EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (ADMINISTRATION, INVESTMENT AND CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2021

S.R. 2021 No. 272

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Communities to accompany the Statutory Rule (details above) which is laid before the Northern Ireland Assembly.

1.2 The Statutory Rule is made under sections 109(1) and (5) to (7) and 177(2) to (4) of the Pension Schemes (Northern Ireland) Act 1993, Articles 35(7) and 166(1) and (2) of the Pensions (Northern Ireland) Order 1995, Articles 55(2)(h) and (3) and 287(1) to (3) of the Pensions (Northern Ireland) Order 2005 and sections 42 and 51(6) of, and paragraphs 1, 2, 3 and 6 of Schedule 18 to, the Pensions Act (Northern Ireland) 2015 and is subject to the confirmatory procedure.

2. Purpose

2.1 These Regulations place administration and governance requirements on trustees of occupational defined contribution (DC) pension schemes, in particular to require trustees of certain DC pension schemes to disclose their investment returns and demonstrate that they are providing value for their members. They also increase flexibility for DC schemes to take account of performance fees payable to fund managers when calculating the cap on charges that applies to default investment arrangements. They make other minor technical changes, including to the ways in which specific types of pension schemes must comply with the requirements to produce a statement of investment principles (SIP). They also include provision in consequence of the Pension Schemes Act (Northern Ireland) 2021 to control the level and range of charges.

3. Background

3.1 These Regulations amend a number of sets of existing Regulations relating to the administration and governance of occupational pension schemes. The aim is to ensure that occupational DC pension scheme members benefit from efficient and operationally resilient administration, sound investment governance, and access to innovative and diversified investment strategies.

3.2 The Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997 ("the Administration Regulations") are amended to require trustees or managers of "relevant schemes", a term which covers

most occupational DC pension schemes, to include additional information in the annual statement regarding governance which they are required to produce under the regulations. A further amendment is made in relation to trustees or managers of "relevant schemes" with total assets of less than £100 million, which have been operating for at least three years, which will require them to assess and report on the value which their schemes provide for their members.

3.3 The Register of Occupational and Personal Pension Schemes Regulations (Northern Ireland) 2005 (the "Register Regulations") are amended, to add to the list of "registrable information" which pension schemes must provide to the Pensions Regulator, in their annual scheme return.

3.4 The Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005 ("the Investment Regulations") impose requirements on trustees of occupational pension schemes in relation to the statement of investment principles (SIP) required under Article 35 of the Pensions (Northern Ireland) Order 1995. They are amended to clarify the SIP requirements for default investment funds (those into which members are placed without choice by the scheme) and for wholly-insured pension schemes (schemes that have no investment other than specified qualifying insurance policies).

3.5 The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations (Northern Ireland) 2014 ("the Disclosure Regulations"), which set out information that must be published by most occupational pension schemes on a publicly available website, are amended to reflect changes made to the Administration Regulations and to the Investment Regulations by these Regulations.

3.6 The Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 ("the Charges and Governance Regulations") impose obligations on trustees and managers of certain occupational pension schemes in relation to charges imposed by, and governance of, those schemes. In particular, they impose a limit on the charges that can be applied to default investment funds often referred to as the "charge cap". The charge cap is a limit on member charges, set at 0.75% of the funds under management each year, or an equivalent combination charge, that applies to all default arrangements. Default arrangements are funds which a pension scheme member is automatically placed in, not one they have expressly selected. The Regulations make amendments to the definition of "charges" and make changes to the way that performance fees may be taken into account when assessing whether or not a scheme complies with the charge cap. They also provide for a cap on early exit charges and a ban on member-borne commission charges arising under existing arrangements (member-borne commission charges under new arrangements were banned from April 2016).

3.7 In complying with the new requirements: to assess the value for members that their scheme provides, to report net investment returns, and to report

on costs and charges, trustees or managers must have regard to guidance published from time to time by the Department. The guidance is available from the Department for Communities, Social Security Policy, Legislation and Decision Making Services, Level 6, Causeway Exchange, 1-7 Bedford Street, Belfast BT2 7EG or from the website: https://www.communities-ni.gov.uk/articles/pensioninformation

4. Consultation

4.1 There is no requirement to consult on these Regulations. They make in relation to Northern Ireland only provision corresponding to provision contained in regulations made by the Secretary of State for Work and Pensions in relation to Great Britain.

5. Equality Impact

5.1 The Pension Schemes Act (Northern Ireland) 2021 was subject to an Impact Assessment. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the legislative proposals for these Regulations. The Department has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

6. Regulatory Impact

6.1 Regulatory Impact Assessments are attached in the Annexes to this Explanatory Memorandum.

7. Financial Implications

7.1 None for the Department.

8. Section 24 of the Northern Ireland Act 1998

8.1 The Department is content that these Regulations comply with section 24 of the Northern Ireland Act 1998 (Convention rights, etc.).

9. EU Implications

9.1 Not applicable.

10. Parity or Replicatory Measure

10.1 The corresponding Great Britain Regulations are the Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 (S.I. 2021/1070) which come into force on 1st October 2021, and the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017 (S.I. 2017/774).

REGULATORY IMPACT ASSESSMENT

THE OCCUPATIONAL PENSION SCHEMES (ADMINISTRATION, INVESTMENT AND CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2021

IMPROVING OUTCOMES FOR MEMBERS OF DEFINED CONTRIBUTION PENSION SCHEMES

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

Summary

Problem under consideration and rationale for government intervention

1. The Pensions Regulator (TPR) research of Defined Contribution (DC) schemes has clearly shown that most small pension schemes are poorly governed in comparison to larger pension schemes[1]. There is a risk that member outcomes are weaker within poorly governed, typically smaller, schemes.

2. To begin to address this, in February 2019, the DWP consultation paper *Investment Innovation and Future Consolidation* put forward proposals encouraging providers of smaller pension schemes to consider consolidation of these schemes into bigger pension schemes. However, the DC industry still consists of a majority of smaller schemes[2], indicating that there may be room for improvement in governance and ultimately member outcomes[3] through faster consolidation of these small, poorly governed, schemes.

3. In addition, Pensions Policy Institute research in 2017 also noted that "UK DC pension schemes have fallen behind many of their international counterparts in their use of a wider range of asset classes"[4]. There is a risk that this lack of diversification in investment also leads to poorer outcomes for members. Following the Patient Capital Review, in October 2018 TPR published guidance on how trustees can invest in assets with long-term investment horizons[5] as part of a diverse portfolio[6] . However, evidence of schemes doing this remains limited. It is expected that the ability of schemes to diversify (including into more illiquid assets[7]) increases along with scale[8], therefore this furthers the rationale for encouraging consolidation.

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[1] "Defined Contribution trust-based pension schemes research - Report of findings on the 2019 survey". LINK

[2] TPR, DC trust: scheme return data 2019 – 2020, Table 1.1 & 1.2. LINK.

[3] TPR, "Importance of good governance". LINK

[4] "The impact of DC asset pooling: International evidence". LINK.

[5] Such as venture capital, infrastructure, market-returning investments that may have a social side benefit and other illiquid assets.

[6] Investment Innovation and Future Consolidation' (Feb 2019). LINK. Page 9.

[7] illiquid investments, in broad terms means assets which are traded off-exchange or are otherwise less readily tradeable. Examples include direct property investment, investment in infrastructure projects, private equity, equity or debt issued by very small listed firms, and venture capital. This definition also includes off-exchange or less readily traded impact investments which deliver comparable returns.

[8] 'Investment Innovation and Future Consolidation' (Feb 2019). LINK. Pages 18-19.

Policy objectives and the intended effects

4. Overall, consolidation of pension schemes should result in more members being in schemes with better governance standards; and it could also bring benefits from improved access to a greater range of investment opportunities, and consequently improved returns for members. As a result, there would be much greater potential for saver outcomes to be improved.

Policy options considered, including any alternatives to regulation

Option 1. Do Nothing

5. Consolidation has, to some degree, already been happening over time, and could possibly continue without further intervention. However, the rate at which this has occurred has been quite low. Between 2010 and 2019 the number of DC schemes[9] decreased by an average of 1.5% per year, with Automatic Enrolment and its creation of a mass DC market, master trust authorisation, and other factors that increase governance requirements on schemes contributing towards this reduction.

6. Approximately 70% of all DC schemes[10] are small or micro schemes (<100 members). Research carried out by the TPR in 2019[11] showed around 70% of micro (2-11 members) and 60 % of small (12-99 members) schemes were not hitting any of the five key governance requirements that applied to them. This indicates that these pension schemes are not well run, increasing the risk that pension savers are (potentially unknowingly) ending up with worse outcomes in retirement than would have been the case if they were in a better governed scheme.

7. Therefore, without further measures that seek to target these poorly governed schemes, there is a risk that the pace of consolidation remains slow and more members spend more time in poorer value for money schemes, leading to potentially worse outcomes in retirement.

Option 2. Alternatives to regulation

8. There are two possible alternatives. Non-statutory guidance could be produced or TPR's guidance on assessing value for scheme members could be updated. TPR could introduce guidance in relation to consolidation. However, experience has shown that unless requirements are in legislation, with consequential actions for non-compliance, a certain degree of non-compliance exists in adhering non-regulatory measures. This is evidenced by the low adherence by small pension schemes to TPR's existing key governance requirements. This therefore indicates that further action is required.

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[9] DC schemes with 2 or more members, excluding hybrid schemes with DC members. Table 1.1, LINK

[10] DC Schemes (including hybrid schemes but excluding SAS, EPPs)

[11] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-research-summary-report-2019.ashx

Option 3. Introduce changes to the Scheme Administration, Disclosure and Register of Information Regulations

Preferred Option

9. Amending existing regulations would target smaller pension schemes and mandate 'specified schemes'[12] to do a more in depth value for members (VFM) assessment compared to the current assessment required in the Chair's statement. Regulations would mandate reporting the outcome of this assessment in the Chair's statement and in the annual scheme return to TPR, along with proposed action to be taken going forward in the event of poor VFM

10. The government expects, that where a specified scheme, after VFM assessment, does not present good overall Value for Members, trustees would adopt the default position of taking immediate action to start winding up the scheme and consolidating members into a scheme that will accept them and provide better value.

11. If trustees choose not to start taking this action immediately, and they believe that they have solid grounds for not doing so, then regulations, if passed, will require trustees to explain these reasons fully to the regulator along with full details of what improvements will be made within a reasonable period, to ensure that the scheme delivers good value.

12. TPR already has existing broad powers under the Pensions (Northern Ireland) Order 1995[13] to force a scheme to wind up in the interests of the generality of its members. These powers will be used more extensively in tandem with the new regulations where necessary.

13. As these new measures would be legal requirements they would require trustees of schemes to consider VFM and encourage them to consider the merits of consolidation more robustly than before. This would provide greater transparency for scheme members and, as the measures would be in regulations, TPR would continue to be able to use powers to enforce them in the event of non-compliance.

[12] 'specified schemes' are defined as DC schemes with total assets of < £100m and running for at least 3 years (including DB hybrids but excluding EPPs and SSAS).

[13] Article 11 Powers to wind up schemes – Pensions (NI) Order 1995 LINK.

Preferred option: Summary of assessment of impact on business and other main affected groups

Impact on Business

14. As a result of the regulations, the relevant schemes in scope (less than £100m assets under management (AUM) and running for at least 3 years, excluding Executive Pension Plans (EPPs) and Small Self-Administered Schemes (SSASs), henceforth 'specified schemes'), will be impacted in the following ways:

- One-off familiarisation cost to the defined 'specified schemes' to read guidance and understand the requirements of the absolute and relative assessments and consolidation;
- Ongoing cost to the defined 'specified schemes' to complete the additional information in the scheme return regarding VFM;
- Ongoing cost to the defined 'specified schemes' to include a more prescriptive VFM assessment in the Chair's statement;
- Ongoing cost to the defined 'specified schemes' in scope to compile the information, carry out the relative assessment and indicate the results; and
- Ongoing cost to the defined 'specified schemes' to actively engage larger pension schemes and determine if they would agree to take them on.

15. The regulations will also place requirements on all occupational DC pension schemes (excluding EPPs and SSASs) to undertake the following:

- One-off cost to all schemes to report on investment returns every year since 2015;
- Ongoing cost to all schemes to report investment returns each future year;
- Ongoing cost to all schemes who do not currently voluntarily complete the question on AUM, to fill out in scheme return.

Impact on Regulatory Bodies

<u>TPR</u>

As a result of the regulations, TPR will be required to:

- amend the scheme return;
- monitor compliance with the regulations and identify non-compliance;
- take enforcement action where necessary.

16. TPR is funded by the General Levy. This levy and its impact is excluded from the definition of a regulatory provision in the Small Business, Enterprise and Employment Act 2015. Therefore, it does not need to be reported on or verified under the Business Impact Target reporting requirements. Any increases in the levy therefore do not count towards the Equivalent Annual Net Direct Costs to Business (EANDCB)[14]. TPR estimates the one-off costs in year 1 to be £16,000 and the ongoing costs to be £62,500. These cost estimates are based on a number of assumptions set out in the additional detail section.

Preferred Option

Evidence behind the rationale for intervention

17. Certain aspects of scheme governance that must be complied with, by occupational DC schemes, are already prescribed in existing legislation. However, not all aspects of what could reasonably be determined as measures of VFM are currently included.

18. Regulation 23(1)(c)(i) of the Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997[15] does not specify what trustees should consider when assessing how scheme costs and charges represent VFM. The existing regulations are ambiguous or too broad in regulating how such an assessment should be carried out and, therefore, inconsistency of approach by scheme trustees could occur.

19. TPR already produces quite comprehensive guidance for scheme trustees on what constitutes good scheme governance as well as guidance on how VFM for scheme members can be achieved. However, a large percentage of schemes (mostly small or micro schemes) are still poorly governed. Research carried out by TPR in 2019[16] indicated that adequately completing the VFM for scheme member assessments is a challenge for most pension schemes. Failure to research and take into account the things that members value was the greatest barrier to meeting the requirement.

20. Without pension schemes properly determining how well their scheme is presenting VFM and taking action where appropriate, badly run schemes could otherwise continue to run to saver detriment. Therefore, amending existing regulations and producing accompanying guidance would give more clarity on what criteria should be considered and inform trustees of those schemes of how to better assess VFM. As this would be prescribed in legislation it is envisaged that compliance would be greater.

21. As well as evidence showing that larger pension schemes are better governed they generally have more competitive charging structures than smaller schemes. Amending existing regulations would mandate pension schemes of less than £100m in total assets to compare transaction costs, charges and net investment returns with larger pension schemes whilst also assessing their own scheme administration and governance. By doing such an assessment, and where specified pension schemes are not delivering as good VFM, regulations will then nudge them to consolidate into larger, better run pension

[14] The Equivalent Annual Net Direct Costs to Business (EANDCB) is an estimate of an intervention's annual net direct costs to business in each year that the measure is in force

[15] The Occupational Pension Schemes (Scheme Administration) (Northern Ireland) Regulations 1997. LINK.

[16] "Defined Contribution trust-based pension schemes research - Report of findings on the 2019 survey". LINK.

schemes with potentially greater access to a wider range of investments[17] and potentially better value for scheme members.

Proposed Intervention

Costs and Benefits to Businesses

22. For the following measures, the 'specified schemes' in scope are defined as Occupational DC pension schemes including hybrid with a value of total assets of less than £100m that have been running for at least 3 years, excluding Executive Pension Plans (EPPs) and Small Self-Administered Schemes (SSASs)[18]. TPR estimate that there are 2,120 DC schemes[19] (including hybrids and micro schemes, excluding SSASs and EPPs) that are at least 3 years old and have a value of total assets of less than £100m.

23. <u>One-off familiarisation cost to the defined 'specified schemes' to read guidance and understand the requirements of the absolute and relative assessments and consolidation</u>

24. The proposed changes will require the 'specified schemes' to carry out an assessment to review their transaction costs, charges, returns on investment, and quality of administration and governance. Scheme trustees are already required to consider how costs and charges are VFM via existing regulations; for example, documenting how they met the requirements for knowledge and understanding[20] in the Chair's statement and explaining how this enables them to properly carry out their functions[21]. These one-off total costs to 'specified schemes' are estimated to total £412,700 in the first year[22].

25. <u>Ongoing cost to the defined 'specified schemes' to complete the additional information in the scheme return regarding VFM</u>

26. The proposed changes will require trustees of the 'specified schemes' to indicate in the scheme return whether it delivers VFM or not. These ongoing costs to all 'specified schemes' are estimated to total £15,400 per year[23].

27. <u>Ongoing cost to the defined 'specified schemes' to include a more prescriptive VFM assessment in the Chair's statement.</u>

28. The proposed changes will require trustees of the 'specified schemes' to include a more prescriptive explanation in the Chair's statement. The total ongoing costs for this element of the requirements are estimated to be £962,700 per year[24].

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[17] The impact of DC asset pooling: International evidence. LINK

[18] Executive Pension Plans (EPPs) and Small Self-Administered Schemes (SSASs) are a type of small/micro schemes typically set up to provide benefits for a small number of a company's directors or key employees.

[19] TPR provided an estimate of "DC schemes (including hybrids and micro schemes, excluding EPPS and SSASs) that are at least 3 years old and have assets under management of less than £100m"

[20] Sections 224-225 of the Pensions (NI) Order 2005 LINK

[21] Regulation 23 of the Occupational Pension Schemes (Scheme Administration) (Northern Ireland) Regulations 1997 LINK

[22] Calculations: (2.5 Hours to Familiarise) *(2,120 Specified Schemes in Scope) *(2.7 Trustees per Scheme in Scope) *(£29.11 Average Hourly Trustee Wage) = £412,700 rounded to the nearest £100. See 'Key Assumptions and Sensitivity Analysis' for more details.

[23] Calculations: (0.25 Hours to Input Extra Information into Scheme Return) *(2,120 Specified Schemes in Scope) *(£29.11 Average Hourly Trustee Wage)

29. Ongoing cost to the defined 'specified schemes' in scope to compile the information, carry out the relative assessment and indicate the results

30. The proposed changes will require trustees of the 'specified schemes' to carry out a relative assessment to compare their transaction costs, charges, returns on investment to at least three other larger pension schemes[25]. The total ongoing costs for this element of the requirements are estimated to be £185,100 per year[26].

31. Ongoing cost to the defined 'specified schemes' to actively engage larger pension schemes and determine if they would agree to take them on.

32. The proposed changes will require the 'specified schemes' to actively seek out three other schemes which trustees have reasonable grounds to believe would take them on should the 'specified scheme' decide to move the pension scheme members into a different scheme. The total ongoing costs for this element of the requirements are estimated to be £61,700 per year[27].

33. For the following measures, schemes in scope are defined as All Occupational DC pension schemes including hybrids, excluding Executive Pension Plans (EPPs) and Small Self-Administered Schemes (SSASs)[28].

34. One-off cost to schemes to report on investment returns every year since 2015

35. The proposed changes will require trustees to report investment returns in each default arrangement and in member selected funds back to at least 2015 as a minimum (some schemes may choose to report back further where figures are available). It is assumed that it will take all trustees approximately 45 minutes to report on investment returns over the period, based on investment return figures already being available to trustees. These one-off costs are estimated to total approximately £929,100[29] in the first year only.

36. Ongoing cost to schemes to report investment returns each year.

37. It is assumed that it will take all trustees approximately 15 minutes to report on investment returns each year, based on investment return figures already being available to trustees.

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[24] Calculations: (1,530 Corresponding Schemes * £190.26 Estimated Unit Cost) + (440 Corresponding Schemes * £924.13 Estimated Unit Cost) + (150 Corresponding Schemes * £1,766.73 Estimated Unit Cost) = £962,700 rounded to the nearest £100. See "Key Assumptions and Sensitivity Analysis" section for more details.

[25] Either large occupational schemes with assets under management greater than £100 million or personal pension schemes which are not investment regulated schemes or a mixture of both. Calculations: (3 Hours Required) * (2,120 Specified Schemes in Scope) * (£29.11 Average Hourly Trustee Wage) = £185,100 rounded to the nearest £100

[26] Calculations: (3 Hours Required) * (2,120 Specified Schemes in Scope) * (£29.11 Average Hourly Trustee Wage) = £185,100 rounded to the nearest £100

[27] Calculations: (1 Hour Required) * (2,120 Specified Schemes in Scope) * (£29.11 Average Hourly Trustee Wage) = £61,700 rounded to the nearest £100.

[28] 1,740 DC and Hybrid Schemes with 12+ members (excluding EPP & SSAS): TPR, DC trust: presentation of scheme return data 2019 – 2020 LINK 1,300 DC Micro Schemes with 2-11 members: TPR estimate Small self-administered schemes (SSASs – also known as Relevant Small Schemes or RSSs) and executive pension schemes (EPSs) are excluded from these regulations.

[29] Calculations: (0.75 Hours Required) * (3,040 Schemes) * (14 Funds per Scheme) * (£29.11 Average Hourly Trustee Wage) = £929,100 rounded to the nearest £100

The total ongoing costs for this element of the requirements are estimated to be approximately £309,700 per year[30].

Ongoing cost to schemes who do not currently voluntarily complete the question on Assets Under Management (AUM), to fill out in scheme return.

38. The proposed changes will require trustees to fill out the question on assets under management. It will be a breach of legislation if trustees do not fill it out. It is assumed that trustees already know the schemes AUM because they are required to include it in their Annual Reports and Accounts. 77% of schemes completed the AUM question voluntarily within the last 3 years. This means 23% of schemes in scope will incur an ongoing cost to complete the AUM question in the scheme return. This gives an ongoing cost of approximately £3,400 per year[31].

Costs and Benefits to Other Affected Parties

39. The potential benefits of the requirements are discussed qualitatively; these chiefly result from an increased number of schemes choosing, or being encouraged, to undergo consolidation. However, the potential impact that the measures may have on consolidation rates is not certain. Therefore to assume/estimate uncertain second and third order impacts of the requirements, and subsequently quantify benefits as a direct result, would not be proportionate. Furthermore, such assumptions could also result in the risk of underestimating the schemes in scope of the measures over the appraisal period, resulting in an underestimation of the total costs to business.

Benefits to Members

40. Members of 'specified schemes' in scope could benefit from the introduction of these regulations, specifically those presently in pension schemes that represent poor VFM if the new VFM requirements meant their schemes subsequently choose to undertake consolidation into larger DC schemes, or are able to improve their VFM in line with requirements.

41. A key benefit for members of 'specified schemes' choosing to consolidate relates to TPR research of DC schemes finding "a significant correlation between the effectiveness of pension scheme governance and scale". Therefore, increased consolidation in the DC scheme market could lead to benefits from there being fewer members with their savings in the sorts of smaller or especially small schemes where TPR "found many instances of weaker governance" and where "strong governance" was "found rarely"[32]. So consolidating could ultimately improve the overall standards of governance and improved outcomes for pension savings.

42. An additional benefit that could accrue to members of poor VFM schemes that are encouraged to go on and consolidate into larger schemes could be that those members may be able to enjoy the economies of scale such as a potentially greater access to a wider

[30] Calculation: (0.25 Hours Required) * (3,040 Schemes) * (14 Funds per Scheme) * (£29.11 Average Hourly Trustee Wage) = £309,700 rounded to the nearest £100

[31] Calculations: (0.17 Hours Required) * (23% * 3,040 Schemes) * (£29.11 Average Hourly Trustee Wage) = £3,400 rounded to the nearest £100

[32] 'Investment Innovation and Future Consolidation' (Feb 2019). LINK Pages 18-19.

range of investment opportunities[33] as well as often lower charges (as found in the Pension Charges Survey 2015[34]), which themselves can improve the prospects of better net returns.

43. Furthermore, research suggests that people care about the impact that their money has on society and the environment[35]. Consolidation may result in more individuals being members of sufficiently large schemes able to invest in illiquid assets[36] and the 'real economy', such as renewable energy or infrastructure projects. This could give members an increased sense of ownership of, and engagement with, their pension pot.

Costs to TPR

44. Table 1 sets out the estimated one-off costs provided by TPR. TPR estimate the cost of adding one question to the scheme return to be £4,000. Assuming that 4 new questions are required, this gives a total one-off cost of £16,000.

Table 1: Estimated one-off costs to TPR in Year 1

One-off costs in year 1	Estimated cost to TPR
Cost to add 4 questions to scheme return	£16,000
Source: TPR, unpublished data	

45. Table 2 sets out the estimated ongoing costs provided by TPR for monitoring and enforcing compliance with the requirement to carry out the more prescriptive assessment(s), submit the information in the scheme return and report investment returns.

Table 2: Estimated ongoing costs to TPR

Ongoing costs	Estimated cost to TPR (per year)
Total cost	£62,500
Of which,	-
Case Officer	£25,500
Lawyer	£25,500
Team Leader	£11,500
Source: TPR, unpublished data	

46. These cost estimates assume the amount of work would be similar to an RPNA[37] enquiry and that TPR identify the schemes through the scheme return.

[33] The impact of DC asset pooling: International evidence. LINK.

[34] The Pension Charges Survey (2015) - Table 3.1. LINK

[35] Navigating ESG: a practical guide https://www.dcif.co.uk/wp-content/uploads/2018/04/navigating-esg-final-lo-res.pdf

[36] Discussed in 'Investment Innovation and Future Consolidation' following on from the Patient Capital Review

[37] Recovery Plan Not Agreed - In this instance a third party notice would be sent to the employer and TPR are expecting to carry out a similar amount of investigation prior to issuing the penalty.

Wider Economic and Societal Impacts

47. One key wider benefit of an increase in consolidation could be the increased share of assets saved in large, well-governed DC schemes potentially able to direct funds towards longer-term, illiquid investments[38]. This could mean that key, potentially strategically important, sectors of the economy such as smaller innovative firms, housing, infrastructure and green infrastructure receive more investment flows than previously (in the less consolidated DC occupational pension scheme market), which can have wide-ranging impacts across society, as discussed in the Patient Capital Review[39].

48. Another longer-term benefit that could arise in the event of a more consolidated DC occupational pensions scheme landscape could be that more individuals in larger schemes that are typically found to be better governed[40] and with lower investment charges[41].This could result in not only better retirement outcomes/higher incomes for these individual members in retirement, but could also have positive wider impacts in the forms of their increased consumption & expenditure in retirement, as well as potentially improved health outcomes as a result of their higher material standards of living in retirement.

Key Assumptions and Sensitivity Analysis

<u>General Assumptions Used in Cost Calculations</u>

- It is assumed that an average cost of an hour of time for a Trustee is £29.11 per hour, this is based on 2019 Annual Survey of hours and Earnings (ASHE) data for Corporate Managers & Directors[42].
    - The median hourly gross pay for corporate managers and directors is £22.92 in Table 2.5. This is uplifted by 27% for overheads from the previous version of the Green Book, no updated estimate is available.
- It is also assumed that there are approximately 2.7 trustees per relevant scheme, based on calculations using TPR data on '*Number of Trustees – by scheme size*'[43].
- It is assumed that there is an average of 14 funds per DC scheme in scope, calculated using "*Disclosure of costs, charges and investments in DC occupational pensions*" information[44].
- For familiarisation costs it is assumed that reading time is 6 minutes per page for Trustees.

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[38] The impact of DC asset pooling: International evidence. LINK.

[39] Patient Capital Review. LINK

[40] 'Investment Innovation and Future Consolidation' (Feb 2019). LINK. Pages 18-19.

[41] The Pension Charges Survey (2015) - Table 3.1. LINK

[42] 2019 Annual Survey of hours and Earnings (ASHE). LINK

[43] Trustee Landscape Quantitative Research 2015. Figure 3.2.3 Number of trustees by benefit type, page 14. LINK

[44] Disclosure of costs, charges and investments in DC occupational pensions. February 2018. LINK

- The number of 'specified schemes' in scope for some measures is assumed to remain broadly the same over the appraisal period.

    - This assumption is based on previous trends in the DC landscape, considered in the context of Automatic Enrolment and Master Trust Authorisation.

    - The potential second and third order impacts that the measures may have on consolidation rates are not certain. To quantify such uncertain second and third order impacts of the requirements, would not be proportionate as such assumptions would risk underestimating the schemes in scope of the measures over the appraisal period, resulting in an underestimation of the total costs to business.

49. The following are key areas of sensitivity for the potential costs and benefits of the regulations.

Ongoing cost to the defined '*specified schemes'* to include a more prescriptive VFM assessment in the Chair's statement

50. It is assumed that the cost for the specified schemes in scope of producing a more prescriptive VFM assessment in the Chair Statement will constitute approximately 50% of the cost of producing a complete Chair Statement itself. The cost of producing a Chair Statement is assumed to have remained constant in real terms since their costs were estimated by TPR for the "Minimum Governance Standards for DC trust-based schemes" impact assessment in 2015[45].

51. The unit costs (to the nearest £10) for a VFM assessment are estimated to be £190 for specified schemes with fewer than 100 members, £920 for specified schemes with 100 to 999 members, and £1,770 for schemes with over 1000 members. Given TPR estimated breakdowns of the specified schemes in scope by membership size, the total ongoing costs are estimated to be £962,700 per year[46].

52. When allowing for sensitivity around the unit cost estimates of 50 per cent the ongoing costs decrease to £481,400 or increases to £1,444,100.

Ongoing cost to the defined 'specified schemes' in scope to compile the information, carry out the relative assessment and indicate the results

53. It is assumed that it will take a trustees of a '*specified scheme'* approximately 3 hours to carry out a relative assessment to compare their transaction costs, charges, returns on investment to at least three other larger pension schemes[47]. The ongoing costs for this

[45] The Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 Minimum Governance Standards for DC Trust-Based Schemes RIA LINK

[46] Calculations: (1,530 Corresponding Schemes * £190.26 Estimated Unit Cost) + (440 Corresponding Schemes * £924.13 Estimated Unit Cost) + (150 Corresponding Schemes * £1,766.73 Estimated Unit Cost) = £962,700 rounded to the nearest £100

[47] Either large occupational schemes with assets under management greater than £100 million or personal pension schemes which are not investment regulated schemes or a mixture of both.

element of the requirements are estimated to be £185,100 per year[48]. When allowing for sensitivity around the time assumptions of 50 per cent the one-off cost decreases to £92,600 and increases to £277,700.

One-off cost to schemes to report on investment returns every year since 2015

54. It is assumed that it will take trustees approximately 45 minutes to report on investment returns over the period, based on investment return figures already being available to trustees giving a one-off cost of approximately £929,100 in the first year only. When allowing for sensitivity around the time assumptions of 50 per cent the one-off cost decreases to £464,600 and increases to £1,393,700.

Ongoing cost to schemes to report investment returns each year

55. It is assumed that it will take all trustees approximately 15 minutes to report on investment returns each year, based on investment return figures already being available to trustees giving an ongoing cost of approximately £309,700 per year. When allowing for sensitivity around the time assumptions of 50 per cent the ongoing cost decreases to £154,900 and increases to £464,600.

One-off and ongoing costs to TPR

56. The cost estimates provided by TPR estimate a one-off cost of £16,000 in the first year and an ongoing cost of £62,500 per year.

- When allowing for sensitivity around the one-off cost assumptions of 25 per cent the one-off cost decreases to £12,000 and increases to £20,000.

- When allowing for sensitivity of 25 per cent around the assumptions on the number of additional questions required in the scheme return, the one-off cost decreases to £12,000 and increases to £20,000.

- When allowing for sensitivity around the ongoing cost assumptions of 50 per cent the ongoing cost per year decreases to £31,300 and increases to £93,800.

Small and Micro Business Assessment

Scope of the Regulations

57. The proposed regulations will impact Occupational DC pension schemes including hybrid schemes but excluding EPP and SSASs. These particular small and micro pension schemes (EPPs and SSASs) have been deemed not relevant to and out of scope of the regulations. Most small businesses do not administer their own pension schemes, but instead use an external provider to meet their duties.

[48] Calculations: (3 Hours Required) * (2,120 Specified Schemes in Scope) * (£29.11 Average Hourly Trustee Wage) = £185,100 rounded to the nearest £100

58. The regulations will affect pension scheme trustees differently depending on the size of the scheme, as measured by Total Assets. These differences are summarised in table 3.

Table 3: Requirements by size of scheme

Schemes, regardless of value of total assets value	**Total assets value of less than £100m that have been running for at least 3 years**
Report on investment returns every year since 2015	
Calculate and report on investment returns each year	
Complete the AUM question in the scheme return (if not completed voluntarily)	
	Complete the additional information in the scheme return regarding value for members
	Include a more prescriptive value for members assessment in the Chair Statement
	Compile the information, carry out the relative assessment and indicate the results
	Actively engage larger schemes and determine if they would agree to take them on

Data on DC Schemes by Size

59. Table 4 shows that the majority of DC pension schemes in scope have fewer than 100 members. This table refers to scheme size and is not a direct measure of the number of employees in the underlying sponsoring employer.

Table 4: Number of DC schemes by scheme size[49]

Number of Members	**Number of Schemes (includes hybrid schemes)**
2-11	1,300
12-99	850
100-999	500
1,000-4,999	250
5,000+	150
Total	**3,040**

Source: TPR Scheme Return 2019 and Micro Scheme estimate 2020

60. The costs to business fall to the trustees of DC pension schemes so small and micro businesses that sponsor DC schemes may be affected. However, assessing the impact of the proposed changes on this group is difficult, as small and micro pension schemes may not necessarily correspond to small and micro businesses[50]. As there is currently no robust

[49] 1,740 DC and Hybrid Schemes with 12+ members: TPR, DC trust: presentation of scheme return data 2019 – 2020 LINK

[50] For example, a large firm may sponsor a small scheme with only a few members. Similarly, many small and micro businesses participate in large multi-employer schemes or master trusts.

evidence to link pension scheme size to employer size, it is disproportionate to accurately assess the impact on small and micro businesses.

61. The Annual Survey of Hours and Earnings (ASHE) dataset provides information on the size of DC sponsoring employers with active members. This will only include those who are contributing to a DC pension so will exclude members who are in schemes closed for future accrual but it helps to provide an indication of the size of sponsoring employers.

62. Table 5 shows the proportion of Private sector and Not for Profit active DC pension scheme members by employer size. The majority of active DC pension scheme members work in businesses with more than 50 employees. Approximately 18% and 11% of active DC members work in Small and Micro businesses respectively.

Table 5: Proportion of DC sponsoring employers, by employer size[51]

Size of Employers	**Proportion of DC members[52]**
0	0%
1-9	11%
10-49	18%
50-99	7%
100-499	13%
500-999	6%
1000+	46%
All sizes	**100%**

Source: ONS Annual survey of Hours and Earnings, Great Britain, 2018

63. If these small and micro employers sponsor smaller sized pension schemes (rather than participating in a commercial multi-employer scheme) then they may encounter a higher cost as a result of this measure relative to their overall costs. However as noted above, small and micro businesses are not the same as small and micro pension schemes. The Employers' Pension Provision Survey[53] shows type of pension provision by size of employer. 30 per cent of private sector employers and 22 per cent of micro organisations offered access to National Employment Savings Trust (NEST) in 2017. Small employers were the most likely to offer access to NEST with 64 per cent of small organisations offering access to NEST in 2017. As many small and micro businesses use large pension schemes, it is anticipated that no disproportionate impact on small or micro employers as a whole.

Monitoring and Evaluation

64. There will be an opportunity, along with with TPR and the industry to understand and review the post implementation impact.

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

[52] Figures are rounded to the nearest 1%

[53] Employers' Pension Provision Survey 2017 Tables 2.4 and 2.5 LINK

Summary of Total Costs[54]

Table 6: One-off costs to the pre-defined 'specified schemes' in scope to understand and familiarise themselves with the guidance, and ongoing costs to complete the additional information on VFM in future scheme returns; include a more prescriptive value for members' assessment in the Chair Statement, to actively engage larger schemes and determine if they would agree to take them on and finally to compile the information, carry out the relative assessment and indicate the results.

Type Of Cost	Scheme Volumes	Cost	Frequency	Assumptions and Rationale
One-off	2,120	£412,700	Once (year one)	An assumed 2.5 hours per trustee to familiarise with the guidance and understand the requirements.
Ongoing		£1,225,000*	Yearly	An assumed 0.25 hours needed by Trustees to complete the extra information sections of the scheme return. An assumed 1 hour needed by Trustees to engage larger schemes and determine if they would agree to take them on. An assumed 3 hours needed by Trustees to compile the information, carry out the relative assessment and indicate the results. Assumed cost of a VFM assessment to be 50% of the cost to a scheme of producing a 'Chair Statement'.
Total Cost	£1,600 in year one and £77,700 every 3 years			

** This Total Ongoing-Costs is from the combined costs to "complete the additional information in the scheme return regarding VFM" (£15,400), "include a more prescriptive VFM assessment in the Chair's statement" (£962,700), "compile the information, carry out the relative assessment and indicate the results" (£185,100) and "to actively engage larger pension schemes and determine if they would agree to take them on" (£61,700)[55].*

Table 7: One-off and ongoing cost to schemes to report on investment returns every year since 2015

Type Of Cost	Scheme Volumes	Cost	Frequency	Assumptions and Rationale
One-off	3,040	£929,100	Once (year one)	It is assumed that investment return figures will already be available to trustees.
Ongoing		£309,700	Yearly	
Total Cost	£929,100 in year one and £309,700 per year			

[54] All costs are rounded to the nearest £100

[55] £1,225,000 = (£15,400 + £962,700 + £61,700 + £185,100) _ this is the sum total of the ongoing annual costs to 'specified schemes' that are detailed in the "Costs & Benefits to Businesses" section.

Table 8: Ongoing cost to schemes who do not currently voluntarily complete the question on Assets Under Management (AUM), to fill out in scheme return

Type Of Cost	Scheme Volumes	Cost	Frequency	Assumptions and Rationale
Ongoing	699	£3,400	Yearly	An assumed 0.17 hours for one trustee per scheme to fill in the relevant AUM figure in the scheme return. It is assumed that the required AUM figures will be readily available to trustees.
Total Cost	£3,400 per year			

Table 9: One-off and ongoing costs to TPR

Type Of Cost	Scheme Volumes	Cost	Frequency	Assumptions and Rationale
One-off	N/A	£16,000	Once (year one)	TPR assume they will need to add 4 questions to the scheme return.
Ongoing		£62,500	Yearly	TPR assume the work would be similar to an RPNA[56] enquiry and that they would identify the schemes through the scheme return.
Total Cost	£16,000 in year one and £62,500 per year			

[56] Recovery Plan Not Agreed - In this instance a third party notice would be sent to the employer and TPR are expecting to carry out a similar amount of investigation prior to issuing the penalty.

Other Impacts

Equality

65. 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

66. There are no implications.

Rural proofing

67. There are no implications.

Health

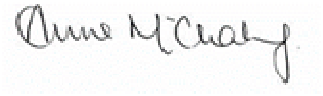
68. There are no implications.

Human rights

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

Competition

70. There are no implications.

Approved by:	 Anne McCleary Director of Social Security Policy, Legislation and Decision Making Services	**Date:**	29th September 2021

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REGULATORY IMPACT ASSESSMENT

THE OCCUPATIONAL PENSION SCHEMES (ADMINISTRATION, INVESTMENT AND CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2021

DEFAULT STATEMENT OF INVESTMENT FOR SCHEMES WITH A DEFAULT FUND THAT IS "WITH PROFITS"

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

Summary

Problem under consideration and rationale for government intervention

New Charges and Governance requirements were introduced in July 2015[1] requiring pension schemes to produce a Statement of Investment Principles for their default arrangement/s (a default SIP). A SIP is a written statement where an occupational pension scheme sets out its investment strategy, objectives and the investment policies they adopt.

Publishing a SIP provides publically available, transparent information that employers (and their employees) are able to see and use in the complex decision-making process around selecting their occupational pension scheme provider. This can also correct for any potential principal-agent problem that can arise when employers select a pension scheme on behalf of their employees (the ultimate beneficiaries of the pension) when their incentives may not be well aligned[2].

Because of the way the regulations providing for a default SIP requirement were drafted, a subset (estimated to be a small number of schemes[3]) of Defined Contribution (DC) pension schemes with a "with profits" default fund, also known as a scheme with a 'promise' (as defined by Regulation 3(6) and (7) of The Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015) (the '2015 Regulations'), were not required in the regulations to produce a default SIP.

This is not consistent with the policy requiring pension schemes which place members in this type of default arrangement to document their rationale for doing so.

Policy objectives and the intended effects

It is intended that pension schemes for whom the default arrangement contains a promise, and meet all the requirements outlined in regulation 2A of The Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005, be required to produce a default SIP[4].

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[1] The Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 LINK

[2] The Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015 Charges in Qualifying Pension Schemes RIA (the '2015 Minimum Governance Standards RIA') LINK page 7

[3] Estimated to be approximately 68 Occupational DC Schemes with a 'with profits' default fund. Detailed in the 'Costs to Benefits & Businesses' and 'Scope of the Regulations' sections of this RIA.

[4] The Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005 LINK

Policy options considered, including any alternatives to regulation

Option 1. Do Nothing

1. Not requiring these DC schemes to publish a Default SIP reduces transparency for, as well as scrutiny from, scheme members and the employers that decide on the suitable occupational pension scheme in which to enrol their employees. By 'doing nothing', the lack of scrutiny enabling transparency of a clear Default SIP publication could see members (potentially unknowingly) exposed to the risks of lower long term investment returns.

2. The lack of published Default SIPs could continue to make the task of employers comparing and selecting a suitable scheme for their members in a complex market more difficult, as well as making employers already enrolling staff into a scheme with a "with profits" default fund less able to explain and demonstrate the value of this decision to their employees.

3. Doing nothing would also perpetuate a two-tier investment governance system, where more modern funds were subject to the full weight of legislation, whilst legacy funds with relatively weak guarantees would be wholly excluded.

Option 2. Alternatives to regulation

4. An alternative to regulation could be issuing guidance to pension schemes with this type of default fund recommending they produce a SIP. However, feedback from industry indicates widespread voluntary compliance by schemes at present or in future with a non-mandatory measure is unlikely. Furthermore, following the 2015 Regulations with the issuing of non-binding guidance would create a two-tier framework between schemes with and without a promise.

Option 3. Introduce changes to disclosure requirement regulations

Preferred Option

5. This is a relatively minor regulatory change which mandates pension schemes to disclose to their members how assets are invested and are done so in their best interests. This is in line with the policy for all other types of default arrangements.

Preferred option: Summary of assessment of impact on business and other main affected groups

Impact on Business

6. The relevant pension schemes (*occupational Defined Contribution (DC) pension schemes with a "with profits" default fund, including hybrids, excluding Executive Pension Plans, Small Self- Administered Schemes*[5]) will be impacted in the following ways:

   - a one-off familiarisation cost for the trustees of DC pension schemes that have a "with profits" default fund to read guidance and understand the requirements around reporting on their scheme's default fund.
   - the cost of producing an initial Default SIP as well as an ongoing cost of producing a renewed statement once every three years.

7. Employers who do have/would have staff enrolled in the relevant DC pension schemes, can benefit from increased transparency and scrutiny of DC scheme governance, which in the case of some schemes could lead to improved governance practices over time and potentially better retirement outcomes for their members. Published Default SIPs may also see employers benefit by being able to more easily demonstrate to their employees that the pension schemes they are providing are good, which could have benefits for workforce management.

Impact on Regulatory Bodies

8. The Pensions Regulator (TPR) is already responsible for monitoring compliance with the minimum governance standards, including the 2015 default SIP requirements, in trust-based DC pension schemes. The costs of monitoring compliance are small and will be met within TPR's existing budget.

Impact on Members

9. For employees enrolled in the pension schemes in scope, they will be impacted in the following ways:

   - the improved clarity and transparency of relevant DC schemes publishing a Default SIP means employers are better able to select a fund for their employees (the occupational DC scheme members) that is well-aligned with their employees' interests, demographics and risk appetite;
   - it may lead pension schemes with default arrangements that are 'with profits' to give more consideration to the aims, objectives and policies of the default fund, and determine whether these investment arrangements are still in the best interest of the scheme members and if not, they are able to decide to make changes that improve member outcomes;

[5] Henceforth EPPs and SSASs respectively

- ongoing scrutiny of value for money on behalf of pension scheme members that can in the long-term improve retirement outcomes.

Additional detail – policy, analysis, and impacts

Preferred Option (Default SIP)

Evidence behind the rationale for intervention

10. This measure is extending the requirement to produce a Default Statement of Investment Principles (SIP) to a specific type of DC scheme (DC schemes that offer a "with profits" default fund) that were previously not covered under the 2015 Charges & Governance Regulations for Occupational Pension Schemes[6]. The preparation of a Default SIP was part of a package with the clear aim to improve overall scheme governance and transparency, and ultimately improve outcomes for occupational DC scheme members.

11. The arguments made in the 2015 Regulations to highlight the importance for improved minimum standards of pension scheme governance – primarily the fiscal challenge of an ageing society and the increased amounts saved in DC Schemes due to Automatic Enrolment – are still relevant now.

12. The particular rationale for the Default SIP measure was it could help "strengthen the weak demand side"[7] in the market as identified in a 2013 Office of Fair Trading (OFT, *now the Competition and Markets Authority, CMA*) investigation into the DC workplace pension market. This demand-side weakness stemmed primarily from employers selecting a pension scheme on behalf of employees even though the incentives and priorities of the two parties may be different or misaligned; known as a 'principal-agent problem'. Even in instances where incentives might be well aligned, the challenge for employers to make decisions in the best interests of their employees can also be complicated by the complexity of the pensions market and products, and the lack of transparent information.

13. The Default SIP requirement helps improve governance and increase scrutiny-enabling transparency on behalf of DC scheme members by requiring that "*default investment strategies must be designed in members' interests with a clear statement of aims, objective and structure and how these are appropriate for their membership*"[8]. Thus playing a role in addressing the principal-agent problem and potential resulting market failures that could result.

14. The DC schemes in scope, those which offer a 'with profits' fund as a default arrangement, would be required by these measures to document their aims and objectives; to explain how the selection of a "with profits" fund is intended to ensure that the assets are invested in the best interests of beneficiaries; and to regularly review its performance and appropriateness. This can lead to increased transparency, and play a role in better alignment of employer and employee incentives around pension scheme selection.

[6] The 2015 Minimum Governance Standards RIA LINK

[7] The 2015 Minimum Governance Standards RIA LINK page 7

[8] The 2015 Minimum Governance Standards RIA LINK page 9

15. The reasoning for the original 2015 Default SIP measures does crucially also apply to schemes that happen to have a "with profits" default fund. Therefore, there is a potential inconsistency if these schemes offering a "with profits" default are not also required to produce a Default SIP, especially as the rationale for extending the requirement to also include them has been demonstrated to be strong and clear.

Costs and Benefits to Businesses

16. The scope of this regulation is limited to those Occupational DC pension schemes (*including hybrids, excluding Executive Pension Plans and Small Self-Administered Schemes*[9]), whose default fund is a "with profits". TPR estimate that there will be approximately 950 pension schemes that offer a fund that is "with profits". Given an estimated average of 14 funds per scheme, it is assumed that 1 in 14 of these 950 schemes' "with profits" fund will be their scheme's default fund[10]. This means approximately 68 default funds will be in scope of this new measure and required to produce a Default SIP every three years[11].

17. The measure would result in a **one-off familiarisation cost for the trustees** of the DC pension schemes in scope to read guidance and understand the requirements on them around reporting on their scheme's "with profits" default fund. The estimated familiarisation costs are calculated from each trustee of the DC funds in scope taking the time to read and understand the regulations. It is assumed that it will take all trustees approximately 18 minutes to read and understand the 3 extra pages of regulations. It is also assumed that an average trustee wage of £29.11 per hour is applicable, based on 2019 Annual Survey of hours and Earnings (ASHE) data for Corporate Managers & Directors[12]. It is assumed that there are approximately 2.7 trustees per relevant scheme, based on calculations using TPR data on '*Number of Trustees – by scheme size*'[13]. These familiarisation costs total approximately £1,600[14].

18. The pension schemes in scope would also face the **cost of producing an initial Default SIP as well as an ongoing cost of producing a renewed statement once every three years**.

19. The requirement to produce the first such default SIP should apply with effect from 3 months following the first scheme year end after the coming into force date, in good time to be included in the first Chair's Statement that is required to be produced after the coming into force date. This gives pension schemes in scope a minimum of 3 months and up to 15 months in order to document the first default SIP. It would be expected that the Default SIP would be reproduced once every 3 years. The extra cost to the relevant schemes of producing a SIP are assumed to be the same in real terms as the estimated costs of

[9] Henceforth EPPs and SSASs respectively.

[10] See "Key Assumptions and Sensitivity Analysis" for details.

[11] (1/14 probability of the "with profits" fund on offer being the scheme's Default Fund) * (950 schemes that offer any fund that is "with profits") = 68 schemes with a "with profits" Default Fund. This is assumed to be constant across the appraisal period. See "Key Assumptions and Sensitivity Analysis" for details.

[12] 2019 Annual Survey of hours and Earnings (ASHE) data. The median hourly gross pay for corporate managers and directors is £22.92 in table 2.5. This is uplifted by 27% for overheads from the previous version of the Green Book, no updated estimate is available.

[13] Trustee Landscape Quantitative Research 2015. Figure 3.2.3 Number of trustees by benefit type, page 14. LINK

[14] (68 Estimated DC Funds in Scope) *(2.7 Trustees per Fund) *(£29.11 Average Hourly Trustee Wage) *(0.3 Number of Hours Required) = £1,600 to the nearest £100.

producing a chair statement[15]. These ongoing costs total approximately £77,700[16] every 3 years.

20. The ongoing cost of £77,700 every three years is calculated using TPR provided information estimating the breakdown of the 950 schemes offering any "with profits" funds by their size in terms of membership[17]. The unit costs of producing a Default SIP, in line with the cost estimates of producing a chair statement[18], are estimated to be different for schemes of different sizes[19]. The proportions of schemes by membership size are applied to estimate the approximate splits by size of the 68 schemes in scope for these regulations. In line with TPR provided breakdowns, it is estimated that approximately 46 of the schemes in scope will have fewer than 100 members and thus face an assumed cost per Default SIP of £380 (to the nearest £10); approximately 9 schemes will have 100 to 999 members and face a cost of £1,850 per SIP (to the nearest £10). It is estimated 12 of the 68 schemes in scope have over 1000 members, and the cost of a Default SIP document for each of these schemes would be approximately £3,530 (to the nearest £10)[20].

Costs and Benefits to Other Affected Parties

21. As detailed in the 2015 Impact Assessment *Minimum Governance Standards for DC trust-based schemes*, the benefits of a Default SIP and more widely of better DC scheme governance are numerous[21]. The purpose of this regulatory measure is to extend these benefits to the remaining Occupational DC Scheme members that were not in schemes impacted by the 2015 legislation.

Pension Scheme Members

22. This regulation extends the Default SIP requirements to DC schemes that have a "with profits" fund as a default arrangement. It will require on behalf of scheme members, as in 2015, that "*default investment strategies must be designed in members' interests with a clear statement of aims*" and that "performance of underlying funds, are regularly reviewed".

23. A key benefit of the default SIP in general is that by regulating to better align incentives, it should help mitigate for the aforementioned principal-agent issue between employers (selecting the pension scheme to enrol employees in) and the employees themselves; ultimately leading to better pension outcomes for members. The resulting increased clarity and transparency of producing and releasing a periodic Default SIP also ultimately makes the task of an employer selecting a pension scheme that best reflects their employee's

[15] See "Key Assumptions and Sensitivity Analysis" for details

[16] Σj(Estimated Unit Costs per SIP)j *(Number of Default Funds of Corresponding Size in Scope)j where "j" is the scheme size by membership group: <100 members, 100-999 members or 1000+ members.

[17] "Fewer than 100 members", "100 to 999 members" and "1000+ members".

[18] Chair statement costs estimated in The 2015 Minimum Governance Standards RIA LINK See "Key Assumptions and Sensitivity Analysis" for details.

[19] In line with previously estimated costs for different sized pensions schemes of producing a 'Chair Statement'. See "Key Assumptions and Sensitivity Analysis" for details.

[20] (46 schemes * £380) + (9 schemes * £1,850) + (12 schemes * £3,530) = £77,000 to the nearest £100. NB: this sum will not be exact as unit costs figures used are rounded to the nearest £10, and estimated schemes are rounded to the nearest whole scheme.

[21] The 2015 Minimum Governance Standards RIA LINK

interests, demographics and risk appetite less complicated, which would again be expected to lead to better outcomes for members.

24. A particular potential benefit of the Default SIP measure for "with profits" funds is that it may lead pension schemes that have a "with profits" default arrangement to consider and determine whether these now older-style investment arrangements are still in the best interest of the scheme members. They may decide more modern types of default funds will deliver improved outcomes for their scheme members.

25. Other broader benefits of the Default SIP requirements are the contribution to improving standards of governance and increased scrutiny of DC pension scheme defaults.

26. So ultimately, by extending measures that require aspects of, and encourage more broadly, good quality default fund governance and transparency amongst more DC schemes, the regulations can be seen to contribute more widely to helping to achieve good retirement outcomes via ensuring ongoing scrutiny on behalf of the relevant pension schemes' members.

Employers

27. One key benefit of the Default SIP regulations, as highlighted in 2015, is that "*Employers will also benefit from good scheme governance, as they will be getting value for money and they can demonstrate to their employees that the schemes they are providing are good which will have benefits for workforce management*"[22].

28. Another benefit is that the improved governance and transparency of producing and releasing a periodic Default SIP ultimately can make the potentially tricky task of an employer seeking to select an occupational DC scheme in the interests of their employees less complicated, and less time consuming.

Regulators

29. TPR is already responsible for monitoring compliance with the minimum governance standards, including the 2015 Default SIP regulations, in trust-based DC pension schemes. The costs of monitoring compliance are small and will be met within TPR's existing budget. The new legislative requirements are specific, making them easier to monitor and enforce.

30. The extension of Default SIP requirements to an additional estimated 68 DC schemes with a "with profits" default fund represents an increase of roughly 3 percent on the approximately 2,110 DC schemes already in scope of the original 2015 legislation requiring them to produce a Default SIP[23].

[22] The 2015 Minimum Governance Standards RIA LINK Page 15

[23] This TPR estimate of schemes is for those with 2+ DC memberships, that are not 'with profits' (including hybrids and excluding SSAS and EPPs)

Wider Economic and Societal Impacts

31. One potential longer-term benefit to wider society could be that improved pension scheme governance and value for members affected could mean improved outcomes and potentially increased incomes in retirement. This could result in higher rates of consumption and spending in the wider economy in retirement. There is also the potential knock on impact to health outcomes as a result of their higher material standards of living. This could also be beneficial to wider public health and social care provision amidst the context of demographic ageing.

Key Assumptions and Sensitivity Analysis

32. In the calculations of the familiarisation and ongoing costs to businesses (the relevant Pension Schemes) the following assumptions were made:

- It is assumed that the costs of producing and documenting a Default SIP are the same as the current costs to produce a Chair Statement (an audited report and accounts for a DC Trust Based scheme)[24].
    - This is a reasonable assumption because the Chair Statement cost estimates required that a scheme "*must produce a statement in the scheme's audited report and accounts covering how the above governance standards are met*"[25], which is analogous to the required activities on trustees in the requirements to produce a Default SIP.
- It is assumed there would be an average of 14 funds per DC scheme in scope, and that for every scheme offering a "with profits" fund, this "with profits" fund is equally likely to be their scheme's default fund as any other of the funds they offer.
    - This is a reasonable assumption because there is not thought to be any reason that a "with profits" fund is any more likely to have been selected by an occupational DC scheme to be the default fund into which new members are enrolled.
    - Industry feedback suggests that it was often the case historically that "with profit" funds were offered as a self-select fund for members who would like smoother, less risky returns. Meaning that a "with profits" fund within a typical DC scheme of 14 funds may actually have a less than 1/14 probability of being the scheme's default fund. In this case the total costs to business could actually be lower as the estimated 68 DC schemes with a "with profits" default fund could be an overestimate. Considering all evidence in proportion, the '*1/14 probability'* assumption is viewed as the most reasonable to proceed with.
- It is assumed that the estimated number of schemes in scope of the requirements will remain broadly unchanged over the appraisal period.

[24] The 2015 Minimum Governance Standards RIA LINK Page 15

[25] The 2015 Minimum Governance Standards RIA LINK Page 17

- The prevalence of "with profits" funds more broadly has declined in recent decades[26]. For "with profits" funds that are specifically a scheme's default fund, it is assumed that the estimated scope of 68 "with profit" default funds is unlikely to change substantially. Although the estimated number of schemes could potentially decline further, to estimate this would not be proportionate and could risk an underestimate of the total costs to business over the appraisal period.

- It is assumed that there will be 3 pages of additional regulation and guidance for trustees to familiarise themselves with, and a reading time of 6 minutes per page.

33. With regards to the one-off familiarisation costs of £1,600, allowing for sensitivity around the reading time assumptions of 50 per cent the one-off cost decreases to £800 and increases to £2,400.

34. With regards to the ongoing costs of producing a Default SIP of £77,700, allowing for sensitivity around the unit cost of producing and documenting a SIP assumption of 50 per cent the ongoing cost decreases to £38,900 and increases to £116,600.

Small and Micro Business Assessment

Scope of the Regulations

35. The proposed regulations will impact Occupational DC pension schemes with a "with profits" default fund, including hybrid schemes but excluding Executive Pension Plans (EPP) and Small Self-Administered Schemes (SSASs). These small and micro pension schemes (EPPs and SSASs) have been deemed out of scope of the regulations as it would be disproportionate for it to apply to them.

36. TPR estimate the number of DC pension schemes that offer any funds that are "with profits" is 950 schemes. Given an estimated 14 funds per scheme, for these 950 schemes it is assumed there is a 1 in 14 probability that the "with profits" funds they each offer is specifically their default fund[27]. Therefore, this Default SIP measure is estimated to bring the default funds of approximately 68 DC schemes into the scope of the requirements. Of these impacted DC pension schemes, Table 1 contains a breakdown by membership size.

[26] With-profits funds: is there a future?", FT Adviser. (January 2019). LINK.

[27] See 'Key Assumptions and Sensitivity Analysis' for details.

Table 1: Relevant DC Pension Schemes in Scope – by size of membership

DC pension schemes which are 'with profits' (including hybrids, excluding EPPs and SSASs)				
Members	<100	100-999	1,000+	Total
Schemes with any funds that are "with profits"	650	130	170	950
Estimated DC Schemes with a default fund that is "with profits"	45	10	10	70

All figures rounded to the nearest 10

37. In terms of Default SIPs aiding the task of employers selecting an appropriate occupational DC scheme for employees, employers with staff currently enrolled into the schemes in scope of these measures will benefit from more transparent, concise documentation around the schemes they have chosen. The employers in scope are likely to be ones with an older style corporate scheme pension arrangement, and these measures can improve the employers' ability to compare their current, potentially older, scheme arrangements with a wide range of other schemes on offer such as master trusts, and make a well-informed decision on whether to continue with their own scheme or not.

38. With regards to proportionality, TPR research of DC schemes finds "*a significant correlation between the effectiveness of pension scheme governance and scale*", and in smaller DC pension schemes they "*found many instances of weaker governance*" and "*found rarely*" instances of strong governance[28]. So while excluding the various types of small and micro ension schemes mentioned above, it is still sensible and proportionate to extend measures to ultimately improve governance to DC schemes "with profits" that have fewer than 100 members, especially when other DC schemes their size have already been required to produce a Default IP since 2015.

Monitoring and Evaluation

39. There will be an opportunity, along with TPR and the industry, to understand and review the post implementation impact on the affected DC Schemes "with profits". The obligation to produce a default SIP periodically is already a requirement of many DC Schemes as of the 2015 Charges & Governance Regulations.

[28] 'Investment Innovation and Future Consolidation' (Feb 2019). Pages 18-19.LINK.

Summary of Total Costs

Table 2: One-off and ongoing cost to the pension schemes in scope (default fund of schemes with profits') to understand and familiarise themselves with the measures, and to comply with the measures by completing and documenting a Default SIP.

Type Of Cost	Scheme Volumes	Default Funds In Scope Volumes	Cost	Frequency	Assumptions and Rationale
One-off	950	68	£1,600	Once (year one)	It is assumed that 1 out of every 14 funds is a 'default fund'. An assumed 0.3 is hours required for each trustee to read through the regulations.
Ongoing			£77,700	Every 3 Years	It is assumed that the cost of producing a Default SIP is the same as producing a Chair Statement, with different unit costs by scheme size.
Total Cost	£1,600 in year one and £77,700 every 3 years				

Other Impacts

Equality

40. 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

41. There are no implications.

Rural proofing

42. There are no implications.

Health

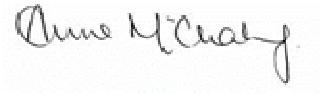
43. There are no implications.

Human rights

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

Competition

45. There are no implications.

Approved by:	 Anne McCleary Director of Social Security Policy, Legislation and Decision Making Services	**Date:**	29th September 2021

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