Department for Work & Pensions	Impact Assessment (Final)	
Title of measure		The Occupational Pension Schemes (Investment) (Employer-related investments by Master Trusts) (Amendment) Regulations
Lead Department/Agency		Department for Work & Pensions
Planned coming into force /implementation date		1st October 2022
Origin (Domestic/EU/Regulator)		Domestic
Policy lead		Doris Zajer
Lead analyst		Rebecca McCaw
Departmental Assessment		Self-certified
Total Net Present Social Value (over 10year period): £0.1m	**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

Legislation was introduced in the 1990s[1] and 2005[2] to prevent the misappropriation of pension scheme funds by the sponsoring employer. This included restrictions on direct loans of a pension scheme's assets to an employer and a limit on trustees and managers investing in any one employer.

The pensions landscape has changed significantly since this Employer-Related Investment (ERI) legislation was introduced. The success of automatic enrolment (AE) has resulted in the emergence of authorised defined contribution (DC) Master Trust (MT) pension schemes, a scheme type that did not exist before 2018, which enables multiple employers to use the same scheme to enrol their employees into a pension. Authorised Master Trusts account for 20.5 million DC memberships excluding hybrid schemes (94 per cent of total DC memberships excluding hybrid schemes).[3]

Rationale for Intervention

The Pension Schemes Act 2017 increased regulation of Master Trusts and introduced an authorisation and supervision regime. However, this did not make changes to the ERI legislation, and therefore Master Trusts face significant burdens in relation to their investment decisions. This means Master Trusts have to closely monitor their investment decisions to ensure the types of investment do not exceed regulations in relation to a single employer who might be using the scheme. The opportunity cost is Master Trusts cannot pursue other projects and innovations which could benefit members and Master Trusts.

The preferred option is to correct the overregulation of Master Trusts under current ERI legislation. This intervention will help reduce unnecessary burdens to schemes in scope and remove barriers preventing schemes from investing member funds in a more efficient manner to improve returns.

Intended Effects

The intended effect is to provide schemes with greater flexibility in their investment strategies and reduce their administrative burdens. This has the potential to benefit members of schemes in scope through:

- A reduction in costs to schemes in scope could potentially be passed on to members through lower charges on pension savings.
- Greater flexibility in scheme's investment strategies mean schemes face fewer limits on where they can allocate member's funds. This has the potential to increase member returns on their investments.
- Greater diversification of investments, reducing the risk of concentration in a narrow range of asset classes.

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

Policy Option 0: Do nothing

[1] Pensions Act 1995 (legislation.gov.uk)
[2] The Occupational Pension Schemes (Investment) Regulations 2005 (legislation.gov.uk)

[3] DC trust: scheme return data 2021 to 2022 | The Pensions Regulator

Existing ERI regulations would continue to apply unchanged, placing unnecessary burden on Master Trusts. All schemes must spend time monitoring each investment and face barriers to where they can invest.

Policy Option 1: Update ERI regulations for Master Trusts with 500 or more participating employers – Preferred Option
This option would involve reforming existing legislation. DWP would lay a statutory instrument that would add a specific regulation on employer-related investments for authorised Master Trusts with 500 or more participating employers. The requirements would bring into force a narrower definition of 'employer-related investments' removing the restrictions currently placed on investments relating to participating employers.
The threshold of 500 or more participating employers has been chosen as the data showed a gap between Master Trusts with numbers of employers around this threshold and Master Trusts with numbers of employers below this threshold, which is anticipated to avoid Master Trusts moving in and out of scope of the policy.

Legislating would minimise the possibility of ambiguity or misinterpretation and ensure all Master Trusts are consistent in taking the same approach to employer-related investments.

Policy Option 2: Alternative to legislation
The Pensions Regulator (TPR) could issue a further 'Letter of Comfort' or statement to reassure trustees of authorised Master Trusts that although the legal requirements remain, TPR is likely to take a generous, light-touch approach to enforcement. A similar letter was issued to some schemes in 2010. However, the impact of a statement or 'Letter of Comfort' could lead to ambiguity as it relies on how different Master Trusts choose to interpret the content. Neither would have the definitive impact of legislation.

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

Impact on Business
As a result of the change in regulations, the relevant schemes in scope (Master Trusts with 500 or more participating employers – currently estimated as 13 schemes[4]), henceforth 'specified schemes', will be impacted in the following ways:

- One-off familiarisation cost to read and understand the change in regulations.

Specified schemes may experience the following benefits from the removal of ERI regulations:

- Cost saving from the reduction of administrative tasks and reporting requirements regarding the implementation of checks and monitoring of connections and associations with all participating employers.
- More resource directed to other projects or innovations which have not been pursued due to the time spent on ERI activities. These may be beneficial to both schemes and members.

Impact on Regulators
TPR is responsible for monitoring compliance and investigating breaches of ERI regulations.
Impacts to TPR as a result of the proposed change in regulations are expected to be minimal and likely to be met within TPR's existing budget. These are explored in further detail below.

Impact on Members
As a result of the change in regulations, members of the specified schemes may be impacted through:

- Cost savings to Master Trusts as a result of the change in regulations, which could potentially be passed onto members in the form of lower fees. If this occurs, it may result in enhanced net returns on their savings and improved outcomes in retirement.
- Potential greater returns on their pension investment as a result of increased flexibility in scheme investment choices and greater flexibility may help to lower risk.

However, it is important to note that these benefits to members are only potential and are based on how "specified schemes" in scope respond to the regulations and cost savings may not necessarily be passed on to members.

Departmental Policy signoff (SCS): Jo Gibson Date: 09/06/2022

Economist signoff (senior analyst): Joy Thompson Date: 20/06/2022

Better Regulation Unit signoff: Prabhavati Mistry Date: 09/06/2022

Additional detail – policy, analysis, and impacts

Preferred Option – Update ERI regulations for Master Trusts with 500 or more participating employers

Evidence behind the rationale for intervention

[4] Data from The Pensions Regulator.

Current Legislation

1. The legislation introduced in the 1990s[5] and 2005[6] to prevent the misappropriation of pension scheme funds by the sponsoring employer has never been updated to accommodate the evolving pensions landscape.
2. The restrictions at present are:
   - a ban on certain loans of a pension scheme's assets to an employer that participates in the pension scheme (debt)[7]
   - a limit on trustees and managers investing more than 5% of a scheme's assets in ERI
   - for multi-employer schemes, a limit on trustees and managers investing more than 5% of a scheme's assets in any one participating employer with a cap of 20% on the total amount of a scheme's assets that are invested in ERI. This also applies to 'associates' and 'connected persons' of any participating employer.
3. DC Master Trust schemes must monitor each investment to ensure none of the participating employers and their "associates and connected persons" are invested in by the Master Trust.
4. This means Master Trusts must spend time and money ensuring compliance with ERI restrictions by monitoring any changes to the governance, operations and ownership of companies that could relate to the scheme's participating employers against the underlying holdings of the scheme.

Rationale for Intervention

5. DC Master Trust pension schemes are multi-employer occupational pension schemes which developed to respond to demand to accommodate the legal requirement for employers to automatically enrol their employees into a pension scheme.
6. The regulations have not been updated to recognise the different structure of DC Master Trusts and neither acknowledges nor makes allowances for the altogether distinct relationship between the scheme and the multiple participating employers using the scheme.
7. Master Trusts are therefore restricted in terms of asset classes in which they can invest. For example, if a Master Trust wished to access private debt markets, they would have to ensure each and every one of the recipients of this private credit were not participating employers or in any way connected to them.
8. The government has a wider objective of opening up all asset classes to DC schemes, most notably illiquids or private markets, to help maximise investment opportunities for these schemes. In the context of removing barriers to this type of investment, the current ERI regulations and the risk of a criminal offence if breached, have been raised as a potential obstacle by a number of respondents to DWP's consultation.
9. This change in ERI regulations could reduce risk of concentration in a narrow range of asset classes through allowing greater diversification of investments for specified schemes in scope as they face fewer restrictions in the types of asset classes and number of firms they can invest in. However, there is potential for this change to allow investment in alternative, riskier assets or in selected employers, though this may also lead to greater returns. This risk is mitigated by TPR's authorisation process and continued monitoring of Master Trusts, and trustees' fiduciary duty.

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[5] Pensions Act 1995 (legislation.gov.uk)
[6] The Occupational Pension Schemes (Investment) Regulations 2005 (legislation.gov.uk)

[7] Note there are some exemptions to this ban namely corporate bonds issued via a stock exchange.

10. According to TPR data, there are currently 36 authorised Master Trusts accounting for 20.5 million members and over £78.8 billion in assets, excluding hybrid schemes[8].

Costs and Benefits to Businesses of preferred option

Counterfactual

11. The counterfactual is the "do nothing" option. The counterfactual assumes that all schemes are currently fulfilling their ERI obligations by checking and reporting any investments relating to employers who are participating in their Master Trust scheme.
12. The size of the impacts to business will vary from scheme to scheme. "Specified schemes" in scope (Master Trusts with 500 or more participating employers) with more participating employers are expected to experience a greater benefit or cost-saving from the change in regulations, relative to 'specified schemes' in scope with fewer participating employers.
13. One respondent to the consultation suggested that the benefits to 'specified schemes' in scope described below are underestimated, as we have not accounted for the cost-saving to schemes from no longer needing to purchase the services of investment consultants to complete detailed analysis of their investments.
14. As the current regulations do not explicitly require such detailed analysis and in the absence of evidence that this is commonplace across all schemes, the cost-saving has not been included below.

Costs to Pension Schemes in Scope

Familiarisation

15. Only "specified schemes" directly affected will be expected to familiarise themselves with the change in regulations.
16. There will be one-off costs to all 'specified schemes' trustees to familiarise themselves with the change in regulations. A pension scheme in scope will experience this one-off cost in the first year only.
17. We estimate there are 13 "specified schemes" in scope of the change in regulations and therefore facing a familiarisation cost[9].
18. We estimate it would take all trustees of in-scope schemes approximately 30 minutes to read and understand the change in regulations (based on assumption the regulations are 5 pages and each page would take around 6 minutes to read).
19. We estimate that schemes in scope of the proposed requirements will have approximately 3 trustees per scheme, with an estimated average hourly cost (including overheads) of around £29 per hour.

Familiarisation with change in regulations cost

13 schemes in scope x 0.5 hours spent familiarising x 3 trustees per scheme x around £29 trustee wage per hour = £600[10]

20. TPR do not expect to add to the DC guidance regarding this change in ERI regulations as it is only relevant to specified schemes in scope.

Benefits to Pension Schemes in Scope

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[8] DC trust: scheme return data 2021 to 2022 | The Pensions Regulator
[9] Data from The Pensions Regulator.
[10] Figure rounded to nearest £100.

Administrative tasks and reporting

21. There will be an ongoing cost-saving to “specified schemes” as they experience a reduction in administrative tasks and reporting requirements associated with ERI.
22. “Specified schemes” will no longer be required to implement checks and monitor the connections and associations with all participating employers.
23. “Specified schemes” will only be required to report investments related to their scheme funder or the scheme funder’s associations and connections should they make any.
24. We assume there is one member of staff responsible for ERI administrative tasks and reporting per scheme with an estimated average hourly cost (including overheads) of around £29 per hour.
25. We assume that relevant staff of schemes in scope will spend 2 hours less per month on administrative and reporting tasks following the change in regulations.
26. The total ongoing benefit to all schemes in scope is estimated to be £9,000 per year.

Administrative tasks and reporting benefit

13 schemes in scope x 2 hours less spent on administrative tasks and reporting requirements per month x 1 staff per provider x around £29 staff wage per hour = £9,000[11] per year

Non-monetised impacts

27. “Specified schemes” in scope may have previously been prevented from pursuing other projects due to the time needed to adhere to ERI regulations. The change in regulations mean “specified schemes” can now redirect this time towards such projects or innovations because of the reduced ERI burden. Some of these projects or innovations may be beneficial to both schemes and members.
28. “Specified schemes” in scope may have previously been restricted in terms of asset classes in which they can invest. Following the change in regulations, “specified schemes” will experience a reduction in such restrictions and be able to more easily take advantage of opportunities for further investment.

Impacts to The Pensions Regulator

Non-monetised impacts

Set-up costs

29. There will be a one-off cost to TPR to familiarise themselves with the change in regulations, understand impacts on their duties and implement required changes. TPR will experience this one-off cost in the first year only.
30. Engagement with TPR suggests that set-up costs will be negligible. TPR will be incorporating this work into business as usual, and do not anticipate this will have an impact on the General Levy through which TPR is funded.

Other impacts

31. We have considered the potential of a reduction in revenue from criminal penalties from ERI breaches received by TPR.

[11] Figure rounded to nearest £100.

32. Engagement with TPR's enforcement team suggests they have never received any revenue from penalties as a result of ERI breaches by “specified schemes” in scope.
33. Therefore, we do not believe TPR will be impacted by reduced penalties as a result of the change in regulations and subsequently, we have not quantified this.
34. We have considered the potential of an ongoing cost-saving to TPR resulting from a reduction in administrative tasks associated with ERI.
35. Engagement with TPR suggests they have not received any ERI related queries for Master Trusts over the last three years.
36. Therefore, we do not believe TPR will be impacted by reduced administrative costs as a result of the change in regulations and subsequently, we have not quantified this.

Wider Economic and Societal Impacts

Members

37. The potential benefits to members from the change in regulations are discussed qualitatively. These benefits are indirect and not quantifiable as they rely on “specified schemes” in scope taking action.
38. The approximate total number of members of “specified schemes” in scope is 19 million[12].
39. Cost-savings to Master Trusts resulting from the change in regulations could potentially benefit members in the form of lower charges and enhanced returns on their pension investments. This could result in improved investment outcomes and potentially increased incomes in retirement.
40. Members of “specified schemes” could also receive greater returns on their pension investments as a benefit of the increased flexibility in scheme’s investment choices.
41. Members could benefit from increased diversification in their investment portfolios as “specified schemes” in scope face fewer restrictions in the types of asset classes they can invest in.

Employers

42. Participating employers of “specified schemes” in scope may also be impacted by the change in regulations. There will no longer be a limit on how much “specified schemes” can invest in each participating employer. Therefore, there is the possibility that employers will receive greater investment.
43. Given this benefit relies on “specified schemes” in scope taking action, we assess it is not proportionate to quantify this indirect, potential impact.

Key Assumptions/Sensitivities/Risks

<u>Sensitivities/risks</u>

Counterfactual

44. The costs and benefits are highly dependent on the counterfactual (how much time schemes currently spend on ERI) which will vary between schemes.
45. “Specified schemes” with greater numbers of participating employers experience a greater benefit from the change in regulations, than “specified schemes” with fewer participating employers.
46. Some pension schemes in scope will experience a greater cost-saving from no longer having to purchase investment consultancy services. However, we do not

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[12] Data from The Pensions Regulator.

expect this to be a commonplace cost-saving across all ‘specified schemes’ in scope and have therefore not included in the ‘Costs and Benefits to Business’ section.

Sensitivity Analysis

Pension schemes in scope

Familiarisation

47. We assume it will take 3 trustees per scheme in scope 30 minutes to familiarise with the regulations in the first year only. When allowing for sensitivity around the time assumption of 50 per cent (i.e. 15 or 45 minutes) holding everything else constant, the familiarisation cost decreases to £300 and increases to £800[13].

Administrative tasks and reporting

48. We assume a time reduction of 2 hours per month for 1 member of staff responsible for ERI administrative tasks per scheme in scope giving an ongoing cost saving of £9,000 per year. When allowing for sensitivity around this time assumption of 50 per cent (i.e. 1 or 3 hours per month) holding everything else constant, the ongoing cost saving decreases to £4,500 per year and increases to £13,600 per year[14].

Assumptions

Assumptions for schemes’ familiarisation

49. We have assumed only “specified schemes” in scope of the change in regulations will need to familiarise themselves. We estimate there are 13 schemes who will be affected[15].
50. We have assumed an average cost of time for a Trustee is around £29 per hour. This is based on the 2021 Annual Survey of Hours and Earnings (ASHE) data for Corporate Managers and Directors. The median hourly gross pay for corporate managers and directors is around £23[16]. This is uplifted by 27% for overheads from the previous version of the Green Book, no updated estimate is available.
51. We have assumed 3 trustees per scheme, based on TPR data on ‘Number of Trustees – by scheme type’, which shows the mean number of trustees per large (1000+ members) scheme is 3[17]. All “specified schemes” in scope belong to this large scheme category.
52. For familiarisation costs we assume a reading time of 6 minutes per page for Trustees[18].

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[13] Figures rounded to nearest £100.
[14] Figures rounded to nearest £100.
[15] Data from The Pensions Regulator.
[16] Earnings and hours worked, occupation by two-digit SOC: ASHE Table 2 - Office for National Statistics (ons.gov.uk)HYPERLINK "https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2"
[17] https://webarchive.nationalarchives.gov.uk/20170712122409/http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf

[18] Consistent with assumptions in previous impact assessments, see for example: Impact assessment: Default SIP for schemes with a default fund that is “with profits” - GOV.UK (www.gov.uk)

53. We have assumed the regulations will be 5 pages.

Assumptions for schemes' administrative tasks and reporting

54. We have assumed only "specified schemes" in scope of the change in regulations will experience a reduction in administrative tasks and reporting associated with ERI. We estimate there are 13 schemes who will be affected[19].
55. Our assumption of the reduction in time spent on administrative tasks and reporting is 2 hours per month. This is based on engagement with industry.
56. We have assumed an average cost of time for a Trustee is around £29 per hour. This is based on the 2021 Annual Survey of Hours and Earnings (ASHE) data for Corporate Managers and Directors. The median hourly gross pay for corporate managers and directors is around £23[20]. This is uplifted by 27% for overheads from the previous version of the Green Book, no updated estimate is available.

Assumptions for TPR's set-up cost

57. We have assumed set-up costs to be negligible and will be incorporated into business as usual. This is based on engagement with TPR.

Impact on Small and Micro Businesses

58. The proposed change in regulations will impact Master Trusts with 500 or more participating employers. Small and micro pension schemes including EPPs (Executive Pension Plans), and RSSs (Relevant Small Schemes) have been identified as out of scope of the change in regulations. These schemes are not currently experiencing the same burdens from existing ERI regulations as "specified schemes".
59. Many small and micro businesses use Master Trusts to fulfil their automatic enrolment obligations. These businesses may benefit from the proposed change in regulations as discussed above.

Monitoring and Evaluation

60. These new regulations remove restrictions on large Master Trusts. They update regulations that at present do not reflect the developments in pensions since the 2005 Regulations were introduced and therefore do not reflect the current pensions landscape and the emergence of Master Trusts.
61. Once implemented there will be a period of time to allow the updated regulations to 'bed in' and for Master Trusts to take advantage of them when developing their investment strategies. As well as updating outdated legislation these new regulations will open up avenues of investment to enable productive finance.
62. Given that the government has a wider objective of opening up all asset classes to DC schemes, most notably illiquids or private markets, these new regulations should, make it easier for Master Trusts to access private credit markets.
63. Monitoring the impact of these new regulations will be continuous to ensure the government's wider objective is met.

Summary of Impacts[21]

[19] Data from The Pensions Regulator.
[20] Earnings and hours worked, occupation by two-digit SOC: ASHE Table 2 - Office for National Statistics (ons.gov.uk)
[21] Figures are rounded to the nearest £100.

Pension schemes in scope

Type/Frequency	Schemes in Scope	Cost/Saving	Assumptions
One-off (Year 1)	13	Cost £600	We assume it will take 3 trustees per scheme in scope 30 minutes to familiarise with the regulations.
Ongoing (yearly)		Saving £9,000	We assume a time reduction of 2 hours per month for 1 member of staff responsible for ERI administrative tasks per scheme in scope.
Total Impact	£600 cost in Year 1 and £9,000 saving per year		