Department for Work & Pensions	Impact Assessment (Final)	
Title of measure		Default SIP for schemes with a default fund that is “with profits”
Lead Department/Agency		DWP
Planned coming into force /implementation date		01 October 2021
Origin (Domestic/EU/Regulator)		Domestic
Policy lead		Andrew Blair
Lead analyst		Tom Drissi
Departmental Assessment		Self-certified
Total Net Present Social Value (over 10-year period): £-0.3m	**Equivalent Annual Net Direct Cost to Business (EANDCB) (over 10-year period): £0.0m**	**Business Impact Status:** Non-Qualifying Regulatory Provision

Summary - Intervention and impacts

Policy Background – Issue – Rationale for Intervention – Intended Effects

The Department for Work and Pensions (DWP) introduced new Charges and Governance requirements in April 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 2015) were not required in the regulations to produce a default SIP.

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

We intend 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 2005, be required to produce a default SIP[4].

Brief description of viable policy options considered (including alternatives to regulation)

1. Do nothing

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

[1] The Occupational Pension Schemes (Charges and Governance) Regulations 2015. LINK.
[2] IA Number DWP0045, Page 9. LINK.
[3] We have estimated 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 IA.
[4] The Occupational Pension Schemes (Investment) Regulations 2005. LINK.

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.

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.

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.

2. Alternatives to regulation

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.

3. Introduce changes to disclosure requirement regulations

Preferred Option

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 DWP's 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

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.

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

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 The Pensions Regulator's existing budget.

Impact on Members

[5] Henceforth *EPPs and SSASs* respectively.

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

Departmental Policy signoff (SCS): Hilda Massey	Date: 23/07/20
Economist signoff (senior analyst): Joy Thompson	Date: 16/07/20
Better Regulation Unit signoff: Prabhavati Mistry	Date: 08/07/20

Additional detail – policy, analysis, and impacts

Preferred Option (Default SIP)

Evidence behind the rationale for intervention

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.

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.

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.

The Default SIP requirement helps improve governance and increase scrutiny-enabling transparency on behalf of DC scheme members by requiring that *"default investment*

[6] The Occupational Pension Schemes (Charges and Governance) Regulations (2015), IA Number DWP0045 LINK.
[7] IA Number DWP0045, Page 9. LINK.

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.

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.

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

The scope of this regulation is limited to the 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].

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. We assume that it will take all trustees approximately 18 minutes to read and understand the 3 extra pages of regulations. We have also assumed an average trustee wage of £29.11 per hour, based on 2019 Annual Survey of hours and Earnings (ASHE) data for Corporate Managers & Directors[12]. We assume approximately

[8] IA Number DWP0045, Page 14. LINK.
[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.

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].

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.**

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

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

As detailed in the 2014/15 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.

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[13] IA Number DWP0045, Figure 3.2.2. 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.
[15] See "Key Assumptions and Sensitivity Analysis" for details.
[16] Σ_j(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 IA Number DWP0045, 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] IA Number DWP0045, LINK.

Pension Scheme Members

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"*.

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

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.

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

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

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].

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

The Pensions Regulator 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 The

[22] IA Number DWP0045, Page 18. LINK.

Pensions Regulator's existing budget. The new legislative requirements are specific, making them easier to monitor and enforce.

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].

Wider Economic and Societal Impacts

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

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

- We have 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.
- We have assumed 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

[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)
[24] IA Number DWP0045, Page 18. LINK.
[25] IA Number DWP0045, Page 20. LINK.

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.
    - 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.
- We have assumed 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.

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.

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

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.

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 we assume 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.

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**

[26] "With-profits funds: is there a future?", FT Adviser. (January 2019). LINK.
[27] See 'Key Assumptions and Sensitivity Analysis' for details.

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

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.

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 pension 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 SIP since 2015.

Monitoring and Evaluation

We will work with TPR and the industry in order 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. It is also worth flagging that DWP is also legally required to carry out a Review of the Chair's statement requirements by April 2021[29].

[28] 'Investment Innovation and Future Consolidation' (Feb 2019). Pages 18-19.LINK.
[29] Regulation 8 of The Occupational Pension Schemes (Scheme Administration) (Amendment) Regulations 2016 - SI 2016/427

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)	We assume 1 out of every 14 funds is a 'default fund'. An assumed 0.3 hours required for each trustee to read through the regulations.
Ongoing			£77,700	Every 3 Years	We assume 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				