

## Summary: Intervention & Options

Department /Agency: Department for Work and Pensions

Title:

### Impact Assessment of

The Financial Assistance Scheme (Miscellaneous Amendments) Regulations 2010

Stage: Final

Date: 8 December 2009

**Related Publications:** The Financial Assistance Scheme (FAS) Review of Assets (the 'Young Review')

Available to view or download at:

<http://www.dwp.gov.uk/consultations/>

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

The Financial Assistance Scheme (FAS) provides assistance to members of defined benefit pension schemes that commenced winding up under-funded between 1<sup>st</sup> January 1997 and 5<sup>th</sup> April 2005 (with a very limited number of exceptions where wind-up began after that date). Financial constraints have meant that assistance provided by government has been limited. In 2007 the Government commissioned the Financial Assistance Scheme Review of Assets (the 'Young Review') to consider whether an alternative treatment of the residual funds in affected pension schemes could supplement the committed government funding of the Financial Assistance Scheme.

### What are the policy objectives and the intended effects?

- The transfer of pension scheme assets to government to supplement funding provided in respect of the Financial Assistance Scheme;
- Making provision for some members of schemes who would have received more than the assistance payments FAS would otherwise provide had their scheme continued to wind-up and purchase annuities rather than transfer assets.
- Provide for other changes to FAS payments including provision for the payment of lump sums to certain members in respect of whom assets transfer.

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

The 'Young Review' recommended three options for the use of pension scheme assets :

- Continue to top up pensions
- Modified annuitisation
- Managed use of scheme assets

The review concluded that, to provide a guaranteed benefit level, the best value would come from government absorbing all residual assets in FAS qualifying schemes and taking responsibility for making associated payments. Based on assets of £1.7billion, the review estimated this would provide additional financial value of between £340 to £425m. Taking in pension scheme assets would be a new process for the FAS.

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

Arrangements to steward the Board of the Pension Protection Fund, as FAS scheme manager, have been put in place. These will be extended to include monitoring the Board's effectiveness in transferring assets and assessing assistance payments. The Board, as FAS scheme manager, is required to submit accounts and reports to DWP for scrutiny. An annual report will be laid before Parliament containing details of FAS annual expenditure and the number of people being paid.

**Ministerial Sign-off** For Impact Assessments:

I have read the impact assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

*Angel Eagle.*

Date: 8/12/09

## Summary: Analysis & Evidence

|                       |                     |
|-----------------------|---------------------|
| <b>Policy Option:</b> | <b>Description:</b> |
|-----------------------|---------------------|

|   |   |   |
|---|---|---|
| <b>COSTS</b>  | <b>ANNUAL COSTS</b>                               | <p>Description and scale of <b>key monetised costs</b> by 'main affected groups'</p> <p><u>Administrative costs of transferring assets.</u> An estimate of the additional cost to pension scheme assets (which is effectively a cost to the public sector as government will be taking in the assets) of providing information to government necessary to transfer member data is between £1m and £3.1m. Taking in scheme assets and making the associated payments will lead to a higher administrative burden on the Board of the PPF. These additional costs will mostly fall over the next 4 years and are estimated to be £25m. These costs will be funded by DWP and hence represent a cost to the tax-payer.</p> |
|   | <b>One-off</b> (Transition) <b>Yrs</b>            |   |
|   | <b>£ 28.1m</b> 4                                  |   |
|   | <b>Average Annual Cost</b><br>(excluding one-off) |   |
|   | <b>£ 0</b>  | <b>Total Cost (PV)</b> <b>£ 28.1m</b>   |
| <p><b>Other key non-monetised costs</b> by 'main affected groups'</p> <p><u>Lost opportunity to annuity providers:</u> Pension schemes who are transferring their assets to government will not secure members' benefits by purchasing annuities. While this is not a cost to annuity providers it does represent a lost opportunity of business that is no longer available to them.</p> |   |   |

|   |  |   |
|---|--|---|
| <b>BENEFITS</b>   | <b>ANNUAL BENEFITS</b>                               | <p>Description and scale of <b>key monetised benefits</b> by 'main affected groups'</p> <p>The Financial Assistance Scheme (FAS) Review of Assets concluded that to provide a guaranteed benefit level, the best value would come from government absorbing residual assets in FAS qualifying schemes. The additional financial value was estimated to be between £340m and £425m. This benefit will accrue over the approximately 90 year lifetime of FAS in the form of lower top-up assistance payments.</p> |
|   | <b>One-off</b> <b>Yrs</b>                            |   |
|   | <b>£ 340m</b> 90                                     |   |
|   | <b>Average Annual Benefit</b><br>(excluding one-off) |   |
|   | <b>£ 0</b>   | <b>Total Benefit (PV)</b> <b>£ 340m</b>   |
| <p><b>Other key non-monetised benefits</b> by 'main affected groups'</p> <p><b>None</b></p> |  |   |

**Key Assumptions/Sensitivities/Risks**

Changes in the value of investments may mean that the estimates of the additional value of bring assets into government may be under or overstated. Also the administrative costs of transferring assets to government will vary considerably depending on the scheme.

|                         |                         |   |   |
|-------------------------|-------------------------|---|---|
| Price Base<br>Year 2009 | Time Period<br>Years 90 | <b>Net Benefit Range (NPV)</b><br><b>£ 312 - 399m</b> | <b>NET BENEFIT (NPV Best estimate)</b><br><b>£ 355m</b> |
|-------------------------|-------------------------|---|---|

|   |   |        |       |        |       |   |   |   |   |
|---|---|--------|-------|--------|-------|---|---|---|---|
| What is the geographic coverage of the policy/option?                 | UK  |        |       |        |       |   |   |   |   |
| On what date will the policy be implemented?                          | Spring 2010   |        |       |        |       |   |   |   |   |
| Which organisation(s) will enforce the policy?                        | DWP   |        |       |        |       |   |   |   |   |
| What is the total annual cost of enforcement for these organisations? | <b>£ Negligible</b>   |        |       |        |       |   |   |   |   |
| Does enforcement comply with Hampton principles?                      | N/A   |        |       |        |       |   |   |   |   |
| Will implementation go beyond minimum EU requirements?                | N/A   |        |       |        |       |   |   |   |   |
| What is the value of the proposed offsetting measure per year?        | <b>£ N/A</b>  |        |       |        |       |   |   |   |   |
| What is the value of changes in greenhouse gas emissions?             | <b>£ N/A</b>  |        |       |        |       |   |   |   |   |
| Will the proposal have a significant impact on competition?           | No  |        |       |        |       |   |   |   |   |
| Annual cost (£-£) per organisation<br>(excluding one-off)             | <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> <tr> <td style="text-align: center;">0</td> <td style="text-align: center;">0</td> <td style="text-align: center;">0</td> <td style="text-align: center;">0</td> </tr> </table> | Micro  | Small | Medium | Large | 0 | 0 | 0 | 0 |
| Micro   | Small   | Medium | Large |        |       |   |   |   |   |
| 0   | 0   | 0      | 0     |        |       |   |   |   |   |

|  |    |    |    |    |
|--|----|----|----|----|
| Are any of these organisations exempt? | No | No | No | No |
|--|----|----|----|----|

|   |       |             |                       |                         |
|---|-------|-------------|-----------------------|-------------------------|
| <b>Impact on Admin Burdens Baseline</b> (2005 Prices) |       |             | (Increase - Decrease) |                         |
| Increase of   | £ N/A | Decrease of | £ N/A                 | <b>Net Impact</b> £ N/A |

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

## Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

### **Background**

The Financial Assistance Scheme (FAS) was created under the Pensions Act 2004 to provide assistance to members of qualifying occupational pension schemes which generally started to wind up, under-funded, between 1<sup>st</sup> January 1997 and 5<sup>th</sup> April 2005.

FAS makes payments to members of defined benefit occupational pension schemes that, because of under-funding, cannot pay members the full amount of their accrued pension rights. FAS tops up any payment from the scheme to 90% of a member's expected pension, subject to a maximum limit. Payments are made from the later of 14<sup>th</sup> May 2004 or a member's scheme normal retirement age. In certain circumstances members may access FAS assistance before their normal retirement age.

The FAS also makes payments to certain survivors of qualifying members on their death.

### **Extension to the Financial Assistance Scheme**

The Financial Assistance Scheme Review of Assets (the 'Young Review') was commissioned by the Government in 2007 to consider whether an alternative treatment of the residual assets in affected pension schemes could supplement the committed government funding of the Financial Assistance Scheme. The review recommended three options for the use of pension scheme assets:

- Continue to top up pensions
- Modified annuitisation
- Managed use of scheme assets

The Review concluded that, to provide a guaranteed benefit level, the best value would come from government absorbing all residual assets in FAS qualifying schemes and taking responsibility for making all associated payments. Taking in assets would be a new process for FAS.

Following acceptance of the 'Young Review' in December 2007, the Government announced, in December 2007, a package of measures to:

- transfer the residual assets of FAS qualifying pension schemes to government; and
- extend the assistance provided by FAS.

In addition, the Government subsequently announced its intention to confer the role of the FAS scheme manager on the Board of the Pension Protection Fund (a non-departmental public body which deals with schemes that had insolvency events from 6th April 2005 onwards and are funded to a level below PPF compensation).

These changes have been implemented in stages and these Regulations cover the final stage. They include transferring relevant FAS qualifying pension scheme assets to government and taking responsibility for making payments to certain beneficiaries, who would have received higher payments than FAS would otherwise provide, when assets transfer.

The transfer of FAS qualifying scheme assets requires the Government to implement a process that provides for the valuation of and transfer of scheme assets and liabilities. As a result

additional information is required for pension scheme members who previously would not have been eligible for help from FAS in relation to survivor benefits and death benefit guarantees payable to members.

These Regulations also provide for the payment of lump sums through the commutation of assistance although this does not require any additional information requirements in respect of these payments.

## **Net Benefit**

From the data contained in the summary on page 3 and in table 4 below, the overall net benefit range of these measures is calculated by taking the lower estimate of additional value (£340m) and subtracting the highest estimate of the additional costs (£28.1m) which gives £312m as the lower end of the range. To calculate the upper end of the range, the upper estimate of additional value (£425m) is taken, from which the lower end of the range of additional value (£26m) is subtracted, producing a figure of £399m.

The overall best estimate of the net benefit is £355m, which is the mid-point of the lower-end estimate of £312m and the upper end estimate of £399m.

## **Impact of the regulatory changes**

Impact on business: The transfer of scheme assets to government could be viewed as resulting in a lost opportunity to annuity providers. This is because pension schemes that have members eligible for FAS assistance and are transferring their assets to government will no longer look to secure pension payments for their members by purchasing annuities.

Impact on pension scheme assets: These Regulations will result in a cost to pension schemes' assets of trustees providing additional information so that the policy of transferring assets from pension schemes to government can take place and extended FAS assistance payments be calculated. The cost of providing this information in the vast majority of cases will be met from scheme assets and therefore will not present a cost to business as they will effectively fall on FAS when topping up a pension scheme member's pension. The Regulations enable the FAS scheme manager to waive some, or all of the information requirements where considered appropriate.

The first part of this evidence base considers lost opportunity costs to annuity providers and the second focuses on the cost to pension scheme assets of trustees providing information to the FAS scheme manager to calculate and pay assistance.

## **Part 1: Lost opportunity to annuity providers:**

### **Background – why the Government are taking into the Financial Assistance Scheme, the assets of qualifying pension schemes**

The 'Young Review' concluded that, to provide a guaranteed benefit level, the best value would come from government absorbing all residual assets in FAS qualifying schemes and taking responsibility for making all associated payments.

Based on estimated assets of £1.7billion, the review estimated this would generate an additional financial value of funds available to FAS of between £340m and £425m than if the government continued to top-up annuity payments.

Part of the additional value to government of taking in assets from FAS qualifying schemes is generated through the FAS in the public sector being a monopoly that does not operate in

contestable markets. Insurers do compete and they need to earn margins to reward shareholders for taking market share risks.

The 'Young Review' estimated that the margin needed by insurers in order for them to offer annuities to members of FAS qualifying schemes was between £120m and £160m in total. This margin included the profits and prudence for the insurer. This means that an upper estimate of the lost opportunity to annuity providers of the Government taking in pension scheme assets rather than pension scheme trustees purchasing annuities might be between £120m and £160m which will be a saving to government. While this figure appears large, it is small when compared to the overall size of the annuities market; in 2008 just over 454,000 annuities were sold with a median fund value of around £15,000 each. This suggests a conservative estimate of the overall value of the annuities market is about £6.5 to £7 billion per year.

There have been no adverse comments from insurers, who specialise in providing annuities for winding-up defined benefit schemes, about government taking in assets rather than allowing pension schemes to purchase annuities for their members.

## **Part 2: Costs of providing information necessary for transferring pension scheme assets to government**

A survey outlining the additional information that would be required as a result of these draft Regulations was sent to a number of trustees who were asked to provide estimated costs for providing the information as outlined.

Their responses have been used to estimate the additional costs. All the costs in this impact assessment have been taken from this survey unless otherwise stated.

The costs related to:

- Transferring assets to government (Cost 1-2)
- Providing information on the new category of pensioner members in FAS (Costs 3-5)
- The cost of purchasing annuities (Cost 6)

### **Costs 1 to 2: Transferring assets to government**

Two notional costs have been identified with transferring pension scheme assets to government and the responses from trustees suggested that these costs are scheme-specific and vary greatly.

Cost 1: The additional cost of a scheme having to sell assets that it may otherwise have been able to transfer to an annuity provider. Whilst in some cases this may be an additional cost for a scheme, discussions with trustees have indicated that in most cases liquidating assets prior to transfer is the easiest and most cost-effective method.

Cost 2: The cost of implementing the valuation calculations and providing information to support validation processes (over and above those that would be incurred were conventional winding-up processes to be followed in relation to these schemes). For instance, although a valuation of assets and liabilities would need to be undertaken in a conventional wind-up 'in-house' approaches might be taken to reconciling past payments made to members against the share of assets allocated to the member. Additionally, standard processes will be required to meet FAS requirements that could incur additional processing costs.

Table 1

|  | <b>Lower estimate</b><br>(per scheme)  | <b>Higher estimate</b><br>(per scheme)                          |
|--|--|---|
| Cost 1: Cashing assets   | Negligible or small administrative costs - £0  | Up to £5000 for a scheme with complex assets                    |
| Cost 2 : Valuation of scheme assets and liabilities and providing information for validation | £2,000 to £3,000 for a replacement valuation of assets and liabilities at the time of transfer | Between £10,000 and £25,000 depending on the size of the scheme |

There are approximately 450 schemes that could transfer assets into government. This means that the costs of cashing the assets are between £0 and £2.25m ( $450 * £5000$ ) and the costs of valuing the scheme assets are between £1.1m ( $(£2,000+£3,000)/2 * 450$ ) and £7.9m ( $(£10,000+£25,000)/2 * 450$ ).

### **Costs 3 to 5: The additional cost of providing information in respect of the new category of pensioner members**

As a result of taking in FAS qualifying scheme residual assets, the FAS will make payments to pensioners who are currently receiving their pension from their pension scheme (above standard FAS levels). The operation of relevant statutory priority orders that dictate the order in which scheme assets are allocated mean many of these pensioners would stand to receive pensions higher than the assistance payments that FAS would otherwise provide.

In order to make payments to this category of member, the FAS scheme manager will need some of the same type of information that it is currently collected from pension schemes for scheme members who receive FAS payments. However, the FAS scheme manager will also require additional information from the trustee in relation to the level and proportion of survivor benefits and death benefit guarantees available to the member under the pension scheme rules.

Trustees would expect to provide information to an insurer for the purpose of purchasing an annuity so only the additional cost of providing the information to the FAS scheme manager compared with providing information to an insurer for an annuity purchase has been assessed. A number of trustees said that much of this data would be necessary in order to wind-up the scheme and purchase annuities, so the additional costs would not be significant and were difficult to cost individually. This would mean that there was no additional cost of the pensioner members being paid through the FAS operational unit.

Table2

|   | Estimate for the administrative review on burdens to trustees of providing information <sup>1</sup> (per member) |                        |
|---|--|------------------------|
| Cost 3: Cost of providing information to FAS per member | £25.50   |                        |
|   | <b>Lower estimate</b>  | <b>Higher estimate</b> |
| Cost 4: Survivor benefit.                               | £ negligible   | £60                    |
| Cost 5: Death Benefit Guarantees.                       | Already included   | Already included       |

There are approximately 23,000 pensioner members currently being paid by their pension scheme who will be paid by the FAS operational unit in the future. The cost of providing information on pensioner members, including for survivor and death benefits, is estimated to be between £586,500 ( $£25.50 * 23,000$ ) and £2.0m ( $(£25.50 + £60) * 23,000$ ).

### Cost 6: Purchasing annuities

To appreciate the additional costs to business of providing information to calculate and pay extended FAS assistance, it is necessary to understand what pension scheme trustees would have spent in providing information in order to purchase an annuity for their members.

Consultation suggested that the cost of purchasing annuities varies widely due to the:

- complexities of each scheme;
- approach taken by the insurer;
- costs of obtaining advice if needed from a consulting firm; and
- cost of legal advice.

The following table summarises details of costs as provided by trustees.

Table3

|  | <b>Lower estimate</b><br>(per scheme) | <b>Higher estimate</b><br>(per scheme)                                     |
|--|---------------------------------------|--|
| Cost 6: The administrative cost of purchasing annuities. | £1,500                                | £20,000 – although costs could be as high as £60,000 for a complex scheme. |

There are approximately 450 schemes that are transferring assets into government. The total cost of purchasing annuities will therefore be between £675,000 ( $£1,500 * 450$ ) and £9m ( $£20,000 * 450$ ). The highest estimate cost of £60,000 relates only to a very small number of schemes and therefore the figure of £20,000 has been used as a representative average for the higher estimate, given also that many schemes will cost considerably less.

<sup>1</sup> This figure is based on standard assumptions that have been used within the FAS programme since 2007. The cost has been inflated using the All Items RPI – not seasonally adjusted (CHAW).

## **The additional cost of providing information to government / Total additional costs**

The following table summarises the total costs in relation to transferring assets into government.  
Table 4

|   | <b>Lower estimate</b> | <b>Higher estimate</b> |
|---|-----------------------|------------------------|
| Cost 1: Cashing assets                                      | £0                    | £2,250,000             |
| Cost 2 : Valuation of scheme assets                         | £1,125,000            | £7,875,000             |
| Cost 3: Cost of providing member information to FAS         | £587,000              | £587,000               |
| Cost 4: Survivor benefit.                                   | £0                    | £1,380,000             |
| Cost 5: Death Benefit Guarantees.                           | £0                    | £0                     |
| Sub total   | £1,712,000            | £12,092,000            |
| Less Cost 6 The administrative cost of purchasing annuities | £675,000              | £ 9,000,000            |
| Total   | £1,037,000            | £3,092,000             |

**Therefore the additional cost to trustees of providing the information necessary to transfer the pension scheme assets into government is estimated to be between £1m and £3m.** This is the difference between the cost of providing information to FAS and the cost of purchasing an annuity which pension schemes currently have to do to ensure the members benefits once the scheme has wound-up.

A FAS Trustee Advisory Panel which comprises of trustees, administrators and annuity providers from the pensions industry has been engaged with DWP officials at all stages of the implementation of the December 2007 announcement and have discussed with them the financial implications of providing additional information requirements resulting from these changes.

In all cases of information collection, the FAS scheme manager will ensure that any requests for information are limited to only that which is necessary and relevant to the calculation and payment of FAS assistance and the management of the FAS.

These Regulations include a provision for the FAS scheme manager to waive some or all of the information requirements where it considers that the information is not necessary or relevant to its FAS work. The Regulations also provide for the FAS scheme manager to restrict valuation requirements in certain exceptional circumstances where it would not be cost-effective for full valuation requirements to be followed - this may arise where a scheme's funding position is such that all residual assets will be allocated to pensioner members and none of those pensioner members would stand to receive payments that would otherwise be above FAS levels.

Costs that a trustee incurs in providing information are likely to be recovered by the trustee from the pension scheme assets prior to their transfer to government. In using scheme assets to cover the cost of providing information members' asset shares may be reduced, however in many cases this will be offset for the member by an increase in FAS assistance (to a maximum of 90% level, subject to the FAS cap). As the cost of providing information will reduce individual asset shares it is possible that a small number of people with asset shares in excess of 90% (and hence do not receive a top up from the FAS) will see a small reduction in the value of their payments due to the cost of information provision reducing their asset share. Whilst detailed information on members which may be in this position is not held, it is believed that the number of members affected to be small, and the loss to affected members also to be small.

## **Administrative Costs**

The FAS scheme manager already pays assistance up to a level of 90%, therefore the extra costs of paying asset-backed payments will be minor once the initial set up and design is implemented. Hence running costs, and start up costs will be minor given that this is already an ongoing process.

## **Competition Assessment**

The Government's absorption of FAS qualifying scheme assets does not affect competition in the insurance sector as it removes business from the entire annuity sector and not from any particular area of this sector.

Government itself is not part of the annuity business sector and would not be purchasing annuities on behalf of FAS qualifying pension schemes.

## **Small Firms Impact Test**

The Government recognise that the additional information requirements may place a cost on small businesses and the definition of small businesses may apply to some of the trustees that manage pension schemes. The basic information requirements, per scheme, are the same regardless of the size of scheme. It should be noted however, that over 75% of FAS schemes are managed by large businesses.

## **Legal Aid**

There will be no impact on legal aid.

## **Sustainable Development, Carbon Assessment, Other Environment.**

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

## **Health Impact Assessment**

The options have been considered against the screening questions for health impact assessments and a full health assessment is considered to be unnecessary.

## **Human Rights**

These regulations are compatible with the Human Rights Act 1998.

## **Rural Proofing**

These regulations have no specific impact on rural communities.

## **Equality Impact Assessment**

An Equality Impact Assessment has been published which relates to FAS in its entirety.

## 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 | <i>Results in Evidence Base?</i> | <i>Results annexed?</i> |
|----------------------------|----------------------------------|-------------------------|
| 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                      |