The Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations

Lead department	Department for Work and Pensions
Summary of proposal	The Department proposes to set out new requirements for pension scheme trustees, which will include a duty to have funding and investment strategies that will ensure the long-term viability of their schemes.
Submission type	Impact assessment (IA) – 06 September 2023
Legislation type	Secondary legislation
Implementation date	2024
Policy stage	Final
RPC reference	RPC-DWP-5296(1)
Opinion type	Formal
Date of issue	01 December 2023

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	As originally submitted, the IA was not fit for purpose; the RPC found that the IA contained unjustified assumptions and required clarity on the directness of the proposed impacts and further explanation of the impacts on small and micro business. The IA now contains sufficient explanation on these points. The Department has identifies a good range of expected impacts arising from the policy and has appropriately monetised the costs and benefits. The IA makes clearer that small and micro businesses (SMBs) can seek exemption if necessary, while also including the impact upon them in the analysis. A stronger case for Government intervention should be made. The analysis that the Department has included is clearly set out and evidenced. Wider impacts of the policy, such as the impact on investment, have been considered but could be strengthened. The Department has committed to review the policy, should provide more detail of what work will be done to support any review.

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. RPC ratings are fit for purpose or not fit for purpose.

Business impact target assessment

	Department assessment	RPC validated
Classification	Qualifying regulatory provision	Qualifying regulatory provision (OUT)
Equivalent annual net direct cost to business (EANDCB)	-£20.6 million	-£20.6 million *(2019 prices, 2020 pv)*
Business impact target (BIT) score	-£103.0 million	-£103.0 million
Business net present value	£177.6 million	
Overall net present value	£177.6 million	

RPC summary

Category	Quality[2]	RPC comments
EANDCB	**Green**	The IA identifies an appropriate range of impacts and has made a sufficient case for why the quantified impacts, including changes to deficit reduction contributions (DRC), are classified as direct.
Small and micro business assessment (SaMBA)	**Green**	The Department clearly identifies SMBs in scope of the legislation, while also highlighting the mechanisms in the policy design that would allow for exemptions. The IA also clearly sets out the expected impact upon SMBs, however the SaMBA would benefit from greater clarity on the support available to SMBs that may need it.
Rationale and options	**Weak**	The case for Government intervention needs to be strengthened, primarily through identification of a clear market failure. The IA should also make a stronger case for why option 1 (to make the funding code of practice enforceable) has not been appraised to allow comparison with the preferred option.
Cost-benefit analysis	**Satisfactory**	The Department clearly sets out the analytical approach, citing the evidence used to support both the approach and key assumptions. The IA could benefit from further discussion to support the Department's assessment of on-going costs to business.
Wider impacts	**Satisfactory**	The IA includes a discussion of the impact on investment, including the demand for Government bonds and the potential effects on the wider economy. The IA would benefit from a deeper consideration of the international trade impacts, akin to that provided for investment impacts. In addition, the IA should seek to include a consideration of any competition impacts.
Monitoring and evaluation plan	**Weak**	While the Department commits to a review of the policy, it has not provided a clear monitoring and evaluation (M&E) plan for how this will be achieved. The IA must provide more detail of the approach necessary to support a future evaluation.

[2] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. The definitions of the RPC quality ratings can be accessed here.

Response to initial review

As originally submitted, the IA was not fit for purpose; the RPC identified potential red-rateable issues relating to both the EANDCB put forward for validation and the assessment of impacts on SMBs. More specifically, the RPC noted that the IA made key assumptions that were not clearly supported by evidence, as well as lacking clarity over why it assumed that the business population remained constant across the appraisal period and why some impacts were classified as direct (and therefore captured in the EANDCB). Additionally, the IA did not discuss whether SMBs were likely to be impacted disproportionately and whether exemption or mitigation had been considered. The Department has now provided appropriate additional explanation and justification for the analytical approach taken, as well as for the classification of impacts. Furthermore, the IA has clarified its discussion of the evidence used to inform assumptions and the Department's view of the impacts faced by SMBs, including how an exemption mechanism has been included in the policy design.

Summary of proposal

To help support pension schemes and reduce longer-term risks that schemes might be unable to meet their liabilities, the Department are seeking to use powers set out in the Pension Schemes Act 2021 to impose new requirements upon scheme operators and trustees. These would include a new duty upon trustees to have both funding and investment strategies in place to ensure that pensions and other benefits continue to be provided into the future. The IA includes three options:

- Option 0: Do nothing;
- Option 1: Make the defined benefit (DB) Funding Code of Practice enforceable; and
- Option 2: Introduce secondary legislation to provide detail of the requirements in the Pension Schemes Act 2021 (preferred option).

In terms of impacts identified by the Department, the principal quantified costs are transitional (including familiarisation) costs for scheme operators, on-going costs of meeting the new requirements and, for those scheme operators currently in deficit, the cost of necessary increases in their deficit DRCs. The IA also includes quantified benefits for scheme operators running a surplus, who are expected to reduce their DRCs.

The Department has estimated the EANDCB for the preferred option to be -£20.6 million, with a net present value (NPV) of £177.6 million.

EANDCB

Identification of impacts

A good range of impacts has been identified, including those for in-scope pension schemes (including both schemes largely facing costs and those likely to accrue benefits), as well as benefits for the pension regulator.

Direct impact classification

The IA assumes that all quantified impacts are direct, including those relating to changes in DRC costs (both increases and decreases). It is clear that one-off costs (including familiarisation and implementing a Funding & Investment Strategy and a Statement of Strategy) and on-going costs (including submitting actuarial statements and reviewing the strategies) are direct business impacts. However, the largest impacts presented in the IA relate to adjustments made to DRCs and are not as clearly identifiable as direct impacts. Some businesses will need to increase their DRCs to demonstrate to the regulator they are complying with the regulations; these increases would be a clear direct impact (cost) for affected businesses. Conversely, other businesses, currently making DRCs that exceed the required level, may opt to reduce them in line with the new lower requirements. The Department has provided an appropriate explanation for why the adjustments in DRC costs would be direct, given the measure does not require them to do so. While it is reasonable to treat the impacts symmetrically (i.e., treating both DRC increases and reductions as direct) the reductions are far more uncertain than the increases.

SaMBA

Scope of impact upon SMBs

The number of SMBs expected to be affected by the policy is clearly set out in the IA. In addition to discussing the likely impacts faced by SMBs, including whether they are more or less likely to face costs of required DRC increases, the Department also clarifies that exemptions for some SMBs has been implemented within the design of the policy. However, the Department has included all SMBs in their quantified analysis to provide a complete picture of the potential impact of the policy.

Consideration of mitigation

While the Department has made clear that SMBs have a route to seek exemption (if necessary), the IA would benefit from discussing what support has been considered for non-exempted SMBs. This may be appropriate to help them cope with disproportionate costs, but also to ensure that they are best placed to comply with the new requirements.

Medium-sized business (MSB) impact

The Department has not addressed potential exemption of businesses with between 50 and 500 employees from the regulatory changes or the use of other measures to mitigate the impacts of this proposal on such businesses. The IA should include an assessment of the applicability of such an exemption in accordance with government guidance[3].

Rationale and options

Rationale

The Department has not made a clear enough case for why Government intervention is necessary. A clear market failure must be identified, and the IA must also outline how the proposed intervention will deliver the stated objectives more effectively than a non-regulatory alternative.

Options

The IA describes three options: the do-nothing option; the preferred option; and an intermediate option that would make the DB code of practice enforceable. The Department claim that this third option is less likely to change behaviour and has not been carried forward, however, they should have appraised this option alongside the preferred option. While it is described as less likely to achieve the desired outcome, the extent to which it could still achieve the stated objectives of the policy should be considered.

Cost-benefit analysis

Methodology

While the IA discusses how the number of private sector DB members has fallen by a third in the past decade, the Department has made an appropriate case for using a static figure for the number of schemes across the appraisal period. Notwithstanding the apparent trend over the preceding decade, the Department assert that this trend has largely levelled off in recent years and it would not be proportionate to attempt to estimate any further annual changes in the analysis. The Department also clearly set out the approach and key assumptions underpinning the modelling of the impacts.

Assumptions, risk and sensitivity

The Department make multiple assumptions throughout the IA to support the quantitative analysis; they provide appropriate explanation of the source of these assumptions as well as why they are reflective of the impacts faced by schemes.

The IA would be improved by further discussion of the percentage of schemes that are assumed to reduce DRCs.

As noted during the discussion of the direct classification of DRC reductions, the business benefits are much more uncertain than costs. The IA would be improved by considering the likelihood that businesses will continue to 'overpay' (i.e., not reduce their DRCs) due to their own concerns of future operating uncertainty, risk aversion or simply that compliance will lead to DRCs 'at or above' the new requirements.

[3] https://www.gov.uk/government/publications/better-regulation-framework/medium-sized-business-regulatory-exemption-assessment-supplementary-guidance

The IA would be further strengthened by including further discussion to support the Department's position on the treatment of on-going costs to business. A good use of sensitivity analysis has been made by the Department to account for the uncertainty in some aspects of the analysis, however, the IA would be strengthened by considering the impact of a longer appraisal period (as a result of the lack of alignment in the profiles of the costs and benefits).

Wider impacts

Competition

The Department does well to discuss the impacts to the wider economy including systemic risk, but the IA would be strengthened by discussing the competition impacts arising from the policy. The IA may wish to consider how some firms may stand to gain if competitors are required to divert more funds towards DRCs in order to comply with the new requirements.

Trade and investment

While the IA does discuss the impact on investment, there is no mention of whether the proposals will have any specific trade or international investment impacts. For example, the new requirements may make firms more or less likely to invest in foreign investment projects.

Monitoring and evaluation plan

The Department commits to reviewing the policy, however, it does not provide a detailed description of the M&E plan that will be necessary to support it. While the IA notes that the Department intends to use existing monitoring via the Pensions Regulator (TPR), it only provides limited additional information on what it will use from the TPR work. The IA needs to clearly set out what metrics and information gathered through this survey activity will be used, as well as any supporting information that may need to be gathered, to assess the effectiveness of the measure. Furthermore, the Department needs to provide an indication of what they would expect to see in these metrics or evidence, to enable them to determine if the policy was successful in delivering its objectives.

Regulatory Policy Committee

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