

Occupational Pensions

Revised Regulatory Impact Assessment

The Occupational Pension Schemes (Cross-Border Activities) Regulations 2005

November 2005

REVISED REGULATORY IMPACT ASSESSMENT

IMPLEMENTATION OF THE CROSS-BORDER REQUIREMENTS OF EU OCCUPATIONAL PENSIONS DIRECTIVE 2003/41 (IORP DIRECTIVE)

THE OCCUPATIONAL PENSION SCHEMES (CROSS-BORDER ACTIVITIES) REGULATIONS 2005

1. This revised Regulatory Impact Assessment (RIA) assesses the impact of the cross-border requirements of the EU Occupational Pensions Directive 2003/41 (otherwise known as the “IORP” or “Occupational Pensions Directive”) when the relevant provisions come into force. This was scheduled for 23 September 2005, but, the Government has chosen to delay implementation in order to ensure that the circumstances of existing cross-border schemes (Anglo-Irish) are taken into account and the correct approach adopted. The European Commission have been informed of the delay.
2. This revised RIA builds on the responses received to the consultation the Government carried out during August and September 2005 on the draft Occupational Pension Schemes (Cross-border Activities) Regulations (“the Cross-border Regulations”). A summary of responses to the consultation is being published alongside this RIA. The Government’s overall plans for transposition of the cross-border elements of the Directive have not changed substantially as a result of the comments received during the consultation, although some refinements have been made as a result of industry concerns arising from the Government’s proposed way of implementing the Directive’s requirement that schemes operating on a cross-border basis must be “fully funded” at all times.

PURPOSE AND INTENDED EFFECT OF THE CROSS-BORDER ELEMENTS OF THE DIRECTIVE

Objective

3. The IORP Directive is an important element of the Financial Services Action Plan and represents a first step towards a single market for occupational retirement provision. The cross-border elements of the Directive seek to give greater freedom for employers to decide where and in which pension schemes they wish to participate.
4. The cross-border elements of the Directive will allow occupational pension schemes established in one EU Member State to be sponsored

by employers in other Member States. Pension schemes operating in this way are said to be engaged in 'cross-border activity'.

5. The Government's aim when transposing this Directive into national legislation, as with any other Directive, is to achieve the objectives of the European measure in accordance with other policy goals such as minimising any burden on business, charities or the voluntary sector. This revised RIA considers the responses to the consultation on the cross-border Regulations which recently took place, and provides details of amendments made as a consequence of those replies.

Background

6. The IORP Directive provides a framework for the operation of and supervision of occupational pension schemes in the EU. Member States were required to have transposed the provisions of the Directive into national law before 23 September 2005. The Directive only applies to occupational pensions (second pillar provision). State schemes and personal pensions are outside its scope.

7. Until now, UK employers with subsidiaries in other EU Member States (other than: those that operate in the Republic of Ireland (ROI) which have received a level of exclusion due to reciprocal agreement with Ireland¹; and employees seconded from the UK to work in other EU Member States for limited periods) have had to establish separate occupational pension schemes in each Member State in which the subsidiary was based. The Directive will now enable multi-nationals operating in a number of EU Member States through subsidiary companies to consolidate their pension arrangements in one Member State. It will, in addition, allow an employer to locate their pension scheme in another Member State for commercial reasons.

Rationale for Government intervention - Update

8. The cross-border elements of the IORP Directive seek to provide a standard procedure for occupational pension schemes established in one EU Member State wishing to be sponsored by employers in other Member States, i.e. entering into cross-border activity. The cross-border elements of the Directive were due to come into force on 23 September 2005, but, as mentioned in paragraph 1, the Government has chosen to delay implementation in order to ensure that existing (Anglo-Irish) cross-border schemes are appropriately taken into account. It remains the

¹ Regulations in the UK, and mirroring Regulations in the Republic of Ireland, disapply certain provisions of pensions legislation in respect of schemes based in one country with members in the other.

case that if the Government takes no action, i.e. does not legislate to introduce these requirements of the Directive, it risks infraction action by the European Commission in the European Court of Justice. The Government has therefore drafted Regulations to implement the cross-border elements of the Directive.

9. The revised draft Regulations take into account the various types of scheme which will be affected by the Directive: existing cross-border cases, i.e. current UK schemes with members in the UK and other EU Member States (in practice only ROI); established UK schemes which may wish to voluntarily become cross-border schemes; and brand new schemes which may wish to become cross-border schemes. They now contain several amendments resulting from comments received during the consultation. These are mostly related to industry concerns arising from the Directive's requirement that schemes operating cross-border must be "fully funded" at all times.

10. We mentioned in our original RIA that discussions were taking place with the European Commission to determine whether existing (Anglo-Irish) schemes would be affected by the cross-border provisions of the Directive. The European Commission has now confirmed that these schemes will be subject to the cross-border requirements of the Directive when these Regulations take effect. The Regulations had, however, already been drafted in anticipation that the Commission would confirm that this would be the case.

OPTIONS

11. Prior to the Governments consultation, two options were considered for dealing with these issues. The consultation has not highlighted any other possible options for implementation, although responses have suggested ways in which the Regulations (option 2) should be revised to implement the Directive. The options were as follows:

Option 1: To do nothing.

Option 2: To legislate to require existing cross-border schemes to establish their funding position and address any shortfall as soon as possible (i.e. within two years of 22 September 2005)

COSTS AND BENEFITS

Option 1 – To do nothing

12. Prior to the consultation, the Government pointed out that if it did not implement the Directive, it would face infraction action by the

European Commission in the European Court of Justice. It would still be required to implement as a consequence of that infraction action. It still considers that there would be no obvious benefits in taking this risk. Any UK schemes who wish to enter into cross-border activity would be prevented from doing so. In economic terms, it would prevent other European employers from possibly participating in UK based occupational pension schemes. It would also prevent multi-nationals from considering the use of the UK as the base for their pension scheme.

Responses from the Consultation

13. There were no responses on this option. For the reasons given in paragraph 12, the Department therefore consider that this is an option which can not be considered.

Option 2 – To legislate using Regulations to require existing cross-border schemes to establish their funding position and address any shortfall as soon as possible (i.e. within two years of 22 September 2005)

14. The Regulations upon which the Government consulted allowed any existing UK cross-border scheme wishing to continue cross-border activity a maximum time period of one year (from 22 September 2005) to choose the first effective date of their first actuarial valuation under the new legislation on scheme funding (Part 3, Pensions Act 2004), and a further year to produce that valuation, in order to establish that they are “fully funded” – able to meet the statutory funding requirement as defined by section 222 of the Pensions Act 2004. For any schemes wishing to enter into cross-border activity, they would need to show that they are “fully funded” before they were authorised to engage in cross-border activity. As this would be a voluntary activity, such schemes would need to take full account of the more stringent funding requirements applying to cross-border schemes and structure their contributions accordingly.

Estimated costs to schemes

Domestic Schemes

15. Prior to the consultation, it was considered that implementation of the Directive in this area would not impose any new costs. It would only be at the point that schemes wished to become cross-border schemes that they might have to bring forward their funding plans to meet the full funded at all times requirement.

Existing cross-border schemes

16. Prior to the consultation, it was estimated that the (approximately) 90 existing cross-border schemes would have to meet a total, across the board, one-off funding requirement of around £250m over the first year and that if the schemes were smaller than 'average' then the impact would obviously be less.

17. However, it was considered that the actual cost of providing the pension benefits would not be increased; simply the period over which they are being funded would change. Short term expenditure now would be offset by lower payments over the longer term (so that schemes that put more money in now would have to put in less later). These schemes would, however, face the additional cost of undertaking annual valuations. It was estimated that the cost of a valuation for a large scheme is around £10,000. If all 90 of the potentially impacted schemes faced costs of this size (i.e. none of these schemes currently undertake annual valuations) **the total additional annual cost (over and above the valuations which would otherwise be required every 3 years) would be in the region of £900,000.**

Responses from the Consultation

18. The responses received have mainly focussed on the burden placed on them by being "fully funded" and are summarised as follows:

- (i) Schemes and their sponsoring employers should be allowed to sectionalise the parts of their schemes relating to workers in other EU Member States (foreign) and domestic parts, so that only the "foreign" parts are required to be "fully funded".
- (ii) The time period for reaching "full-funding" should mirror that of the draft Scheme Funding Regulations (which allow recovery plans lasting several years).
- (iii) The length of time allowed for existing cross-border schemes to reach "full funding" should be increased from 2 years to 5 years.
- (iv) The estimated average amount for existing cross-border schemes to reach "full funding" - £3m per scheme, is not an amount they would be able to afford.
- (v) Anglo-Irish schemes should be excluded from the implementation of the provisions of the Directive.
- (vi) The period of time in which a scheme is expected to resecure "full-funding (12 months) is too short and should be extended by a further 12 months.

Revisions following the Consultation

19. (i) and (ii), Whilst Articles 16(1) and 16(2) of the Directive detail the funding requirements for occupational pension schemes, which mirror the funding requirements of the Government's new scheme funding regime", **Article 16 (3) requires that any scheme operating cross-border must ensure that "the technical provisions shall at all times be fully funded in respect of the total range of pension schemes operated". The Government is therefore unable to consider either of these suggestions.** The new scheme funding regime allows an underfunded scheme to have a recovery plan covering a number of years. The Government does not believe that this is consistent with the requirement for cross-border schemes to be "fully funded" at all times.

20. (iii) and (iv) The Government does not consider that the implementation of the Cross-border Regulations will involve extra costs to existing cross-border schemes in the longer term, rather it is the shape of the future contribution pattern which will change (paragraphs 16 and 17 refer). However, it does acknowledge that the period we have suggested in which these schemes reach "full-funding" (within 2 years of 22 September 2005) may place an undue financial burden on their sponsoring employer. As a result **we have therefore decided to extend this period by 1 year to 3 years. The period will now end on 22 September 2008..**

21. (v) As we have already mentioned in paragraph 10, following discussions with the European Commission, **this approach is not possible.**

22. (vi) This response relates to the period a cross-border scheme has to reassume a position of being "fully funded" when a valuation shows that they are underfunded (Regulation 8(4) of the draft Regulations). The Government's original position was that a 1 year period should be sufficient to resume "full funding". From the comments we have received, **we acknowledge that this period could be impractical, and have therefore decided to increase this period to 2 years to address the pensions industry's concerns.** This change does not affect our cost assessment, but – as above- simply the shape of the contribution pattern over which full funding should be achieved.

SOCIAL AND ENVIRONMENTAL IMPACT

23. There are no specific social or environmental impacts coming from the proposed implementation of the cross-border elements of the

Directive. There is no evidence to suggest that the cross-border elements of the Directive will have any race equality impact.

SMALL FIRMS IMPACT TEST

24. Although some small firms may operate defined benefit (DB) occupational pension schemes, research suggests that they are less likely to do so. Less than 4% of companies with fewer than 50 employees have a salary-related pension scheme² (compared to more than 50% of companies with 500 or more employees). Also, there are less than 0.1 million (currently active) members of private sector DB schemes in small businesses, compared to around 3.6 million in total for all sizes³. Finally, small firms are also less likely to wish to operate a cross-border scheme. Therefore, these provisions are proportionately less likely to impact on small firms.

COMPETITION ASSESSMENT

25. There is no 'market' currently in cross-border pension schemes and therefore the responses to most of the competition filter test, with regard to that market, were negative. One of the aims of the IORP Directive that these Regulations seek to implement is to grow such a market and, as such, they will have an equal impact on all schemes operating in that market. Obviously option 1 would inhibit the scope for growth of the market.

26. Businesses currently operating such schemes do so as part of their remuneration package on a voluntary basis. No information is currently held on the market sectors in which businesses operating schemes on a cross-border basis function. It is therefore not possible to assess which particular sectors will be impacted and the relative size of those businesses affected in comparison with the sector overall. Businesses that operate in more than one Member State will have to fund their pension schemes more stringently than those operating solely in the UK, but this would have to be taken into account, along with a range of other factors, when deciding where to locate employees and what remuneration package to offer them. Existing cross-border schemes will face additional costs in the region of £10,000 per scheme (as detailed at paragraph 17). However, this additional cost and the cross-border pension requirements would be balanced against the competitive advantage and administrative savings which could exist in offering all employees in EU Member States access to the same occupational pension scheme.

² Source: Employers' Pension Provision Survey 2003.

³ Source: Government Actuary's Department's Occupational Pension Schemes Survey (2004), and DWP estimate.

ENFORCEMENT

27. Member States are under an absolute obligation to ensure that the provisions of the Directive are carried out. Incomplete compliance with the Directive could risk infraction action by the European Commission in the European Court of Justice. Enforcement of the legislative requirements will be by the Pensions Regulator who will rely on existing whistleblowing requirements and its own investigations. The Pensions Regulator will have the option of revoking authorisation and approval to operate cross-border if a scheme breaches any of the requirements to operate and ultimately to impose civil penalties if schemes continue to operate without authorisation and approval.

SANCTIONS AND MONITORING

Option 2 - To legislate using Regulations to require existing cross-border schemes to establish their funding position and address any shortfall as soon as possible (i.e. within three years of 22 September 2005)

28. The Regulations for transposing the terms of the Directive have been drafted so that existing schemes operating in more than one EU Member State will become cross-border schemes, will be authorised by the Pensions Regulator to operate cross-border and will be given until 22 September 2008 to show that their schemes are “fully funded”. The Pensions Regulator will keep a record of the date a scheme was authorised and by which date it must show that it is “fully funded”. If a scheme fails to comply with the requirement by 22 September 2008, the Pensions Regulator will have the option of revoking the authorisation for the scheme to operate cross-border, or, in certain circumstances, of allowing the scheme an additional period to meet the “full-funding” requirement. Trustees of schemes that are not authorised are prevented from accepting contributions. Failure to comply with this will attract civil penalties on the trustees.

IMPLEMENTATION AND DELIVERY

29. The Department for Work and Pensions (DWP) has been working closely with the Pensions Regulator (TPR), who will be responsible for implementing the new policy, to ensure that implementation is carried out efficiently and in a timely way. (TPR, the successor to OPRA, have a wealth of experience in dealing with occupational pension schemes and will have the necessary skills to implement the policy). This has involved:

- DWP’s consultation meetings with representatives from within the Pensions Industry and TPR to discuss what the information requirements should be for schemes wishing to approach TPR for authorisation and approval to operate cross-border.
- Several meetings with TPR representatives to discuss the processes for schemes wishing to be authorised and approved to operate cross-border including information requirements, design of forms and the need to avoid unnecessarily duplicating existing information requirements.
- TPR has organised meetings with stakeholders to address their concerns.
- TPR will launch a consultation with stakeholders detailing its intended approach to the authorisation and approval process and seek responses.
- TPR will provide support to existing cross-border schemes and schemes wishing to become cross-border schemes in the coming months.
- TPR attends the European Commission’s CEIOPS⁴ working group and has played an active role in determining the protocol which will govern its collaboration with supervisory authorities in other Member States in relation to occupational pension schemes cross-border activities.

30. TPR will be responsible for imposing civil penalties on schemes which fail to comply with the requirements of the Regulations as detailed in paragraph 28.

Allowing existing cross-border schemes to continue to operate

31. In order that existing cross-border schemes are allowed sufficient time to go through the processes of being authorised and approved by the Pensions Regulator to operate cross-border, the commencement date of section 287 of the Pensions Act 2004 (Occupational pension scheme receiving contributions from European employer) for these schemes will be up to 8 months after that of other schemes (existing domestic schemes and brand new schemes). This is to allow them:

- A maximum of 3 months to apply to TPR for authorisation and approval to continue to operate.

⁴ The Committee of European Insurance and Occupational Pensions Supervisors

- 3 months for TPR to decide on the authorisation and approval of the scheme (Article 20(4))
- 2 months for the competent authority of the host Member State (the Member State where the sponsoring employer is based) to provide the necessary social and labour law to TPR and for TPR to pass this on to the relevant scheme. (Article 20(5))

REVIEW

32. The Department for Work and Pensions intends to review these Regulations in 4 years time in order to gauge:

- The efficiency of the authorisation and approval procedure allowing schemes to operate cross-border; and
- The extent to which UK schemes have undertaken cross-border activity through sponsorship by European employers.

SUMMARY

33. Following the responses received to the consultation, the Department has decided to draft the Regulations on the basis of option 2 – requiring existing cross-border schemes to address their funding position as soon as is reasonable (i.e. by 22 September 2008) (there were no responses favouring option 1). We cannot consider taking no action (option 1), as there are no benefits from this action.

34. The Department has taken account of the responses received on option 2. These responses have requested: an extension to the period existing Anglo-Irish schemes are given to reach a position of “full-funding”- up to 5 years; and a lengthening of the time cross-border schemes are allowed to fall below the position of being “fully- funded”. The Department, in acknowledgement that these Regulations may place an undue immediate financial burden on cross-border schemes (although this is simply changing the period over which funds will be required rather than the actual amount), has amended the Regulations so that:

- Existing cross-border schemes will be given an extra year to plan to reach the position of “full-funding”, i.e. until 22 September 2008; and
- Any cross-border schemes which fall below the position of being “fully funded” will be given an extra year to resume that position, i.e. 24 months from the effective date of the valuation that reveals the shortfall.

35. Finally, the responses received have not highlighted any other costs involved in implementing these Regulations. Therefore the total additional costs from the requirement to undertake annual valuations (over and above the valuations which would be required every 3 years) are unchanged from the initial RIA and are estimated at around £900,000 across all schemes.