EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (REGULATORY OWN FUNDS) REGULATIONS 2005

2005 No. 3380

1. This explanatory memorandum has been prepared by Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 These Regulations transpose the requirements of Article 17 of the European Directive on the Supervision of Institutions for Occupational Retirement Provision (2003/41/EC).

2.2 Article 17 of Directive 2003/41/EC requires schemes that bear certain risks themselves, to hold additional assets above the normal funding levels. Article 17 and these Regulations, apply to schemes where the scheme itself, and no employer in relation to that scheme, underwrites liability to cover against biometric risk[1], or guarantees a given investment performance, or a given level of benefits.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Background

4.1 These Regulations are made under the powers in section 2(2) of the European Communities Act 1972. That section allows the Government to make provision for the implementation of any Community obligation by means of regulations.

4.2 These Regulations form part of a series of Regulations which are due to come into force as a result of the Directive 2003/41/EC around the end of 2005. The other Regulations are:

- The Occupational Pension Schemes (Scheme Funding) Regulations
- The Occupational Pension Schemes (Investment) Regulations
- The Occupational Pension Schemes (Cross-border Activities) Regulations
- The Occupational Pension Schemes (Internal Controls) Regulations

4.3 (a) Transposition took the route of elaboration rather than simple copy-out to give proper effect to the Directive, and to provide for a practical application of the requirements. The latter was particularly important given that Article 17 deals with a concept that would be alien to most UK schemes. The elaboration

1 Biometric risks are those linked to death, disability or longevity

approach also provides for a scheme's compliance to be monitored, making for fuller transposition. The Government believes that these Regulations implement the Directive's requirements without superequivalence.

(b) A transposition note is attached as Annex A.

(c) Scrutiny history of Directive 2003/41/EC: It stems initially from Doc Ref 13420/00, COM(200)507 (Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, Regulations and administrative provisions relating to institutions for occupational retirement provisions). The Government submitted explanatory memoranda to Parliament dated 11 December 2000 and 16 May 2001. The House of Commons European Scrutiny Committee reported on the proposal and the Government's explanatory memoranda in report No. 2, Session 00/01 and in report no. 31, Session 01/02. The proposal and explanatory memoranda were sifted to Sub-Committee A of the House of Lords European Union Committee and were cleared by that Committee following correspondence with Ministers on 17 June 2002.

4.4 The draft Regulations provide for the Pensions Regulator to issue a Code of Practice. Information such as the definition of the term 'reasonable period' as used in these Regulations is included in Code of Practice No. 3: Funding defined benefits.

5. Extent

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The government does not know of any UK schemes that function in the manner described by Article 17. However, the UK is still required to transpose this element of the Directive as schemes are not legislatively prohibited from being set up on the basis described.

7.2 These Regulations require schemes where the scheme itself, and not ***any*** sponsoring undertaking (e.g. employer), underwrite the liability to cover against risks linked to death, disability or longevity, or guarantees a given investment performance or a given level of benefits, to maintain a buffer of additional assets above the normal funding requirements (technical provisions).

7.3 These Regulations lay down the rules to apply for the purposes of calculating the minimum amount of the buffer. The rules are based on those laid down in Articles 27 and 28 of Directive 2002/83/EC (concerning life assurance), as required by Article 17(2) of Directive 2003/41/EC (on occupational pensions).

7.4 These Regulations require schemes to obtain annual valuations and to put in place a schedule of contributions based on that valuation within 12 months of the effective date of the valuation. Where any valuation identifies a shortfall in the amount of assets required, schemes must make good that shortfall within two years.

7.5 These Regulations also apply Part 3 of the Pensions Act 2004 (c. 35), and the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (S.I. 2005/3377) to any money purchase schemes which are subject to these Regulations. These are otherwise exempted from Part 3, which requires schemes to hold technical provisions which the buffer is to supplement, and on which the calculation for the buffer is based. The Regulations cannot include a blanket exemption for money purchase schemes, as there is no power for such an exemption in the Directive.

7.6 These Regulations require the calculation of the Regulatory Own Funds requirement to be certified by an actuary when a scheme valuation is carried out. The certificate must take the form of that shown in the Schedule to the Regulations. The actuary must report to the Pensions Regulator if he cannot certify the calculation of the Regulatory Own Funds requirement.

7.7 The requirement to hold additional assets above the normal funding requirements does not apply to schemes which on 23 September 2005 do not have the minimum level of regulatory own funds required until 22 September 2010 (in line with Article 22(3) of the Directive). The postponement does not extend to schemes undertaking cross-border activity as described in Part 7 of the Pensions Act 2004.

7.8 Although the Government does not know of any UK schemes set up on the basis described in the Regulations, a standard list of exemptions is included in the Regulations to provide further clarity on the position of those schemes or description of schemes.

7.9 Consultation on these Regulations was undertaken between 9 August and 19 September 2005. Responses from 8 organisations were received. The majority of the responses concerned the scope of the Regulations (some suggested types of schemes which might fall under the scope of the Directive). No significant changes were made to the Regulations in this respect. Other comments were of a technical nature, concerning for instance, the rules for calculating the buffer. A number of changes were made to ensure the Regulations would work in practice as intended.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it is expected to have only negligible impact on business, charities or voluntary bodies.

8.2 The Regulations are expected to have only negligible impact on the public sector.

9. Contact

Ulele Mwenitete at the Department for Work and Pensions, tel: 020 7712 2106 or email: Ulele.Mwenitete@dwp.gsi.gov.uk regarding any queries regarding this instrument.

APPENDIX A **Transposition Note**

The Occupational Pension Schemes (Regulatory Own Funds) Regulations 2005 (Transposition Table)[2]

Article	**Requirements**	
17 (1)	Requirement for institutions where the institution itself, and not the sponsoring undertaking, underwrites the liability to cover against biometric risk, or guarantees a given investment performance or a given level of benefits, hold on a permanent basis additional assets above the technical provisions to serve as a buffer The amount of the buffer should reflect the type of risk and asset base in respect of the total range of schemes operated These assets shall be free of all foreseeable liabilities and serve as a safety capital to absorb discrepancies between the anticipated and the actual expenses and profits	Regulation 3 copies out this requirement. The calculation of the additional assets required is comprised of a percentage of the scheme's technical provisions (normal funding level), and a percentage of the capital at risk. The latter is only calculated in relation to members and benefits by virtue of which a scheme is classed as undertaking activities that bring it under the scope of these Regulations. Regulation 3 requires that the assets taken into account to fulfil the regulatory own fund requirement must be free of all foreseeable liabilities.
17(2)	For the purposes of calculating the minimum amount of the additional assets, the rules laid down in Articles 27 and 28 of Directive 2002/83/EC shall apply	Regulation 4 lays down rules for the calculation of the required assets. It is based on the rules in Articles 27 and 28 of Directive 2002/83/EC, as required, and incorporates the rules that can be applied to pensions. It is difficult to transport some of the rules directly from the insurance field (for which they were designed) to pension schemes. For instance, to calculate the buffer required, the rules lay down two figures 0.15% for short-term risk, and 0.3% for longer-term group cover. It is impractical to separate these two calculations in the field of pensions, where calculations of risk are not undertaken on an individual member basis, and the risk is generally longer term (short-term risk is 3 years or less). The figure of 0.3% complies with the Directive's requirements, but in a manner that is more compatible with the field of pensions.
17(3)	Paragraph 1 shall, however, not prevent Member States from Requiring institutions located in their territory to hold regulatory own funds or from	The Regulations do lay down more detailed rules than the Directive, in order to give effect to proper transposition, and to provide for a practical application of the Directive's requirements. In this respect, the Regulations:

[2] This table illustrates how the relevant elements of Directive 2003/41/EC have been implemented by these regulations.

Article	Requirements	
	laying down more detailed rules provided that they are prudentially justified	• Require schemes to produce annual reports and accounts, and to have annual actuarial valuations • Require schemes to inform the Pensions Regulator if the Regulations apply to them • Specify the period within which the additional assets should be restored if they dip below the required level, and require a report of how the restoration is to be effected. • Require an actuary to certify that the calculation of the regulatory own funds requirement had been made in a manner that complied with the Regulations • Require actuarial certification of a schedule of contributions that could have been expected to meet the requirement for additional assets, or that could have been expected to meet the requirement within two years of the date of the valuation. • Require trustees and managers to produce a policy for securing that the Regulatory Own Funds requirement is met
22(3)	Option for Member States to postpone until 23 September 2010 the application of Article 17(1) and (2) to institutions which on 23 September 2005 do not have the minimum level of regulatory own funds required.	Regulation 10 postpones application of the requirement to hold additional assets to any schemes which would have had insufficient assets as at 23 September 2005 to comply with the requirement for additional assets. Schemes to which the postponement applies are required to inform the Pensions Regulator.
5	Optional exemption for small pension institutions (fewer than 100 members) and statutory schemes.	Regulation 14 exempts certain small schemes and statutory schemes, taking advantage of the latitude offered by Article 5, as well as some other schemes which fall outside the scope of the article. These exemptions follow those in the Occupational Pensions (Scheme Funding) Regulations 2005 where applicable, to make for consistency.

NB: The term ‘reasonable period’ as used in regulations 6(3) and 7(2) and 10(2) is defined in the scheme funding code of practice.