Title: The Occupational Pension Schemes (Miscellaneous Amendment No.2) Regulations 2013 **IA No:** 0036 **Lead department or agency:** DWP **Other departments or agencies:**	Impact Assessment (IA) **Date:** 1/12/2012 **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Caroline Blackett 020 7449 7370 DWP-Private Pensions Policy and Analysis caroline.blackett@dwp.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
Nil	Nil	Nil	Yes	Zero Net Cost

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

Some pension schemes pay bridging pensions up to State Pension Age (SPA) but trustees, without legislation, may not have power under their scheme's rules to change the bridging pensions to take account of the SPA changes. In addition consequential, minor and technical amendments are required following changes to private pension indexation requirements. These include removing references to RPI, and reflecting changes which have been made to general pension provision in pension sharing regulations. If these amendments are not made, anomalies and errors in legislation would remain, creating uncertainty and administrative burdens for pension scheme providers when they calculate members' benefits.

What are the policy objectives and the intended effects?

The objectives and intended effects are to:

- allow trustees to alter scheme rules so bridging pensions can be paid past 65 to new increased SPA
- ensure that the index preferred by the Government for statutory minimum indexation rather than the RPI is used to determine whether pre-1986 leavers should be able to transfer their preserved pension
- ensure that the statutory minimum indexation requirements for certain defined benefit pensions arising from pension sharing on divorce reflects those for defined benefits pensions generally

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

Two options were considered in each case - to do nothing, or to make changes to regulations. In all cases, to do nothing was not considered appropriate since that would leave anomalies or errors in legislation and cause difficulty to the pensions industry when providers tried to calculate benefits due.

A non-regulatory alternative has not been considered as the changes are amendments to existing legislation which needs to be retained. The legislation which is being amended is part of the regulatory framework to which pension schemes must adhere when considering whether and how to provide for indexation to certain pension benefits once in payment or if they wish to transfer scheme members' accrued rights.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 04/2018

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A		**Non-traded:** N/A

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

Signed by the responsible Minister: Steve Webb Date: 5/01/13

Summary: Analysis & Evidence

Policy Option 1

Description: Make changes to regulations

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate: Nil**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional	10	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'

none

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional	10	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'

A transfer involves the trustees paying, to another pension arrangement, a lump sum based on the total expected value of the member's future benefits in the scheme. The changes mean that a small number of pension schemes (those who revalued deferred pension by uncapped RPI but have subsequently switched to uncapped CPI) will not be obliged to offer transfers to certain deferred members (those who left prior to 1 Jan 1986) who historically have not had that right. It is rarely to a member's advantage to transfer from a defined benefit scheme. However, in the small number of cases in which it might be beneficial to the member (where, because of circumstances, the member's transfer value is higher than the benefits he anticipates drawing from the scheme), the scheme will not have to meet the unforeseen additional expenditure of paying a transfer value.

Key assumptions/sensitivities/risks | **Discount rate (%)** 3.5

N/A

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: Nil	**Benefits:** Nil	**Net:** Nil	Yes	Zero net cost

Evidence Base (for summary sheets)

Rationale for intervention

1. Consequential, minor and technical amendments are required to various regulations, following changes to State Pension age and as a consequence of other changes which have already been implemented regarding the indexation requirements for private pensions to:

   - enable trustees, who would not otherwise be able to do so, to modify their scheme rules to continue the practice of paying bridging pensions to scheme members until they receive their State Pension, in line with the changes to State Pension age;
   - reinstate an exemption from transfer rights for certain pre 1 Jan 1986 leavers
   - amend the indexation cap for pension credit benefit (see paragraphs 12 and 15 for definition) from RPI.
   - calculate the indexation level for pension credit benefit rights
   - remove the requirement for annuities bought by pension credit rights in cash balance schemes (see paragraph 18 for definition) to provide for Limited Price Indexation (see paragraph 12 for definition).

   If not made, anomalies and errors in the regulations will remain, creating uncertainty and administrative burdens for pension scheme providers when they calculate members' benefits.

Policy objectives and proposed changes

<u>Bridging pensions: permit schemes to modify their rules to take account of increasing State Pension Age</u>

2. Some defined benefit schemes pay members who retire before State Pension Age (SPA) a higher pension at the outset, which is then reduced at SPA to take account of the payment of State Pension. This enables the member to receive a consistent pension income throughout retirement, albeit the sources of that income vary.
3. The Finance Act 2004 prevents bridging pensions being reduced after age 65. HMRC have announced proposals to amend this to take account of changes to SPA, but trustees may not have power under their scheme's rules to make amendments which take account of the SPA changes. In such cases, the trustees would then be unable to modify the scheme even if they consider this necessary in order to take account of later SPA.
4. The policy is to enable trustees, who would not otherwise be able to do so, to modify their scheme rules in line with the changes to State Pension age in order to continue the practice of paying bridging pensions to scheme members until they receive their State Pension. The proposed changes introduce a limited power to enable trustees, who do not have the power to amend their scheme rules in order to take account of the changes to SPA to modify their scheme if they wish to do so.
5. The regulations do not, however, impose any obligations or requirements as regards what trustees decide. As such, the amendment will not impose any direct costs on business.

<u>Amend the reference to RPI in existing regulation in order to reinstate the exemption from transfer rights for deferred pensions for certain pre 1 Jan 1986 leavers</u>

6. Most scheme members who have left a pension scheme before normal pension age are able to request their rights be transferred to another pension scheme, if the receiving scheme is willing to accept them. However, the right to request a transfer was not extended to deferred members, who, prior to 1 Jan 1986, left either public services schemes or private pension schemes which revalued deferred benefits in full by the Retail Prices Index (RPI), since the value of these benefits in deferment were already being protected against inflation.
7. The RPI was the index that the Government was using at the time for certain public service and State Pension increases although the legislation simply states that the Secretary of State must have regard to increases in the general level of prices. In 2010, the Government considered that the Consumer Prices Index (CPI) was a more appropriate indicator of increases in the general level of prices for

State Pensions, public service pensions and the statutory minimum for private pensions. Therefore, some private pensions have also switched to using CPI, usually as their rules either reference public service pension scheme rules or the statutory minimum.

8. Since CPI has been lower than RPI since the change, it means that any scheme which now used uncapped CPI for revaluation would not be meeting the exemption requirement of revaluing by uncapped RPI.

9. The Government's position is that references to inflation in connection with increasing pensions should refer to the general level of prices as decided by the Secretary of State rather than a specific index. Those deferred members who had been specifically exempted from transfer rights should not gain new rights simply because a different index is being used.

10. By changing the reference to "RPI" in regulations to "the general level of prices", people who continue to receive uncapped revaluation of deferred benefits will not inadvertently acquire new rights simply because their scheme has changed to using the Government's preferred index.

11. The number of people who will have gained this unintentional right to a transfer will be very small and the numbers who would benefit by exercising that right will be even lower. (see paragraph 21). Therefore the savings to schemes of not paying transfer values which would exceed the benefits the person would have drawn from the scheme will be very low.

Amendment of indexation cap for pension credit benefit from RPI.

12. A pension credit benefit is the part of a pension which has been passed from the member to the member's former spouse as part of the financial settlement following a divorce. Courts can grant a pension sharing order for any proportion of the value of the member's pension rights. The pension credit benefit may stay with the original scheme or, frequently, is transferred to another pension arrangement of the former spouse's choice. However, the intention is that if the benefits remain in a defined benefit arrangement, those benefits should be subject to a similar statutory minimum indexation requirement as defined benefit pensions in general. The statutory minimum indexation requirement, known as Limited Price Indexation (LPI), is that defined benefit pensions accrued after 6 April 1997, when in payment, must be increased in line with inflation, subject to a cap of either 5 per cent for rights accrued between 6 April1997 and 5 April 2005 or 2.5 per cent for rights accrued after 6 April 2005).

13. The numbers involved are low. There have been around 10,000 pension sharing orders each year since 2001 (pension sharing has been available for divorce petitions filed after 1 December 2000). Many of these pensions will not yet be in payment and many of those that are will be money purchase benefits.

14. The current statutory minimum level of indexation for schemes which use their own reference period to calculate increases (rather than the annual revaluation order) in the pension credit benefit regulations refers specifically to the Retail Prices Index. The intention is that this is replaced with a reference to the Consumer Prices Index, in line with the change made for such schemes in general by the Pensions Act 2011. This will ensure that pension credit benefits will be indexed in the same way as other pensions including the main scheme benefits from which the pension shares have been derived.

Calculation of indexation level for pension credit benefit rights

15. The intention is that any indexation requirements for pension benefits derived from a pension share should reflect the requirements relating to similar types of pension generally. This means that those benefits derived from defined benefit schemes need to provide for limited price indexation, the only difference with the indexation of pension credit benefits being that the level is dependent on the date the pension share took place rather than the date that the rights accrued. The relevant levels are a cap of 5 per cent for rights shared before April 2005 and a cap of 2.5 per cent for rights shared after that date.

16. The annual Revaluation Order published the statutory minimum figures to be used. However, the pension sharing regulations are not explicit as to which of the figures in the published revaluation order should be used in which circumstances. The proposed change is a minor technical amendment

that will avoid confusion for scheme administrators and trustees by confirming which figures should be used and clarifying the method by which the appropriate indexation figure is calculated.

17. Additionally, the Pensions Act 2011 introduced an easement for schemes which have always indexed by RPI and continue to do so in that they do not have to also track CPI and pay increases based on that for any year that CPI is higher. It has always been intended that this easement will also apply to pension credit benefits and this change will amend the relevant regulation.

Removal of requirement for annuities bought with a pension share held in a cash balance schemes to provide for Limited Price Indexation

18. Cash balance schemes are schemes which provide a lump sum with which the member can purchase an annuity. The difference between a cash balance scheme and a pure money purchase scheme is that the cash balance scheme contains some form of promise or guarantee as to how the lump sum is calculated. This guarantee meant that annuities bought with cash balance benefits needed to provide for limited price indexation. However, the requirement for annuities to be indexed was removed for cash balance schemes from 3 January 2012 by the Pensions Act 2011. The proposed change will bring annuities bought with cash balance schemes derived from a pension credit into line with the requirement for cash balance schemes generally to allow pension credit members to take advantage of the wider choice. There would be no cost or savings to schemes since the starting rate of an indexed annuity is lower than a flat rate annuity to reflect the indexation.

Micro-businesses

19. These proposals apply to pension schemes sponsored by all sizes of business and micro-businesses are not exempted. However, in practice, micro-businesses are unlikely to be involved in the administration of pension schemes. Defined benefit schemes are generally used by employers with a large workforce.

Costs and benefits to business

20. The **bridging pension** changes are deregulatory: they are voluntary, and their use will depend on the wishes of the trustees and the sponsoring employer. They will not impose any obligations or requirements on trustees to make any changes to their scheme. They would simply permit scheme trustees to align their payment of bridging pension with changes to the State Pension age. As such the amendment will not impose any costs on business.

21. The **transfer rights** are deregulatory in that, by preventing certain members gaining new transfer rights, schemes will not be obliged to process applications. They will also prevent, in a specific set of circumstances, the possibility of a scheme having to pay transfer values to members in excess of the benefits that the member would have drawn if they had stayed in the scheme. However, the number of pension scheme members that could gain new transfer rights if the reference to RPI is not amended is likely to be very small (but data is not available). Therefore the **potential benefit to schemes of this change will be very low and could be zero**. A member would have had to satisfy *all* of the following conditions to gain new transfer rights–

    - had left the scheme before 1986 with a preserved pension (likely to have required 5 years service) but has not yet claimed that pension (hence majority of potential members affected will be aged between 47 and 59 with less than 18 years membership earned before age 34, thus the value likely to be low)
    - had been a member of a scheme which offered uncapped revaluation at RPI which switched to uncapped revaluation at CPI following the Government adopting CPI as its preferred index for increasing pensions (at most 39% of private sector schemes but likely to be much lower since most schemes only provide for the statutory minimum revaluation (inflation capped at either 5% or 2.5%) and uncapped revaluation is only offered by a minority of schemes, many of which are former public service schemes.)
    - has a transfer value above the value of their scheme benefits – this is likely to be the case only if individuals have significantly impaired life expectancy (and so will gain little from their scheme benefits which are paid only during the limited years they expect to live)

- being aware of all the above conditions, actively requests a transfer of their benefits and an Independent Financial Adviser signs-off the transfer to demonstrate it is in the member's best interest. The FSA state that "the starting point for pension transfer advice is that a transfer will not be in the member's best interests.

22. This issue has not been raised with the Department by any non-public service scheme pension provider or member. A specific question was asked during the public consultation as to whether any respondents could provide figures on either the number of schemes/members or the value of the benefits involved. Eight respondents agreed that the number of schemes and members involved would be very small but none could provide specific figures or costs. One respondent estimated the number of schemes involved "would be in the tens" and another reported that they administered only one scheme which offered uncapped increases. Several respondents indicated that, in their view, at least some of the relevant schemes would permit such a member to transfer on a voluntary basis, even though the member would have no statutory right to do so. Numbers affected, and hence costs, are therefore expected to be very low.

23. The **indexation changes to pension credit benefit** will not lead to any extra costs to business.

    (i) The amendments which clarify how the indexation figure for pension credit benefit is calculated are minor, technical amendments which are intended to make rules clear and consistent for scheme administrators.

    (ii) The amendments to the indexation rules for schemes which use their own reference period are minor technical changes since they replicate in shared pensions the provisions that have already been made to pensions in general. This amendment is required since separate legislation applies to shared pensions but the saving for employers resulting from the abolition of the underpin were included in the Impact Assessment about the saving to industry from moving from RPI to CPI published July 2011 at http://www.dwp.gov.uk/docs/cpi-private-pensions-consultation-ia-120711.pdf .

    (iii) The change to the indexation requirement for annuities brought with cash balance schemes are also minor and technical since they amend the pension credit benefit legislation to replicate provisions that have already been made for pensions in general. There are no costs or savings to schemes since the starting rate of an indexed annuity is lower than a flat rate annuity to reflect the indexation. The changes are reflected in the Impact Assessment for the Pensions Act 2011at http://www.dwp.gov.uk/docs/pensions-bill-2011-ia-annexf.pdf

24. These measures are in scope for One-in, Two-out policy because they would have a positive effect on business. However the savings are likely to be small and are unquantifiable, and are therefore assessed as having a net zero impact.

Summary and implementation plan

25. The bridging pension changes are being introduced as a result of representations from the pensions industry following the changes to SPA. Other changes are consequential, will ease administrative burdens for business with small (but unquantifiable) savings, and clarify the policy intention of the regulations.

26. It is proposed that a package of amending regulations will be brought forward, coming into force in April 2013.

    The Regulations which will be affected by the proposed changes are:

    The Occupational Pension Schemes (Transfer Values) Regulations 1996 (SI 1996/1847)
    The Pension Sharing (Pensions Credit Benefit) Regulations 2000 (SI 2000/1054)
    The Occupational Pension Schemes (Modification of Schemes) Regulations 2006 (SI 2006/459)

Regulatory Policy Committee	**Validation of the Net Direct Impact on Business**
Title of the 'Validation' Impact Assessment (IA)	The Occupational Pension Schemes (Miscellaneous Amendment No.2) Regulations 2013
Lead Department/Agency	Department for Work & Pensions
IA Number	0036
Expected date of implementation	April 2013
Origin	Domestic
Date IA submitted to RPC	08/01/2013
Date of RPC Assessment	07/09/2012
Date of Regulatory Triage Confirmation	29/01/2013
Regulatory Triage Assessment reference	RPC12-FT-DWP-1532(2)
Departmental Assessment	
One-in, One-out (OIOO)status	IN SCOPE
Estimate of the Equivalent Annual Net Cost to Business (EANCB)	Zero Net Cost
RPC Validation	
Direction of Impact	OUT
Estimate of the Equivalent Annual Net Cost to Business Validated by RPC	Not quantified

RPC comments

The IA says *"the bridging pension changes are being introduced as a result of representation from the pensions industry following the changes to SPA. Other changes are consequential, will ease administrative burdens for business with small (but unquantifiable) savings, and clarify the policy intention of the regulations"* (paragraph 25). On this basis the IA assesses the proposal to be in scope of OIOO with a zero net cost to business. However, as the proposal is an amendment to existing regulations, which is expected to have a positive impact on business, it must be classified as an OUT to be consistent with the OIOO Methodology. As the impacts are likely to be negligible, it has not been deemed proportionate to quantify them. This appears to be a reasonable assessment.

Signed		**Michael Gibbons,** Chairman