Regulatory Policy Committee

The Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2018

Department for Work and Pensions

RPC rating: fit for purpose

Description of proposal

Where an employer, who is participating in a multi-employer occupational defined benefit pension scheme, ceases to employ any active members of the scheme, legislation sets out the requirements for what is commonly known as 'employer debt'. The employer debt is the amount of money that the employer must pay into the scheme if it is underfunded in order to relinquish responsibility for the scheme. This debt is currently required to be paid up front, as a lump sum, into the pension scheme. In recognition that this may not always be feasible or necessary, existing legislation provides for a number of alternative arrangements, such as flexible apportionment or a period of grace.

Employers within 'non-associated multi-employer schemes' (where employers are from unconnected businesses or organisations) are, however, much less likely to be able to take advantage of these arrangements. These employers are often small or not-for-profit businesses. To address this, the proposal is to introduce a new deferment option that would provide these employers with an arrangement to defer the payment of an employer debt arising on ceasing to employ an active member.

Impacts of proposal

The proposal will benefit business by providing an option that will allow employers to manage employer debt flexibly, allowing them to pay smaller individual amounts over time (known as deficit repair contributions, or DRCs) rather than paying an up-front lump sum. The main steps in the calculation of business benefits are as follows:

i) Non-associated multi-employer schemes with a 'last man standing' structure (where all assets and liabilities are held together, and the scheme does not wind-up until the last employer withdraws and is liable for the remaining deficit) are expected to be the main beneficiaries of the proposal. Data from the Pensions Regulator indicate that there are at least 22 such schemes. The total 'buy-out' deficit of these is £50 billion. With 5,000 employers in these schemes, this implies an average employer debt (per employer) of £10 million.

ii) Based upon evidence from the pensions industry gathered for the IA on the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2011, the Department assumes that one per cent of the 5,000 employers will take up the proposal, i.e. the deferment option. Assuming that half of these will take up the option during the next ten years, the Department estimates that the proposal will affect around £25 million of employer debt per year that would need to be paid up-front under the present arrangements.

iii) Under the proposed deferment option, it is assumed that DRCs are paid over eight years, based on the actual average DRC payments length observed across defined benefit (DB) schemes, in equal amounts each year. DRCs are based on the same underlying debt but calculated on the statutory funding objective (SFO) (also known as technical provisions - TP) basis because of regulatory requirements. The Department assumes that the employer debt estimated on the full buyout basis is equal to 140 per cent of the same underlying debt estimated on the SFO/TP basis. This is in line with the calculation used by the Department and its arm's-length bodies when illustrating DB pension deficit on different bases, and is driven primarily by differences in required assumptions of future returns on investment. An employer debt of £25 million on the full buyout basis is, therefore, equivalent to approximately £17.9 million on the SFO basis.

iv) Benefits to businesses are calculated by comparing the profiles of the employer debt payments. The profile under the counterfactual is the employer debt calculated on the full buyout basis and paid in full up-front (£25 million each year). The profile under the proposed option is the employer debt calculated on the SFO basis and paid in equal amounts over eight years (£2.23 million each year). Payments in the counterfactual and proposal are assumed to maintain their value in real terms and are, therefore, discounted at the Treasury (real) discount rate of 3.5 per cent. Discounted costs under the counterfactual and proposal are £215.2 million and £132.1 million, respectively, making a saving to business of £83.1 million in present value terms. This equates to an equivalent annual net direct cost to business (EANDCB) of -£8.7 million.

Quality of submission

The Department's assessment of the overall impacts of the measure, including the impacts on business, is fit for purpose. Where the evidence to support assumptions is limited and the impact particularly uncertain, the Department undertakes useful sensitivity analysis.

Following discussions between the RPC, the Department and the Treasury's Green Book team, the Department revised its method of estimating the benefits of the proposal. The benefits are now calculated by comparing the before, and after, time profiles of employer debt payments. This replaces the previous method based on interest payments avoided on loans assumed to be taken out by businesses to finance the up-front payment. The change in method reflects that estimates of business impact in economic (as opposed to financial) appraisals do not normally take into account how businesses choose to finance their liabilities. The RPC is satisfied that the new approach is consistent with Treasury Green Book methodology. The IA would benefit from including a discussion, drawing upon the financial analysis in the previous version of the IA, of businesses potentially experiencing greater financial savings where they would otherwise have had to finance the up-front payment through a loan.

The IA would be improved by some further assessment of wider impacts, described below.

- The IA provides an assessment of the proposal's impact on pension scheme members (pages 12-13). This explains the safeguards in place to ensure that the proposed arrangements would not be detrimental to the scheme or its members, so that the risk to members of not getting their pension paid in full is negligible. The IA would be improved by explaining more clearly how the safeguards achieve this.
- Providing a discussion of whether there are any losses to businesses associated with the removal of up-front payments, in particular to insurance companies as insurance premia are no longer paid. In the discussions referred to above, the RPC raised whether the gain to business would be offset by lower profits to pension providers or insurers. In response, the Department explained why there would be an overall net gain to business. The IA should address this issue and include this explanation before publication.

The IA would also be improved by using more recent data to inform the likely take-up of the deferment option, or providing a clearer explanation for why collecting such data would not be proportionate.

Departmental assessment

Classification	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£9.8 million (initial estimate) -£8.7 million (final estimate)
Business net present value	£83.1 million
Societal net present value	£83.1 million

RPC assessment

Classification	Under the framework rules for the 2015-17 parliament: qualifying regulatory provision (OUT)
Small and micro business assessment	Sufficient

Anthony Browne, Chairman