Impact Assessment for the Pensions Act (Transitional and Consequential Provisions) Regulations 2014

Introduction

1. The definition of money purchase benefits is a key component of pensions law. The regulatory framework that protects members of occupational pension schemes is built on the understanding that money purchase benefits cannot develop a funding deficit. Consequently they are not subject to a regulatory regime in respect of funding or accrued rights in the same way as occupational non-money purchase schemes.

2. The Pensions Act (Transitional and Consequential Provisions) Regulations 2014 (the Transitional Regulations) to be made under sections 30, 31 and 33 of the Pensions Act 2011 (and other regulation making powers in pensions legislation) will provide transitional and consequential measures or modify the effects of section 29 of the Act.

3. Section 29 of the Pensions Act 2011 clarifies the definition of money purchase benefit, and this clarified definition will come into force with retrospective effect from 1 January 1997[1]. It will remove the uncertainty created by a Supreme Court judgment (*Bridge Trustees v Houldsworth and another (2011)* (*Bridge)* made on 27 July 2011 on the legal definition of money purchase benefits in section 181 of the Pension Schemes Act 1993. The judgment gave rise to the possibility that a benefit which could face a funding deficit could be considered money purchase.

4. Immediately following the Supreme Court's judgment the Government released a statement making clear its intention to restore the legal definition of money purchase benefits to one under which a deficit could not arise. The Government's intention was to notify the pensions industry of the impending changes so that they had an early opportunity to comply and were reassured that if they were acting in accordance with the Government's understanding then they would be validated with retrospective legislation.

5. This impact assessment does not cover section 29 of the Pensions Act 2011. An enactment impact assessment was published in 2011 and showed no new impact on business as the clarified definition of money purchase benefits in section 29 simply restored the policy intention that existed prior to the Judgment.[2]

6. The Transitional Regulations will come into force at the same time as the commencement of section 29 and will provide transitional and consequential measures and modify legislation as appropriate.

7. The Supreme Court case highlighted that some scheme trustees and scheme managers had used a definition of money purchase benefit

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[1] This is the earliest relevant instance of money purchase pension in existing legislation.

[2] See paragraphs 12 to 14 and Table 1 of the *Summary of Impacts* and paras 28 to 32 of *Annex F: Other Pension Bill Measures* at https://www.gov.uk/government/publications/pensions-act-2011-impact-assessment

incompatible with the government view and therefore with the clarified definition in section 29 of the Pension Act 2011. The Transitional Regulations made under sections 30, 31 and 33 (and other regulation making power in pensions legislation) are intended to ease the practical burdens these schemes may face in order to comply with section 29 when it comes into force.

8. Section 32 of the Pensions Act 2011 gives powers to amend the clarified definition. The transitional regulations do not use this power because it is not necessary to meet the policy objectives.

Issue

9. This impact assessment covers the Transitional Regulations made under sections 30, 31 and 33 of the Pension Act 2011 (and other regulation making power in pensions regulations).

10. The Regulations discussed in this impact assessment will make consequential and supplementary changes to manage the effects of commencing section 29. They will introduce transitional arrangements limiting the retrospective impact of the clarified definition in respect of other pensions legislation in certain circumstances so that affected schemes have to either comply from a future date or from a date after 1 January 1997.

Policy objectives

11. There are three key policy objectives:

- **Protection for members.** Government will ensure it meets its obligations under article 8 of the European Union's Insolvency Directive (2008/94/EC) and articles 15 – 17 of the Directive on the activities and supervision of institutions for occupational retirement provision (2003/41/EC)(the IORP Directive) to protect member benefits;
- **Minimising the burden on industry and provide clarity and certainty in the law.** The Transitional Regulations (sections; 30,31,32) are intended to ease the practical burdens schemes may face in order to comply with s.29 when it comes into force and to modify the effect of existing legislation on schemes that will become subject to the protection regime/legal framework for Money Purchase Schemes, and provide for consequential changes. They also provide clarity and certainty as to how the regulatory requirements in both primary and secondary legislation apply to occupational pension schemes over a transitional period. The measures also modify the effect of existing legislation on schemes newly subject to the protection regime; and provide for consequential changes;
- **Consistency with Departmental and Governmental priorities**. Clarifying the law through sections 29 of Pension Act 2011 and the Transitional Regulations made under section 30, 31 and 33 of the

Act fulfils the Government's earlier commitments and ensures clarity and consistency in the existing legal framework.

Options

12. Option Zero: Do nothing following commencement of section 29 of the Pensions Act 2011. This means all schemes would be required to comply with section 29 from 1 January 1997 on commencement.

13. Option One: Use regulation making powers 30, 31 and 33 in the Pensions Act 2011 (and other regulation making power in pensions regulations) to modify the effects of section 29 of the Act and to make transitional and consequential provision for schemes which may have taken decisions based on a different understanding of money purchase benefits to that defined in section 29 or as understood prior to the *Bridge* judgment.

14. There is no alternative to regulations that would achieve the policy objectives.

15. The Government prefers Option One.

Rationale for Preferred Option

16. To support scheme trustees and scheme managers who may have used a definition of money purchase benefit incompatible with that in section 29 of the Pension Act 2011, and could face costs as a result, the Transitional Regulations under sections 30, 31 and 33 will:

    - give schemes time to ensure they can comply with section 29 and meet the necessary legal and funding requirements attached to non-money purchase benefits while ensuring members have access to the appropriate protection mechanisms;
    - ensure other pensions legislation is aligned with section 29; and
    - where it is proportionate to do so and with due regard for the affect on members' benefits, modify the requirements of particular legislation from 1997 to the date of commencement.

17. Failure to make these transitional, consequential and modifying provisions could give rise to unnecessary costs, without noticeable benefit to members, by requiring trustees and scheme managers of affected schemes to revisit past decisions. The Regulations will also ensure that members of schemes affected by the judgment in *Bridge* and section 29 will have access to pension protection and that trustees and scheme managers have certainty as to how the law applies to their scheme.

Costs and Benefits

Monetised and non-monetised costs and benefits of each option

18. The information the Government holds on these schemes is self reported and not monitored or confirmed.

19. There are approximately 40,000 private occupational pension schemes in the UK which include money purchase benefits. About 2% of these are hybrid schemes, meaning they contain both money purchase and salary-related or other defined benefits.

20. The Government commissioned additional questions in the Pensions Regulator annual survey to gather information on the numbers of schemes that may be affected, and engaged with the wider pensions industry in an effort to narrow down the number of schemes potentially affected. The information provided was inconclusive and efforts to assess the monetary costs and benefits to schemes are ongoing.

21. Based on this engagement the Government believes that only a small number of hybrid schemes share some or all of the particular characteristics (self-annuitisation, a notional interest rate or a guarantee that the accrued fund would not fall in value) that were the subject of the judgment in the Bridge and therefore could be likely to be affected by section 29. The Government will test this assumption in the consultation exercise to be published on 31 October 2013.

22. The definition contained in section 29 when commenced will come into force with effect from 1 January 1997. If regulations under section 30, 31 and 32 are not made schemes may have to revisit past decisions to ensure that they have acted consistently with that definition.

23. The Government understands that in most circumstances revision of this sort would be impractical. Therefore the Transitional Regulations will, in those circumstances, modify the effect of specific legislation either on a transitional or ongoing basis.

24. Prospectively, the Transitional Regulations will give schemes affected by section 29 appropriate time to become compliant, while ensuring that members are not excluded from protection mechanisms.

25. Benefits that are already recognised by their trustees or scheme managers as non-money purchase will not be affected by commencement of section 29 and therefore the Transitional Regulations will have no impact on them.

Summaries of policy areas and intended action

26. The Transitional Regulations will impact on a number of existing policy areas and the legal framework for pension schemes. Each of these policy areas is addressed separately below.

27. Section 29 will apply with retrospective effect from 1 January 1997. However the impact of other legislation will be modified in some

circumstances to prevent non-money purchase regulatory requirements applying with retrospective effect. In other areas, such as employer debt, legislation will be modified so that some schemes newly affected by section 29 will be required to comply with requirements only from 27 July 2011 in some circumstances.

28. This is the date of the judgment in the *Bridge* and of the Secretary of State's announcement of the Government's intention to legislate retrospectively to restore the law to the position it bore immediately after the judgment in a previous case, *KMPG v Aon Trustees (2005)* which confirmed the Government's understanding on this point.

29. Section 29 will apply to both occupational pension schemes and personal pension schemes. The former are sponsored by an employer and are typically trust-based, while the latter take the form of arrangements between a pension provider and individual, which may or may not be work-based.

30. Benefits under personal pension arrangements are regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Prudential Regulation Authority ensures at least the equivalent protections in the form of capital requirements for providers and support for members in the event of provider insolvency.

31. No consequences to existing legislation affecting personal pension schemes resulting from the commencement of section 29 have been identified and therefore there is no need for regulations to be made in respect of them.

Summary of policy proposals and potential impact

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Scheme funding (Part 3 of the Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005)	**Proposal:** • Schemes which were considered wholly money purchase but are newly recognised as providing non-money purchase benefits are subject to scheme funding provisions from April 2014. • Actions taken by schemes before this date are not revisited. • Hybrid schemes will not be required to repeat valuations or conduct out of cycle valuations.	• Schemes will benefit, because they do not have to open up past decisions, where: • Trustees considered their scheme to be wholly money purchase, but recognise that some or all of the benefits offered mean that the scheme can no longer be a money purchase scheme. If any such schemes exist, the sponsoring employers may face additional costs if the scheme is not currently funded to the appropriate level; • In non-money purchase schemes, some of the benefits offered were considered to be money purchase and would be defined benefits under section 29, trustees will not have to repeat historic actuarial valuations. No risk to members because the assets and liabilities considered to be money purchase would have previously been excluded from funding valuations relating to the defined benefit part of such a scheme. • This will not give rise to any costs for members. They will benefit because schemes will have to fund their promises.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Employer debt (section 75 of the Pensions Act 1995 and Occupational Pension Schemes (Employer Debt) Regulations 2005)	**Proposal:** • Employer debt decisions since July 2011 may need to be reviewed to ensure consistency with the section 29 definition where trustees have not taken into account the Government announcement of intent to legislate retrospectively. • Actions take by schemes before this date are not revisited.	• Schemes will benefit compared to the do nothing option. Any employer debt decisions will need to be revisited, but not for the period before July 2011. • No cost should arise in respect of schemes revisiting decisions since July 2011, because schemes should have taken the Government's announcement in respect of section 29 into account and made decisions accordingly. If administrative costs do arise here it is because the schemes have not behaved prudently and taken the announcement of the Government's intention to restore the definition of money purchase benefits with retrospective effect. • An employer debt event which was calculated in a manner inconsistent with section 29 would create a burden on the remaining employers in a multi-employer scheme – allowing section 29 to be effective from July 2011 will redress this burden by spreading the risk across a greater number of employers. • The payment of an employer debt to a scheme reduces the risk to the remaining employers and to member benefits, and therefore represents only distributional costs / benefits. It may also strengthen the employer covenant and thus reduce PPF levy payments.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Winding up (Part 3 of the Pensions Act 2004 and Occupational Pension Schemes (Winding Up) Regulations)	**Proposal**: • Winding up decisions will not need to be revisited prior to July 2011. They may need to be reviewed after that date to ensure consistency with section 29 definition only where trustees have not taken into account the Government's announcement of intent to legislate retrospectively. • Actions taken by schemes before this date are not revisited.	• Beneficial to schemes (and their sponsoring employers) which began winding up prior July 2011 on a non-section 29 basis. There is no way of quantifying this benefit or even knowing if there are any employers in this position. • Members or employers owed money by schemes which began winding up prior to July 2011 on a non-section 29 basis could conceivably benefit from the scheme having to go back and revisit earlier decisions. However the Government has no way of quantifying this benefit or knowing if it would definitely arise. Since allocation of assets in winding up is a zero sum process any benefit to one member or employer in relation to a multi-employer scheme would be matched by an equal cost to another.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Pension Protection Levy (section 175 of the Pensions Act 2004)	**Proposal**: • Schemes which are recognised as non-money purchase on commencement of section 29 are required to pay the pension protection levy from 2014/15 levy year.	• Beneficial to schemes as they will not have to pay retrospective levy. • Members of schemes which are newly recognised as non-money purchase will receive Pension Protection Fund (PPF) protection should the scheme be underfunded and experience an employer insolvency event after April 2014. • Members of schemes which were previously thought to be wholly money purchase have no recourse to PPF protection where there has been an insolvency event pre-April 2014. It is not thought that there are currently any schemes in this position.
Pension Compensation (Schedule 7 of the Pensions Act 2004 and the Pension Protection Fund (Compensation) Regulations 2005)	**Proposal**: • Clarify the arrangements for the conversion of non-money purchase lump sums that are not part of cash balance scheme into compensation.	• No impacts. • Necessary as current legislation governing payment of compensation in respect of cash balance benefits is unclear.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Internal annuities from additional voluntary contributions (AVCs)	**Proposal:** • Transitional arrangements for members with internal annuities from money purchase AVCs and those who take them up until April 2015 will allow these annuities to be treated as money purchase benefits for pension protection purposes.	• Benefits members with AVC internal annuities in payment at the coming into force date and those who take them out during the following year if their scheme winds up or enters the Pension Protection Fund in the future. • Possible marginal costs to non-money purchase members where using scheme assets to discharge AVC internal annuities in full reduces the assets available to be shared among the remaining members (to a minimum of PPF pension compensation levels).
Financial Assistance Scheme (FAS) (Financial Assistance Scheme Regulations 2005)	**Proposal**: • Transitional arrangement to allow for decisions made between 2011 and commencement of section 29 to remain as they are.	• Beneficial to schemes in FAS as they will not have to attempt to revisit past decisions. • There is no cost associated with these regulations. Even if section 29 were commenced without making these regulations it would be a practical impossibility to revisit past decisions. Theoretically if such a revision were possible it would alter the allocation of assets for schemes in FAS but would not alter the overall value of assets. Therefore this is a distributional impact.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Indexation (sections 51 – 54 the Pensions Act 1995 and the Occupational Pensions Schemes (Indexation) Regulations 1996)	**Proposal:** • Minimum statutory indexation requirements would apply to benefits recognised as non-money purchase from April 2014, unless they are cash balance schemes which are already exempt. No interference with benefits already subject to indexation under scheme rules or statutory requirements. • No additional minimum indexation requirements would be applied before this date.	• Without this provision schemes would face confusion as to how to act which could lead to unnecessary administrative and legal costs. Therefore they will benefit from these provisions.
Revaluation (sections 83-86 Pension Schemes Act 1993)	**Proposal**: • Use regs to make clear schemes do not have to revisit revaluation of benefits and pensions which have already been put into payment. • Also to introduce a new revaluation methodology for cash balance schemes.	• Schemes will have clarity and certainty about which revaluation method to use. • It is theoretically possible that some members might benefit from past revaluations being revisited, but this is unlikely and the benefits would be negligible.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Preservation (Part IV of the Pension Schemes Act 1993 and the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991	**Proposa**l: • Revoke redundant/obsolete regulation 10. • Repeal regulations 14 and 14A and replace with provision setting out how to calculate short term impact.	• Schemes will have clarity and certainty about their legal obligations. • Trustees/scheme managers will benefit from having clarity and certainty in the law. Will not give rise to extra costs.
Transfers (sections 93-101 Pension Schemes Act 1993 and Occupational Pension Schemes (Transfer Value) Regulations 1996)	**Proposal**: • Transfers regulations are subject to section 29 from April 2014. • Actions taken by schemes before this date are not revisited. • Under Option 0, this legislation would apply from 1997.	• Benefits to schemes, which will not have to face the administrative costs of unpicking past decisions. • Some members would have benefited substantively from revisiting transfers, while others might lose out. • Scheme might have benefited substantively as they would have been able to reduce transfer values of benefits recognised as non-money purchase rather than valuing them in full as money purchase. However the Government understands that these would be significantly outweighed by the associated administrative costs.

Policy area/legal framework for pension schemes	Preferred Option: modify affect of section 29 on pensions legislation using regulations	Impact
Disclosure Occupational Pension Scheme (Disclosure of Information) Regulations 1996	**Proposal**: • Amend Disclosure of Information regulations to ensure schemes with cash balance benefits should disclose some information to members on the same basis as that applying to money purchase benefits.	• Benefits to members who will get the most appropriate information. • The Government expects that affected schemes, being hybrid schemes, will already be familiar with both types of disclosure.
Pension Sharing on Divorce (Schedule 5 of the Pensions Act 2008 and the Pension Protection Fund (Pension Compensation Sharing and Attachment on Divorce etc) Regulations 2011)	**Proposal**: • Where schemes are in the process of valuing pension rights or implementing a pension sharing order prior to commencement of section 29, allow them to continue doing so with whichever method they are using. • We will also make provision to preclude revisitation of orders already implemented. • From April 2014, valuations in respect of pension sharing on divorce regulations will need to be based on the clarified definition.	• Benefits to schemes, members and members' former spouses involved as they do not face the costs and delays of revisitation. • Theoretically some members might benefit from revisiting decisions already taken, while other members might lose out to an exactly equal degree. However that would likely to be negligible.

Policy area/legal framework for pension schemes	**Preferred Option:** **modify affect of section 29 on pensions legislation using regulations**	**Impact**
Equal Treatment	**Proposal**: • Small amendment to clarify that schemes can continue to use differing actuarial factors for men and women when self-annuitising money purchase benefits.	• Schemes will have clarity and certainty about their legal obligations. It does not change the outcomes.

Further detail on proposed regulations and their affect on other pensions legislation

Impact of Transitional regulations on schemes and employers

Winding up

32. Pension schemes complete wind up when all assets and liabilities are discharged or transferred to a separate scheme. Winding up may be triggered by the sponsoring employer's insolvency. If the scheme assets are insufficient to fund all the benefits under the scheme, then the scheme must wind up in accordance with section 73 of the Pensions Act 1995, which sets the priority order by which the liabilities must be discharged. Winding up provisions in primary legislation are principally contained in Part 3 of the Pensions Act 2004 and section 73 of the Pensions Act 1995.

33. However, section 73 of the Pensions Act 1995 only applies to non-money purchase schemes. Where a scheme with money purchase benefits becomes under-funded there is no statutory priority order which applies, as, until the *Bridge* judgment, it was not possible for a money purchase scheme to become underfunded except where there was fraud or error.

34. When section 29 of the Pensions Act 2011 is commenced it will apply from the 1 January 1997. It will not, however, affect schemes which have wound up prior to 27 July 2011, as these schemes have ceased to exist and therefore related employer debt events cannot be revisited. This will be clarified by transitional arrangements in the regulations. Schemes currently winding-up in line with the clarified definition will be validated, but decisions made using an incompatible definition will need to be revisited and potentially unpicked.

Impact

35. Regulations under sections 30, 31 and 33 will be used to modify the retrospective application of winding up legislation so that wind-ups that commenced before July 2011 are not required to be reopened. This should be seen as a cost saving for schemes because past decisions will not need to be revised. (Trustees would have been required to do this without the measures proposed in the Transitional Regulations).

36. This provision will benefit schemes which have made winding up decisions before July 2011 using a definition of money purchase benefits incompatible with the clarified definition. With these regulations those schemes will not need to undertake a revision of their past decisions. The Government does not believe that this will have any adverse impact for the Pension Protection Fund or members, because schemes with affected benefits will have discharged these benefits (in full) as money purchase benefits.

37. Some employers in relation to multi-employer schemes that began winding up prior to July 2011 and on a basis incompatible with section 29 could conceivably benefit from the scheme having to go back and revisit earlier decisions. However, we have no way of quantifying this benefit or even knowing if there are any employers in this position. Since allocation of assets and winding up is a zero sum process any benefit to one employer in relation to a multi-employer scheme would be matched by an exactly equal cost to another.

38. All schemes that have commenced wind-up since 27 July 2011 should have done so with knowledge of the Government's stated intention to clarify the definition. The consultation document published on 31 October 2013 will ask for further evidence from trustees.

Deficiencies in assets – Employer debt

39. When an employer's relationship with a scheme offering non-money purchase benefits ends, there may be a requirement for a payment of an employer debt to the pension scheme. An employer debt can be triggered by the insolvency of an employer participating in a pension scheme or by the scheme commencing a voluntary wind up, or when an employer stops employing active members in a multi-employer scheme when at least one other employer continues to employ active members. Employer debt provisions are principally contained in section 75 of the Pensions Act 1995, the Occupational Pension Schemes (Employer Debt) Regulations 2005 and the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008.

Impact

40. Regulations under sections 30, 31 and 33 of the Pensions Act 2011 will be used to modify the retrospective application of the employer debt legislation where schemes are newly affected by section 29. This means that such schemes will not be required to re-open employer debt decisions already taken prior to 27 July 2011. This date is when the Government stated its intention to restore the legal definition of money purchase benefits to one under which a deficit could not arise.

41. By limiting retrospection to only as far back as July 2011 the Government will reduce the obligation on affected schemes, which would otherwise have to revisit decisions as far back as 1997. That would be a disproportionate cost as trustees and scheme managers would only have been aware of the Government's intention to pass clarifying legislation from July 2011.

42. The transitional arrangements allow debt to be pursued by the trustees and scheme managers, ensuring that the burden of debt is fairly allocated between departed employers and those remaining in the scheme.

43. The Government's expectation is that, since the statement in July 2011, any schemes experiencing an employer debt should have taken account of that statement, and therefore the commencement of section 29 should not change the funding position of these schemes, or increase employer

debt.

44. Costs could arise where trustees failed to take into account the Government's statement and therefore have to revisit past decisions. The Government is not aware of any schemes in this situation. If employers did depart without paying in respect of their full share of the deficit in line with the clarified definition this share could then fall to the remaining employers in a multi-employer scheme with insufficient funding, or impact adversely on members.

45. The consultation on the draft regulations, published on 31 October 2013, will seek evidence from trustees and remaining members as to whether costs would arise.

Revaluation

46. Where a member has left a scheme prior to normal pension age, schemes are required to revalue many deferred benefits relative to inflation when that member reaches that age. For non-money purchase schemes, this is generally done by reference to the annual revaluation order or in accordance with the scheme rules, if these are more generous. However, average salary benefits relating to deferred members may be revalued on the same basis as the basis used to revalue the benefits of active members. In the case of money purchase benefits, the member must receive any investment income growth on the preserved fund that he would have received if he had still been an active member.

47. With the commencement of section 29, there may be schemes which have put into payment benefits which have been revalued in a way incompatible with the new definition. Schemes could face administrative costs if they were obliged to revisit calculations made prior to the commencement of section 29.

48. The Government also appreciates that the detail of the final salary, average salary and money purchase methods of revaluation do not apply neatly to many cash balance schemes. A new cash balance method of revaluation, based on the same principles as the money purchase and average salary methods, that active and deferred members should be treated in the same way; will give trustees and scheme managers a further alternative to the default final salary method with the Revaluation Order.

49. The Government is not aware of evidence of any scheme in this situation but understands that they exist. The consultation document published on 31 October 2013 will ask for further evidence from trustees.

50. Revaluation provisions are principally found in sections 83-86 Pension Schemes Act 1993.

Impact

51. Regulations in respect of cash balance benefits will ensure that the benefits of active and deferred members may be revalued in the same way and give schemes certainty as to how this may be done. This may

include no revaluation for deferred members if the benefits of active members are not revalued under the rules of that particular scheme.

52. The Government also intends to ensure that where benefits have been revalued by the application of notional interest or investment growth, schemes are not required to revisit this. In addition, trustees and scheme managers will have the option of revaluing cash balance benefits accrued before the coming into force of section 29 by the money purchase method. The requirement in section 72 of the Pension Schemes Act 1993 (no discrimination between long and short service members) will ensure that the investment growth on the funds is applied fairly to both deferred and active members' benefits.

53. Going forward, the provision of a revaluation method specifically for cash balance schemes will give trustees and scheme managers of those schemes a clear, easy-to-administer option for revaluation.

54. The provisions which allow trustees and scheme managers to use the money purchase method in relation to periods before the commencement of section 29 will avoid the need for trustees and scheme managers to undertake complex and possibly costly reviews of benefits already in payment and seek costly legal advice.

Indexation

55. Indexation is the amount by which a pension in payment is increased each year to take into account the effect of inflation. Schemes are required to increase non-money purchase benefits accrued after 1997 by a minimum of Limited Price Indexation.[3]

56. Money purchase benefits have not been subject to indexation requirements since 2005. Pensions resulting from cash balance benefits are required, where the pension came into payment prior to the 3 January 2012, to be indexed to at least Limited Price Indexation.

57. Indexation regulations are principally contained in Sections 51 – 54 of the Pensions Act 1995 and the Occupational Pensions Schemes (Indexation) Regulations (1996).

Impact

58. The effect of commencement of section 29 of the Pensions Act 2011 on affected benefits would not be clear in the absence of consequential modifications of the indexation requirements. In some circumstances it would impose an indexation requirement on incomes in payment, the terms of which would have already been agreed between the member and the scheme or annuity provider. To add indexation to such benefits would mean revisiting and unpicking that decision at additional cost.

59. The Government will ensure that the statutory minimum indexation requirements do not apply, going forward, to any scheme pensions

[3] Limited Price Indexation requires that, once in payment, pensions accrued between 1997 and 2005 must be increased by inflation capped at 5 per cent per annum. For pensions accrued from 2005 onwards, the figure is inflation capped at 2.5 per cent per annum.

derived from funds which were either money purchase or cash balance benefits in the accrual phase and which are not required to be indexed under the rules of the scheme or under a statutory requirement.

60. Transitional arrangements will ensure that there is no impact on the indexation rate of any existing pensions in payment. Where a pension in payment derived from cash balance benefits came into payment prior to 3 January 2012 and was not subject to indexation, the transitional measures will allow the pension to be continued to be paid at a flat rate after the commencement of section 29.

61. This will benefit schemes which will not have to revisit the terms of existing agreements or pay the associated administrative costs.

62. The Government is not aware of evidence of any scheme in this situation but understands that they exist. The consultation document published on 31 October 2013 will ask for further evidence from trustees.

Preservation

63. Legislation provides a level of benefit protection to a member of an occupational pension scheme who has accrued benefit but leaves before the normal pension age of that scheme. This is referred to as preservation.

64. Commencing section 29 of the Pensions Act 2011 will create technical inconsistencies between section 74 of the Pension Schemes Act 1993 and the Preservation Regulations by suggesting that a benefit which meets certain criteria could still be a money purchase benefit, whereas section 29 means it should be a non-money purchase benefit.

65. Preservation regulations are principally found in sections 71 to 76 Pension Schemes Act 1993.

Impact

66. To repeal regulations 14 and 14A of the Preservation Regulations on commencement of the transitional arrangements for section 29 and replace them with a clarified regulation setting out how short term benefits should be calculated.

67. This will benefit trustees and scheme managers who had faced uncertainty as to the effect of the regulations now being repealed. This does not give rise to costs.

68. The Government is not aware of any schemes that will be affected by this. The consultation in late summer 2013 will ask for further evidence from trustees.

Transfers

69. A member of a pension scheme can transfer the value of their pension to another scheme or an insurance provider in the accumulation phase subject to certain conditions. For money purchase benefits the transfer amount is the current cash value of the fund. For non-money purchase benefits, other than cash balance benefits, schemes take account of the

projected preserved pension that would be payable at the scheme's normal retirement age and the value of the fund needed to provide that pension. For all non-money purchase benefits, the transfer value may reflect any deficit within the overall fund.

70. Transfer regulations are principally found in sections 93 to 101 of the Pension Schemes Act 1993 and Occupational Pension Schemes (Transfer Value) Regulations 1996.

Impact

71. A new provision will enable the transfer value of non-money purchase benefits which are cash balance benefits to be calculated at the current value of the fund, including any notional interest, guarantees, bonuses or discretionary payments but subject to an adjustment if the scheme is underfunded. This will make it easier for schemes to calculate the transfer values of these benefits and explain it to members.

72. Regulations will be made to ensure that section 29 will have only prospective effect for the purposes of transfers.

73. It is necessary to make it clear that the transfer value of money purchase benefits cannot be reduced to reflect scheme underfunding, but that transfer values for non-money purchase benefits, which can become underfunded, may be reduced proportionately to scheme underfunding in that category of benefits.

74. To do anything different might mean that a member's transfer value could be determined to be higher than the underlying assets. This would impact detrimentally on the scheme's stability. Therefore this measure is beneficial to schemes as it increases their stability and protects their funding level.

75. Revisitation of past transfers between schemes would be practically very difficult.

76. It is theoretically possible that there would be some distributional impact between schemes if their transfer value was revisited. However the Government believes that the administrative costs associated with this would be disproportionate.

Pension Protection Levy

77. Section 175 of the Pensions Act 2004 requires the Board of the Pension Protection Fund to impose an annual levy on occupational pension schemes with members who may be eligible to receive compensation.

Impact

78. Regulations under sections 30, 31 and 33 of the Pensions Act 2011 will be used to modify the retrospective application of the levy requirements. This will ensure trustees do not have to revisit past valuations or conduct out of cycle valuations. This should be seen as a cost saving for schemes because they will not need to construct historic valuations (which trustees would be required to do without the regulations covered in this impact assessment).

79. Any schemes that have not undertaken previous valuations because they believed themselves to be money purchase will be treated as if they were a new scheme from the commencement date of section 29 of the Act. They will be required to pay a pension protection levy and treated as eligible from this point in time. The Government believes that there are no schemes of this type which have suffered, or are likely to suffer, an insolvency event between 2005 and the date that section 29 will come into force. Therefore, members of these schemes will not be left unprotected in the period before section 29 comes into force.

80. For hybrid schemes already paying levy on non-money purchase elements, modifying the effect of section 29 will save the cost of obtaining out of cycle valuations. It will also ensure that past valuations will not need revisiting.

81. Levy bills take account of scheme assets and liabilities and revisiting them in respect of benefits previously treated as money purchase could result in over and underpayments. The practical implications of such a task would be complex and costly for schemes and the Pension Protection Fund and would not benefit other levy payers.

Pension Compensation

82. At present legislation on how the Pension Protection Fund pay pension compensation is primarily based on the scheme having promised the member an income in retirement. Pension compensation provisions are principally set out in primary legislation in schedule 7 to the Pension Act 2004.

83. Where the scheme has offered a guarantee on a lump sum to the member, for example using a guaranteed minimum investment return, there is no income stream. On retirement the member would normally take the lump sum and convert it into an income stream either on the open market, or through a mechanism provided by the scheme itself.

84. The Pension Protection Fund is currently able to pay compensation to members of cash balance schemes which guarantee the amount of a lump sum under the compensation provisions for such schemes. However there is no provision for non-money purchase lump sums that are not part of a cash balance scheme.

Impact

85. Regulations under sections 30, 31 and 33 of the Pensions Act 2011 will clarify the process by which a non-money purchase lump sum is converted to periodic compensation. By applying standard actuarial factors to the lump sum, it could be turned into an income, which is comparable to pension compensation. This will then be regarded as the protected pension rate, to which compensation arrangements can be applied.

86. Members with a guarantee on a lump sum whose schemes enter the Pension Protection Fund will be provided with a mechanism through which they can be paid compensation.

87. This may not give rise to administrative costs for either schemes or members since it merely provides a method for the Pension Protection Fund to take in the rights and to pay compensation. This will apply from the commencement of section 29.

88. The Government is not aware of any schemes in this situation. The consultation document published on 31 October 2013 will ask for further evidence from trustees.

Internal annuities from additional voluntary contributions

89. Some schemes offer members the option on retirement of using their additional voluntary contributions to take a pension from the scheme funds rather than buying a pension from an external provider. Such benefits will not be money purchase once actuarial factors are applied to the accumulated fund to convert it to an income stream in the form of an internal annuity. In the past such internal annuities have been treated as money purchase benefits for pension protection purposes.

90. At present if the scheme entered the Pension Protection Fund the member would receive compensation for the salary related pension scheme and an external annuity purchased by the scheme in place of the internal annuity they were receiving from scheme funds. On commencement of section 29 of Pensions Act 2011 the internal annuity will not meet the definition of money purchase benefits so the compensation would be calculated on the combined total of their salary related pension and internal annuity.

91. For members who have not yet reached normal scheme retirement age and have not taken early retirement on medical grounds an age related cap is applied and compensation is paid at 90%. This means that a few members who retire early could receive significantly less benefit.

Impact

92. For scheme members in receipt of an internal annuity at commencement of section 29, transitional arrangements will allow such benefits to continue to be treated as money purchase benefits. As such the trustees or managers of the scheme could discharge them from scheme funds should the scheme enter a Pension Protection Fund assessment period. Members with internal annuities bought with additional voluntary contributions and which are in payment at the coming into force date will benefit if their scheme winds up or enters the Pension Protection Fund as their pension payment will not be reduced.

93. Where a scheme winds up outside the Pension Protection Fund, treating internal annuities as money purchase and discharging in full will reduce the scheme assets available to meet non-money purchase benefits with a lower priority. This could potentially reduce non-money purchase benefits for scheme members to a minimum level of pension compensation that would have been paid by the Pension Protection Fund.

94. Internal annuities would also be treated as money purchase benefits for

the purposes of the section 73 priority order if the scheme winds up outside the Pension Protection Fund. This means that the member will continue to receive the full amount of their annuity, without it being potentially reduced in line with Pension Protection Fund compensation rules.

95. This protection will also be extended to scheme members who use money purchase additional voluntary contributions to purchase an annuity within twelve months of the coming into force of section 29.

96. This approach allows time for members who are making additional voluntary contributions to be made aware that if they choose an internal annuity in the future, their benefit will be not be treated as money purchase from that point for pension protection purposes.

97. The Government is not aware of any members in this situation. The consultation document published on 31 October 2013 will ask for further evidence from trustees and scheme managers.

Scheme funding

98. Trustees of *s*chemes containing non-money purchase benefits must obtain regular actuarial valuations. If a funding deficit is identified a recovery plan must be prepared setting out how the deficit will be eliminated. Scheme funding requirements are principally set out in primary legislation in Part 3 of the Pensions Act 2004, and in the Occupational Pension Schemes (Scheme Funding) Regulations 2005.

99. Section 29 of the Pensions Act 2011 applies from 1 January 1997. Past scheme funding valuations in line with the clarified definition will be validated by the commencement of section 29, but without suitable transitional arrangements, valuations which used an incompatible definition may need to be revisited and potentially unpicked.

Impact

100. Regulations under sections 30, 31 and 33 will be used to modify retrospective application of the scheme funding provisions in cases where schemes are affected by the commencement of section 29. This should be seen as a cost saving for schemes because historic valuations will not need to be revised (which they would need to do without the regulations covered in this impact assessment). This will not reduce member protection as, where trustees or scheme managers believed affected benefits were money purchase, the assets and liabilities relating to those benefits should have been set aside.

101. However, liabilities in hybrid schemes for non-money purchase benefits accrued in relation to periods of pensionable service will be required to be taken into account for the purposes of prospective valuations in accordance with Part 3 of the Pensions Act 2004, regardless of whether they were accrued before or after the commencement of section 29. This will apply where a scheme contains benefits which are covered by section 29, but which have been treated as money purchase benefits in previous valuations.

102. Schemes which will no longer be recognised as wholly money purchase once section 29 is in force will be required to obtain an initial actuarial valuation with reference to an effective date not later than one year from the date of commencement of section 29 (a position analogous to a newly created scheme). Engagement with the industry and the Pensions Regulator suggests that there will not be many schemes in this position.

103. Prospectively these schemes will still have to meet the requirements associated with being non-money purchase. However regulations will lift the need for them to go back over past funding valuations. These regulations will therefore benefit schemes which would otherwise have to take action to revisit past decisions in light of the Supreme Court's decision.

Financial Assistance Scheme

104. The Financial Assistance Scheme came into operation in September 2005 and the relevant regulatory provisions are contained in the Financial Assistance Scheme Regulations 2005. It helps members of qualifying schemes who have suffered losses to their defined benefit pensions as a consequence of employer insolvency, generally between 1 January 1997 and 5 April 2005. The majority of these schemes are transferring their defined benefit related assets to the Government in return for assistance. Money purchase liabilities in these schemes are discharged separately as they are not covered by the Financial Assistance Scheme.

105. The Supreme Court's judgment has caused uncertainty amongst qualifying schemes that have yet to complete the transfer of assets to government which offered money purchase benefits affected by section 29.

106. The Government understands that most of these schemes used an interpretation of money purchase benefits which equates to that arrived at in the Supreme Court judgment. This meant that these schemes could not finalise the allocation of assets against liabilities until the Government clarified its intentions regarding the implementation of section 29 and related transitional arrangements.

107. The retrospective nature of section 29 could also generate risks for qualifying schemes that have already wound up using the Supreme Court interpretation as they might be considered to have acted illegally unless their actions are transitionally protected.

Impact

108. The Government does not intend to unpick decisions already taken in relation to the treatment of affected money purchase benefits in qualifying schemes which used either the Pensions Act 2011 or the Supreme Court's interpretation of money purchase benefits.

109. This means that schemes:

- which applied the Pensions Act 2011 interpretation will be protected retrospectively by the commencement of section 29;

- which wound up using an interpretation similar to the Supreme Court interpretation of money purchase benefits will not be required to revisit past decisions;
- which are still in the process of allocating assets and have used the Supreme Court interpretation of money purchase benefits to date will not be expected to unpick their calculations. The transitional regulations will allow for these benefits to be discharged as money purchase.

110. This approach will avoid uncertainty for scheme members and the further erosion of limited assets due to additional administration costs.

111. Even if section 29 were commenced without supporting regulation it would be a practical impossibility to revisit past decisions. Theoretically if such a revision were possible it would alter the allocation of assets for schemes in the Financial Assistance Scheme but would not alter the overall value of assets.

112. The Government is not aware of any schemes in this situation. The consultation document published on 31 October 2013 will ask for further evidence from trustees.

Equality

113. The Sex Equality Act 2010 (Sex Equality Rule) (Exceptions) Regulations 2010 are made using the power in paragraph 5(2) of Schedule 7 of the Equality Act 2010. These Regulations contain permitted exceptions to the Sex Equality Rule in the Equality Act. Regulation 4 allows the use of actuarial factors which differ for men and women in relation to the calculation of employers' contributions in certain circumstances and the provision of certain benefits.

Impact

114. The Regulations will be amended to make give certainty that schemes which apply different actuarial factors for men and women when converting money purchase benefits to a rate of scheme pension will continue to be able to do so.

115. This will not give rise to any costs.

Pension sharing (on divorce)

116. The value of pension rights are included as part of the couple's assets on divorce or dissolution of a civil partnership, for the purpose of calculating a financial settlement. Options include either sharing the value of the pension or offsetting the value. If pension sharing is chosen, the pension rights are valued a second time, immediately before the pension sharing order is implemented.

117. Pension sharing on divorce legislation is mainly contained in Welfare Reform and Pensions Act 1999 and associated regulations.

Impact

118. Money purchase and non-money purchase pensions are valued in different ways. If a scheme valued the rights by the money purchase method but then, after the commencement of section 29 of the Pensions Act 2011, had to value the rights by the non-money purchase method, complexity and confusion could arise. This could lead to an administrative burden on schemes.

119. Regulations made under section 31 of the Pensions Act 2011 will ensure that, where a scheme is in the process of valuing pension rights or implementing a pension sharing order, the scheme can continue using the same valuation method, rather than switch during the implementation process.

120. This provision will benefit schemes which are in the process of valuing pension rights in respect of a member's divorce. They will not be required to undertake a costly revision of valuations already in progress.

121. Theoretically some members would benefit from revisiting decisions already taken, while other members would lose out to an equal degree. However this cost is likely to be negligible since the disposition of assets is based principally on the underlying value of the benefits, rather than their classification. Further, any benefit to one part would be equal to the cost of the other.

122. The Government is not aware of evidence of members in this situation but understands that some may be. The consultation document published on 31 October 2013 will ask for further evidence from trustees.

Disclosure

123. The disclosure regulations set out the information which must be disclosed in certain situations; to whom the information must be disclosed; the timescales for doing so, and the manner in which the information should be provided.

124. Some disclosure requirements currently apply only to money purchase benefits, while others apply only to non-money purchase benefits.

125. The policy intention is that the distinction should be drawn between:

    - pensions that in accumulation principally comprise a defined set of assets, even if they are also subject to other factors such as a guaranteed rate of return; and
    - pensions that, in accumulation are defined in terms of a defined income in retirement.

126. This is because different types of information are useful to members in respect of each of these benefits.

127. The Government will therefore amend the disclosure regulations to reflect this intention.

128. When a member approaches retirement the Government would want to ensure that schemes are required to disclose the right to the Open

Market Option (to buy an annuity from an insurance provider) and provide the relevant information to those members who have that right. The right to the Open Market Option is contained in the Finance Act 2004 and is not amended or affected by bringing into effect section 29 of the Pensions Act 2011. The disclosure regulations will be amended to reflect the Finance Act 2004 definition.

129. Disclosure regulations are principally found in the Occupational Pension Scheme (Disclosure of Information) Regulations 1996 (SI1996)

Impact

130. This will benefit members who will receive the appropriate information.

131. The Government expects that affected schemes, being hybrid schemes, will already be using both types of disclosure and therefore will not face additional costs.

Risks and Assumptions

132. Although the Pensions Regulator reports that only 2% of the 40,000 private occupational pension schemes in the UK which include money purchase benefits are hybrid schemes, the Government has no way of knowing how many, if any, of these will be affected by commencement of section 29 of the Pensions Act 2011. Only schemes which have been acting inconsistently with the definition of money purchase benefits set out in section 29 will be affected.

133. The Government will test these assumptions through consultation later this year.

One In, Two Out

134. The regulations to be made using sections 30, 31 and 33 (and other pensions legislation) of the Pensions Act 2011 are in scope for One-In, Two-Out.

135. Those schemes that have not acted in accordance with section 29 or the understanding of money purchase benefit prior to the *Bridg*e judgment would benefit from these measures. For example the regulations would give schemes a limited time following the commencement of section 29 to comply.

136. In other circumstances the measures require schemes to take further action and may be deemed regulatory.

137. The proposed transitional arrangements should allow schemes more time to comply with the legal framework for occupational pension schemes and greater certainty as to how it applies to them. This will minimise any practical burdens where trustees and scheme managers held a different understanding of money purchase benefits to the Government.

138. The Government is repealing regulations 14 and 14A of the Preservation Regulations and replacing them with a clarified regulation setting out how short term benefits should be calculated. Neither represents an Out

as there are no savings to business as a result of the repeal.

139. It is not possible to quantify the benefits at this stage. The consultation document is intended to elicit information that may allow the Department to quantify the number of schemes affected and to monetise the benefits.

Wider Impacts

140. These regulations will support the Government’s commitment to ensure it pays to save, by ensuring that members who have made additional voluntary contributions receive the amount they expect.