find this option easier to use or more suitable to their circumstances. These are classed as **existing cases**. As these employers would normally use other easements in order not to pay the debt, they have not been included in the savings figures set out above for new cases. No attempt has been made to quantify any of the circumstantial benefits accruing to these employers if they used this option because the advantages will be as perceived by the employers i.e. for largely qualitative rather than quantitative reasons. This option will also help employers to restructure their businesses, but no attempt has been made to quantify these benefits.

### Key assumptions/sensitivities/risks

Discount rate (%)

3.5% real

Information from the pensions industry is that in most cases where an employer debt is triggered, employers use existing easements in the regulations in order not to pay the full value immediately. In terms of costing this option, the number of new cases would therefore be at the margins, drawn from those few employers who would otherwise have paid the employer debt. In terms of the total number of employers participating in multi-employer pension schemes, a very cautious assumption has been made that less than 1% would use this option. (More robust estimates will be sought in the consultation.) The basis of the saving is that it is assumed that these companies would borrow to meet the debt and would do so by issuing 10 year bonds with an 'AA' rating at a nominal yield of 5.25%, and the term structure of their payments would be such that they paid only the interest in each year, with repayment of the principal on maturity of the bond. Liabilities on a full buy out basis are discounted by gilt yields – the calculations use the current yield on a 10 year nominal gilt, 3.75%. The estimated benefits are highly sensitive to: scheme funding levels, which are measured on a mark-to-market basis and can fluctuate dramatically over short periods of time; employers' borrowing costs, which are determined in the corporate bond market; gilt yields, which are determined in the sovereign bond market; and the assumed level of take-up of the proposal.

|  |               |          |                          |                             |
|--|---------------|----------|--------------------------|-----------------------------|
| <b>Direct impact on business (Equivalent Annual) (£m):</b> |               |          | <b>In scope of OIOO?</b> | <b>Measure qualifies as</b> |
| Costs: 0   | Benefits: 6.2 | Net: 6.2 | Yes                      | OUT                         |

## Summary: Analysis and Evidence Policy Option 2: Apportionment Arrangements

**Description:** The option would mean that instead of paying an employer debt to the pension scheme immediately, the pensions liabilities of the departing employer would be passed to another employer remaining in the scheme. The employers would normally be associated with one another in a corporate group and the transaction would be undertaken for the overall benefit of the group. If at some future date the employer taking on the liabilities underwent an employer debt event, it would be required to pay a debt representing its own liabilities and the liabilities it had taken on from the departing employer.

| Price Base<br>Year 2011 | PV Base<br>Year 2011 | Time Period<br>Years 10 | Net Benefit (Present Value (PV)) (£m) |           |                    |
|-------------------------|----------------------|-------------------------|---------------------------------------|-----------|--------------------|
|                         |                      |                         | Low: N/A                              | High: N/A | Best Estimate: 151 |

| COSTS (£m)    | Total Transition<br>(Constant Price)<br>Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Cost<br>(Present Value) |
|---------------|---|---|-------------------------------|
| Low           | Optional                                      | Optional  | Optional                      |
| High          | Optional                                      | Optional  | Optional                      |
| Best Estimate | 0   | 0   | 0                             |

### Description and scale of key monetised costs by 'main affected groups'

None.

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

As with option 1, there would be some existing one-off administrative, legal and actuarial costs, falling in the range of £40 - 60,000 for each case. Because these costs are already incurred in the existing employer debt arrangements the additional one-off costs of this option are nil.

If at some future time, the new employer debt amount could not be paid in full, it is possible that there could be an effect on scheme funding and on members' pension benefits. It is possible that some employers might subsequently become insolvent and some schemes might be eligible for entry into the Pension Protection Fund.

However as with option 1, it is not possible to quantify how many of them might fail to meet their obligations in this way.

| BENEFITS (£m) | Total Transition<br>(Constant Price)<br>Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Benefit<br>(Present Value) |
|---------------|---|---|----------------------------------|
| Low           | Optional                                      | Optional  | Optional                         |
| High          | Optional                                      | Optional  | Optional                         |
| Best Estimate | N/A   | 17.4  | 151                              |

### Description and scale of key monetised benefits by 'main affected groups'

As with option 1, the employers who would benefit from this option would be those who would otherwise have paid the employer debt, rather than make use of the existing easements. As in option 1 these would count as the new cases to whom the benefit of the option accrued. The methodology for the calculation of the saving is as for option 1. The estimate of savings to employers under this option is a net present value of £151 million over a ten year period.

### Other key non-monetised benefits by 'main affected groups'

Some of the employers who would normally use one of the existing easements to defer the payment of the debt would be expected to use this option instead. But as with option 1, no attempt has been made to quantify any of the circumstantial benefits accruing to these employers if they used this option because the reasons for their choosing will be based on the perceived advantages to them. This option will also help employers to restructure their businesses, but no attempt has been made to quantify these benefits.

### Key assumptions/sensitivities/risks

### Discount rate (%)

3.5% real

As with option 1, in terms of costing this option, the number of new cases would be drawn from those few employers who would otherwise have paid the employer debt. However option 1 only applies to corporate restructurings **whereas this option applies to any case where an employer ceases to employ any active member of the pension scheme.** It is assumed therefore that there would be a greater take up of option 2 than option 1. But even so, this would still be less than 1% of eligible employers, estimated on the same cautious basis as for option 1. (Again, more reliable information will be sought in the consultation.)

The assumptions about borrowings and the sensitivities are the same as for option 1. The risk with this option is that all of the pensions liabilities of departing employers might be apportioned to an employer not able to support them. However there would be a number of safeguards, including the funding test they are required to carry out and the fact that the trustees could refuse to agree to an apportionment where they had concerns about this issue.

| Direct impact on business (Equivalent Annual) (£m): |                |           | In scope of OIOO? | Measure qualifies as |
|---|----------------|-----------|-------------------|----------------------|
| Costs: 0  | Benefits: 16.6 | Net: 16.6 | Yes               | OUT                  |

## Summary: Analysis and Evidence

Policy Option 3: Extended period of grace

**Description:** Extension of the period of grace under which an employer can avoid triggering a debt in the event of the last active member of a scheme leaving prior to a new individual being employed and joining the scheme.

| Price Base<br>Year 2011 | PV Base<br>Year 2011 | Time Period<br>Years 1 | Net Benefit (Present Value (PV)) (£m) |           |                  |
|-------------------------|----------------------|------------------------|---------------------------------------|-----------|------------------|
|                         |                      |                        | Low: N/A                              | High: N/A | Best Estimate: 0 |

| COSTS (£m)    | Total Transition<br>(Constant Price)<br>Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Cost<br>(Present Value) |
|---------------|---|---|-------------------------------|
| Low           | Optional                                      | Optional  | Optional                      |
| High          | Optional                                      | Optional  | Optional                      |
| Best Estimate | 0   | 0   | 0                             |

### Description and scale of key monetised costs by 'main affected groups'

There are no costs envisaged, as any additional risks are mitigated by this option being available at trustee discretion. The period of grace proposal is intended to assist in particular faith groups and not-for-profit organisations, where an employer ceases to employ an active member of a scheme. As long as a new employee joins the scheme within 12 months of this event, no debt is triggered. This proposal extends this period to 36 months. This change is being proposed following representations from faith groups who say that the current 12 month period is not long enough for them to employ a new active member following the departure of the employer's last active scheme member.

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

N/A

| BENEFITS (£m) | Total Transition<br>(Constant Price)<br>Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Benefit<br>(Present Value) |
|---------------|---|---|----------------------------------|
| Low           | Optional                                      | Optional  | Optional                         |
| High          | Optional                                      | Optional  | Optional                         |
| Best Estimate | 0   | 0   | 0                                |

### Description and scale of key monetised benefits by 'main affected groups'

None.

### Other key non-monetised benefits by 'main affected groups'

This proposal is aimed at faith groups and not-for-profit organisations and will avoid inappropriate triggering of an employer debt where an employer temporarily ceases to employ an active member of the scheme. Employer debts are reported to have been triggered in such cases but no information is available on the size of these employer debts, nor the number of times they have been triggered.

Faith groups say they find it difficult to borrow to pay an employer debt and have to rely on funding it through asset sales. Selling these assets would incur transaction costs and there would also be an opportunity cost involved in disposing of these assets (as against the benefit of retaining them). The benefit to such sponsors is the value of no longer having to incur the transaction costs or opportunity cost of selling their assets to pay the inappropriately-triggered debt. There is no data with which to estimate these possible costs. Benefits are therefore unable to be quantified but will be small.

### Key assumptions/sensitivities/risks

N/A

### Discount rate (%)

N/A

|   |             |        |                   |     |                      |
|---|-------------|--------|-------------------|-----|----------------------|
| Direct impact on business (Equivalent Annual) (£m): |             |        | In scope of OIIO? |     | Measure qualifies as |
| Costs: 0  | Benefits: 0 | Net: 0 | No                | YES | n/a                  |

# Summary: Analysis and Evidence

# Policy Option 4: Do nothing

**Description:** No change to the current regulatory regime.

| Price Base<br>Year 2011 | PV Base<br>Year 2011 | Time Period<br>Years 0 | Net Benefit (Present Value (PV)) (£m) |           |                  |
|-------------------------|----------------------|------------------------|---------------------------------------|-----------|------------------|
|                         |                      |                        | Low: N/A                              | High: N/A | Best Estimate: 0 |

| COSTS (£m)    | Total Transition<br>(Constant Price)<br>Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Cost<br>(Present Value) |
|---------------|---|---|-------------------------------|
| Low           | Optional                                      | Optional  | Optional                      |
| High          | Optional                                      | Optional  | Optional                      |
| Best Estimate | 0   | 0   | 0                             |

**Description and scale of key monetised costs by 'main affected groups'**

There are no additional costs arising from this option.

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

This option does not meet employer concerns e.g. that in engaging in a beneficial corporate restructuring they might inadvertently trigger an employer debt.

Not extending the period of grace could lead to small employers such as faith groups and not-for-profit organisations facing the prospect of selling assets to fund inappropriately-triggered employer debts.

| BENEFITS (£m) | Total Transition<br>(Constant Price)<br>Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Benefit<br>(Present Value) |
|---------------|---|---|----------------------------------|
| Low           | Optional                                      | Optional  | Optional                         |
| High          | Optional                                      | Optional  | Optional                         |
| Best Estimate | 0   | 0   | 0                                |

**Description and scale of key monetised benefits by 'main affected groups'**

There are no additional benefits arising from this option.

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

None.

**Key assumptions/sensitivities/risks**

None.

**Discount rate (%)**

N/A

|  |             |        |                          |                             |
|--|-------------|--------|--------------------------|-----------------------------|
| <b>Direct impact on business (Equivalent Annual) (£m):</b> |             |        | <b>In scope of OIOO?</b> | <b>Measure qualifies as</b> |
| Costs: 0   | Benefits: 0 | Net: 0 | No                       | n/a                         |

## Enforcement, Implementation and Wider Impacts

|   |                |           |                    |             |            |
|---|----------------|-----------|--------------------|-------------|------------|
| What is the geographic coverage of the policy/option?   | Great Britain  |           |                    |             |            |
| From what date will the policy be implemented?  | 1/10/2011      |           |                    |             |            |
| Which organisation(s) will enforce the policy?  | N/A            |           |                    |             |            |
| What is the annual change in enforcement cost (£m)?   | N/A            |           |                    |             |            |
| Does enforcement comply with Hampton principles?  | N/A            |           |                    |             |            |
| Does implementation go beyond minimum EU requirements?  | N/A            |           |                    |             |            |
| What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions?<br>(Million tonnes CO <sub>2</sub> equivalent) | Traded:<br>N/A |           | Non-traded:<br>N/A |             |            |
| Does the proposal have an impact on competition?  | No             |           |                    |             |            |
| What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?            | Costs:<br>N/A  |           | Benefits:<br>N/A   |             |            |
| Annual cost (£m) per organisation<br>(excl. Transition) (Constant Price)  | Micro<br>0     | < 20<br>0 | Small<br>0         | Medium<br>0 | Large<br>0 |
| Are any of these organisations exempt?  | No             | No        | No                 | No          | No         |

## Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

| Does your policy option/proposal have an impact on...?  | Impact | Page ref within IA |
|---|--------|--------------------|
| <b>Statutory equality duties</b> <sup>1</sup><br><a href="#">Statutory Equality Duties Impact Test guidance</a> | No     |                    |
| <b>Economic impacts</b>   |        |                    |
| Competition <a href="#">Competition Assessment Impact Test guidance</a>   | No     |                    |
| Small firms <a href="#">Small Firms Impact Test guidance</a>  | No     |                    |
| <b>Environmental impacts</b>  |        |                    |
| Greenhouse gas assessment <a href="#">Greenhouse Gas Assessment Impact Test guidance</a>                        | No     |                    |
| Wider environmental issues <a href="#">Wider Environmental Issues Impact Test guidance</a>                      | No     |                    |
| <b>Social impacts</b>   |        |                    |
| Health and well-being <a href="#">Health and Well-being Impact Test guidance</a>                                | No     |                    |
| Human rights <a href="#">Human Rights Impact Test guidance</a>  | No     |                    |
| Justice system <a href="#">Justice Impact Test guidance</a>   | No     |                    |
| Rural proofing <a href="#">Rural Proofing Impact Test guidance</a>  | No     |                    |
| <b>Sustainable development</b><br><a href="#">Sustainable Development Impact Test guidance</a>                  | No     |                    |

<sup>1</sup> Public bodies including Whitehall departments are required to consider the impact of their policies and measures on race, disability and gender. It is intended to extend this consideration requirement under the Equality Act 2010 to cover age, sexual orientation, religion or belief and gender reassignment from April 2011 (to Great Britain only). The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

## Evidence Base (for summary sheets) – Notes

### References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

| No. | Legislation or publication |
|-----|----------------------------|
| 1   |                            |
| 2   |                            |
| 3   |                            |
| 4   |                            |
| 5   |                            |

### Evidence Base

#### Annual profile of monetised costs and benefits\* - (£m) constant (2011) prices

|  | Y <sub>0</sub> | Y <sub>1</sub> | Y <sub>2</sub> | Y <sub>3</sub> | Y <sub>4</sub> | Y <sub>5</sub> | Y <sub>6</sub> | Y <sub>7</sub> | Y <sub>8</sub> | Y <sub>9</sub> |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>Transition costs</b>                            |                |                |                |                |                |                |                |                |                |                |
| <b>Annual recurring cost</b>                       |                |                |                |                |                |                |                |                |                |                |
| <b>Total annual costs</b>                          |                |                |                |                |                |                |                |                |                |                |
| <b>Policy option 1: Group Guarantees</b>           |                |                |                |                |                |                |                |                |                |                |
| <b>Transition benefits</b>                         |                |                |                |                |                |                |                |                |                |                |
| <b>Annual recurring benefits</b>                   | £7.4           | £7.2           | £7.0           | £6.8           | £6.7           | £6.4           | £6.2           | £6.0           | £5.8           | £5.7           |
| <b>Total annual benefits</b>                       | £7.4           | £7.2           | £7.0           | £6.8           | £6.7           | £6.4           | £6.2           | £6.0           | £5.8           | £5.7           |
| <b>Policy option 2: Apportionment arrangements</b> |                |                |                |                |                |                |                |                |                |                |
| <b>Transition benefits</b>                         |                |                |                |                |                |                |                |                |                |                |
| <b>Annual recurring benefits</b>                   | £19.6          | £19.2          | £18.7          | £18.2          | £17.7          | £17.1          | £16.6          | £16.1          | £15.6          | £15.1          |
| <b>Total annual benefits</b>                       | £19.6          | £19.2          | £18.7          | £18.2          | £17.7          | £17.1          | £16.6          | £16.1          | £15.6          | £15.1          |

\* For non-monetised benefits please see summary pages and main evidence base section

The monetised benefits in this table are the interest payments that will no longer have to be made as there will be no borrowing required to pay off inappropriately triggered employer debts, net of the increase in liabilities that arises from the debt not being paid off immediately. Under option 1 (group guarantees) or option 2 (apportionment arrangements), the instances of inappropriately triggered debt are reduced, and affected employers are no longer required to borrow to pay this debt. No longer having to make interest payments is a benefit to them. It is assumed that they would normally borrow by issuing 10 year bonds – so the benefit extends over a 10 year period. However, there is also a benefit in the counterfactual from paying the debt off in full – this arises because liabilities increase as they come closer to payment (through the unwinding of discounting). Because the new arrangements now no longer require the debt to be paid off at a time of restructuring, sponsors will see their liabilities increase over time and this needs to be netted off from the benefit of the foregone interest payments. It is this difference between the savings from foregone debt interest and increasing liabilities that is shown in the table.

# Evidence Base (for summary sheets)

## Problem under consideration

1. **Employer debt** Defined benefit pension schemes provide pension benefits based on the individual member's salary, often his or her final salary, and the individual's length of service. The role of the employer in a defined benefit pension scheme is very important. The employer is the scheme's "sponsor" and if the funds in the scheme are insufficient to pay benefits, it is the employer's responsibility to make good the shortfall.

2. Where an employer's relationship with their under-funded pension scheme is ended, legislation sets out requirements for the "**employer debt**", which is the amount the employer must pay into the scheme in order to relinquish responsibility for the scheme. This is also called a "**section 75 debt**"<sup>2</sup>. For a variety of reasons, it may no longer be appropriate for an employer to be the sponsor of a particular pension scheme. During a company restructure, when one company merges with or takes over another, an 'exiting employer' may sever its relationship with its pension scheme, and so trigger an employer debt.

3. The policy intention behind the employer debt legislation is to provide protection for pension scheme members after the departure of the sponsoring employer. The basis of the protection is that the scheme should be funded to the "full buy-out" level with sufficient monies to fully cover the cost of securing the members' benefits with a regulated insurance company. For larger schemes, employer debts as calculated on a "full buy-out" basis can amount to hundreds of millions of pounds.

4. The main reasons for the triggering of an employer debt are the insolvency of a participating employer, the winding up of the pension scheme or the occurrence of an "employment-cessation event". An **employment-cessation event** occurs when an employer no longer employs any members of the pension scheme, whilst other employers still employ active members. In these circumstances, the employer's relationship with the scheme is treated as ending, hence the requirement for the payment of the employer debt.

5. Most commentators agree that an employer debt should be paid on an insolvency or winding up. But there has been a long running debate about the appropriateness of an employer debt triggering on the occurrence of an employment-cessation event. An employment-cessation event can occur in a variety of circumstances, for example where an employer's last active member<sup>3</sup> retires or leaves service. However a major cause of concern is where an employment-cessation event occurs as a result of a corporate restructuring. In such circumstances a requirement to pay an employer debt could lead to cash-flow problems for employers and the need to use the capital markets or borrow from banks for additional funds.

6. The starting point for the policy is that where an employer debt is triggered, the amount of the debt should be paid as a lump sum into the pension scheme. However, it is accepted that it may not always be feasible or necessary for the employer to fund the entire lump sum up front, and there are several easements<sup>4</sup> already in existing legislation which permit the payment of the debt to be deferred or the amount paid up to be safely reduced. One of these existing measures allows for the employer debt to be transferred or apportioned to another employer remaining in the scheme. (Option 2 below builds on this existing measure.)

7. The above paragraphs are about the situation where an employer experiences an employment-cessation event and has no intention of employing a member of the pension scheme in the future. However an employment-cessation event can occur where an employer **temporarily** ceases to employ an active member of the scheme. This issue has been raised by some faith groups who face difficulties when, for example, a minister may leave a church, but may not be replaced for a number of years. This currently triggers an employer debt if the replacement minister is not appointed within the existing 12 month "period of grace" provision. The **period of grace** is a provision whereby a debt does not trigger if an employer tells the trustees they intend to employ an active member of the scheme within 12 months

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<sup>2</sup> Section 75 of the Pensions Act 1995 and the Occupational Pension Schemes (Employer Debt) Regulations 2005 SI 2005/678.

<sup>3</sup> An active member is one who is employed by the scheme's sponsor and is making contributions into the pension scheme and accruing benefits within it.

<sup>4</sup> Existing provisions for reducing the size of the employer debt paid up front include withdrawal arrangements and scheme apportionment arrangements.



of losing their last active member (and they do in fact re-employ an active member within that time). Faith groups that could be affected have called for a relaxation of the employer debt rules in this regard.

8. Any proposals to amend the employer debt rules require amendments to secondary legislation.

## Rationale for intervention

9. There are a number of existing mechanisms in the regulations for deferring the payment of an employer debt. But representations have been made from employers' representative bodies that they would like some extra flexibility. Any changes would not significantly increase the number of instances where the employer debt was deferred, but they would give employers and pension schemes another option, which may be more useful in particular cases, for example in dealing with a corporate restructuring.

10. For cases where an employer ceases to employ an active member on a temporary basis, the proposal is to extend the time period of the current 12 month "period of grace" provision up to a maximum of 36 months, but this would be at the discretion of the trustees. This would allow employers more time to replace their outgoing employees before triggering a debt. The intended effects are to relax the rules so that all employers (including faith groups) have more time to replace their outgoing employees. For example, in the case of faith groups, asset sales (for example of a church) would not be required in order to pay an employer debt where the intention is to replace the employee within the period of grace.

## Description of options considered (including do nothing)

11. Four options have been considered:

Option 1 Group guarantees

Option 2 Apportionment arrangements

Option 3 Extended period of grace

Option 4 No change

12. Discussions on the options have taken place with selected stakeholders (for example the Pensions Regulator, the Pension Protection Fund, CBI, EEF, TUC and faith groups). An informal consultation with a wider range of stakeholders was held between December 2010 and January 2011, to seek their views on options. In addition, in the same period, the views of a small group of industry practitioners were sought about various technical aspects of the regulations.

### Policy Option 1: Group Guarantee Proposal

13. The purpose of any new measure on group guarantees would be to allow companies within a group to restructure without triggering an employer debt.

14. The intention is that the measure on group guarantees should be:

- available to group employers participating in a multi-employer pension scheme, and
- used with respect to employment-cessation events arising from a group or corporate restructuring.

15. Where guarantee arrangements have been entered into, an employer debt would not be triggered on the occurrence of an employment-cessation event where this arose as part of a corporate restructuring.

16. Guarantee arrangements could be entered into in two ways:

- a guarantee in respect of the whole employer debt of the group, provided by a single employer or by a number of employers. The group could then undertake future restructures without triggering a debt.

- individual guarantee arrangements put in place in advance of, on, or after the occurrence of each employment-cessation event which would allow employers flexibility in making arrangements to manage their employer debt.
17. The proposed conditions for entering into a guarantee arrangement are as follows.
- **Estimate** To inform discussions between trustees and the employers about putting in place a guarantee, an estimate would be made of the level of debt. This would be to avoid the expense of formally calculating the full level of the employer debt.
  - **Guarantor** It is not intended that there would be any restriction on who could be the guarantor. The guarantor could be other employer(s) in the group or an external body. The trustees would be able to reject a proposed guarantor where they are not satisfied about the resources of the guarantor.
  - **Parties** The parties to the guarantee arrangement would be the trustees of the pension scheme, the employers whose debts are being guaranteed and the guarantor(s).
  - **Funding test** The funding test contained in regulation 2(4A)(a) of the Employer Debt Regulations<sup>5</sup> would need to be met. The test requires the trustees to be reasonably satisfied that the remaining employers in the scheme will be reasonably likely to be able to fund the scheme and that it will have sufficient and appropriate assets to cover its liabilities on a technical provisions basis<sup>6</sup>.
  - **Resources** The trustees would need to be satisfied that at the date of the guarantee agreement, the guarantor(s) had sufficient financial resources to be able to pay the amount entered on the guarantee at that point in time.
  - **Jurisdiction** The guarantee would need to be enforceable under UK jurisdiction.
  - **Status of group** Most restructurings would involve companies within the group. However it is not proposed to introduce rules excluding the sale of companies outside of the group, because it is possible that such restructurings could improve the strength of the group/guarantor. It would be for trustees to decide if restructurings (involving the sale of companies) had a materially adverse effect on the group/guarantor during the ongoing review of the guarantee.
18. It is proposed that the guarantee arrangement should contain the following features.
- **Signatories** The parties to the guarantee must be signatories to the guarantee arrangement.
  - **Guarantee called in** The guarantee arrangement must contain the circumstances in which the employer debt would be paid. For example, the scheme starting to wind up. It is also envisaged that the arrangement would contain a condition that trustees could call in the guarantee for payment if a material adverse change occurred to the guarantor.
  - **Joint and several** Where there was more than one guarantor, the guarantee arrangement would need to be drawn up on a joint and several basis<sup>7</sup>.
  - **Expenses** The guarantee arrangement must provide that the guarantors and the employers whose debts are being guaranteed would meet the expenses incurred in drawing up the arrangement.
  - **In force** The terms of the arrangement should provide that the arrangement was to remain in force until (a) the winding up of the scheme starts, (b) the arrangement was replaced by another arrangement in accordance with the Employer Debt Regulations, (c) the guarantor wants to end the guarantee by paying the debt, or (d) the trustees decide to end the guarantee arrangement if there is a material adverse change. The trustees would be expected to regularly

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<sup>5</sup> The Occupational Pension Schemes (Employer Debt) Regulations 2005 SI 2005/678.

<sup>6</sup> These are an estimate, made on actuarial principles, of the assets needed at any particular time to make provision for benefits already considered accrued under the scheme – in other words, what is required for the scheme to meet the statutory funding objective at a given date.

<sup>7</sup> A joint and several basis means an agreement whereby the liability for default is enforceable against all of the parties as a group or against any one of them as an individual.

review the guarantee arrangements they have put in place. One possible approach is that the trustees might be required to consider whether any change in the guarantor's circumstances were of a material adverse nature. If a change was material and was adverse, the trustees would have the option of ending the guarantee arrangements and possibly, calling in the guarantee for payment.

19. The Government has considered a variant of this option that would be even more permissive for sponsoring employers, by not requiring any conditions for entering into a guarantee arrangement. There would be no negotiations with trustees. Employers would impose a group guarantee and trustees would have no opt-out. However, this additional freedom has been ruled out on the grounds that the benefit to employers would mean significantly increased risks to members' benefits and could lead to the abandonment of some schemes by their employers.

## **Costs and benefits of the Group Guarantee Proposal**

20. Defined benefit scheme sponsors are not required to do anything unless they wish to make use of the easements. If they choose to do so, they will inevitably incur some one-off administrative, legal and actuarial costs. These costs would vary considerably from scheme to scheme, but are estimated to fall in the range of £40 - 60,000. Actually paying an employer debt already involves a similar level of costs. So there are no *additional* costs of using this proposal. Furthermore, these costs would be small in relation to the estimated benefits to the employer of not having to pay an employer debt. In addition the costs would only be incurred if the employer felt it was in its commercial interests to do so i.e. if the expected benefits of taking up the option were greater than the costs of advice.

21. There may also be some costs in terms of impacts on members' benefits. The option would mean that instead of paying an employer debt to the pension scheme immediately, there would be an agreement that, if appropriate, it would be paid at some time in the future (under the terms of the guarantee). If at that future time, the guarantee could not be paid in full, it is possible there could be an effect on scheme funding and on members' pension benefits. However, given the very small number of employers to which this option could apply (see below), and the fact that guarantees could last for many years, it is not possible to estimate how many guarantors might fail to meet their obligations in the future, but reassurance would be provided by the trustees being able to end the guarantee arrangements where a material adverse change had occurred to a guarantor.

22. A shortfall in funding could also mean that an eligible scheme had to be admitted to the Pension Protection Fund (PPF). The PPF is funded by means of a levy on pension schemes, so potentially there could be another cost in terms of an increase in the levy requirement. But, just as it is not possible to estimate the number of guarantors who might fail to meet their obligations in the future, so it is not possible to estimate the number of schemes that might ultimately be admitted to the PPF for that reason.

23. The benefit of the group guarantee proposal is that unnecessary employer debts will no longer trigger, allowing corporate restructuring to be managed more effectively. No debt will be payable as a lump sum, and, there will be a wider benefit to employers who will find it easier to restructure their business.

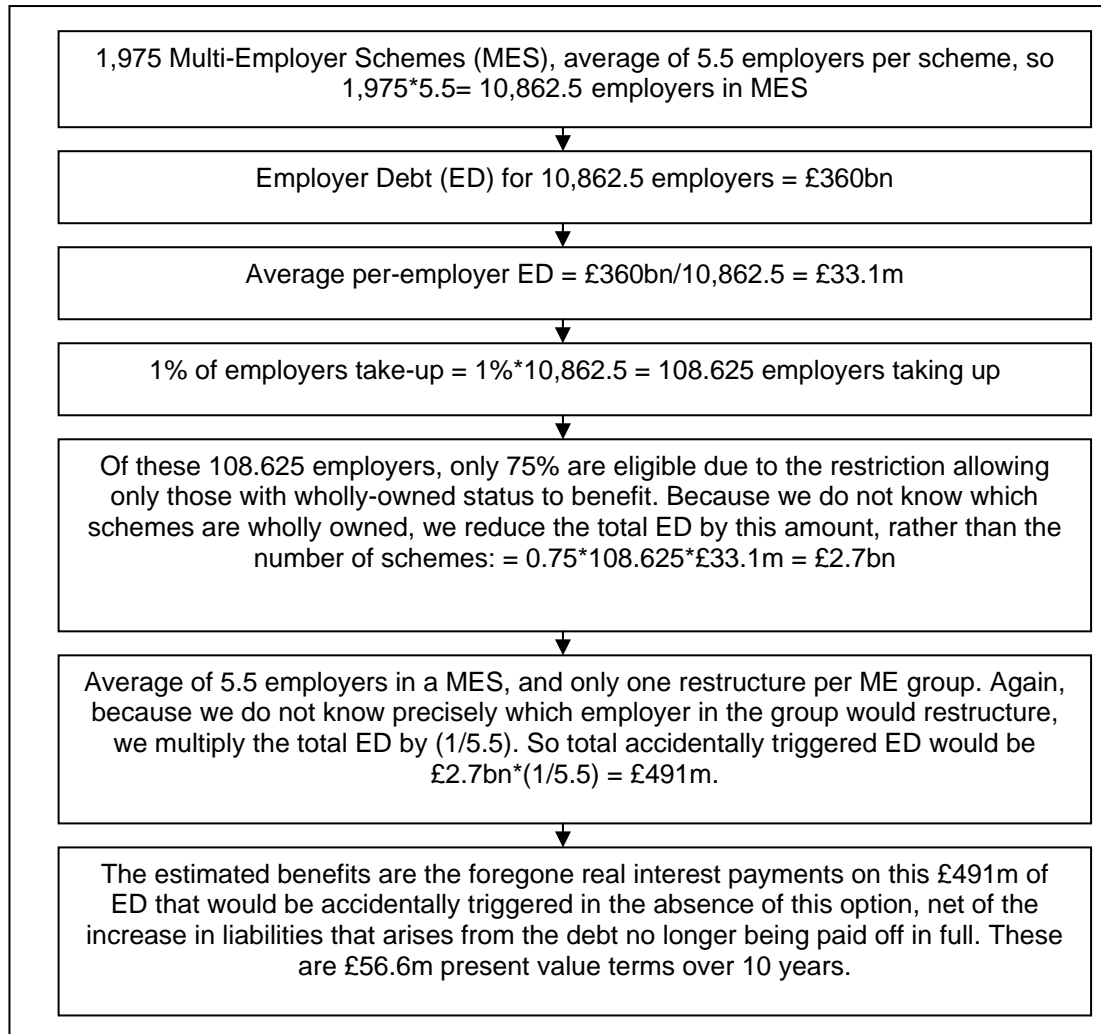
24. However information from the pensions industry is that whenever an employer debt currently triggers, employers and pension schemes do in practice make use of the existing mechanisms in order to defer payment. The number of "new cases" using this option is therefore likely to be at the margins. In this context, "new cases" is taken to mean cases where the employer debt would otherwise be paid. Nonetheless, the benefits from this option would still be significant for the individual employers who use it.

25. This is a difficult area to quantify costs and benefits because Government does not require employers to report the triggering of employer debts and how they are dealt with, nor any intentions about corporate restructuring. Doing so would impose an unnecessary burden on sponsoring employers for no reason. DWP has also asked the Pensions Regulator to see if the Regulator possesses data on the number of instances where employers participating in multi-employer schemes trigger an employer debt through their actions. The Regulator has confirmed that they do not have any such data – there is no requirement on scheme sponsors to report the triggering of employer debts to the Regulator. Nevertheless, DWP has made its best attempt to quantify costs and benefits. In doing so, reliance has been made on informal discussions with industry figures with experience in this area to generate

assumptions about take-up of the options and how employer debts are currently dealt with. The assumptions used are set out in the paragraphs below.

26. The flowchart below and the following paragraphs describe the calculation of the estimated benefits.

### Flowchart showing calculations of estimated benefits for group guarantees



27. The estimates of benefits are based on the following assumptions. There are 1,975 associated multi-employer schemes, with an average of 5.5 employers per multi-employer scheme<sup>8</sup>, so 10,862.5 employers.

28. Information on assets and estimated liabilities (on a full buy-out basis) of these employers' pension schemes have been taken from a dataset provided to the DWP by the Pensions Regulator at the end of February 2009. These scheme funding estimates have been updated to end January 2011 using information from the PPF 7800 Index<sup>9</sup>, a monthly index showing the aggregate values of assets and liabilities of private sector defined benefit schemes covered by the PPF. The aggregate employer debt across the schemes estimated to be eligible to take advantage of the easement is currently estimated to be around £360 billion. This represents the excess of full buy-out liabilities over scheme assets. The per-employer amount of Employer Debt is simply  $\frac{£360\text{bn}}{10,863} = £33.1$  million.

29. Given the widespread use of existing mechanisms for dealing with employer debts, the number of "new cases" of employers using this option is expected to be low. Again based on discussions with contacts in the pensions industry, and in the absence of any other data source, it is estimated that the population eligible to use this option would be around 1 per cent of employers – 109 employers.

<sup>8</sup> Source: The Pensions Regulator

<sup>9</sup> <http://www.pensionprotectionfund.org.uk/Pages/PPF7800Index.aspx>

30. The measure is assumed to apply only to wholly owned UK companies; figures provided to the DWP by the Department for Business, Innovation and Skills suggest that of all the subsidiaries of UK companies, around 75 per cent are wholly-owned. Because it is not known which of the 109 employers would take advantage of the easement, the adjustment is applied to the level of employer debt, rather than the number of employers. This yields  $0.75 \times 108.625 \times \text{£}33.1\text{m} = \text{£}2.7\text{bn}$ .

31. However, given that there are on average 5.5 employers in a multi-employer group, and typically only one in each group would be restructured in a way that could trigger an employer debt, the number of employers actually estimated to take advantage would be only (1/5.5) of the total. Again, because it is not known which employer within the group would restructure, this adjustment is applied to the level of employer debt, rather than the number of employers. This yields  $\text{£}2.7\text{bn} \times (1/5.5) = \text{£}491\text{m}$ .

32. So the total Employer Debt that could be accidentally triggered in the absence of this proposal is  $\text{£}491\text{m}$ . Applying the adjustments above to the number of employers would give around 15 employers that would benefit from the measure ( $108.625 \times 0.75 \times [1/5.5]$ ). This shows that the number of employers expected to benefit is small.

33. For the purposes of calculating the monetised benefits of this proposal, it is assumed that all of these restructures will occur in year 1. Given the modest numbers involved, this seems a reasonable way of proceeding without knowledge of the future distribution of corporate restructures.

34. For the purposes of calculating the benefits of this proposal, the amount of the employer debt itself has not been counted as a saving. This is because amounts of the order of the employer debt may be paid when the scheme winds up and discharges its liabilities via a regulated insurance company. Instead the focus has been on employers' cash flow and an assumption that employers will have borrowed to meet the debt. However, a consequence of the debt no longer having been paid off is that sponsors will see a natural increase in their liabilities as a result of the unwinding of discounting – this increase would be equivalent to the discount rate, which on a full buy out measure would be an appropriate gilt yield. As an example, a debt of  $\text{£}10$  million due to be repaid in 10 years would be discounted to  $\text{£}6.9\text{m}$  today (10 years of discounting at the assumed yield on 10yr gilts of 3.75% compounded). With each year that passes, the debt increases by 3.75% due to one less year of discounting.

35. On this basis, the additional cost of borrowing to employers would be the interest on the debt. The monetised benefit to employers is calculated as the value of the interest payments that no longer have to be paid as a result of debt no longer being triggered net of the increase in liabilities that arise from the unwinding of discounting now that the debt is not paid off at once<sup>10</sup>.

36. It is assumed that companies borrow by issuing 10 year corporate bonds and that their full buy out liabilities increase by the yield on a 10 year gilt. The current (June 2011) market yield on a 10 year nominal gilt is 3.75%<sup>11</sup>. The current spread of 10 year AA bond yields over 10 year gilts is around 150 basis points, a level which has been stable for some time. This gives an assumed nominal AA bond yield of 5.25%. However, it is the spread that is relevant in calculating the estimated benefits, since the interest payments are based on the AA yield and the increase in liabilities is based on the gilt yield – and it is the difference between them that is the estimated benefit of the policy.

37. Based on the assumptions above, we estimate that  $\text{£}491\text{m}$  of employer debt will no longer be triggered. Over 10 years the present value of aggregate real interest payments net of increases in liabilities will amount to around  $\text{£}56.6$  million – with these interest payments now foregone following the introduction of the proposed policy option, net of the increase in future liabilities that arises as a result of the debt not being paid off, this figure now represents the benefit to employers. On the same basis the average annual real savings will amount to around  $\text{£}6.5$  million – this is a simple average of the annual aggregate interest payments net of the increase in liabilities, expressed in real terms.

38. Although the number of “new cases” used in this costing is expected to be very low, it is possible that if the option was introduced, other employers would use it who would normally have used one of the existing mechanisms for dealing with an employer debt. This would be for scheme- or employer-specific reasons. However as the benefits and the costs for these employers of using option 1 would be broadly the same as for the existing mechanisms, these cases have not been included in the costing; they are instead classed as non-monetised costs and benefits.

<sup>10</sup> This treatment of liabilities has been chosen following guidance from the independent Regulatory Policy Committee.

<sup>11</sup> Source: Bank of England. Data on gilt yields available to download from <http://www.bankofengland.co.uk/mfsd/iadb/index.asp?Travel=NIxIRx&levels=1&FullPage=X4051&FullPageHistory=X4051&Nodes=X401X4052X4053X4054&SectionRequired=I&HideNums=-1&ExtraInfo=true&B4054XBMX4051X4052X4053.x=7&B4054XBMX4051X4052X4053.y=7>

39. The option would maintain the security of members' benefits. In addition members will benefit from the additional flexibility this option gives to employers to run their businesses in a more efficient manner.

## **Risks and assumptions**

40. The monetised benefits shown in this Impact Assessment derive from a dataset holding funding details for PPF-eligible defined benefit schemes as estimated at the end of February 2009, with a further estimate made of assets and liabilities at the end of January 2011. The estimated benefits are critically dependent on scheme funding positions. Defined benefit scheme assets and liabilities are measured on a mark-to-market basis<sup>12</sup> and can fluctuate significantly over very short time periods. The estimated benefits of this measure could therefore themselves fluctuate significantly. For this reason caution should be exercised when considering them.

41. A further important assumption is the borrowing cost faced by employers and the yield on gilts. The yield on both AA corporate bonds and gilts are also market-determined figures. So in principle the estimated benefits are also sensitive to this yield. However, with the exception of 2008, when corporate borrowing costs spiked in the depths of the financial crisis and gilt yields fell to very low levels as investors opted for safety, the spread between AA bond yields and gilts has been fairly steady over time. In practice therefore, the estimated benefits are not as sensitive to bond yields as might initially be supposed, given its long term stability.

42. The other key assumption affecting the size of the estimated benefits is on the proportion of "new cases" - employers who would make use of the easements where previously they would have paid the debt or taken steps to avoid a debt triggering. This is extremely difficult to gauge, but a modest assumption has been used, based on discussions with the industry. If the number of employers making use of the easement turns out to differ significantly from this assumption, then the benefits could also differ significantly. Again, this suggests that caution should be exercised when considering these estimates. Further information on likely take up will be sought in the consultation.

43. Finally, the safeguards put in place under this option are assumed to be effective such that the group guarantee proposal should not increase the risk to the PPF and, more widely, should not increase, or introduce new risks, to members' benefits or to the viability of schemes.

44. There are however a number of risks associated with the proposal, which were articulated by respondents to the informal consultation referred to above. With a guarantee, the trustees of the pension scheme would be giving up their right to an immediate payment of the employer debt in return for the right to a payment in the future. The risk is therefore on the trustees and pension scheme members rather than the guarantors. Steps could be taken to mitigate the risks: for example, the trustees would need to be satisfied about the resources of the guarantors; they would also need to monitor the financial health of the guarantor on an ongoing basis. There would also be a risk to trustees and the pension scheme if the guarantor were located outside the UK.

45. From the perspective of the guarantor, the risk would be that the trustees would take the opportunity of calling in payment of the guarantee on the occurrence of a material adverse change. Some respondents to the informal consultation were of the view that guarantee arrangements would not be entered into with this level of uncertainty about when payment would be demanded.

## **Policy Option 2: Apportionment Arrangements Proposal**

46. The Employer Debt Regulations already make provision for apportionment arrangements. This option would extend those arrangements. Under the existing arrangements, where an employer ("Employer A") undergoes an employment-cessation event an employer debt is calculated; the debt is then passed over or apportioned to another employer ("Employer B"), (with their agreement) and the consent of the trustees of the pension scheme. The trustees in particular have to be satisfied that the apportionment will not have any adverse effect on the future funding of the scheme (they have to carry out the funding test mentioned in paragraph 17).

47. Pension schemes' trustees and advisers have for some time commented that the existing apportionment arrangements are quite limited. One particular issue is why an employer debt needs to

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<sup>12</sup> Their values are determined in the financial markets.

be calculated immediately, when, if it is apportioned, it may not be payable until many years in the future. This is particularly an issue because the calculation of an employer debt can be a costly matter.

48. To address these issues, option 2 introduces a new flexibility into apportionment arrangements. Under the option an employer debt would not be calculated. Instead the liabilities of the departing employer (as above, Employer A) would be reattributed to another employer remaining in the group (Employer B). Commonly this is described as Employer B “stepping into the shoes” of Employer A. (Employer B as part of a corporate group would be willing to undertake this obligation because it would be for the benefit of the group overall.) The effect of this reattribution of liabilities would be that if, at some future time, Employer B ceased to participate in the scheme and its employer debt had to be calculated, it would be calculated by reference to the service of the members of the scheme Employer B had actually employed plus those members who had been employed by Employer A. (It should be noted that this reattribution would only be for employer debt purposes – it would not affect a scheme member’s benefits or their employment record.)

49. Under this option, an employer debt would not be triggered on an employment-cessation event (and hence no debt would need to be calculated) provided that the following conditions were satisfied:

- the funding test was satisfied. Where there were a number of related employment-cessation events, perhaps as part of a corporate restructuring, only one funding test would be needed;
- all of the pensions liabilities of the departing employer were reattributed to another employer remaining in the group; and
- the trustees were content with the arrangements.

50. The advantages of this option are that an employer debt need not be calculated for each employment-cessation event. In fact a debt might only need to be calculated when one of the employers becomes insolvent or when the scheme winds up. Provided scheme records are maintained in proper order the calculation of the amount of the employer debt should be straightforward. The new option builds on existing apportionment procedures which are familiar to pension scheme trustees and advisers. Whereas with option 1 a guaranteed debt could be called in for payment on the occurrence of a material adverse change, this requirement would not apply to option 2. This would also give greater certainty to employers. Under this option, a corporate group could undertake restructuring exercises safe in the knowledge that an employer debt would not be triggered unexpectedly.

### **Costs and benefits of Apportionment Arrangement Proposal**

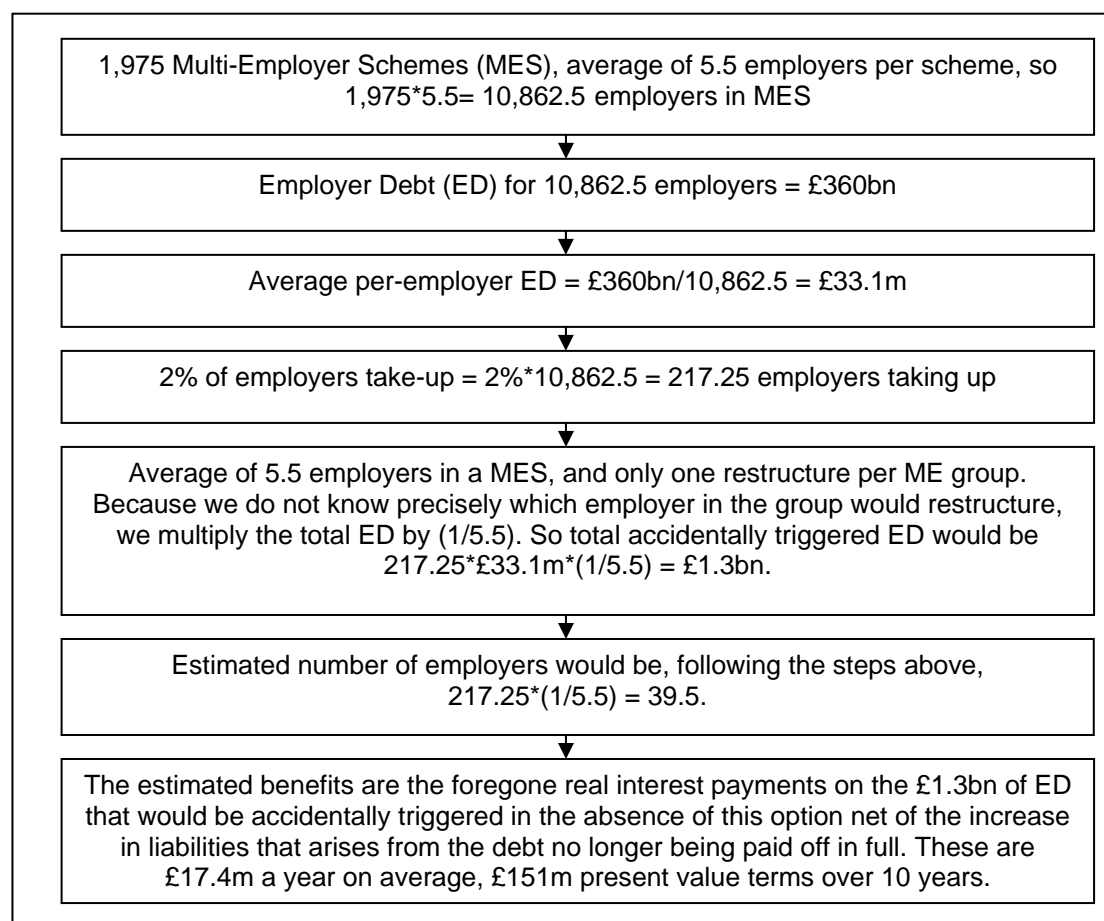
51. The option would mean that instead of paying an employer debt to the pension scheme immediately, the pensions liabilities of the departing employer would be passed to another employer remaining in the scheme. If at some future date that employer underwent an employer debt event, it would be required to pay a debt representing its own liabilities and the liabilities it had taken on from the departing employer. If at that future time, the quantum of the new employer debt amount could not be paid, it is possible that there could be a cost reflected in a reduced level of scheme funding, which would have implications for members’ pension benefits. However, given the very small number of employers to which this option would apply, and the fact that the new debt event might not occur for many years, it is not possible to estimate how many employers might fail to meet their obligations in the future, although this will be small and further reassurance is provided through trustees having to be content with the arrangements.

52. A shortfall in funding could also mean that an eligible scheme had to be admitted to the PPF. The PPF is funded by means of a levy on pension schemes, so potentially there could be a cost, reflected in an increase in the levy payment. But, as it is not possible to estimate the number of employers who will fail to meet their obligations in the future, so it is not possible to estimate the number of schemes that might ultimately be admitted to the PPF for that reason, but it is expected that this will be small for the reasons outlined above.

53. In terms of administrative costs, as with option 1, there would be some one-off administrative, legal and actuarial costs and these are similarly estimated to fall in the range of £40 - 60,000. In order for the apportionment arrangements to be effective, it will be necessary for scheme records to be maintained to a good standard, so that the move of responsibility for liabilities from one employer to another can be tracked. However this is part and parcel of good scheme administration and is something that trustees should be doing anyway. Trustees’ responsibilities in this area are already set out in extensive guidance from the Pensions Regulator. No separate cost has therefore been included for this item.

54. This option uses the same methodology as option 1 for calculating the benefits. However two of the assumptions about take up have changed. Firstly it is assumed that the eligible population for this option would be around 2 per cent of employers in multi-employer schemes – 217 employers. (The equivalent assumption in option 1 is 1 per cent.) The reason for this higher assumption is that option 2 can be used in relation to any kind of employment-cessation event (whereas option 1 can only be used where the employment-cessation event occurs as a result of a corporate restructuring). The second assumption that has been changed is that option 2 is not restricted to wholly owned UK companies; the option can be used by employers in any kind of multi-employer pension scheme. The effect of these two different assumptions is that the estimate for the number of employers who could benefit is around 40. As with option 1, these assumptions err on the side of caution; further information about likely take up will be sought at the consultation. The flow chart below sets out the assumptions underlying this.

### Flowchart showing calculations of estimated benefits for apportionment arrangement



55. The other parts of the costing methodology are unchanged. Based on the assumptions above, it is estimated that £1.3bn of employer debt will no longer be triggered. Over 10 years, the present value of aggregate interest payments will amount to around £151 million. On the same basis the average annual savings will be around £17.4 million.

56. As with option 1, whilst the number of “new cases” used in this costing is low, it is expected that if the option was introduced, other employers would use it who would normally have used one of the existing mechanisms for dealing with an employer debt. This would be for scheme- or employer-specific reasons. However as the benefits and the costs for these employers of using option 2 would be broadly the same as for the existing mechanism, these cases have not been included in the costing; they are instead classed as non-monetised costs and benefits.

### Risks and assumptions

57. The caveats about the assumptions used in option 1 also apply to this option.

58. The main risk attached to this option is that all of the pensions liabilities of departing employers would be apportioned to a single remaining employer, who had insufficient resources to support them. The safeguard against this happening is that the trustees would have to be satisfied about the ongoing funding of the scheme (i.e. the funding test must be satisfied at each apportionment). In addition, if the



trustees still have cause for concern, they can refuse to give their consent to the proposed apportionment. Another risk is that the liabilities would be reapportioned to another employer in the group who was not participating in the scheme, and therefore had no statutory responsibilities towards it. This will be addressed by a requirement in the regulations that any employer to whom liabilities are apportioned must be a participating employer.

### **Policy Option 3: Period of Grace Proposal**

59. Regulation 6A of the Employer Debt Regulations provides for “periods of grace”. The “period of grace” is a provision whereby an employer ceasing to employ an active member of the pension scheme does not trigger a debt if he tells the trustees he intends to employ an active member within 12 months (and in fact does so).

60. The proposal is that the period could be extended beyond 12 months at the discretion of the trustees. Regulations would however limit the trustees’ discretion to extend the period. The limit would be in terms of a maximum period for the period of grace of 36 months from the date of the original employment-cessation event.

61. As now, the employer in respect of whom the period of grace applied would continue to be an “employer” as required by regulation 6A(2) of the Employer Debt Regulations.

62. The Government has also considered a further variant on this option in which there would be no trustee discretion to extend. An automatic extension of 36 months would be allowed in all cases. However, this has been rejected on the grounds that the increased risk to members’ benefits would be unacceptable.

### **Costs and benefits of the Period of Grace Proposal**

63. There are no costs to this proposal. It does not impose anything on employers or require them to do anything differently.

64. The benefits of this proposal are unquantifiable, but are likely to be small. The proposal has been made in response to representations from faith groups. Very small employers are the type of employer most likely to benefit from this proposal. Faith groups have informed the Government that they find it difficult to borrow to pay an accidentally triggered debt – they would have to resort to forced asset sales to pay their debt. In doing so they would incur unnecessary transaction costs as well as the opportunity cost of selling those assets (i.e. the benefit of retaining them). So there are clear benefits of this measure for such employers.

65. No data is available on the employer debts of the affected faith groups; nor is anything known in advance about the likelihood or timing of employment-cessation events which lead to debts being inappropriately triggered. There is no past data on these employment-cessation events which could be applied to estimate the likelihood of any such events occurring in the future. Given this lack of data it is not possible to quantify the benefits but it is expected they will be small with any additional risks being mitigated by this option being available at trustee discretion

66. Scheme members will continue to see their benefits well protected; trustee discretion over the extension of the period of grace ensures that they will not see any increase in the risks to their benefits. They may even benefit from the increased security of their employer as a result of the change.

### **Risks and assumptions**

67. There will be no material increased risks from this proposal to the PPF.

### **Policy Option 4: Do Nothing**

68. There are already a number of mechanisms in the regulations for deferring the payment of employer debt. However the pensions industry continues to press Government for greater flexibility. Albeit that the immediate savings on “new cases” are small, it is likely that either option 1 or 2 would be

useful as an alternative to the existing mechanisms. On balance therefore, the “no change” option is not considered the preferred way forward.

69. In the case of the extended period of grace proposal, Government considers that the current rules are unnecessarily restrictive and could lead to faith groups having to resort to forced asset sales to pay off their unnecessarily-triggered employer debts. A relaxation of the rules would be an improvement - it is possible to make these employers better off without making members any worse off. For this reason doing nothing on the period of grace is not considered a preferred way forward.

### **Costs and benefits of the do-nothing option**

70. There are no additional costs and benefits of this option.

### **Risks and assumptions**

71. There will be no additional risks to members or the PPF.

## **Direct costs and benefits to business calculations (following OIOO methodology);**

72. Options 1 and 2 both constitute a regulatory OUT under the OIOO methodology since they ease the regulatory burden on sponsoring employers of DB schemes. Using the Estimated Annual Net Cost to Business (EANCB) formula cited in the OIOO methodology, option 2, the preferred option, yields an estimated annual benefit to business of £16.6 million. That is, the regulatory OUT from this measure is around £16.6 million a year.

## **Wider impacts**

73. The proposed easements of the employer rules could help improve the sustainability and profitability of the UK corporate sector. This will aid the UK's continued economic recovery.

## **Summary and preferred option with description of implementation plan**

74. Options 1 and 2 address the situation where an employer undergoes an employment-cessation event and does not intend to re-employ an active member of the pension scheme. Under both options, the trustees forego an immediate payment of an employer debt for an arrangement whereby the debt is paid at some time in the future. The gain for employers is financial, in respect of the savings they make from not having to pay interest on borrowings to meet the employer debt. The gain for pension schemes, particularly their members, is indirect. If their employer is stronger, it will be better able to support the pension scheme; and a stronger employer can also lead to greater job security.

75. Option 1, group guarantees, would introduce new guarantee arrangements into pension schemes. Although trustees are familiar with guarantees, they may well have concerns about entering into the complex legal arrangements that they can involve. Trustees may have concerns that once the arrangement is entered into, employers can continue to undertake further corporate restructurings without any employer debt being payable. Trustees may also be concerned that the guarantor can be a body that is not participating in the pension scheme, for example the principal employer who may be based abroad. On the other hand, employers will be concerned about how trustees interpret the requirements on “material adverse change” to call in the payment of the employer debt.

76. Option 2 will be more familiar to trustees and employers in that it builds on the existing apportionment arrangements which are the most commonly used method of addressing employer debt. The obligation to pay the employer debt will remain with another participating employer in the scheme, which will reassure the trustees about the arrangement. Trustees will also like the opportunity to consider each debt event separately and to carry out a funding test to determine whether a reapportionment will have any effect on the scheme. Employers and trustees will both welcome the fact

that a single funding test can be used where there are a group of related employment-cessation events, perhaps on a restructuring.

77. The preferred option is option 2 because it gives trustees and employers increased flexibility within known boundaries. Option 1 on the other hand would mean a significant change to the way that schemes deal with employer debts and would introduce new uncertainties.

78. The proposals are permissive, and would complement (rather than replace) the existing options for dealing with employer debts. Although the “new cases” would be limited, it is expected that, for scheme specific reasons, some of the schemes who would normally use one of the existing mechanisms for dealing with the debt would use option 2.

79. Where an employer temporarily ceases to employ an active member of the pension scheme, the proposal in option 3 is to extend the period of grace from 12 months to a maximum of 36 months. The safeguard in the option is that the extension to the period of grace would be at the discretion of the trustees.

80. The preferred options are therefore options 2 and 3.

81. The proposals are to be introduced by secondary legislation. The aim is to introduce the proposals in October 2011.

## Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

### Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

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| <p><b>Basis of the review:</b> [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review];</p>   |
| <p><b>Review objective:</b> [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?]</p>  |
| <p><b>Review approach and rationale:</b> [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach]</p>  |
| <p><b>Baseline:</b> [The current (baseline) position against which the change introduced by the legislation can be measured]</p>   |
| <p><b>Success criteria:</b> [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives]</p>  |
| <p><b>Monitoring information arrangements:</b> [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review]</p>  |
| <p><b>Reasons for not planning a PIR:</b> [If there is no plan to do a PIR please provide reasons here]<br/>No formal Post Implementation Review is planned, but the operation of the regs will be monitored on an ongoing basis by means of representations and feedback from the pensions community, the Pensions Regulator and the Pension Protection Fund.</p> |