Title: Enabling the transfer of contracted-out pensions in payment to new pension schemes that have never had contracted-out provisions.	# Impact Assessment (IA)
IA No: DWP2017_06	**Date:** 25/04/2017
RPC Reference No:	**Stage:** Final (Validation)
Lead department or agency: Department for Work and Pensions	**Source of intervention:** Domestic
Other departments or agencies:	**Type of measure:** Secondary legislation
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Summary: Intervention and Options

RPC Opinion: Awaiting Opinion

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year**	**One-In, Three-Out**	**Business Impact Target Status**
0	0	0	In scope	In scope

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

DWP has identified that for some Defined Benefit (DB) pension schemes facing financial difficulties a solution that both protects the interests of members and ensures the sustainability of the scheme is to transfer members' rights, with their consent, to a new scheme. Whilst the current legislative regime permits transfers of active and deferred *(definitions explained in Annex A)* contracted-out pensions rights, with members' consent, to new schemes, it prevents the transfer of contracted-out pensions that are in payment to new schemes that have never had contracted-out provisions. The current legislation was implemented to protect contracted-out pensioners from being transferred into new schemes which may not protect their contracted-out rights. However, with the ending of State Earning Related Pension (SERP) and 'contracting-out' in April 2016, it is no longer legislatively possible to create a new scheme with contracted-out provisions in the scheme rules. That means it is currently impossible to transfer contracted-out pensioners into a new scheme even where it would be beneficial to them (i.e. potentially resulting in higher pension than if the current scheme's financial difficulties would lead to their transfer into the Pensions Protection Fund). This regulatory barrier means pensions received may be lower as a result.

What are the policy objectives and the intended effects?

The objectives are (i) to maximise the level of pensions that pensioner members of schemes facing financial difficulties receive, and, in some cases, (ii) to help sponsoring employers avoid insolvency.

The intended effect is to allow schemes to provide an alternative option for contracted-out pensioner members where the only current option would be to enter the PPF, such that they have the potential opportunity to receive a higher level of pension than the PPF level of compensation *[see Annex A for an explanation of the PPF compensation level]*.

To meet these objectives and to deliver the intended effects, the proposed option will enable contracted-out pensions that are in payment to be transferred to new schemes that have never had contracted-out provisions, subject to a number of conditions. This is currently not permitted by the existing legislation.

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

Option 1: Do nothing.

Doing nothing would mean that pensioner members who have contracted-out in the past would have to remain with their current scheme, and, in cases where their sponsoring employer becomes insolvent, would have no alternative but to enter the PPF. This means these members and their schemes will have fewer choices when it comes to finding optimal solutions (maximising their pension receipts) where their sponsoring employer is or about to become insolvent. As a result, members may end up receiving a lower pension than they would in the absence of this regulatory barrier.

Option 2 (the preferred option): Amend existing legislation to allow the transfer, under specified conditions, of contracted-out pensions in payment to new schemes that have never been contracted out.

The legislative change would allow the transfer, under specified conditions *(as set out below)*, of contracted-out pensions in payment to new pension schemes that have never had contracted-out provisions. It would only be applicable to those employers and schemes that enter the PPF Assessment Period or a Regulated Apportionment Arrangement (RAA) (*see Annex A for explanation of the definitions*), where opening a new scheme could better protect their members' interests.

A scheme and its sponsoring employer would only be able to request permission from the Pensions Regulator (tPR) to transfer its members (with the consent of members) to a new scheme if they had evidence that their sponsoring employer is insolvent or the pension liabilities are causing significant insolvency risks to the sponsoring employer. The trustees of the scheme will have to be satisfied that such an arrangement would not be detrimental to the members' interests. In addition, the pensioner members will always be able to choose between remaining in the old scheme (and potentially transferring into the PPF) and accepting the offer to transfer into a new scheme.

The proposed deregulatory change will be permissive. No scheme (or sponsoring employer) will be required to make use of it. They will only choose to take advantage of this option where there is an agreement among all involved parties that a transfer would be in the members' best interest, and consent is given by scheme trustees and members for the transfer to take place. This change will provide a greater choice of options to sponsoring employers, schemes and members where the sponsoring employer may be facing insolvency risk.

Alternatives to regulation.
Alternatives to regulation have not been considered, as legislation is required to amend the existing law.

Will the policy be reviewed? It will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?		N/A		
Are any of these organisations in scope?	**Micro** Yes	**Small** Yes	**Mediu m**Yes	**Larg e**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, 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: ....

Summary: Analysis & Evidence

Policy Option 1

Description: Enabling the transfer of contracted-out pensions in payment to new pension schemes that have never had contracted-out provisions.

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2017	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	**High:** 0	**Best Estimate:** 0

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0		0	0
High	0	**1**	0	0
Best Estimate	0		0	0

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

Counterfactual (base case scenario)

The counterfactual scenario is one where contracted out pensioner members will have no other option but to enter the PPF along with their old scheme where the sponsoring employer becomes insolvent.

Costs to businesses

Net additional costs – summary.
The proposed measure is permissive. We expect that businesses (i.e. sponsoring employers in this context) will only seek to or agree to make use of it if, on balance, the benefits outweigh the costs – i.e. there is no additional net cost to business when compared against the counterfactual.

Implementation and administrative costs.
Additional implementation and administrative costs are assessed to be zero. The assessment is based on informal engagement with key stakeholders.

The responses received from the informal engagement with key stakeholders suggested that there could be some implementation and administrative costs incurred under the counterfactual scenario, which are:
- communicating the move to the PPF to the scheme members;
- completing a template of member data, which is required by the PPF when transferring members to them;
- updating administrative software to pay out the PPF level benefits instead of the original scheme's benefits.

The same responses suggested that there would be similar costs associated with moving pensioners into the new scheme (i.e. the proposed option), which are:
- communicating the move to the new scheme to the scheme members;
- closing off the existing payroll and setting up a new payroll and banking arrangements;
- updating scheme's administrative software to pay out the level of benefits that the new scheme will be providing.

Both of the responses received from stakeholders suggest that on balance there will be no or negligible additional familiarisation, implementation, and administrative costs to businesses. One states that '*the impact on administrative costs of transferring members to a new scheme, relative to transferring them to the PPF is broadly neutral',* and another one that *'overall our assessment is that the cost of transferring pensioners to the PPF and* the new scheme [DWP's note] *would be close to the same and effectively met from* the scheme's [DWP's note] *assets in either scenario'*. Therefore our assessment is that on balance there will be no or negligible additional implementation and administrative costs to businesses.

It is also worth noting that because a pensioner member has no statutory right to transfer (and is unlikely to have such a right under a scheme's rules), any costs incurred will be costs that a scheme incurs voluntarily by offering these members the transfer option.

Familiarisation costs.
Familiarisation costs are assessed to be zero or negligible.

HMRC will announce this change in regulation and (will likely) broadly explain what they do in their 'Countdown' bulletin for June 2017. The bulletin regularly goes out to all schemes, so they will not incur any additional cost in obtaining it. Usually, if not always, it is the advisers to the schemes and to the employers who will read up on the new legislation. We expect that the advisory packages that the schemes and employers have in place as part of their business as usual do not charge a separate fee per each topic included in the bulletin, and thus reading about the option will not result in an additional cost.

We expect that schemes will decide to acquaint themselves thoroughly with this legislation only if they are in financial difficulty and need to. We expect the schemes not in financial difficulty will not go any further than reading the bulletin when it comes to familiarising with the option as it is not relevant to them anyway. Also, we expect that the schemes not in financial difficulty that do not have any regular advisory package and/or do not read the bulletin as part of their usual business will not be familiarising with the option at all as it is not relevant to them.

Schemes in financial difficulty, i.e. those sponsored by the employer facing insolvency, will need to familiarise themselves with the options and processes in both the base case and if they consider choosing / choose to use the new option (usually they will have administrators assigned to them who will have to consider all possible options). If one of the options explored is a new scheme any advice given will be part of a packaged fee and there should be no marginal addition to this fee.

In addition to informing about the new option in the bulletin, we are in the process (as at April 2017) of updating HMRC's general guidance for schemes that will be available on Gov.UK, and we intend to make some changes there to explain how these new transfers take place. The advisors will be able to take advantage of this free guidance.

Costs to members

Familiarisation and implementation costs.
We expect that it will be the scheme's responsibility to provide all relevant information to the members to help them make an informed choice. Members may still seek some independent financial advice as they would in the absence of the proposed measure as well (e.g. in situations where they are at risk of or about to enter the PPF). Therefore we assume that there will be zero additional spend for members on seeking independent financial advice. We have no evidence, incl. anecdotal, which would suggest otherwise.

Loss of benefits.
Scheme members will always be able to choose between staying in the old scheme which would be transferred into the PPF or accepting the offer to transfer into a new scheme (formal member consent will be needed before the transfer into a new scheme can happen). We expect that they will choose to transfer into a new scheme only when it is beneficial to them. Also, scheme trustees, who are obliged to work in the best interest of members, would have to approve the arrangement – which we expect will mitigate any residual risk associated with imperfect information at an individual/personal level. On this basis we assess that members will incur no loss of benefits (i.e. zero cost).

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	0	1	0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'
No benefits monetised as it is not possible to determine the extent of the difference between the pensions under the counterfactual and this option.

A high level indication of potential scale of benefits is given in the section below.

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

Benefits to businesses (sponsoring employers in this context)

The proposed change could potentially benefit sponsoring employers who enter into a Regulated Apportionment Arrangement (RAA), under certain circumstances (where creating a new scheme is being considered as an optimal solution). By transferring their pension commitments into a newly created scheme they may have a better chance of operating on an ongoing basis rather than potentially become insolvent because of their DB pension burden.

We are not able to quantify the benefit at this stage. It will depend on how many sponsoring employers will be in the situation where they may benefit from the proposal and make use of it, their financial situation, business specifics, and several other complex factors. We do not have sufficient quantitative evidence needed to quantify the benefit.

In the instances where the sponsoring employer has become insolvent and the scheme has entered a PPF Assessment period, we do not expect that any new arrangement will be of any benefit to the business as it will not materially change the fact that they are unable to operate on an ongoing basis anymore anyway.

Benefits to members

As set out above, the proposed measure will allow the possibility, under specified circumstances and conditions, for pensioner members to receive higher pensions than the compensation level pension that the PPF would provide otherwise – i.e. a direct financial gain.

We are not able to quantify the benefit at this stage. It will depend on how many members will end up being transferred over into new schemes, and by how much their benefits would exceed the PPF compensation level. However, to illustrate the fact that some members are likely to benefit substantively we present an example. As set out in the Pensions Regulator's letter to Frank Field sent on 14 March 2017, in that particular case all members would be better off in a new scheme than under the PPF, with around two-thirds of them estimated to receive a benefit that has a value which could be up to 30% higher than the PPF level, and the remaining one-third greater than 30% of the PPF level (*more details are set out in Annex B*).

High level indication of potential scale of benefits

In terms of the businesses and schemes within scope, as at 6 April 2016 there were about 5,900 private sector DB schemes sponsored by about 2,500[1] private sector employers. It is highly likely that their schemes will have at least one pensioner who had contracted out. The proposed option may apply to them only under certain specific circumstances (*as set out above*), and we expect that most employers will be able to adequately fund their pension schemes and will never make use of it. Only a very small minority of schemes enter a PPF Assessment Period or a RAA. As of November 2016, there have been a total of 26[2] schemes approved by tPR in regards to RAA. In addition, the number of schemes in PPF Assessment Period peaked in 2010 and has been steadily declining since then; there were 96 schemes in the PPF Assessment Period as at 31 March 2016[3]. And it is important to note that only a subset of them may consider and make use of the option.

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

The assessment of familiarisation, implementation, and administrative costs is based on two responses we have received from the key stakeholders. Although the responses confirm our understanding and we are reasonably confident in our conclusions, we have to acknowledge that other schemes and sponsors may, in theory, have different views.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**Score for Business Impact Target (qualifying provisions only) £m:**
Costs: 0.00	**Benefits:** N/A	**Net:** 0.00	0.0

[1] Source: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/538963/employers-overview-state-pension-changes-fact-sheet.pdf

[2] Source: http://www.thepensionsregulator.gov.uk/foi/list-of-schemes-which-have-received-an-raa-october-2016.aspx

[3] PPF, Purple Book 2016.

Evidence Base (for summary sheets)

Problem under consideration:
DWP has identified that for some occupational pension schemes facing financial difficulties a solution that both protects the interests of members and ensures the sustainability of the scheme is to transfer members' rights, with their consent, to a new scheme. However, the current legislative regime does not permit the transfer of contracted-out pensions that are in payment to new schemes that have never had contracted-out provisions. Given that contracting-out was ended in April 2016 no newly created scheme can have contracted-out provisions, which means contracted-out pensioners are not allowed to be transferred and potentially benefit from higher levels of pension in the new scheme.

Rationale for intervention:
The proposed legislative change is needed to allow the possibility for pensioner members to benefit from being transferred into a new scheme, rather than potentially transfer into the PPF where they will receive reduced benefits.

Policy objective:
The objectives are (i) to maximise the level of pensions that pensioner members of schemes facing financial difficulties receive, and, in some specific cases, (ii) to help sponsoring employers avoid insolvency.

Description of options considered (including status-quo):
Option 1: Do nothing.
Doing nothing would mean that pensioner members who have contracted-out in the past would have to remain with their current scheme, and, in cases where their sponsoring employer becomes insolvent, would have no alternative but to enter the Pensions Protection Fund (PPF).

Option 2 (the preferred option): Amend existing legislation to allow the transfer, under specified conditions, and with member's consent, of contracted-out pensions in payment to new schemes that have never been contracted out. It would only be applicable to those employers and schemes that enter the PPF Assessment Period or a Regulated Apportionment Arrangement (RAA).

Alternatives to regulation have not been considered, as a legislation option is required to amend the existing law.

Monetised and non-monetised costs and benefits of preferred option (including administrative burden):
The proposed measure is permissive. We expect that businesses (i.e. sponsoring employers in this context) and trustees on behalf of the scheme members (pensioners) will only seek to or agree to make use of it if, on balance, the benefits outweigh the costs – i.e. there is no additional net cost to businesses and members when compared against the counterfactual.

Additional familiarisation, implementation, and administrative costs are assessed to be zero. The assessment is based on responses received from the key stakeholders, which suggested that there could be some costs - communicating with members, closing off the existing payroll and setting up a new payroll and banking arrangements, and updating scheme's administrative software. However, similar costs would be incurred under the counterfactual (if the scheme was to move into the Pensions Protection Fund), and therefore the additional costs are likely to be zero or negligible.

The proposed option could potentially benefit sponsoring employers who enter into a Regulated Apportionment Arrangement (RAA), under certain circumstances (where creating a new scheme is being considered as an optimal solution). By transferring their pension commitments into a newly created scheme they may have a better chance of operating on an ongoing basis rather than become insolvent because of their DB pension burden. We are not able to quantify the benefit at this stage.

The proposed measure will allow the possibility, under specified circumstances and conditions, for pensioner members to receive higher pensions than the compensation level pension that the PPF would provide otherwise – i.e. a direct financial gain. We are not able to quantify the benefit at this stage, but have an example case which illustrates that some members may get high higher pensions than the compensation they would be getting from the PPF otherwise.

Direct costs and benefits to business calculations (following BIT methodology);
Zero net cost. Benefits not quantified.

Summary and preferred option with description of implementation plan.
Legislation will be changed to allow the possibility for contracted-out pensioner members, with their consent, to be transferred into a new scheme.

Annex A

Explanation of definitions

Pension Protection Fund (PPF) Assessment Period.
All schemes go through an Assessment Period before entering the PPF. PPF must be notified when insolvency occurs (such as the appointment of administrators) at a company that sponsors a DB pension scheme. Subsequently PPF will work with the scheme's trustees to obtain necessary information to determine if the scheme is eligible to pass into the PPF or not.

PPF aims to complete the assessment for most schemes within two years. During this period PPF ensures that all the data held for schemes is accurate, and the trustees are responsible for informing their members about all aspects of the assessment process. The final stage of this section is the production of a section 143 valuation by an actuary. This is a confirmation of whether the scheme can pay member benefits at or above PPF levels. If not, the scheme will transfer to the PPF.

Regulated Apportionment Arrangement (RAA)
A Regulated Apportionment Arrangement is a statutory mechanism which allows a company to free itself from its financial obligations to a pension scheme in order to avoid insolvency, provided that certain conditions are met and the RAA is approved by both the Pensions Regulator and the PPF. More details can be found on the Pensions Regulator's website[1].

PPF compensation level
PPF pays compensation to those Defined Benefit (DB) occupational pension scheme members whose sponsoring employer has become insolvent and where the scheme is unable to secure benefits at least equal to the level of compensation the PPF provides. The PPF compensation level is based on the member's pension or accrued benefits, at:

- 100% for anyone who was over the scheme's normal pension age at the date of employer insolvency or who was paid their pension on the grounds of ill health, or who was in receipt of a spouse/dependant's pension; and
- 90% for everyone else, subject to a cap (which currently produces maximum compensation of £33,678 a year at age 65); and
- Important: the inflation protection given to PPF compensation may be less generous than the level which would have been provided by the original scheme.

Active member
A current employee who is contributing to (or having contributions made on their behalf to) an organisation's occupational pension scheme.

Deferred member
A member of an occupational pension scheme who has accrued rights or assets in the scheme but is no longer actively contributing (or having contributions paid on his behalf) into the scheme, and is not receiving their pension yet.

[1] http://www.thepensionsregulator.gov.uk/docs/regulated-apportionment-arrangements-statement-august-2010.pdf

Annex B

An illustration of potential benefits to members when transferring into a new scheme – BHS case

A summary of the distribution of the number of members (in BHS' occupational pension schemes) split by the value of new scheme benefits as a percentage of the value of PPF benefits is provided in the table below.

Table 1. Distribution of the value of benefits in the new scheme compared to the PPF levels.

Percentile Range[2]	Number of members	Percentage of members
100% to 110%	1,588	8%
110% to 120%	5,434	29%
120% to 130%	5,206	27%
130% to 140%	2,606	14%
140% to 150%	1,980	10%
150% to 160%	1,739	9%
Over 160%	490	3%

Source: tPR's letter to Frank Field, 14 March 2017.[3]

This is a particular case based example for the purposes of illustrating how beneficial the proposed option could be. The total benefit will depend on how many affected cases will be in the future, and what level of benefits each of them will derive from the transfer into a new scheme. The degree to which the value of benefits in the new scheme exceeds the value of those in the PPF depends on a number of factors, including capped benefits, service dates and type of pension, life expectancy and commuted pensions.

[2] of the value of new scheme benefits as a percentage of the value of PPF benefits.

[3] Published online: http://www.parliament.uk/documents/commons-committees/work-and-pensions/Correspondence/Letter-from-Pensions-Regulator-to-Frank-Field-re-future-of-BHS-pension-schemes-14-03-2017.pdf