Deregulatory Review of Private Pensions

Deregulatory review - Government response

22 October 2007

Executive summary

The Government is determined to continue to support and encourage employers who provide high quality pensions, with valuable employer contributions for their employees. In attempting to achieve this, it has to balance two, sometimes conflicting, imperatives - a commitment to reducing burdens on employers to encourage the continuing provision of high quality pensions and the need to maintain an appropriate level of protection for members of pension schemes.

In December 2006, James Purnell, the then Minister of State for Pensions Reform appointed Chris Lewin and Ed Sweeney to help with this task by reviewing the regulatory framework for occupational pensions. They delivered their report in July 2007. The Government is very grateful for their efforts. Their task was not an easy one, but they have produced a thorough and thoughtful report. It contains a wide range of recommendations and, even where they have been unable to agree on a recommendation, it explores from all angles the key issues to be considered, and endeavours to represent the wide variety of views put to them by stakeholders. The Government is also grateful to those stakeholders who have set out their priorities for action in discussions since the reviewers' report was published.

This paper outlines the Government's response to the reviewers' recommendations. It sets out:

- Government proposals for change on which views are sought;
- Government decisions on other areas where either the reviewers were agreed, and/or there is broad support from stakeholders, and on which no further consultation is proposed because the Government accepts the reviewers' recommendations.

In considering the recommendations made by the reviewers, it is important, first, to note that this is complex and difficult territory. The Government does not believe there is a single measure or even a series of measures which would guarantee that employers would continue to provide and even strengthen their existing pension provision. There are many factors which affect employers' decisions about pension provision - a number of which are outside any Governmental control. And, as the reviewers themselves found, it is difficult to strike the right balance between removing legislative burdens and protecting members. Changes that would produce the most savings for, and therefore provide potentially most encouragement to, employers would be those that would have most impact on members, and could undermine confidence in pensions. However, the Government believes that the proposals outlined below are a step in the right direction.

The Government agrees that it would not be appropriate to make changes which would affect rights which have already accrued.

The Government is encouraged by the reviewers' comments regarding the scope within existing legislation for the development of innovative approaches to risk sharing and intends to explore the scope for further guidance which might help small and medium sized scheme sponsors take advantage of this flexibility. However, it is also interested in views on whether it would be appropriate to introduce a third layer of legislation to make provision for a particular type of risk sharing scheme.

The Government is also seeking views on proposals to:

- reduce the cap on revaluation of deferred benefits for all pension rights accrued on or after a future date from 5% to 2.5%. Rights accrued before that date will be revalued in accordance with the current statutory requirements; and

- introduce a statutory override to enable schemes to amend their scheme rules to reflect the reduction in the cap on indexation from 5% to 2.5% which came into effect from 6 April 2005 where they are otherwise not able to do so and also introduce a similar override to enable scheme rules to be amended to reflect any change to the cap on revaluation.

We would be grateful for comments on the proposals by 15 November 2007.

The Government will:

- carry out further work to seek a practical solution to the difficulties encountered in relation to the application of the employer debt provisions where there is a group reconstruction in a multi employer scheme;
- explore with stakeholders, over the coming months, the scope to address concerns about the legislative requirements which must be met before surplus funds can be returned to the employer;
- move towards a principles based approach to legislation with the disclosure requirements relating to the day to day running of a pension scheme being used as a test bed for that approach;
- repeal the legislative requirements on pension sharing which apply to safeguarded rights and review the remaining legislation applying to the payment of pension credit benefits (i.e. those benefits which arise from pension sharing, not state pension credit);
- move to combat misconceptions about the trustee knowledge and understanding requirements by clarifying the effect of the relevant legislation.

The aim of the measures outlined above is a broadly beneficial impact on the cost-benefit balance of running an occupational pension, and the Government hopes they will be welcomed as such by employers, trustee boards and scheme members. It hopes that they will have some influence on decisions yet to be taken on whether or not to keep defined benefit pension schemes open.

Contents

1 Introduction

1.1 Deregulatory Review

1.1.1 Background

The pensions reform White Paper "Security in retirement: towards a new pension system" published in May 2006, contained a proposal to establish a rolling deregulatory review to make the private pensions regulatory framework simpler and less burdensome. In order to take account of external stakeholders' views as part of the review, the Government established an Advisory Group that first met on 3 July 2006. The advisory group has representatives from the CBI, the TUC, Amicus, and the major pension industry bodies (Association of British Insurers, Association of Consulting Actuaries, Association of Pension Lawyers, Investment Management Association, National Association of Pension Funds, Society of Pension Consultants and Actuarial Profession); as well as a trustee representative, DWP, HM Revenue and Customs, HM Treasury, the Pensions Regulator and the Pensions Protection Fund.

In December 2006, the Government announced the appointment of two external reviewers, Ed Sweeney (then joint Deputy General Secretary of Amicus) and Chris Lewin (formerly Head of UK Pensions at Unilever). The reviewers' terms of reference were that they should examine legislation with the aim of simplifying and reducing the burden of legislation governing private pensions, drawing on proposals from stakeholders and seeking consensus on the balance between member protection and encouraging employer pension provision.

The reviewers published a consultation paper in March which set out the issues which were raised during their meetings with stakeholders and sought the views of readers on a variety of areas. The reviewers published their final report on 25 July (their recommendations are reproduced at Annex A). Ministers undertook to respond to their recommendations in the Autumn.

This paper outlines the Government's response to the reviewers' recommendations. It sets out:

- Government proposals for change on which views are sought;
- Government decisions on other areas where either the reviewers were agreed, and/or there is broad support from stakeholders, and on which no further consultation is proposed because the Government accepts the reviewers' recommendations.

An impact assessment covering selected specific proposals is attached at Annex B.

Note on Accrued Rights

As a starting point, the reviewers agreed and recommended, that no changes should be made which would adversely affect the position of pensioners or deferred pensioners at the present time, or the past-service rights at the present time of active staff. The Government agrees that recommendation, and the Government responses to the reviewers' other recommendations should be viewed in that context.

2 Government response

2.1 Statutory requirement to increase pensions once they come into payment (LPI)

2.1.1 **Reviewers' recommendation**

"We both, for example, recognise the strength of the arguments for and against the removal of the current requirement to provide limited price indexation ("LPI") after retirement, but have been unable to agree on whether removal would have the desired outcome in terms of encouraging continued strong provision through workplace-based pension schemes. Ed Sweeney believes that the case has not been made that employers would keep their defined benefit schemes open or adopt risk sharing approaches if LPI were abolished. Chris Lewin, on the other hand, believes that making LPI optional would open up important new avenues for risk-sharing and creativity in scheme design as well as encouraging scheme sponsors to continue to fund defined benefit provision".

2.1.2 **Government response**

LPI applies to all defined benefit occupational pension rights which have accrued since 1997. Legislation requires annual increases to pensions in payment of at least the rate of inflation (RPI) capped at 5 per cent for pensions based on rights accrued between 1997 and 2005 and 2.5 per cent for rights accrued from 2005 onward.

Not all schemes have chosen to take advantage of the reduction in the cap in 2005, and some have been unable to change scheme rules to reflect the change due to the way their scheme rules are worded.

The reviewers took differing views as to whether the requirement to increase pensions in payment in respect of future accruals should be removed. Removal of the requirement could pave the way for new types of risk sharing schemes which currently do not exist - proponents of some forms of risk sharing schemes argue that the risk of post-retirement inflation should at least partially be borne by the member rather than the employer. However, general removal of the requirement could be a significant detriment to individuals.

It has been argued that because the removal of LPI would offer large potential savings for defined benefit (DB) pension schemes, and because of the size of those savings, it may persuade some sponsoring employers to continue with DB pension provision, not least because savings could only be realised by keeping schemes open for future accruals. Removing the statutory requirement would return the decision on whether to index to scheme sponsors. This was the position before 1997 and many schemes might still decide to continue to provide it.

However, where employers took advantage of the removal of the mandatory requirement - the eventual annual benefits for employers were estimated by the reviewers to be in the region of £1.0bn to £1.9bn if only a quarter of schemes took advantage of the change - members' future pensions would decline in real terms over their retirement. In some cases this could potentially lead to hardship. Estimates suggest that average DB pension income could be reduced by around 15 per cent by 2050, with losses concentrated on the wealthiest income levels.

Removing the requirement to increase pensions in payment has the potential to deliver significant savings for employers, but at the expense of future pensioners. In the absence of clear evidence that removing the LPI requirement would have a direct and significant effect on employer provision, the Government does not believe that the removal of such an important protection for members would strike the right balance between employer concerns and member protection and has therefore decided not to make any changes to the current requirements.

2.2 Reduction in the cap for revaluation of deferred rights from 5% to 2.5%

2.2.1 Reviewers' comments

“We carefully considered representations put to us that the cap on the revaluation of deferred pensions should be reduced from 5% to 2.5%. We both recognise the strength of the arguments for and against and on balance recommend no change. However, we acknowledge that there needs to be significant lessening of the current regulatory regime to encourage employers to continue to provide work based pensions. We would understand if Government took the view that, when looking at the package as a whole, a reduction in the cap from 5% to 2.5% was one of the measures needed to provide that encouragement”.

2.2.2 Government response

The Government has carefully considered the areas where deregulation would be of most benefit to employers whilst at the same time bearing in mind the need to balance any changes to legislation with protection for members. Stakeholders have told the Government that they want changes that will be of real benefit to employers and that will ease the burdens they face. One of the measures which would have the potential to make a significant difference to the burdens faced by employers is the removal of the requirement to index pensions in payment (LPI). However, for the reasons already outlined, the Government feels that this would be a step too far as it would remove a vital element of member protection.

The revaluation legislation currently requires schemes to protect the value of early leavers' deferred pensions against inflation by increasing the amount of pension payable from normal pension age by the increase in the retail price index (RPI) over the period of deferment, or by 5 per cent compound, whichever is the less. Such a requirement has existed since 1986.

Some stakeholders have questioned why the revaluation cap remains at 5% whereas the cap on the indexation of pensions in payment is set at 2.5%. Revaluation was originally intended to provide a degree of protection - but not total protection - against the impact of inflation on deferred pension benefits until they come into payment. When the revaluation requirement was first introduced, inflation was higher than in recent years and a cap of 5% was appropriate in an environment where inflation was higher than present levels.

A reduction in the cap would deliver potential savings for employers if inflation remains above 2.5%. Statistical analysis indicates that given the current forecasts for inflation a reduction in the cap on revaluation would have very little effect on average private sector incomes from defined benefit schemes. Individuals with deferred pensions are likely to have a number of different sources of pension income so the impact on one part of that overall income may not necessarily bear so heavily on the individual’s total pension income. A reduction in the cap accompanied by high inflation could result in a more significant reduction in DB pension incomes and a consequent increase in state funded benefits costs. However, analysis indicates that the impact on members’ incomes and state funded benefits would be far less severe than if the requirement to increase pensions in payment were removed. Further details are outlined in the Impact Assessment.

A cut in the cap to 2.5 per cent in the current economic climate would restore the position to that which existed at the time the revaluation requirements were introduced - that legislation would not require schemes to provide total protection against inflation. It would also bring the cap on revaluation into line with that on LPI. After careful consideration the Government is minded to reduce the cap on the revaluation of deferred pension benefits accruing from a future date from 5% to 2.5%. This change would not have any effect on the revaluation of accrued rights built up before the change takes place. Any change to the statutory requirement would not preclude schemes revaluing up to the higher level, and schemes could still choose to do so. Initial analysis suggests that if employers took advantage of a reduction in the cap to 2.5% it could lead to long-run savings in the order of £250 - £400 million per year (2007/08 prices). Savings in the early years would be lower than the £250 million average but in later years would be higher. Total overall savings to 2050 are estimated to be in the region of £4.4 billion (using present values).The ultimate level of savings which could be achieved will depend on future deferral patterns and inflation rates.

We would be grateful for your comments on the proposal to reduce the cap to 2.5% and for your views on whether such a change is a measure which would usefully reduce burdens on employers providing defined benefit schemes for their employees.

Questions

What is your view of the proposal to reduce the cap on revaluation to 2.5%?

Would a reduction usefully reduce burdens on employers providing defined benefit schemes for their employees?

Would such a move maintain a fair balance between member protection and encouraging continued employer provision?

What effect might it have on continued employer provision?

2.3 Statutory override

2.3.1 **Reviewers' recommendations**

“We propose that legislation be enacted that will provide an override to restrictions on the amendment power where those restrictions would prevent schemes from changing their rules to allow benefit changes for future service where such changes are made possible by changes in legislation. We would extend this override to situations in which schemes have been unable to implement the Pensions Act 2004 changes to LPI”.

They added, “It has been brought to our attention that some paid up schemes administered through insurance companies have been unable to implement Finance Act changes, including those that would be helpful to members, due to the absence of an employer with whom to agree changes. We believe that this problem should be addressed as well”.

2.3.2 **Government response**

Scheme rules set out who can be admitted to an occupational pension scheme, the contributions payable by members and by sponsoring employers, the rate at which benefits accrue, and when benefits become payable. Scheme rules generally also set out when the rules can be amended and by whom.

Legislation also places requirements on schemes. It is common for new mandatory legislation to override scheme rules so that the rules must be read and applied as if the legislative requirement was reflected in scheme rules. This means that trustees and employers are not forced to amend their rules when new requirements are introduced. However, they usually take the opportunity, at a future date, to ensure that their scheme rules comply with statutory requirements. Difficulties arise where schemes rules have been amended to reflect legislative requirements but scheme sponsors/trustees are then unable to reflect legislative relaxations because the scheme rules do not provide them with a power to do so. An imbalance exists where amending legislation does not override scheme rules in the same way as it did when the more rigorous requirements were introduced - this results in a “one way valve”.

There is evidence that some schemes have been unable to take advantage of relaxations to statutory requirements because of restrictions in their scheme rules. The reviewers specifically recommended an override to situations in which schemes have been unable to implement the Pensions Act 2004 changes to the statutory cap on LPI. Anecdotal evidence suggests that there may be a significant number of employers who were unable to amend their scheme rules to take advantage of the relaxation introduced in 2004. Some schemes have made a conscious decision not to change the cap. However, others may have been unable to do so due to the way their scheme rules have been drafted. The Government considers that it would be of benefit to those operating schemes to provide them with the flexibility to amend scheme rules to reflect relaxations in the statutory requirements with which they must comply. Such flexibility should only be available to enable scheme rules to reflect specific relaxations to legislative requirements. The Government agrees that it would be appropriate to provide such flexibility in respect of the reduction in the indexation cap from 5% to 2.5% which came into effect from 6 April 2005, but only in respect of pensions accrued from a future date. The average annual savings from such a change are estimated to be £20 million. The Government also agrees that it would be appropriate to introduce the same flexibility if the cap on revaluation is reduced from 5% to 2.5%.

The reviewers considered that any override should only be available providing both trustees and employers agree to the appropriate change. Other stakeholders have suggested that the employer alone should be able to use any statutory override to reflect the unilateral nature of the original imposition of the requirement. We would be grateful for views. In addition, should a special provision be made for those paid up schemes administered by insurance companies with no current employer (specifically identified by the reviewers) so that they can implement Finance Act 2004 changes?

The Government is aware that statutory overrides risk disturbing the balance of power between trustees and employers in unintended ways. We are also aware that provisions limiting changes for future benefits are sometimes deliberate, perhaps as a result of negotiations related to the sale of the employer. We would be grateful for views as to whether a special provision should be made to exclude some schemes from any statutory override and if so, how such schemes could be identified and excluded.

Questions

Should any statutory overrides to restrictions on amendments in scheme rules only be exercisable if trustees and employers agree to the change, or should it be available to employers without trustee consent?

If trustee and employer consent is appropriate should special provision be made for paid up schemes administered by insurance companies where there is no employer and they are unable to implement Finance Act 2004 changes?
Is the inability to make changes creating significant problems for such schemes?

Is there any case for any particular classes of schemes to be exempted from any statutory override? If so, what kind of schemes should be exempted?

2.4 Issues relating to risk sharing schemes

The reviewers considered a number of issues which had the potential to have an impact on the development of risk sharing schemes. The areas they considered included:

- Section 67 of the Pensions Act 1995 which imposes restrictions on modifications to accrued rights
- Changes to normal pension age
- Limited price indexation
- PPF levy and compensation

2.4.1 **Reviewers' recommendations and comments**

"We have not endorsed the use of any one approach to risk sharing. Particularly, we have not endorsed any approach, like that put forward by the ACA, that the Government initiate a new set of regulations, with a third set of restrictions and mandates, favouring a particular mode of provision. […] we think that at this point freedom of sponsors to tailor their approaches would be more beneficial than freezing a particular approach in another layer of law".

"We have concluded that the present formulation of section 67 should give sponsors and trustees sufficient scope to affect change. […] However, we would like to see DWP's rolling deregulatory review keep section 67 and the procedures it entails under consideration, and we would like DWP and TPR to consider publicly affirming that they are comfortable that our understanding regarding the application of section 67 is correct".

"We both, for example, recognise the strength of the arguments for and against the removal of the current requirement to provide limited price indexation ("LPI") after retirement, but have been unable to agree on whether removal would have the desired outcome in terms of encouraging continued strong provision through workplace-based pension schemes. Ed Sweeney believes that the case has not been made that employers would keep their defined benefit schemes open or adopt risk sharing approaches if LPI were abolished. Chris Lewin, on the other hand, believes that making LPI optional would open up important new avenues for risk-sharing and creativity in scheme design as well as encouraging scheme sponsors to continue to fund defined benefit provision".

"Schemes should be able to adjust normal pension age for pensionable service from now on and we believe that current regulations do not inhibit this (see comments on section 67 above), provided that the scheme rules are written in appropriate ways. We therefore make no recommendations in this area".

"We recommend that the DWP examine and further calibrate the basis for compensation to ensure a better match between PPF protection and the structure of risk based DB schemes".

"Consideration should be given to permitting employers to prefund (with tax relief) any top-up payments they wish to make in order to supplement the funds available at retirement to DC scheme members".

2.4.2 Government response

Traditionally, occupational pension schemes are either defined benefit or defined contribution. In the former, the employer bears all the risk and, in the latter, the scheme member. The Government recognises the importance of "risk sharing" schemes as a halfway house which mitigates some of the risks a member is exposed to in a defined contribution scheme, but does not place all the risks solely on the employer. The Government is encouraged by the reviewers' comments about the scope in current legislation for the development of such schemes.

It has been suggested that a third layer of legislation may be needed to enable certain types of risk sharing scheme to develop. The type of scheme envisaged would be one where members would accrue benefits on a career average basis, and the age at which the benefits became payable (normal pension age) could move by reference to a longevity index calculated by the actuary. Increases to pensions in payment and revaluation of pensions would be targeted, rather than guaranteed, and would only be paid where scheme funding allowed - in effect, this would remove the requirement to provide LPI and revaluation for these schemes. The proposal is that legislation would ring-fence these changes for risk sharing schemes, meaning that relaxations of this kind would not be available to other defined benefit schemes.

It is true that such a scheme could not exist within the current legislative framework because of the existing requirements which apply in relation to revaluation and indexation. The reviewers felt that creating a specific legislative regime for risk sharing schemes would be inappropriate and would introduce an unwelcome layer of legislative complexity. There is also a danger that making special provision for a particular type of risk sharing scheme within legislation would inhibit the development of other types of scheme and constrain any further innovative approaches to risk sharing. However, as noted above, the Government recognises the importance of risk sharing schemes and would be interested in views as to whether it would be appropriate to introduce a third layer of legislation which would make provision for the kind of risk sharing schemes outlined above, introducing flexibility for such schemes, for example, on revaluation and indexation which currently does not exist. Do you think this is the right model? Alternatively, is there already sufficient flexibility for innovative approaches to risk sharing?

The Government agrees with the reviewers that there is scope for "risk sharing" in relation to improving longevity. The reviewers commented that there are concerns that section 67 of the Pensions Act 1995, which restricts changes to accrued rights, would prevent schemes from "sharing" the risk of improving longevity. Section 67 is intended to protect scheme members against adverse amendment of scheme rules affecting their entitlement in relation to accrued rights.

Many in the pensions industry are concerned that section 67 is open to misinterpretation and that a contingent promise could be construed to result in an accrued benefit even in circumstances where the contingency has not occurred. In this event, some fear, a court could hold section 67 to require a benefit to be paid, or paid at a higher level, than had been intended by those who established the scheme.

This concern has been raised in the context of normal pension age where schemes are considering fixing normal pension age by reference to a longevity index. These concerns are believed to be an inhibitor on the establishment of risk sharing schemes. Section 67 acts to limit the detrimental application of modification powers, so provided the contingencies are written into the rules in such a way that no further exercise of a modification power is necessary, the subsisting rights provisions in section 67 should not apply. The Government and the Pensions

Regulator agree with the reviewers that section 67 should not prevent schemes from drafting rules in such a way that benefits in respect of future service are linked to clearly defined contingencies. However, the Government is mindful that it is ultimately for the courts to determine how statute applies in particular circumstances. Any employer or scheme considering amending existing scheme rules or setting up a new scheme should consider taking their own legal advice so that the particular circumstances in their case can be fully taken into account.

The Government agrees that it is too early to assess the impact of section 67 and to obtain information about any possible unintended effects and accepts the reviewers' recommendation that DWP should keep section 67 under consideration.

The Government recognises that not all companies have access to consultancy expertise for advice and designing risk sharing schemes and that smaller companies might welcome information on the types of risk sharing schemes which are currently in existence. The Government, together with the Regulator will consider the scope for sharing information about the various types of risk sharing scheme currently in existence, and how they have been designed and implemented. Such information would highlight what might be possible under current legislation.

There is a perception that certain risk sharing schemes are charged disproportionately high Pension Protection Fund (PPF) levies, despite the fact that their benefit structures are less generous than the "model" benefit structure on which the levy is based and that this might act as a disincentive to employers considering adopting a risk sharing approach. The Government acknowledges that there may be a mismatch in the benefits payable by certain types of risk sharing schemes and the compensation available from the PPF. The Government will examine the basis for PPF compensation for members of risk sharing schemes but reserves acceptance of the need to further calibrate the basis of compensation until its examination is complete.

In order to attempt to encourage more reliable outcomes from defined contribution provision, and in particular to provide a way of guarding against a last minute downturn in the financial markets disadvantaging particular cohorts of retirees, the reviewers recommended that consideration be given to permitting employers to pre-fund (with tax relief) any top up payments they wish to make in order to supplement the funds available at retirement to defined contribution scheme members. The Government is willing to discuss proposals with stakeholders to explore the potential impact of change.

Questions

Would it be appropriate to introduce a third layer of legislation which would make provision for a specific type of risk sharing scheme and to introduce flexibility for such schemes for example, on revaluation and indexation which currently does not exist? Do you think the model outlined is the right model?

Alternatively, is there already sufficient flexibility for innovative approaches to risk sharing?

2.5 Circumstances which trigger an employer debt calculation

2.5.1 **Reviewers' recommendations**

"Where a company that participates in a DB multi employer scheme ceases to have employees actively participating in that scheme but the scheme continues, the debt should not be triggered if, within a period of up to one year, the employer acquires more employees who participate in the scheme".

"Where there is a group reconstruction of employers in a multi employer scheme, the principle should be established that the debt should not be triggered, where the original covenant was strong and if the remaining employers' covenant remains as strong, following the reconstruction, as the original covenant. The judgement as to whether the covenant remains intact should be the responsibility of the trustees, after taking appropriate professional advice. However, one of us (Chris Lewin) recommends that, where the original covenant is potentially weak, provided it remains unchanged after the reconstruction, the debt should still not be triggered".

2.5.2 **Government response**

Section 75 of the Pensions Act 1995[1] ("section 75") places a debt on an employer where a pension scheme has started winding-up, the employer has an insolvency event or in the case of a multi employer scheme, an employer withdraws from the pension scheme. The employer's debt is calculated at full buy-out level[2], and the purpose of this debt is to ensure that an employer cannot 'walk away' from their pension obligations without ensuring that they are properly funded.

The Government has already accepted the first of the reviewers' recommendations and draft amending regulations which (among other proposed changes aimed at addressing concerns around the existing legislation) allow a twelve month period of grace before the triggering of a cessation event have recently been consulted on. The Government is now considering responses to that consultation.

The Government also accepts that the current provisions may create difficulties for employers who wish to undertake a reorganisation and believes that, in principle, there is much to be said for distinguishing between reorganisations and complete severance of an employer from a scheme. However, this is a difficult area and it may not be easy to find a way to address this without creating loopholes within legislation. In addition to the changes already outlined in draft amending regulations, the Government intends to work with the industry over the coming months to seek a practical solution to the difficulties created by the current provisions which does not undermine the principle that employers should fully meet their pension obligations.

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1 As amended by section 271 of the Pensions Act 2004.

2 The level an actuary judges appropriate to buy out the benefits through the annuities market.

2.6 Return of surplus defined benefit funds to an employer (section 37 of the Pensions Act 1995)

2.6.1 **Reviewers' recommendations**

"The current provisions in section 37 of the Pensions Act 1995 should be amended to allow return of surplus to employers once the scheme has reached the scheme specific funding target and the trustees agree at that time that such a payment should be made".

"The existing explicit statutory requirement that the trustees must be satisfied that any surplus return is in the members' interests before giving their agreement should be repealed, on the grounds that it encourages overly conservative behaviour by trustees, who already have their fiduciary duties to observe".

2.6.2 **Government response**

Where the rules of a scheme allow payments to be made to the employer from the scheme's funds, legislation prohibits such a payment unless the scheme is funded to a full buy out level[3], and the trustees are satisfied that a payment is in the interests of the scheme's members. The current rules came into force on 6 April 2006.

The "members' interest" requirement is not new; it was carried forward from the Pensions Act 1995. The provision reflects a trustee's general fiduciary duty to act in the interest of the scheme's members, but it does not impose a higher test than that which exists under general trust law. The reviewers have, however, received evidence that an overly narrow and literal reading of this provision has led to difficulties, with some trustees assuming that it imposed a higher test than that covered by their general fiduciary duties. In the light of the reviewers' recommendations the Government is minded to remove this specific legislative requirement provided it can find a way to do so without calling into question the trustees' fiduciary duties to scheme members under existing common law rules and equitable principles.

The Government does not agree with the reviewers' recommendation that a return of surplus should, with trustees' agreement, be available once the scheme specific target is reached. The Government is of the view that such a change has potential significantly to jeopardise the current level of protection for scheme members. The recent sharp falls in stock market values highlight the risk of sudden fluctuations in scheme solvency overtaking decisions to return funds to employers, and the consequent risks to the Pension Protection Fund. On the other hand, the Government recognises the concerns that some employers may have about funds building up in their scheme when the test for recovering any surplus is so stringent. Over the coming months we will work with employers, and other stakeholders, to explore the scope for addressing these concerns.

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[3] The level required to buy annuities for all members to cover all liabilities.

2.7 Principles based approach to legislation and review of Disclosure regulations

2.7.1 **Reviewers' recommendation**

"Renewed emphasis should be placed on a principles based approach to regulation of pensions, and in future the Department should prescribe required outcomes alone where appropriate, and make both rules and guidance more accessible and intelligible. Guidance should be developed to indicate some of the ways in which these prescribed outcomes can be met, whilst leaving employers and trustees free to find alternative ways that are efficient and meet the needs of their workforce".

"A framework of outcome-related principles accompanied by guidance, should take the place of the existing disclosure regulations. The guidance should set out some of the ways in which schemes could comply with the disclosure principles while making clear that the outcomes specified in the principles could be reached by other means. Schemes that comply with the existing legislation should be deemed to comply with the principles as long as their disclosure practice remains unchanged. If this approach to disclosure proves feasible and is considered an improvement on the current regime, the Government should consider other areas to which a principles based approach could be applied and establish a rolling programme".

2.7.2 **Government response**

Pension schemes currently operate in a highly rule-based environment. They are founded on trust deed and rules, or contracts, supplemented by primary and secondary legislation, codes of practice, guidance and notes. The legislation that pension schemes must comply with has evolved over a number of years. The Government agrees, in principle, to the reviewers' recommendations for a more framework based approach to legislation and is encouraged by the fact that stakeholders have supported the reviewers’ recommendation.

The reviewers have recommended that the current disclosure regime should be replaced with a framework of outcome-related principles accompanied by guidance and again the Government is encouraged by the fact that stakeholders agree that disclosure would be the right place to start.

The disclosure of information requirements are spread across more than a dozen sets of regulations and cover various issues. The Government takes the view that replacing all the current requirements with a principles based approach in a single exercise could prove too unwieldy. The Government intends to focus initially on the main disclosure requirements that apply to the day to day running of occupational pension schemes deriving from section 113 of the Pension Schemes Act 1993. The Government will take forward further work with stakeholders to see how the principles based approach is best likely to work.

2.8 Pension sharing

2.8.1 **Reviewers' recommendation**

"The policy and legislation regarding pensions and divorce should be reviewed with a view to making significant simplifications if possible".

2.8.2 **Government response**

Pension sharing on divorce was introduced for all new divorces[4] commenced on or after 1 December 2000. When a divorcing couple seek a financial settlement, the court must take into account the value of any pensions held by either party to the divorce. In order to achieve a fair settlement, one of the options available to the court is to make a pension sharing order requiring a percentage of the value of the pension scheme member's shareable pension rights to be transferred to the former spouse. The former spouse's share is then discharged into a pension arrangement as a pension credit.

There are concerns about the complexity of the requirements and the different treatment of pension credit rights. The Government agrees that some of the requirements are unnecessary and at the next suitable opportunity will repeal the legislative requirements relating to safeguarded rights. DWP in consultation with relevant stakeholders will also be looking at the legislation with a view to aligning the payment of pension credit benefits (i.e. those benefits which arise from pension sharing, not state pension credit) with the rules that apply to private and occupational pensions.

[4] The pension sharing on divorce legislation also applies to civil partners on dissolution of a civil partnership.

2.9 Trustees

2.9.1 **Reviewers' recommendations**

"The legislation should be amended so that individual trustees or trustee-directors are not required to have particular standards of knowledge or understanding on a range of issues. Instead each trustee board should be required to ensure that the board as a whole have sufficient knowledge and understanding between them to carry out their duties properly. The same should apply to any subgroup to whom trustee functions are delegated".

"In addition, we recommend that by overriding legislation a rule be inserted in all schemes that reasonable personal legal expenses of trustees that arise from the performance of their duties will be promptly reimbursed by the scheme, subject to the power of a court or tribunal to order that such reimbursement should be refunded to the scheme later".

Chris Lewin also recommended that the Government should develop plans for a broad statutory indemnity for trustees of pension schemes.

2.9.2 **Government response**

The Government and Regulator are of the view that the legislation as it currently stands does not require trustees to have comprehensive knowledge of all the issues. The Government do not consider that it would be appropriate to amend legislation in a way which could lead individual trustees to believe that they do not need to attain even a basic understanding of more complex issues where there are experts in that field on the board. This would be inconsistent with each trustee's fiduciary duty, and could compromise the ability of non-specialised trustees to challenge information presented to them, and result in proposals not being exposed to meaningful consultation by trustee boards. However, the Government accepts that there may be widespread misconceptions about the existing requirement for trustee knowledge and understanding. The Government will work with the Pensions Regulator to examine how best to put right these misconceptions.

The Government does not agree with the reviewers' recommendation for overriding legislation to provide for reasonable personal legal expenses of trustees that arise from the performance of their duties to be reimbursed by the scheme or with the recommendation from one of the reviewers that Government should develop plans for a broad statutory indemnity for trustees of pension schemes.

There is no significant evidence that the absence of any specific legislative provision relating to the re-imbursement of personal legal expense is causing problems in recruiting and retaining trustees, and schemes can (and do) manage trustee personal liability issues effectively on a scheme-by-scheme basis in a way which meets their particular needs. Usually trustees are provided with protection either through insurance cover, an employer indemnity or an indemnity in the trust deed.

2.10 Trivial commutation

2.10.1 **Reviewers' recommendation**

"The current regulatory difficulties regarding trivial commutation should be resolved by HM Revenue and Customs (HMRC) as quickly as possible".

2.10.2 **Government response**

The Finance Act 2004 sets out the circumstances where a small pension can be commuted into a lump sum. The requirement is that the value of all the members' pension rights are less than 1 per cent of the current lifetime allowance and that the commutation takes place within a twelve month window. This applies to all commutations from 6 April 2006 and contrasts with the regime which applied before then.

Before 6 April 2006, a pension could be commuted if it was less than £260 per annum, and no account had to be taken of any other pensions in payment.

At the 2006 Pre-Budget Report in response to pensions industry concerns over administration of trivial commutation the Government announced that HMRC would discuss with interested parties the administration of the trivial commutation rules. These discussions are ongoing.

3 Consultation arrangements

The Government would welcome your responses to the following questions:

Revaluation What is your view of the proposal to reduce the cap on revaluation to 2.5%? Would a reduction usefully reduce burdens on employers providing defined benefit schemes for their employees? Would such a move maintain a fair balance between member protection and encouraging continued employer provision? What effect might it have on continued employer provision?
Statutory override Should any statutory override to restrictions on amendments in scheme rules only be exercisable if trustees and employers agree to the change, or should it be available to employers without trustee consent? If trustee and employer consent is appropriate should special provision be made for paid up schemes administered by insurance companies where there is no employer and they are unable to implement Finance Act 2004 changes? Is the inability to make changes creating significant problems for such schemes? Is there any case for any particular classes of schemes to be exempted from any statutory override? If so, what kind of schemes should be exempted?
Risk sharing Would it be appropriate to introduce a third layer of legislation which would make provision for a specific type of risk sharing scheme and to introduce flexibility for such schemes for example, on revaluation and indexation which currently does not exist? Do you think the model outlined is the right model? Alternatively, is there already sufficient flexibility for innovative approaches to risk sharing?

The Government has said in the past that its aim would be to include any legislative measures, as appropriate, in the next Pensions Bill and to that end we would be grateful for comments by close on 15 November 2007.

Comments can be sent to:
Ruth Saunders
Deregulatory Review, Department for Work and Pensions
3rd Floor
Adelphi
1 – 11 John Adam Street
London
WC2N 6HT

Email: adelphi.deregulatoryreview@dwp.gsi.gov.uk

Phone: 020 7712 2059

It would be very helpful when responding to indicate whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation please make it clear whom the organisation represents and, where applicable, how the views of members were assembled.

According to the requirements of the Freedom of Information Act 2000, all information contained in the response, including personal information may be subject to publication or disclosure.

By providing personal information for the purposes of the public consultation exercise, it is understood that a Respondent consents to its disclosure and publication. If this is not the case, the Respondent should limit any personal information which is provided, or remove it completely. If a Respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with Freedom of Information Act obligations and general law on this issue. The contact point if you want to discuss this is:

Charles Cushing
Freedom of Information
Department for Work and Pensions
2nd Floor
Adelphi
1-11 John Adam Street
London
WC2N 6HT

More information about the Freedom of Information Act can be found on the website of the Department for Constitutional Affairs: http://www.dca.gov.uk/foi/guidance/exguide/index.htm.

Feedback

A summary of responses will be published following the consultation. The Government will aim to publish this summary within three months of the consultation closing. The summary of responses will be available on the Department's website: http://www.dwp.gov.uk/consultations/2007/. If you have any comments, suggestions or complaints about the way in which this consultation exercise has been conducted please contact the Departmental Consultation Co-ordinator:

Roger Pugh
Department for Work and Pensions Consultation Co-ordinator
2nd Floor, Britannia House
2 Ferensway
Hull
HU2 8NF
Telephone:01482 609571
Fax:01482 609658
e-mail:roger.pugh@dwp.gsi.gov.uk

<u>List of organisations included in consultation exercise</u>

Accounting Standards Board
Actuarial Profession
AEGON
Age Concern
Alliance for Finance
Amicus
ARC Benefits Limited
Association of British Airways Pensioners
Association of British Insurers
Association of Corporate Trustees
Association of Consulting Actuaries
Association of Member-Directed Pension Schemes
Association of Pension Lawyers
AXA-Sunlife
Baker & McKenzie
Balfour Beatty
Barclays
BECTU
Board of the Pension Protection Fund
BP
British Air Line Pilot's Association
British Chamber of Commerce
Carers UK
CBI
Civil Aviation Authority Retired Staff Association
Citizens Advice Bureaux
Committee of Unilever Pensioners
Communication Workers Union
Connect Union
Co-operative Group Pensions Department
Department for Social Development in Northern Ireland
Electricity Pensions Services Limited
Engineering Employers Federation
Equal Opportunities Commission
Federation of Small Businesses
Fidelity International
Financial Services Authority
First Actuarial PLC

Foster Wheeler Pensioners Association
Freshfields Bruckhaus Deringer
GMB
Help the Aged
HM Revenue and Customs
HM Treasury
HSBC
Hundred Group
ICI Pensions Trustee Limited
Inchcape PLC
Independent Television Commission Retirement Association
Institute of Chartered Accountants
Institute of Directors
Investment Management Association
Jardine Lloyd Thompson
Legal & General
Mayer, Brown, Rowe & Maw
Mercer Human Resource Consulting
National Association of Pension Funds
NTL Pension Association
Occupational Pensioners' Alliance
Pension Protection Fund
Pensions Advisory Service
Pensions Management Institute
Pensions Policy Institute
Pensions Research Accountants Group
PricewaterhouseCoopers
Prudential
Punter Southall
Railways Pension Scheme
Royal Ordnance Pensioners' Association
SAUL Trustee Company
Small Business Service
Society of Pension Consultants
Standard Life
Tesco
The Pensions Advisory Service
The Pensions Regulator
Towers Perrin
Trustee Risk Management Advisory Service
TUC
UNITE
Watson Wyatt
Which

4 Annex A - Reviewers' views and recommendations

The areas covered in their report and their views are outlined below:

Accrued rights

No regulatory changes should be made which will adversely affect the position of pensioners or deferred pensioners at the present time or the past-service rights at the present time of active staff.

Statutory requirement to increase pensions once they come into payment (LPI)

We both, for example, recognise the strength of the arguments for and against the removal of the current requirement to provide limited price indexation ("LPI") after retirement, but have been unable to agree on whether removal would have the desired outcome in terms of encouraging continued strong provision through workplace-based pension schemes. Ed Sweeney believes that the case has not been made that employers would keep their defined benefit schemes open or adopt risk sharing approaches if LPI were abolished. Chris Lewin, on the other hand, believes that making LPI optional would open up important new avenues for risk-sharing and creativity in scheme design as well as encouraging scheme sponsors to continue to fund defined benefit provision.

Requirement to revalue deferred pensions up to a cap of 5% (revaluation)

We carefully considered representations put to us that the cap on the revaluation of deferred pensions should be reduced from 5% to 2.5%. We both recognise the strength of the arguments for and against and on balance recommend no change. However, we acknowledge that there needs to be significant lessening of the current regulatory regime to encourage employers to continue to provide work based pensions. We would understand if Government took the view that, when looking at the package as a whole, a reduction in the cap from 5% to 2.5% was one of the measures needed to provide that encouragement.

Statutory override

We propose that legislation be enacted that will provide an override to restrictions on the amendment power where those restrictions would prevent schemes from changing their rules to allow benefit changes for future service where such changes are made possible by changes in legislation. We would extend this override to situations in which schemes have been unable to implement the Pensions Act 2004 changes to LPI.

They added:

It has been brought to our attention that some paid up schemes administered through insurance companies have been unable to implement Finance Act changes, including those that would be helpful to members, due to the absence of an employer with whom to agree changes. We believe that this problem should be addressed as well.

Issues relating to risk sharing schemes

We have not endorsed the use of any one approach to risk sharing. Particularly, we have not endorsed any approach, like that put forward by the ACA, that the Government initiate a new set of regulations, with a third set of restrictions and mandates, favouring a particular mode of provision.   We understand the reasoning that a particular risk sharing scheme, if enshrined in regulation, would be adopted in a more uniform way and for that reason may be more easily understood. We also understand that a good deal of thought has been given both to the safeguards for employees and to the freedoms for sponsors that this third sort of provision should entail. But we think that at this point freedom of sponsors to tailor their approaches would be more beneficial than freezing a particular approach in another layer of law.

We have concluded that the present formulation of section 67 should give sponsors and trustees sufficient scope to affect change.   It has only been in effect for a little over a year, and time should be given to observe how it is being applied in practice.   However, we would like to see DWP's rolling deregulatory review keep section 67 and the procedures it entails under consideration, and we would like DWP and TPR to consider publicly affirming that they are comfortable that our understanding regarding the application of section 67 is correct.

We both, for example, recognise the strength of the arguments for and against the removal of the current requirement to provide limited price indexation ("LPI") after retirement, but have been unable to agree on whether removal would have the desired outcome in terms of encouraging continued strong provision through workplace-based pension schemes.   Ed Sweeney believes that the case has not been made that employers would keep their defined benefit schemes open or adopt risk sharing approaches if LPI were abolished. Chris Lewin, on the other hand, believes that making LPI optional would open up important new avenues for risk-sharing and creativity in scheme design as well as encouraging scheme sponsors to continue to fund defined benefit provision.

Schemes should be able to adjust normal pension age for pensionable service from now on and we believe that current regulations do not inhibit this (see comments on section 67 above), provided that the scheme rules are written in appropriate ways. We therefore make no recommendations in this area.

We recommend that the DWP examine and further calibrate the basis for compensation to ensure a better match between PPF protection and the structure of risk based DB schemes.

Consideration should be given to permitting employers to prefund (with tax relief) any top-up payments they wish to make in order to supplement the funds available at retirement to DC scheme members.

Employer debt

Where a company that participates in a DB multi employer scheme ceases to have employees actively participating in that scheme but the scheme continues, the debt should not be triggered if, within a period of up to one year, the employer acquires more employees who participate in the scheme.

Where there is a group reconstruction of employers in a multi employer scheme, the principle should be established that the debt should not be triggered, where the original covenant was strong and if the remaining employers' covenant remains as strong, following the reconstruction, as the original covenant. The judgement as to whether the covenant remains intact should be the responsibility of the trustees, after taking appropriate professional advice. However, one of us (Chris Lewin) recommends that, where the original covenant is potentially weak, provided it remains unchanged after the reconstruction, the debt should still not be triggered.

Return of surplus funds in a defined benefit scheme (section 37 of the Pensions Act 1995)

The current provisions in section 37 of the Pensions Act 1995 should be amended to allow return of surplus to employers once the scheme has reached the scheme specific funding target and the trustees agree at that time that such a payment should be made.

The existing explicit statutory requirement that the trustees must be satisfied that any surplus return is in the members' interests before giving their agreement should be repealed, on the grounds that it encourages overly conservative behaviour by trustees, who already have their fiduciary duties to observe.

Principles based legislation and disclosure

Renewed emphasis should be placed on a principles based approach to regulation of pensions, and in future the Department should prescribe required outcomes alone where appropriate, and make both rules and guidance more accessible and intelligible. Guidance should be developed to indicate some of the ways in which these prescribed outcomes can be met, whilst leaving employers and trustees free to find alternative ways that are efficient and meet the needs of their workforce.

A framework of outcome-related principles accompanied by guidance, should take the place of the existing disclosure regulations. The guidance should set out some of the ways in which schemes could comply with the disclosure principles while making clear that the outcomes specified in the principles could be reached by other means. Schemes that comply with the existing legislation should be deemed to comply with the principles as long as their disclosure practice remains unchanged. If this approach to disclosure proves feasible and is considered an improvement on the current regime, the Government should consider other areas to which a principles based approach could be applied and establish a rolling programme.

Pensions sharing on divorce

The policy and legislation regarding pensions and divorce should be reviewed with a view to making significant simplifications if possible.

Trustees

The legislation should be amended so that individual trustees or trustee-directors are not required to have particular standards of knowledge or understanding on a range of issues. Instead each trustee board should be required to ensure that the board as a whole have sufficient knowledge and understanding between them to carry out their duties properly. The same should apply to any subgroup to whom trustee functions are delegated.

In addition, we recommend that by overriding legislation a rule be inserted in all schemes that reasonable personal legal expenses of trustees that arise from the performance of their duties will be promptly reimbursed by the scheme, subject to the power of a court or tribunal to order that such reimbursement should be refunded to the scheme later.

Chris Lewin also recommended that the Government should develop plans for a broad statutory indemnity for trustees of pension schemes.

Trivial Commutation

The current regulatory difficulties regarding trivial commutation should be resolved by HM Revenue and Customs (HMRC) as quickly as possible.

5 Annex B

Impact assessment

Summary: Intervention & Options

Department /Agency: Department for Work and Pensions	Title: Impact Assessment of the Government Response to the Deregulatory Review of Private Pensions	
Stage: Consultation	**Version:**	**Date:** 18 October 2007

Related Publications: Deregulatory Review of Private Pensions, A Consultation Document

Deregulatory Review of Private Pensions, an independent report by Chris Lewin and Ed Sweeney

Available to view or download at:

http://www.dwp.gov.uk/pensionsreform/deregulatory_review.asp

Contact for enquiries: Ruth Saunders **Telephone:** 020 7712 2059

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

The extent of the burden on employers of private pensions legislation and the effect on their willingness to provide pension schemes for their employees. Government has stated that it wants to make legislation simpler and less burdensome. The Government is undertaking a rolling deregulatory review of private pensions legislation.

What are the policy objectives and the intended effects?

The aim is to reduce the regulatory burdens on employers to encourage them to continue to provide pension schemes for their employees. The reduction in legislative burden on employers needs to be balanced against the impact on protection for members.

What policy options have been considered? Please justify any preferred option.

- Removal of statutory requirement to revalue deferred pensions
- Revaluation of deferred pensions-reduce cap from 5% to 2.5% and provide a statutory override - preferred option
- Statutory override for reduction in limited price indexation cap which came into effect in 2005 - preferred option
- Repeal pension sharing safeguarded rights requirements -preferred option

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 2013

Ministerial Sign-off For consultation stage Impact Assessments:

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:

Mike O'Brien

....Date: 18 October 2007

Summary: Analysis & Evidence

Policy Option: 1 **Revaluation-remove**	**Description: Remove the requirement for future pension rights accompanied by a statutory override**

COSTS			
ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'	
One-off (Transition)	**Yrs**	Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits.Public sector - estimates indicate that costs of increased payments of income related state benefits are negligible.	
£ 0			
Average Annual Cost (excluding one-off)			
£ 1.3bn		**Total Cost** (PV)	**£ 21.3bn**
Other **key non-monetised costs** by 'main affected groups'			

BENEFITS			
ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'	
One-off	**Yrs**	Savings to employers arising from removing the revaluation cap.	
£ 0			
Average Annual Benefit (excluding one-off)			
£ 1.3bn		**Total Benefit** (PV)	**£ 21.3 billion**
Other **key non-monetised benefits** by 'main affected groups' Employer sponsoring schemes - increased profits because of lower pension scheme costs which could result in: higher wages for employees; increased employment and improved company viability. Scheme members-may increase likelihood of continuing defined benefit pension provision by employer.			

Key Assumptions/Sensitivities/Risks

100% of employers will implement the new requirement. Long term inflation is 2.9%

Price Base Year 2007	Time Period Years 43	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?		Great Britain		
On what date will the policy be implemented?		January 2009		
Which organisation(s) will enforce the policy?		PO and Courts		
What is the total annual cost of enforcement for these organisations?		£ Negligible		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ 0		
What is the value of changes in greenhouse gas emissions?		£ Negligible		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ N/A	Decrease of £ N/A	**Net Impact**	£ N/A

Key: **Annual costs and benefits:** **(Net) Present**

Summary: Analysis & Evidence

Policy Option: 2 **Reduce cap to 2.5%**	**Description: Reduce revaluation cap accompanied by statutory override**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits. Public sector - estimates indicate that costs of increased payments of income related state benefits are negligible.
£ 0		
Average Annual Cost (excluding one-off)		
£ 250 million		**Total Cost** (PV) **£ 4.4 billion**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Analysis suggests that if employers took advantage of the reduction in cap to 2.5% it could lead to average savings of the order of £250 million per year (2007/08 prices), although savings could reach as much as £400 million in the long term.
£ 0		
Average Annual Benefit (excluding one-off)		
£ 250 million		**Total Benefit** (PV) **£ 4.4 billion**

Other **key non-monetised benefits** by 'main affected groups' Employer sponsoring schemes - increased profits because of lower pension scheme costs could result in: higher wages for employees; increased employment and improved company viability. Scheme members - may increase likelihood of continuing defined benefit pension provision by employer.

Key Assumptions/Sensitivities/Risks

All employers sponsoring defined benefit schemes will implement the new requirement. Long term inflation is 2.9%.

Price Base Year 2007	Time Period Years 43	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			Great Britain	
On what date will the policy be implemented?			January 2009	
Which organisation(s) will enforce the policy?			PO and Courts	
What is the total annual cost of enforcement for these organisations?			£ Negligible	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ Negligible	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ N/A	Decrease of £ N/A	**Net Impact** £ N/A

Key:	Annual costs and benefits: Constant Prices	(Net) Present Value

Summary: Analysis & Evidence

Policy Option: Statutory override for LPI	**Description: Introduce a statutory override to enable schemes to take advantage of the reduction in the cap on LPI**

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'	
One-off (Transition) **Yrs**	Savings for employers are generated from a corresponding reduction in the level of inflation protection provided to pensions in payment. Public sector - estimates indicate that costs of increased payments of income related state benefits are negligible.	
£		
Average Annual Cost (excluding one-off)		
£ **20million**	**Total Cost** (PV)	£ **0.9 billion**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'	
One-off **Yrs**	Employers would benefit from reduced scheme costs	
£ **0**		
Average Annual Benefit (excluding one-off)		
£ **20 million**	**Total Benefit** (PV)	£ **0.9 billion**

Other **key non-monetised benefits** by 'main affected groups' Employer sponsoring schemes - increased profits because of lower pension scheme costs could result in: higher wages for employees; increased employment and improved company viability. Scheme members - may increase likelihood of continuing defined benefit pension provision by employer.

Key Assumptions/Sensitivities/Risks

Long term inflation 2.9%

Approximately 25% of schemes rules would be changed as a result of this measure

Price Base Year 2007	Time Period Years 43	**Net Benefit Range** (NPV) £ **0**	**NET BENEFIT** (NPV Best estimate) £ **0**

What is the geographic coverage of the policy/option?			Great Britain		
On what date will the policy be implemented?			January 2009		
Which organisation(s) will enforce the policy?			Regulator		
What is the total annual cost of enforcement for these organisations?			£ Negligible		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			No		
What is the value of the proposed offsetting measure per year?			£ 0		
What is the value of changes in greenhouse gas emissions?			£ Negligible		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large	
Are any of these organisations exempt?	No	No	N/A	N/A	

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ N/A	Decrease of £ N/A	**Net Impact**	£ N/A

Key:	**Annual costs and benefits: Constant Prices**		**(Net) Present Value**

Summary: Analysis & Evidence

Policy Option: Repeal safeguarded rights	**Description: Repeal current requirements which relate to safeguarded rights**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	
£ 0		
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 0**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Estimates are that there would be a small number of individuals affected by the change and therefore minimal savings for pension schemes
£ 0		
Average Annual Benefit (excluding one-off)		
£ Negligible		**Total Benefit** (PV) **£ Negligible**

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

Administrators of pension schemes -they would not have to ensure that safeguarded rights are treated differently from pension credits rights. Individuals will have more flexibility when transferring their rights and when the pension credit comes into payment.

Key Assumptions/Sensitivities/Risks

10,000 pension sharing orders per annum . 4,000-5,000 pension sharing orders per year affected by the change

Price Base Year 2007	Time Period Years 43	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			Great Britain	
On what date will the policy be implemented?			October 2008	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ Negligible	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ Negligible	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ N/A Decrease of £ N/A **Net Impact** £ N/A

Key:	Annual costs and benefits: Constant Prices	(Net) Present Value

Summary: Analysis & Evidence

Policy Option: Amend surplus provisions	Description: Amendment to section 37 of the Pensions Act 1995 to remove the "members' interest" requirement

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	
£ 0		
Average Annual Cost (excluding one-off)		
£ 0		**Total Cost** (PV) **£ 0**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Employers-may result in some additional payments of scheme funds to employers but this does not alter the long-term costs of funding the benefits under the scheme.
£ 0		
Average Annual Benefit (excluding one-off)		
£ 0		**Total Benefit** (PV) **£ 0**

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

Key Assumptions/Sensitivities/Risks

Price Base Year 2007	Time Period Years	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			Great Britain	
On what date will the policy be implemented?			2008	
Which organisation(s) will enforce the policy?			The Regulator	
What is the total annual cost of enforcement for these organisations?			£ Negligible	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ Negligible	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ N/A	Decrease of £ N/A	**Net Impact**	£ N/A

Key:	Annual costs and benefits: Constant Prices	(Net) Present Value

Evidence Base (for summary sheets)

Introduction

1 The Government announced a rolling deregulatory review in May 2006. As part of the review it appointed Chris Lewin and Ed Sweeney in December 2006 to act as external reviewers and to make recommendations for change. Their report, "Deregulatory Review of Private Pensions" containing recommendations for change, was published on 25 July 2007.

2 This Impact Assessment is published in conjunction with the Government Response to the reviewers' report and it covers only those areas where there are specific proposals for change. This Impact Assessment considers the proposals for the following changes to legislation applying to private pension schemes:

- Reduction in the cap applying to revaluation of deferred pensions from 5% to 2.5% for future accrued rights together with a statutory override to enable all scheme rules to be changed to reflect the new cap (the alternative of reducing the cap to zero is also considered).
- The introduction of a statutory override to enable scheme rules to be amended (where they could otherwise not be) to reflect the reduction in the cap on increases to pensions in payment (LPI) from 5% to 2.5% which came into effect from April 2005. The override would only apply for pensions accrued from a future date.
- The removal of requirements which apply to contracted-out pension rights following a pension sharing order ("safeguarded rights").
- Removal of the superfluous requirement in the Pensions Act 1995 for the trustees to be satisfied that a payment to the employer from the funds of a defined benefit scheme is in the interest of the schemes' members.

Background to the legislation on private pensions

3 The present regulatory system governing occupational pensions has grown incrementally over the course of the past thirty years. It is now, by common consent, lengthy, complicated and hard to understand. Although each successive layer usually had the aim of protecting scheme members or simplifying the regulatory structure, there have been unintended consequences, leading to undesirable outcomes. Whilst by no means wholly attributable to the growth of regulatory burdens, there is little doubt that the weight of regulation has contributed to a belief by some employers that the costs and risks of having their own pension schemes are becoming too great.

Government objective

4 The Government is committed to reducing legislative burdens on employers but recognises that there needs to be a balance between reducing legislative complexity and making legislation simpler, and protecting members' interests.

5 The Government also recognises that it is important that there should be scope, where appropriate, for scheme rules to be amended to reflect any legislative easements.

Revaluation

6 The revaluation legislation currently requires schemes to protect the value of early leavers' deferred pensions against inflation by increasing the amount of pension payable from normal pension age by the increase in the retail price index (RPI) over the period of

deferment, or by 5 per cent compound, whichever is the less. Providing revaluation for deferred pensions imposes costs on employers, and provides benefits for former members of schemes in the form of an element of protection of the value of the deferred pension.

7 Scheme rules set out the circumstances and conditions in which benefits may be paid to members. It is common for new compulsory legislation to override scheme rules (hence 'statutory override') so that the rules must be read and applied as if the legislative requirement was reflected in scheme rules. This means that trustees and employers are not forced to amend their rules when new legislation is introduced, but they usually do take an early opportunity to ensure that their scheme rules comply with statutory requirements.

8 Some scheme rules allow very limited scope for amendment and may not provide for either employers or trustees of schemes to make amendments to reflect any subsequent relaxations to the legislative requirements which have already been incorporated into scheme rules. This leads to a form of "one way valve" where legislation imposes requirements with which schemes must comply but does not provide an override where the legislative requirements are relaxed. This means that employers are not able to take advantage of any legislative easements introduced to reduce burdens on employers. The proposal is that the reduction in the cap on revaluation from 5% to 2.5% be accompanied by a statutory override to enable all scheme rules to be amended (it is also proposed to introduce a statutory override to enable scheme rules to be amended (where they otherwise could not be) to reflect the reduction in the cap in indexation (LPI) from 5% to 2.5% for future accruals (see paragraph 11).

Options

1. *Remove the requirement to revalue deferred pensions and provide a statutory override to enable all schemes to amend scheme rules to reflect the new cap – not proposed*

Removing the requirement to revalue future accrued pensions once they become deferred could have a significant impact on individuals and the state over the long term as individuals begin to accrue rights which will not have any protection against inflation should the individual leave the scheme before they draw their pension.

The attached table shows the proportionate decline in average defined benefit pension income compared to the case of a 5% cap. It can be directly compared with the table in paragraph 30.

Percentage reductions in average private sector DB pension income compared to the base case, long term inflation rate of 2.9% and removal of the cap from 2009

	100% deferred pension affected by change
2020	1.4%
2030	3.5%
2040	7.1%
2050	10.2%

Source: DWP estimates

2. *Reduce the revaluation cap from 5% to 2.5% and provide a statutory override to enable all schemes to amend scheme rules to reflect the new cap – preferred option*

The Government proposes to reduce the cap on revaluing deferred pensions to 2.5% for all pension rights accrued from a date in the future. This will provide savings for employers sponsoring occupational pension schemes and demonstrates that the Government is committed to making changes which will reduce burdens on employers. The savings and costs of the proposal will build up over time as the change to the cap will only apply to rights built up from a future date-pension rights accrued until then will have to be revalued under the current regime. Individuals with deferred pensions are likely to have a number of different sources of pension income so the impact on one part of that overall income may not necessarily bear so heavily on the individual's total pension income. The Government is seeking views as to whether the power provided by a statutory override should only be exercisable with employer and trustee agreement or whether there should be circumstances where the employer alone should be able to make use of the power. If the statutory override is only exercisable where there is employer and trustee agreement there may be fewer schemes which would benefit from the override.

Statutory override to enable schemes to implement easements the statutory requirement to increase pensions in payment (Limited price indexation (LPI))

9 Schemes are required to increase any pension rights earned on or after 6 April 1997 when those pension rights come into payment. Until April 2005 schemes had to increase those rights by RPI or 5% whichever is less. The reduction in the LPI cap from 5% to 2.5% was introduced in April 2005 to reduce burdens on business. However, a number of employers have not been able to take advantage of the flexibility because of restrictions in their scheme rules.

10 Some scheme rules allow very limited scope for amendment and may not allow either employers or trustees of schemes to make amendments to reflect any subsequent relaxations to the legislative requirements which have already been incorporated into scheme rules. As highlighted in paragraph 8 this leads to a form of "one way valve" where legislation imposes requirements with which schemes must comply but does not provide an override where the legislative requirements are relaxed.

11 As a balance to the legislative override which imposes certain requirements on schemes, Government wants to provide those schemes with the scope to make amendments to reflect relaxations in the statutory requirements. Anecdotal evidence is that around a quarter of occupational pension schemes were unable, because of constraints on amendments to scheme rules, to make changes to reflect the reduction in the LPI cap from 5% to 2.5% from April 2005.

Introduce statutory override for the reduction in the LPI cap from 5% to 2.5%

This is the proposed approach and it would introduce flexibility that some employers would like. It would enable them, if they wish, to amend their scheme rules to reflect legislative easements for future accruals. It could result in savings for employers and might provide them with an incentive to continue to provide defined benefit schemes for their employees. The override will only enable schemes to amend the rules in respect of future accruals and would not for example enable schemes to introduce a rule change which would cap LPI at 2.5% for all accruals since the change was introduced in April 2005. The Government is seeking views as to whether the power provided by a statutory override should only be exercisable with employer and trustee agreement or whether there should be circumstances where the employer alone should be able to make use of the power. If the statutory override is only exercisable where there is employer and trustee agreement there would be fewer schemes which would benefit from the override.

Safeguarded rights

12 When a divorcing couple, or civil partners dissolving their partnership, seek a financial settlement, the court must take into account the value of any pensions held by either party to the divorce. In order to achieve a fair financial settlement one of the options open to the court is to make a pension sharing order requiring a proportion of the value of the pension scheme member's shareable pension rights to be transferred to the former spouse/civil partner. The former spouse's/civil partner's share is then discharged into a pension arrangement as a pension credit.

13 When the member of a scheme is divorced, or becomes a former civil partner, and their pension credit includes contracting out rights, the former spouse's/civil partner's share of those rights is known as "safeguarded rights". These rights are subject to a detailed regulatory regime restricting the type of scheme that can hold these rights and the way in which those rights can be paid. There have been complaints that the special requirements which apply to safeguarded rights introduce unnecessary complexity particularly as the rules which apply to pension credit rights are in any event different to those which apply to other accrued pension rights.

Repeal the requirements relating to safeguarded rights

Although the repeal of the requirements would not generate significant savings for schemes generally because of the small number of cases where safeguarded rights exist, it will remove an extra unnecessary layer of complexity which will be of some benefit to administrators of schemes which hold pension credit rights. There is no purpose in retaining this extra layer of complexity when it is not needed.

Return of surplus defined scheme funds to an employer

14 Where the rules of a defined benefit (DB) pension scheme allow payments to be made to the employer from the funds of the scheme, section 37 of the Pensions Act 1995 prohibits such a payment unless certain conditions are satisfied. Section 37(3)(d) specifies that, among other conditions, the trustees must be satisfied that such a payment is in the interests of the members of the scheme.

15 The provision reflects a general fiduciary duty to act in the interest of the scheme's members, but it does not impose a higher test than that which exists under general trust law. There is evidence that an overly narrow and literal reading of this provision has led to some trustees taking the view that the legislation imposes a higher test, which is not the policy intention.

Repeal the specific "members' interest" requirement

16 All trustees are subject to fiduciary duties under general trust law which require them to exercise these duties in the best interests of the beneficiaries of the trust, regardless of their own personal interests or preferences. Guidance on the Pensions Regulator's website also makes it clear that their first loyalty must be to their scheme's beneficiaries. The requirement in section 37(d) of the 1995 Act, therefore, already exists under existing common law and equitable principles.

17 The removal of the requirement in section 37 will remove what some trustees incorrectly view as an additional requirement which must be satisfied in over and above their normal fiduciary duties.

Financial consequences

Impact on schemes/employers

Revaluation

18 A reduction in the cap would deliver potential savings for employers. These are estimated to be around £250 million a year on average although in the long term they could rise to as much as £400 million a year. The key assumption in this is a long term inflation rate of 2.9%, in line with HM Treasury forecasts. All private sector defined benefit pension schemes will be able to take advantage of the reduction in the cap. As most defined benefit pension schemes are provided by medium/ large enterprises the proposal is more likely to be of benefit to organisations of those sizes.

19 Removal of the requirement to revalue would provide even greater savings for employers. Average annual savings are estimated to be in the region of £1.3bn.

Option	Overall costs for employers	Overall savings
1. Remove the revaluation cap	None	£21.3 billion (PV)
2. Reduce the cap to 2.5%	None	£4.4 billion (PV)

Note: The savings in the table are present value figures covering the period to 2050. Savings would build up over time and in the early years would be lower but in the later years would be higher - the average falls somewhere between.

20 Savings for employers are generated from a corresponding reduction in the level of inflation protection provided for members' benefits.

21 A potential non-monetised benefit resulting from the savings for employers might be increased business profits which may lead to improved company viability.

Statutory override-change in LPI cap

22 Estimates are that around a quarter of defined benefit occupational pension schemes were unable to amend their scheme rules to reflect the reduction in the LPI cap from 5% to 2.5%. On the assumption that all of those employers are able to override their schemes rules to reflect the relaxed statutory requirement, annual savings are estimated to be in the region of £20 million (2007/08 prices) but over time savings will be greater in the long run. Total estimated savings are as follows:

Option	Overall costs for employers	Overall savings
Statutory override introduced	None	£0.9 billion (PV)

Note: Assumes average annual savings of £20 million (at 2007/08 prices).

23 Savings for employers are generated from a corresponding reduction in the level of inflation protection provided to pensions in payment.

24 Again a potential non-monetised benefit resulting from the savings for employers might be increased business profits which may lead to improved company viability.

Safeguarded rights

25 Estimates are that the actual savings from repealing the requirements relating to safeguarded rights would be minimal because of the small numbers involved. However, there would be benefits for scheme administrators in that they would not have an extra layer of complexity when dealing with pension credit rights and individuals will have more flexibility when transferring their pension credit rights and less restrictions when the pensions come into payment.

Option	Overall costs for employers	Overall savings
Repeal safeguarded rights requirements	None	Minimal

Return of surplus defined benefit scheme funds to an employer

26 The amendment may result in some additional payments being made to sponsoring employers of well funded schemes. This would not alter the total costs of providing the pension benefits promised by the scheme in the long term, although it could impact on the pace at which those benefits are funded in the future (because a payment to the employer would increase the likelihood that additional contributions will ultimately be required at some point). Apart from this effect (which could apply to the small number of funded public service schemes which are subject to Part 3 of the Pensions Act 2004), the amendment is not expected to have impact on public finances.

Option	Overall costs for employers	Overall savings
Remove “members’ interest” from section 37 of the Pensions Act 1995	None	None

<u>Impact on individuals</u>

Removal of the requirement to revalue deferred pensions

27 The impact of removing the requirement to revalue deferred pensions for future pension accruals will depend on the level of pension built up after the requirement is removed, the length of time which elapses before the pension comes into payment and the rate of inflation over that period. As indicated in the table in paragraph 8 the impact of the removal

of the requirement could be fairly significant after a long period of time -10.2% reduction in pension income after 43 years assuming all the individual's defined benefit pension is affected by the change. However, the impact is not as significant in the short term particularly as individuals with deferred pensions are likely to have a number of different sources of income of which the deferred pensions is only one element.

28 Increased business profits arising from the savings for employers from such a change could result in non-monetised benefits to members of the scheme and employees. For example by way of higher wages for employees; increased employment opportunities within the business and improved company viability leading to increased job security. It may also result in employers continuing to offer defined benefit pension provision for their employees.

29 In addition, there is also a redistribution of pension income from the best-off defined benefit scheme members (under current revaluation rules) to the group who are able to join defined benefit schemes following the change and who would otherwise be worse off (because they would otherwise have been in defined contribution schemes which tend to have lower employer contribution rates). This would be expected to raise overall social welfare.

Reduction in the revaluation cap

30 Analysis indicates that given the current forecasts for long term inflation a reduction in the cap on revaluation would have very little effect on average private sector incomes from defined benefit schemes as illustrated below.

<u>Percentage reductions in average private sector DB pension income compared to the base case, long term inflation rate of 2.9% and reduction in the cap from 2009</u>

	2.5% cap - 100% deferred pension affected by change
2020	0.2%
2030	0.5%
2040	1.1%
2050	1.6%

Source: DWP estimates

31 Deferred pensioners are likely to have a number of different sources of pension income so any impact on one part of their overall income might not necessarily bear so heavily on the individual's total pension income. The measure is likely to affect more female scheme members than male scheme members as women tend to have more breaks in their employment and therefore are more likely to have deferred pension entitlement. No concrete evidence exists as to what proportion of deferred pension entitlement relates to women as opposed to men.

32 There is a risk that a reduction in the cap accompanied by high inflation could result in a significant reduction in defined benefit pension incomes and a consequent increase in income related state benefits

33 Again increased business profits arising from the savings for employers from such a change could result in non-monetised benefits for members of schemes and employees as outlined in paragraphs 28 and 29. It is very difficult to estimate the size of these benefits but one approach would be to consider the scenario whereby the employer chooses to channel these savings back into pension provision. Assuming all the savings from the change were spent by employers on expanding the coverage of their defined benefit schemes, we estimate an upper bound of 165,000-265,000 additional defined benefit members in the medium to long term. In practice the actual impact would certainly be lower than this since employers are unlikely to choose to spend savings on expanding the coverage of their defined benefit schemes.

34 Whilst positive, such figures must be seen in the context of the total number of active defined benefit scheme members, estimated to be 3.4 million in 2006, and the rate of change of membership, with a net decrease in membership of around 210,000 between 2005 and 2006 and 195,000 between 2004 and 2005.

Statutory override-change in LPI cap

35 Paragraph 8 sets out the rationale for introducing a statutory override to scheme rules. Analysis indicates that given the current forecasts for long term inflation (2.9%) the impact of a reduction in the cap on indexation from 5% to 2.5% would build up over time to a reduction of 1.2% in the average private sector defined benefit pension income by 2050. The long term impact is likely to be greater on pensioners who live longer. However, pensioners in receipt of defined pension benefits tend to belong to the best-off socio-economic groups who are most likely to have access to other assets or sources of income.

<u>Percentage reductions in average private sector DB pension income compared to the base case</u>

	2.5% cap from 2009-100% pension affected by the change
2020	0.5%
2030	0.9%
2040	1.1%
2050	1.2%

Source: DWP estimates

36 Savings to employers of such a change could result in non-monetised benefits for members of schemes and employees as outlined in paragraphs 28 and 29. We estimate that there could be an upper bound increase in defined benefit membership of 13,000 members if employers were to use all the savings in expanding coverage of their defined benefit schemes. Again, the caveats in paragraphs 33 and 34 apply.

Return of surplus defined benefit scheme funds to an employer

37 Removing the “members’ interest” requirement would not change the trustees’ fiduciary duties to scheme members under existing common law rules and so should not result in any less protection for members than exists at present.

Summary of costs and savings

Change	*Overall costs (to employees)*	*Overall savings (to employers)*
Reduction in the revaluation cap		
Option 1- remove the revaluation cap	£21.3 billion(PV)	£21.3 billion(PV)
Option 2- reduce the cap to 2.5%	£4.4 billion (PV)	£4.4 billion (PV)
Statutory override-change to LPI cap		
Statutory override introduced	£0.9 billion (PV)	£0.9 billion (PV)
Safeguarded rights		
Repeal safeguarded rights requirements	Minimal	Minimal
Return of surplus defined benefit scheme funds to an employer		
Remove " members' interest" from section 37 of the Pensions Act 1995	None	None

Competition assessment

38 The proposals would not affect any particular market sector. Nor would they have an impact on suppliers. Instead they would affect any company which has a defined benefit pension scheme and, in the case of safeguarded rights, a company who operates a contracted-out money purchase pension scheme.

39 The Government's preferred options of a reduction in the revaluation cap from 5% to 2.5% and removal of the requirements applying to safeguarded rights will entail some minor one-off costs to administration systems, but these costs would have no impact on competitiveness.

Small firms impact test

40 These proposals would impact on employers who operate defined benefit pension schemes and on some employers who operate defined contribution pension schemes.

Smaller companies are less likely to provide defined benefit occupational pension schemes for their employees than medium to larger enterprises .The proposal for reduction in the revaluation cap from 5% to 2.5% has the same impact on the costs of providing members' benefits regardless of the size of the employer.

41 The removal of the requirements relating to safeguarded rights will produce some administrative savings as it removes a layer of administrative complexity. This may be of more benefit to smaller firms who have smaller occupational schemes as the extra administrative burden imposed by safeguarded rights may be proportionally greater on a smaller pension scheme.

Legal aid

42 There will be no impact on legal aid.

Sustainable Development, Carbon Assessment, Other Environment.

43 It is not expected that these proposals will have any impact in these areas.

Health impact assessment

44 The options have been considered against the screening questions for health impact assessments and such an assessment will not be necessary.

Race Equality, Disability Equality

45 These proposals do not have any consequences for race equality or disability equality.

Gender equality

46 Defined benefit pension schemes have traditionally been established in male dominated industries at a time when female participation in the labour force was far lower than it is today. Consequently any change to the regulatory framework for defined benefit schemes is likely to impact more on men than women.

47 The proposed change to the revaluation cap however may have a particular impact on female scheme members because women tend to earn pension benefits early in their careers and then leave the work force for periods of time to undertake caring responsibilities. However, as already outlined in paragraph 30, the impact on any individual member is likely to be small.

48 On the introduction of a statutory override to enable employers to change their rules to reflect the reduction in the LPI cap from 5% to 2.5% the position is as follows. Changes in indexation rights would apply to all individual members equally, irrespective of gender, and it is an intrinsic feature of pension schemes that the aggregate amounts of pension paid out vary according to how long each pensioner lives. The introduction of a statutory override would have an impact on a higher proportion of female than male scheme members as they tend to live longer. However, indications are that male life expectancy is now increasing faster than female life expectancy and, assuming this continues, the impact on men and women should move towards becoming equal in the future.

49 The proposals for changes to the cap on revaluation and introduction of a statutory override are designed to encourage continued provision of defined benefit schemes and that will be of equal benefit to men and women.

50 Removal of the requirements applying to safeguarded rights would have minimal impact on individuals but it will provide them with more scope should they wish to transfer their

pension credit rights. Anecdotal evidence is that more pension sharing orders on divorce are made in respect of women than men so the minimal benefits for individuals are likely to impact more on women than men.

Human Rights

51 These proposals are compatible with the Human Rights Act 1998.

Rural proofing

52 These proposals have no specific impact on rural communities.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

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