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THE EMPLOYMENT EQUALITY (AGE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2019

REGULATORY IMPACT ASSESSMENT

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The costs and savings outlined in this Regulatory Impact Assessment are calculated on a United Kingdom-wide basis.

Evidence Base

Problem under consideration

1. Some defined benefit (DB) pension schemes[1] currently pay one (higher) rate of pension when a member reaches the pensionable age under the scheme; and a reduced rate when the member reaches State Pension age. This permits schemes to take account of the State Pension the member receives when they reach State Pension age. This process is known as "integration".

2. It means that a member's pension is actuarially enhanced between scheme retirement date and State Pension age; and actuarially reduced thereafter. The practical effect is that the member's income is smoothed out so there are no sudden changes.

3. The Employment Equality (Age) Regulations (Northern Ireland) 2006 ("the 2006 Regulations") and similar Great Britain legislation makes discrimination on the grounds of age unlawful and applies to trustees and managers of an occupational pension scheme and employers whose employees may be members of the scheme. The 2006 Regulations require occupational pension schemes to be treated as including a non-discrimination rule prohibiting trustees, managers and employers in carrying out functions in relation to the scheme from discriminating against, victimising or harassing scheme members or prospective members. It is not a breach of a non-discrimination rule to use a practice, action or decision specified in Part 2 of Schedule 1 to the 2006 Regulations. Paragraph 16(1) of Part 2 of Schedule 1 to the 2006 Regulations provides an exemption in relation to age related equality obligations.

4. The 2006 Regulations currently only allow integrated pension schemes to reduce the amount of occupational pension they pay the member by amounts up to the new State Pension where they apply the deduction between the member's 60th and 65th birthdays. Schemes would not be able to rely on the exception if they commenced applying the reduction where the member has a State Pension age greater than age 65. As the State Pension age is increasing incrementally from age 65 to 68 from 5 December 2018, this means that schemes would either be required to carry out any reductions at age 65 or continue to pay a higher rate of pension benefit.

5. The equalisation in State Pension age means the exception for discrimination on the basis of sex isn't needed any more – men and women's pensions will now both be reduced at the same age. However, reducing the scheme pension when the member reaches State

[1] There is limited information available on integration, with the most recent published evidence from the Pensions and Lifetime Savings Association (PLSA) being from 2005 – *see paragraphs 23 to 29 for more detail*.

Pension age – at 65, or 66 or whenever, could be considered a breach of the non-discrimination rule based on age and so needs to be allowed for by the 2006 Regulations to provide an exception for it not to be in breach of the non-discrimination rule.

Rationale for intervention

6. The rationale for intervention is that without changes to the relevant legislation, integrated pension schemes will either incur additional costs as a result of not being able to take into account State Pension payable to the member, where the member has a State Pension age greater than age 65; scheme members may suffer a reduction in their benefits as pension schemes would be required to continue to make the reduction at age 65; or pension schemes would have to change their rules to smooth out payments.

Policy objective

7. The policy objective is to ensure that these pension schemes can continue to operate "integration", as provided for within their scheme rules, and reduce the amount of occupational pension they pay members by an amount related to the new State Pension, where the member has a State Pension age between 65 and 68, without breaching their equality obligations relating to age.

8. The intended effect is that these pension schemes will not have to face additional costs through not being able to make these deductions in order to maintain compliance with their equality obligations relating to age.

9. More generally, the changes will ensure these pension schemes remain financially sustainable.

10. The change to legislation also avoids the need for schemes to reduce the pension payable at the last opportunity (age 65) causing the member to suffer a shortfall in their retirement income until they reach their State Pension age.

11. The amendments to legislation will maintain the status quo for these schemes.

Description of options considered

<u>Option 0: Do nothing</u>

12. This option would not deliver the policy objective that integrated pension schemes should continue to be able to take into account the State Pension when calculating occupational pension payable where the member has a State Pension age greater than age 65. The schemes would not be able to rely on the current exception under the 2006 Regulations and potentially be in breach of their equality obligations relating to age.

13. To ensure they did not breach their equality obligations, schemes could decide not to apply pension deductions at all, thereby incurring significant additional costs. Schemes might also consider applying the deduction at the last possible opportunity (the member's 65th birthday), but this would result in the member suffering losses until their State Pension became payable.

14. Therefore, doing nothing would incur costs for pension schemes; or for scheme members.

Option 1: Legislate to amend the 2006 Regulations

15. This is the preferred option which would amend the 2006 Regulations so that integrated pension schemes could take into account the State Pension when calculating occupational pension payable where the member has a State Pension age greater than age 65. This option also removes the risk that these schemes might breach their equality obligations relating to age. This option fully achieves the policy objective, and presents savings for pension schemes.

Evidence behind the rationale for intervention

16. Before the State Pension age increased beyond age 65 for men and women (for those reaching age 65 on 6 December 2018), DWP were alerted by stakeholders that, unless changes were made to the legislation, schemes they represented would be unable in the near future to operate integration when calculating occupational pension for anyone with a State Pension age greater than age 65. Or if they were to continue to operate integration for this group of people, they risked breaching their equality obligations relating to age.

Impacts on affected parties (of preferred option)

Baseline

17. This change is designed to maintain the status quo, so that integrated pensions schemes can continue to make deductions at State Pension age. If this change was not made, then employers continuing to apply integration at State Pension age would be at risk of challenge under the relevant legislation.

18. It is unclear what decision employers would take in the baseline (or counterfactual). Potential options include:
    - (i) Make deductions at State Pension age (above a members 65th birthday) and take the risk of not being covered by the exemption.
    - (ii) Not making any deductions at all, and absorbing the cost of integration (central scenario).
    - (iii) Changing scheme rules to get around the issue. For example, to allow the scheme to make deductions before State Pension age on member's 65th birthday, and then apply a bridging pension from age 65 until State Pension age to make up the shortfall.
    - (iv) Make deductions at the last permitted time, i.e. the member's 65th birthday.

19. Based on DWP preliminary discussions with the sector and consultation feedback[2],[3] it is likely that option (ii) not making any deductions at all would be taken. Option (i) making deductions at State Pension age above 65, though possible, it is not appropriate to discuss the merits of legal risk in this impact assessment. As such this option is not considered as

[2] The public consultations are available here:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/771126/consultation-equality-act-age-exceptions-for-pension-schemes-amendment-order-2019.pdf
https://www.communities-ni.gov.uk/consultations/draft-employment-equality-age-amendment-regulations-northern-ireland-2019

[3] The DWP consultation response document is yet to be published. However, once published it will be available here:
https://www.gov.uk/government/consultations/the-draft-equality-act-age-exception-for-pension-schemes-amendment-order-2019

a viable baseline. Options (iii) and (iv) changing scheme rules, for example to allow deductions before State Pension age and then apply a bridging pension to cover the difference have not been mentioned by any providers.

20. Therefore option (ii) has been chosen as the central baseline scenario, for the schemes who have raised this issue. Consequently, under the preferred policy option (policy option 1), firms will make savings equal to the amount of deductions they would apply to integrated pensions compared to the baseline – see “Impacts (Costs and Benefits) on Businesses” below for more details.

Impacts (Costs and Benefits) on Businesses

Costs of complying with the revised legislation - familiarisation and ongoing.

Familiarisation costs

21. This is a permissive measure in response to scheme requests to consider the issue. The legislation would simply change the 2006 Regulations so that schemes could continue to apply integration up to a member’s State Pension age (as opposed to a fixed age of 65). For firms wishing to apply they would already be aware of this. Therefore no familiarisation costs involved (as firms who are concerned by this are already considering their courses of action and actively want this change made).

Ongoing costs

22. This is a permissive measure, therefore there are no direct net costs to businesses. Extending the age exemption beyond age 65 neither prevents nor mandates schemes to do anything. However, it does allow them to continue to conduct integration (permissive) without the risk of legal challenge. It also means savings over the alternative of doing nothing; and the assumption is that there would be a high take-up of the option to make those savings.

Benefits to Businesses

Benefits to businesses

23. Under the central baseline that schemes would otherwise not make any deductions at all, there would be significant benefits to business equal to the amount of deductions they would apply to integrated pensions.

24. The benefits to business each year would be equal to:

- The number of members with integrated pensions reaching State Pension age since March 2019
- The average value of integration each year

25. Schemes responding to the DWP consultation have provided some information on the scale of this issue, which is set out below. Though more schemes may be affected, the analysis has prudently not been extended in the central scenario as it is assumed that they either do not operate integration, or the impact of State Pension age exceeding the current exemption is not a significant cost concern for them.

Table 1. Assumptions provided at consultation on impact of not integrating

Assumption	Figure	Source/justification
Number of integrated members per year	1,400	Consultation response (of 700 members in next 6 months, and another 700 in a following 6 month period)
Average value of integration per member per year	£1,000	Average integration (£20 p.w. * 52 weeks)
Cost per year of not integrating	£1,400,000	Derived from above (1,400 * £1,000)

26. These benefits would increase over time as more members retire each year. The table below sets out the impact over the 10 year timeframe. In addition to the above assumptions, we have also applied a weighted average mortality rate to members by age over the ten year period[4] as some integrated members will die each year. Following these assumptions, we can see that the estimated cost to businesses as a result of not integrating in year 0 is approximately £1.39m (1,400 * (100% - 0.88%) * £1,000). When applying the standard discount rate of 3.5% from the Green Book[5] for year 1 onwards, it can be seen that the total estimated cost to businesses of not integrating over the ten year period is approximately £60.2m.

Table 2. Discounting cost to businesses of not integrating

Year	Discounted cost of non integration
0	£1.39m
1	£2.67m
2	£3.85m
3	£4.93m
4	£5.92m
5	£6.82m
6	£7.63m
7	£8.37m
8	£9.03m
9	£9.61m
Total	**£60.21m**

27. There are potential additional benefits to business from administrative savings of not having to amend scheme rules or take legal advice related to the change. As no representations of these have been received these have not been included at this stage.

Sensitivity analysis

28. The above focuses on the information provided by the consultation responses. Though other firms have not made representations about the number of members affected, this

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[4] Source: DWP estimates derived from ONS Population Projections (table PPP). For example, over the ten year period (2019/20 – 2028/29) the weighted average mortality rate is 0.88% for those aged 65, the first year in which businesses would incur additional costs as a result of the Equality Act (Age Exceptions for Pension Schemes) Order 2010 not being amended, whilst those aged 66 have a weighted average mortality rate of 0.97% over the ten year period.

[5] HM Treasury. 'The Green Book: Central Government Guidance on Appraisal and Evaluation'. 2018. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685903/The_Green_Book.pdf

could potentially be a broader issue. There is limited information available on integration, with the most recent published evidence from the Pensions and Lifetime Savings Association (PLSA) being from 2005. The following analysis provides the upper estimate of members which could be in scope, assuming levels of integration similar to in 2005. The assumptions used to calculate these benefits are set out below in Table 3.

Table 3. Sensitivity - impact of not integrating assuming 26% of DB members in integrated schemes

Assumption	Figure	Source/justification
Number of DB active and deferred members (still to retire)	6,138,600	PPF Purple Book 2018[6]
Members in integrated schemes	26%	NAPF (National Association of Pension Funds (now PLSA)) annual survey 2005[7]
Retirees each year	4.0%	Broadly based on the proportion of open schemes declining significantly since 2006, indicating a lower proportion of active and deferred members under the age of 40. Assuming that approximately 40% of all current non-pensioner DB members will retire over the next 10 years, using a uniform distribution, we assume there will be 4.0% of retires each year.
Number of members with integrated pensions retiring each year	64,000	Derived from above assumptions (6,138,600 * 26% * 4.0%)
Average value of integration per member per year	£1,000	Consultation response from provider on average value of integration, of approximately £20 p.w. or £1,000 p.a.
Cost per year of not integrating	£64,000,000	Derived from above (64,000 * £1,000)
Mortality rates per year	Weighted average mortality rate dependent on age	Same mortality rates used as for the previous analysis. These mortality rates are derived using the ONS population projections.

29. These benefits would increase over time as more members retire each year. Using the mortality assumption as outlined above, in addition to the Green Book discount rate of 3.5%, we can see the upper estimate of potential costs to business as a result of not integrating to total approximately £2.75bn over the ten year period.

[6] Pension Protection Fund. *Purple Book 2018*. Available at: https://www.ppf.co.uk/sites/default/files/file-2018-12/the_purple_book_web_dec_18_2.pdf
[7] NAPF, Annual Survey 2005. The State of Britain's Pensions, Figure 36

Table 4. Sensitivity - impact of not integrating assuming 26% of DB members in integrated schemes, discounted costs over 10 years

Year	Discounted cost of non integration
0	£63.3m
1	£121.7m
2	£175.4m
3	£224.8m
4	£269.9m
5	£310.9m
6	£348.1m
7	£381.7m
8	£411.7m
9	£438.3m
Total	**£2,745.8m**

Impacts (Costs and Benefits) to scheme members

Costs to scheme members

Familiarisation costs to scheme members

30. There will be no familiarisation costs to members because they will not need to take any action. From the member point of view pension integration will continue to operate as expected at the time of them joining the scheme.

Ongoing costs to scheme members

31. Under the central baseline that business would otherwise not make any deductions at all, then there would be a cost to members from reduced payments associated with the preferred option. As pension payments are a transfer between scheme and members, the costs to members would equal the benefits to business set out above in paragraphs 23 to 29.

Benefits to scheme members

Ongoing benefits to scheme members

32. Under the central baseline that schemes would otherwise not make any deductions at all, then there would be no direct benefits to members from allowing schemes to integrate at State Pension age under the exemption.

33. However, scheme funding will have been based over time on the expectation that integration could be applied. Under the central baseline, schemes would incur additional and unforeseen costs which could impact their sustainability. Therefore there is a potential second order offsetting benefit to members if this measure improved the sustainability of underlying schemes and reduced the probability of a scheme entering the PPF. Given the uncertainty around the potential second order impacts this benefit is not deemed proportionate to monetise.

34. If, in the counterfactual, some schemes decided to deduct from age 65, then there would be a benefit to members from allowing schemes to integrate at State Pension age (over 65) under the exemption. This benefit would be equal to the level of deductions between 65 and State Pension age (so on the assumptions in paragraphs 23 to 29 up to £3,000 per member (£1,000 per year * (68-65)). However, as no schemes have indicated that this is the counterfactual decision they would make, this benefit has not been monetised.

Sensitivity analysis.

Amount of integration

- *Covered above in paragraphs 23 to 29*

Small and Micro Business Assessment

35. As this measure is permissive there is no requirement for businesses of any size to change their actions as a result of this measure.

36. The benefits to business fall predominantly on pension schemes and providers. Small and micro businesses who operate small and micro pension schemes may also benefit. However, assessing the impact of the regulations on this group is difficult, as it is not necessary that small and micro pension schemes correspond to small and micro businesses. For example, many large firms may run Executive Pension Plans with only a few members. Similarly, small employers may enter their staff in larger master trust schemes. For the part of the legislation that applies to pension schemes and providers, as there is currently no robust evidence to link pension scheme size to employer size, it is difficult to accurately assess the impact on small and micro businesses.

37. However, for completeness, information on small and micro businesses in the DB sphere is provided below.

38. There is information in the Annual Survey of Hours and Earnings (ASHE) data set on the size of DB sponsoring employers with active members. This will only include those who are contributing to a DB pension so will exclude members who are in schemes closed for future accrual but it helps to provide an indication of the size of DB sponsoring employers. The table below shows the proportion of private sector and not for profit active DB members by employer size.

Table 5: Proportion of active DB members, by employer size[8],[9]

Size of Employers	Proportion of DB members
0	0%
1-9	2%
10-49	10%
50-99	4%
100-499	14%
500-999	9%
1000+	61%
All sizes	**100%**

[8] Source: DWP estimates derived from ONS Annual Survey of Hours and Earnings (GB)

[9] These percentages are rounded to the nearest 1%.

39. The above evidence shows that the majority of active DB members work in businesses with more than 50 employees. The assumption is therefore that there will not be a disproportionate impact on small and micro employers, and that where such an impact occurs, it will be beneficial.

Monitoring / post implementation review

40. As this measure aims to restore the existing policy intent of the exemption, and allow firms to continue to apply integration in line with their scheme rules, no monitoring is proposed.

Other Impacts

Equality

41. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on these legislative proposals and has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

Environmental

42. There are no implications.

Rural proofing

43. There are no implications.

Health

44. There are no implications.

Human rights

45. The Department considers that the regulations are compliant with the Human Rights Act 1998.

Competition

46. There are no implications.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed for the Department for Communities

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