EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (GOVERNANCE AND REGISTRATION) (AMENDMENT) REGULATIONS 2022

2022 No. [XXXX]

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument integrates an Order produced by the Competition and Markets Authority (CMA) into pensions legislation. That order implemented the CMA remedies to address weak competition found within the investment consultancy ("IC" – the provision of advice to pension scheme governance bodies) and fiduciary management ("FM" – the provision of advice combined with the delegation of investment decisions) markets.

2.2 This statutory instrument will encourage better trustee engagement, transparency and governance when buying investment consultancy and fiduciary management services. It will require trustees of occupational pension schemes in scope to set objectives for their investment consultant and carry out a tender exercise in certain circumstances before appointing a fiduciary manager. It will also enable The Pensions Regulator (TPR) to oversee the remedies which apply to such trustees and ensure compliance.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

4.3 The Department for Communities in Northern Ireland will be producing its own legislation replicating this instrument for Northern Ireland.

5. European Convention on Human Rights

5.1 The Minister for Pensions and Financial Inclusion, Guy Opperman has made the following statement regarding Human Rights:

"In my view the provisions of The Occupation Pension Schemes (Governance and Registration) (Amendment) Regulations 2022 are compatible with the Convention rights."

6. Legislative Context

6.1 These Regulations will replace Articles 3 and 4 (Part 3), Article 12 (Part 7), Articles 14 to 16 (Part 9) and Article 17 (Part 10) and Article 18 (Part 11) of the Investment

Consultancy and Fiduciary Management Market Investigation Order 2019 ("the 2019 Order")[1] as they apply to the trustees of most trust based occupational pension schemes. The relevant provisions of the 2019 Order, which was made by the Competition and Markets Authority ("the CMA"), apply in relation to occupational pension schemes other than those covered by the specific exclusions in Article 1.6 of the 2019 Order. Part 3 of the 2019 Order currently requires the trustees of those pension schemes to, in certain circumstances, carry out a competitive tender process before appointing a person to provide them with fiduciary management services or changing the mandate of a such a provider. Part 7 of the 2019 Order currently requires trustees of these pension schemes to set objectives for those who provide them with investment consultancy services and review their performance against those objectives. Parts 9 to 11 of the 2019 Order make various provisions connected with the monitoring of compliance with, and enforcement of the duties in Parts 3 and 7 by the CMA.

6.2 These Regulations are made following the Government's commitment to put the relevant provisions of the 2019 Order into the main body of pensions law and enable The Pensions Regulator ("TPR") to oversee compliance with these duties by trustees to allow for effective monitoring and enforcement. This commitment was contained within the 'Investment Consultants Market Investigation Government Response'[2] published 12 March 2019.

6.3 Questions were raised on this issue at the Work and Pensions Select Committee - Pension Costs and Transparency Inquiry on 3 April 2019. This was attended by the Economic Secretary, HM Treasury, DWP officials and the Minister for Pensions and Financial Inclusion (MfPFI) (Parliamentary Under-Secretary of State). MfPFI re-affirmed the Government's intention to implement this legislation.

6.4 These Regulations amend the Occupational Pension Schemes (Scheme Administration) Regulations 1996 ("the 1996 Regulations")[3] to require the trustees of the relevant occupational pension schemes to set objectives for any person who provides them with investment consultancy services and to review the performance of those providers (new regulations 35 and 36 of the 1996 Regulations). They also amend the 1996 Regulations to require trustees of the relevant occupational pension schemes to carry out a tendering process before appointing, or increasing the amount of the scheme's assets managed by, a fiduciary manager as well as in relation to certain existing providers (new regulation 33 of and the Schedule to the 1996 Regulations). Specific enforcement powers are given to TPR in relation to these new duties (new regulations 37 to 43 of the 1996 Regulations).

6.5 These Regulations also amend the Register of Occupational and Personal Pension Schemes Regulations 2005 to require trustees of relevant schemes to include information about their compliance with these new duties in their scheme return to TPR.

[1] https://assets.publishing.service.gov.uk/media/5cfdfa86e5274a090f9eef8e/Order_investment_consultants.pdf
[2] https://www.gov.uk/government/publications/investment-consultants-market-investigation-response/investment-consultants-market-investigation
[3] https://www.legislation.gov.uk/uksi/1996/1715/contents

7. Policy background

What is being done and why?

7.1 The CMA laid their Order on 10 June 2019 to, amongst other things, place duties on the trustees of the relevant occupational pension schemes. These duties are to set, monitor and review objectives for their investment consultant and carry out a tender exercise before appointing a fiduciary manager. The instrument also brings the regulatory responsibility for these duties into the remit of TPR.

7.2 The Competition and Markets Authority is an independent non-ministerial department that work to ensure that consumers get a good deal when buying goods and services, and businesses operate within the law. Following a reference from the Financial Conduct Authority (FCA)[4] the CMA carried out an investigation into investment consultancy and fiduciary management services provided to pension schemes.

7.3 Following its investigation, on 12 December 2018, the CMA published its final report, entitled Investment Consultants Market Investigation Final Report[5]. Their report found an adverse effect on competition in both IC and FM services. The CMA found that there are weaknesses in the demand side based on a low level of engagement by some pension scheme trustees with investment matters. In addition, the information trustees need to assess value for money (fees, costs, quality etc.) of these services is currently difficult to access. These two factors reduce the competitive pressure on both ICs and FMs.

7.4 Investment Consultancy services cover advice on e.g. a particular investment strategy; strategic asset allocation; and asset manager selection. The Pensions Act 1995[6] requires both defined benefit (DB) and defined contribution (DC) pension scheme trustees to take and consider 'proper advice' before taking investment decisions. Other drivers of trustees' reliance on IC are the number and complexity of investments, the challenge of managing DB scheme liabilities and lack of investment knowledge, which is linked to the sub-scale status of many schemes.

7.5 Fiduciary Management (FM) services go beyond IC by involving the legal delegation by the investor to the FM of some investment strategy and execution. FM has become more popular for the same reasons that trustees rely on IC, as well as economies of scale. The CMA's report found that concerns also arise in the FM market at the point at which trustees first purchase FM services. IC firms providing a FM service have an incumbency advantage in selling FM to their existing customers, combined with a lack of clear and comparable information for customers to assess the value of alternative providers.

7.6 As a result of the competition problems found, DB sponsoring employers and DC members are more likely to pay higher prices for lower quality services for IC and FM than they otherwise would. In turn this can have a major impact on pension scheme outcomes through the IC/FM influence on the overall strategy, asset allocation and risk management.

7.7 The CMA's final report proposed a number of 'Remedies' and also made a number of recommendations to Government (DWP and HM Treasury) and to regulators FCA

[4] https://www.fca.org.uk/publications/market-studies/asset-management-market-study-final-decision-mir
[5] https://assets.publishing.service.gov.uk/media/5c0fee5740f0b60c8d6019a6/ICMI_Final_Report.pdf
[6] https://www.legislation.gov.uk/ukpga/1995/26/contents/enacted

and TPR to facilitate the implementation of the remedies proposed (and implemented initially by the 2019 Order). For DWP, there are two remedies that require action by trustees in the CMA Order:

- Remedy One – is the mandatory competitive tendering for pension schemes first buying fiduciary management services or if they have not tendered previously.
- Remedy Seven – places a duty on trustees to set their investment consultants strategic objectives.

The report also made a recommendation to DWP to pass the necessary legislation to enable The Pensions Regulator (TPR) to oversee the Remedies One and Seven.

7.8 The Government published a joint response 'Investments Consultants Market Investigation Government Response'[7] to the Competition and Markets Authority final report[8] on 12 March 2019. This response confirmed that DWP accepted the CMA's recommendation and would introduce regulations which put the CMA's remedies, insofar as they apply to trustees, into the main body of pensions legislation. As well as allowing TPR to monitor compliance more effectively, they will integrate the monitoring function with the production and maintenance of guidance, allowing TPR to update one in the light of insights from the other.

7.9 The Government launched a consultation on policy proposals, an impact assessment and proposed changes to the 1996 Regulations and the Register of Occupational and Personal Pension Schemes Regulations 2005 which ran from 29 July 2019 to 2 September 2019 'Consultation on delivering the Competition and Markets Authority (CMA) recommendation for trustee oversight of investment consultants and fiduciary managers' before producing these final draft Regulations[9].

Amendments to the Occupational Pension Schemes (Scheme Administration) Regulations 1996

Use of Fiduciary Management Services

7.10 These Regulations amend the 1996 Regulations to impose new duties on trustees of relevant trust schemes in connection with the provision of fiduciary management services by fiduciary management (FM) providers (new regulation 33 of and the Schedule to the 1996 Regulations). Part 1 of the Schedule includes various definitions and in particular defines 'fiduciary management provider' and 'fiduciary management services' for the purposes of the Schedule. This Part also sets out what the "asset management threshold" is, and how it is to be determined whether that threshold has been met, and what constitutes a "qualifying tender process".

7.11 Part 2 of the Schedule to the 1996 Regulations sets out the duties of trustees of relevant trust schemes who continue to use the services of FM providers who were appointed before the date on which these Regulations come into force. These duties only apply in cases where the scheme meets the asset management threshold before, or has met the asset management threshold at certain times before, these Regulations come into force and will meet that threshold at the end of the relevant day. A scheme

[7] https://www.gov.uk/government/publications/investment-consultants-market-investigation-response/investment-consultants-market-investigation
[8] https://assets.publishing.service.gov.uk/media/5c0fee5740f0b60c8d6019a6/ICMI_Final_Report.pdf
[9] https://www.gov.uk/government/consultations/trustee-oversight-of-investment-consultants-and-fiduciary-managers

meets the asset management threshold if 20% or more of the schemes in-scope assets are being managed by in-scope fiduciary management providers (see paragraph 4 of the Schedule to the 1996 Regulations). Trustees to whom this Part of the Schedule applies must carry out a qualifying tender process in relation to the fiduciary management services provided by their existing FM providers before the end of the relevant day. In most cases, "the relevant day" is the last day of the period of 5 years beginning with the day on which the earliest of the arrangements with the existing FM providers were entered into. However, a further grace period is allowed for, in cases where that period will have expired before these Regulations come into force, or will expire within the two year period following the coming into force of these Regulations.

7.12 Part 3 of the Schedule to the 1996 Regulations sets out the duties of trustees of relevant schemes where they propose to appoint a Fiduciary Management (FM) provider, or to change the mandate of an FM provider, on or after the commencement date of the Regulations. If the proposed appointment, or change to the mandate, would mean that the asset management threshold is met or to be treated as met, the trustees must carry out a qualifying tender process before proposed appointment of, or proposed change to the mandate, is made. Where this duty is triggered, the trustees must at the same time carry out a qualifying tender process in respect of arrangements with any existing fiduciary management providers who were not appointed following an equivalent process or a procurement exercise. Any trustees to whom this Part of the Schedule applies and who appoint an FM provider, or change the mandate of an FM provider, must give a notice to the FM providers concerned. This notice must confirm that the necessary qualifying tender process has been carried out in accordance with paragraph 8 or paragraph 9 of the Schedule, or that no tender was in fact required before the appointment or increase was made.

Use of Investment Consultancy Services

7.13 New regulations 34 to 36 of the 1996 Regulations set out the obligations of trustees of the relevant trust schemes in relation to the use of providers of investment consultancy services. Regulation 34 sets out what is meant by 'Investment Consultancy (IC) Provider' and 'Investment consultancy Services', for the purposes of the 1996 Regulations.

7.14 Regulation 35 of the 1996 Regulations places a duty on the trustees of a relevant trust scheme to set objectives for each of their investment consultancy providers, and to review these objectives at intervals of no more than three years from the date they were set. Regulation 36 requires the trustees to review the performance of their IC providers annually.

Compliance

7.15 New regulations 37 to 43 of the 1996 Regulations give specific enforcement powers to The Pensions Regulator (TPR) in connection with the new duties outlined above. These provisions set out the process for TPR to issue a compliance notice or third party compliance notice if it is of the opinion that a person is not complying, or has not complied, with the relevant provision. They also add a provision to set out the process for issuing penalty notices, the review of notices and the procedure for reference to the Upper Tribunal.

Amendment of the Register of Occupational and Personal Pension Schemes Regulations 2005

Registrable Information

7.16 Regulation 3 of these Regulations amends regulation 3 of the Register of Occupational and Personal Pension Schemes Regulations 2005[10] so as to, among other things, require certain information about IC providers and FM providers to be included in the scheme return. Trustees will be required to provide the name, address and appointment date of each of their fiduciary management providers and whether the trustees carried out a qualifying tender process in relation to that provider. If they did not carry out such a process in relation to that FM provider, the trustees have to state why it was not carried out.

7.17 Trustees will also be required to confirm the name, address and appointment date of each of their investment consultancy providers and whether the trustees have set and reviewed those objectives, and reviewed the performance of the provider, and if not, why that is the case.

Post-Implementation Review

7.18 Regulation 4 of these Regulations places a duty on the Secretary of State to review the provisions of Part 6 of the 1996 Regulations as inserted by these Regulations, set out the conclusions of the review in a report and publish the report (see paragraph 14). The Secretary of State must publish the first report under this regulation by 31st December 2028, and subsequent reviews must be carried out at intervals of no more than five years.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 Informal consolidated text of instruments is available to the public free of charge via 'the National Archive' website legislation.gov.uk.

10. Consultation outcome

10.1 The Government publicly consulted between 29 July and 2 September 2019 to seek views on the proposed draft Regulations and policy proposals to integrate the Order produced by the Competition and Markets Authority (CMA). The consultation was aimed at pension scheme trustees, members, beneficiaries and service providers, other interested bodies and professionals, civil society organisations and any other interested stakeholders. It sought views on our proposals to (in the main) replicate the trustee duties to tender for fiduciary managers and set objectives for their investment consultant at parts 3 and 7 of the 2019 Order, with slight differences in the policy approach as set out in the consultation document. It also sought views on the draft Regulations enabling The Pensions Regulator (TPR) to carry out the monitoring and compliance role (parts 9 and 10 of the CMA Order) and to take on the regulatory function for these processes.

[10] https://www.legislation.gov.uk/uksi/2005/597

10.2 We received 22 formal responses to the consultation from a range of individuals and organisations, and during the consultation we conducted further engagement with stakeholders, including regulators, trustees, consultants, asset managers, law firms, actuaries and trade associations.

10.3 DWP worked with the Competition and Markets Authority, the Pensions Regulator, Her Majesty's Treasury and the Financial Conduct Authority to consider the comments received. The majority of responses welcomed the proposals and regulations, with the bulk of the comments calling for more alignment with the CMA's Order on some of the policy proposals, particularly around the definitions of investment consultants and fiduciary management services. We have made changes to the text of the Regulations to address these comments. In addition, a number of amendments have been made to the text of the Regulations, as consulted on, to align more closely, other than in the cases specifically mentioned above, with the 2019 Order. The response to this consultation 'Delivering the Competition and Markets Authority recommendation for trustee oversight of investment consultants and fiduciary managers' has been published on 6 June 2022 on gov.uk.

11. Guidance

11.1 The Pensions Regulator (TPR) has guidance available to support compliance – 'Tendering for Fiduciary Management Services guidance' and 'Setting objectives for Investment Consultants guidance'[11] – which will be updated before the commencement of the Regulations.

12. Impact

12.1 The impact on business, charities or voluntary bodies is £0.4m (Equivalent Annual Net Direct Cost to Business). The impacts are principally on the pensions industry, specifically the occupational pension schemes which are the in scope "relevant trust schemes". Impacts to business are primarily driven through familiarisation and reporting costs. The Regulations bring additional schemes into scope compared to the Competition and Markets Authority (CMA) Order which results in a one-off and ongoing financial costs.

12.2 There will be an impact on the public sector through compliance and enforcement costs. Regulations bring these activities into the remit of TPR which results in a one-off cost of £10,000 and an annual cost of £59,000 (whilst regulations are in place). The CMA will no longer incur the costs associated with enforcing compliance which results in an annual saving of £4,000 until the CMA Order expires on 9 December 2029.

12.3 A full Impact Assessment has been produced and is published alongside the Explanatory Memorandum on the legislation.gov.uk website. [Insert link]

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 The costs to business fall to the trustees of Defined Benefit (DB) and Defined Contribution (DC) trust schemes, so small and micro businesses that sponsor DB trust

[11] https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/tender-and-set-objectives-for-investment-service-providers

schemes or run/are involved in the running of DC trust schemes may be affected. Small and micro businesses would not be directly impacted by the Regulations, but they may face indirect costs if small schemes face higher relative charges that are then passed onto sponsoring employers.

14. Monitoring & review

14.1 Regulation 4 of these Regulations provides for the Secretary of State, from time to time, to carry out a review of the operation and effect of Part 6 of the 1996 Regulations, as inserted by these Regulations, and publish a report outlining the findings of that review. The first such report must be published by 31 December 2028. Subsequent reports must be published at intervals of no more than 5 years. The review must assess to what extent the policy objectives have been achieved and if the provisions are still appropriate.

15. Contact

15.1 Vicky Bird at the Department for Work and Pensions, email: vicky.bird@dwp.gov.uk can be contacted with any queries regarding the instrument.

15.2 Joanne Gibson, Deputy Director for Automatic Enrolment and Defined Contribution Pensions Policy, at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.3 Minister for Pensions and Financial Inclusion (Parliamentary Under-Secretary of State), Guy Opperman MP at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.