

EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (PRESERVATION OF BENEFITS AND CHARGES AND GOVERNANCE) (AMENDMENT) REGULATIONS 2018

2018 No. 240

1. Introduction

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

2. Purpose of the instrument

- 2.1 This instrument simplifies the conditions which must be satisfied for trustees or managers of pension schemes, or other parties who hold the right, to transfer groups of pension scheme members from one scheme to another without having to seek the explicit permission of individual members in advance. The revised conditions will only apply to members with money purchase benefits which do not include any potentially valuable guarantees or promises (broadly, ‘pure’ Defined Contribution pensions).
- 2.2 It also amends the protection offered by the cap on member-borne charges in pension schemes used for automatic enrolment into workplace pensions, when members are moved between or within schemes without their active consent.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 Section 73 (form of short service benefit and its alternatives) of the Pension Schemes Act 1993 (“the 1993 Act”)¹ permits alternatives to short service benefit², including alternatives prescribed in regulations, and also transfers without consent in prescribed cases.
- 4.2 Regulation 12 of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991 (“the Preservation Regulations”)³ sets out the current conditions under which a member’s accrued rights⁴ may be transferred from one occupational

¹ <http://www.legislation.gov.uk/ukpga/1993/48>

² This is the pension benefit that must be provided for a member who leaves the scheme before retirement and does not receive a pension immediately

³ <http://www.legislation.gov.uk/uksi/1991/167/contents>

⁴ In Defined Contribution pensions, broadly, the member’s pension pot. In Defined Benefit pensions, the member’s right to a future pension income.

scheme to another. This requires a relationship between the ceding and receiving schemes (regulation 12(2)) and certification by an actuary (regulation 12(3)).

- 4.3 This instrument amends these regulations to impose a new procedure for the transfer of money purchase benefits without any guarantee or promise. It removes the actuarial certificate⁵ and the scheme relationship condition⁶, and instead requires the ceding scheme (or employer where they make the decision) to seek advice from an independent adviser prior to the transfer. This requirement applies to all money purchase benefits without a guarantee unless the transfer is to a ‘connected scheme’⁷ or a multi-employer ‘master trust’⁸ authorised under the Pension Schemes Act 2017⁹.
- 4.4 Finally it changes the cap on pension scheme charges introduced by the Occupational Pension Schemes (Charges and Governance) Regulations¹⁰ (“the Charges Regulations”). The charge cap is applicable to any member invested in the default investment option or ‘arrangement’ of a scheme used for automatic enrolment – so that, broadly, members who did not choose their arrangement should be protected by the cap. This instrument provides that the cap will continue to apply when members are moved without consent to a different scheme not used for automatic enrolment. In addition, it modifies the application of existing regulations so that members who originally did make an investment choice and are moved without consent will not be placed into a default arrangement, if that original choice was made in the previous 5 years.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is Great Britain.
- 5.2 The territorial application of this instrument is Great Britain.
- 5.3 Northern Ireland will make separate parallel provisions.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

- 7.1 Regulation 12 of the Preservation Regulations sets out the conditions to be satisfied in order to transfer members without consent. This instrument redefines the conditions permitting transfers without consent for members of Defined Contribution (DC) occupational schemes which do not include underlying guarantees.

⁵ Formal certification signed by an actuary and stating that the benefits in the receiving scheme have been assessed as being ‘broadly no less favourable’ than those in the ceding scheme

⁶ This relates to a number of tests defining how ceding and receiving schemes, or the sponsoring employers of the ceding and receiving schemes should be linked, as described in paragraph 12(2) of the <http://www.legislation.gov.uk/ukxi/1991/167/regulation/12>

⁷ Described in 7.11 of this Explanatory Memorandum

⁸ Defined in s1 of the Pension Schemes Act 2017 as an occupational pension scheme which provides money purchase benefits, is used by two or more employers, is not used solely by employers connected with each other, and is not a relevant public service pension scheme.

⁹ <http://www.legislation.gov.uk/ukpga/2017/17/contents>

¹⁰ <http://www.legislation.gov.uk/ukxi/2015/879/contents>

- 7.2 The latest data published by The Pensions Regulator¹¹ shows that there are currently 2,180 Defined Contribution (DC) occupational schemes (including hybrid schemes offering both DC and Defined Benefit (DB) pensions) with 12 or more members¹². More than 80% of these are schemes with fewer than 1000 members. These schemes often represent poor value for money for their members. The Pensions Regulator's recent DC Schemes Research found that 55-75% of such schemes report having weak governance¹³. Other studies have indicated that smaller schemes pay significantly more in charges¹⁴, are much less able to negotiate effectively with service providers to deliver good member outcomes¹⁵, and are less able to invest in certain asset classes¹⁶.
- 7.3 The current process for scheme consolidation is very burdensome. Schemes can seek consent to consolidate from every individual member – but this is time-consuming and difficult, with low response rates, even after concerted efforts. A ‘without consent’ approach is available, but the tests to be met are either difficult to apply or serve no useful purpose when used for many Defined Contribution schemes, having originally been designed for use with Defined Benefit schemes.
- 7.4 The instrument provides for an alternative process for the bulk transfer of pension scheme members’ money purchase benefits where they do not have any underlying guarantees. In broad terms, a money purchase benefit is a ‘cash pot’ which is attributable to the member. Typical guarantees include those about the rate of growth of the pot or the rate at which the final pot can be converted into a retirement income.
- 7.5 Non-money purchase benefits and money purchase benefits with guarantees will continue to be subject to the two current requirements for bulk transfers without member consent – an actuarial certificate and meeting the ‘scheme relationship condition’. In contrast to money purchase benefits without guarantees, evaluating these benefits is actuarial work, and ensuring that the guarantees or promises are paid may require the long-term support of a sponsoring employer. It is for this reason that it would not be appropriate to make the new alternative process for bulk transfers available for members of these sorts of schemes.
- 7.6 Trustees of all pension schemes have a fiduciary duty of undivided loyalty to act in the best interests of their beneficiaries, usually known as members, and this fiduciary duty will continue to be the underpinning principle when considering a transfer of members without their consent.
- 7.7 In addition to this continuing fiduciary duty, we have introduced three alternative routes by which money purchase benefits without guarantees or promises may be transferred without consent.

¹¹ The Pensions Regulator. DC trust: presentation of scheme return data 2017-18, published January 2018 - <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>

¹² Most schemes with 11 or fewer members are Small Self-Administered Schemes or Executive Pension Schemes, where the members are the trustees or the directors of a corporate trustee. This means that these schemes do not have the same difficulty getting member consent for a transfer.

¹³ The Pensions Regulator. DC trust-based pension schemes research, published September 2017 - <http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx>

¹⁴ Pension charges survey 2016: charges in defined contribution pension schemes, published October 2017 - <https://www.gov.uk/government/publications/pension-charges-survey-2016-charges-in-defined-contribution-pension-schemes> .

¹⁵ Financial Conduct Authority. Asset Management Market Study: final report, published June 2017 - <https://www.fca.org.uk/publications/market-studies/asset-management-market-study>

¹⁶ The Law Commission. Pension Funds and Social Investment, published June 2017 - <https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/>

- 7.8 The first, default, route requires trustees to obtain and consider the advice of an appropriate adviser¹⁷, within a year of the transfer taking place. The trustees should satisfy themselves that the adviser, who may be an individual or a firm, is independent from the receiving scheme. They do this by determining whether, in a period prior to the transfer, the adviser or a related firm has received payment for advice, administration or investment services from the receiving scheme, a service provider or an undertaking connected with a service provider to the scheme, or the receiving scheme's principal employer or controlling employer, or from an undertaking which is connected with that employer.
- 7.9 Following consultation, we have amended the independence requirements to narrow down the scope of services provided for which payment was received. We have also reduced the period of time under consideration to a year prior to the transfer, and slightly amended the types of relationship in question. We have introduced the adviser safeguard to ensure that the decision to transfer is not influenced by any conflict of interests and are satisfied that the right balance is struck between protecting schemes from inappropriate influence and allowing normal business practice to continue.
- 7.10 Under the second route, where the transfer is to a scheme authorised under the Pensions Scheme Act 2017, we do not require the trustees to seek independent advice. This is because the regulatory framework which covers authorised schemes gives trustees the reassurance that the scheme meets certain standards of governance and administration. This does not, however, replace the trustees' exercise of their fiduciary duty to act in members' best interests.
- 7.11 Following consultation, we have also introduced a third route, for bulk transfers between 'connected' schemes – these typically result from corporate restructurings. Where the sponsoring employers are connected through a common ownership structure and have a controlling position in their respective schemes – for example, where two firms merge and wish to consolidate their pension schemes – we believe the risk of conflicts of interest between advisers is minimal. We have therefore removed the requirement to seek independent advice in relation to transfers of current and former employees of the connected firms.
- 7.12 The instrument also removes the option of using the existing process (involving the actuarial certificate and scheme relationship condition) for transfers of money purchase benefits without guarantees. Retaining the option to use the current system may encourage some trustees to bear the increased burdens and delays involved, in the belief that it is more robust, despite the fact that the process is not appropriate for their type of scheme. This option will be turned off from October 2019, so that schemes have a full 18 months to complete any transfers which are underway.
- 7.13 Finally, the instrument extends the protection offered by the cap on pension scheme charges. This already applies to so-called 'double defaulters' - members of a pension scheme automatically enrolled by their employer into a pension scheme, and who do not make a choice of fund or arrangement to which they will contribute. With the coming into force of this instrument, where such a member is moved without consent

¹⁷ In these regulations, we define an 'appropriate adviser' as one who is a person whom the trustees reasonably believe to be qualified by reason of that person's ability in, and practical experience and knowledge of, pension scheme management

to another scheme, or subsequently to another arrangement, the charge cap will continue to apply, as the member will still not have made a choice.

- 7.14 Following consultation, we have also clarified the application of the cap to members who originally did make an investment choice but are moved to another arrangement within a scheme or in a separate scheme. Where the member made an active choice of fund in the past 5 years and is moved without consent, they will not be forced into a default arrangement. Guidance will make clear that trustees should make all reasonable efforts to contact members prior to the transfer to notify them of their plans and their options. Where members do not respond, trustees will be allowed to move the member into a fund which better reflects the member's original choice of investment.

8. Consultation outcome

- 8.1 A call for evidence was held between December 2015 and February 2016 on the desirability of amending the conditions for carrying out bulk transfers without consent for members of Defined Contribution pension schemes¹⁸. We received 45 responses which were overwhelmingly in favour of simplifying the process. A policy proposal was developed based on analysis of the responses.
- 8.2 The policy proposal and accompanying regulations were put to public consultation, held between October 2017 and November 2017 for five weeks¹⁹. The consultation was supported by meetings with stakeholders and smaller groups of industry and legal experts to examine the detailed proposals, the drafting, and financial impact of the proposed changes.
- 8.3 We received 35 responses to the consultation, from a range of stakeholders in the pensions industry including actuarial firms, legal professionals, pension scheme trustees, employer representatives, investment consultancy firms and advisers to pension schemes.
- 8.4 We consulted on the proposal that for transfers to authorised master trusts, trustees could rely on fiduciary duty alone to make the decision to transfer, but for transfers to any other type of scheme, trustees should seek the advice of a person who is independent of the receiving scheme, and so can offer advice on a non-conflicted basis. We also consulted on the additional requirement that any member protected by the automatic enrolment charge cap should continue to be protected in the receiving scheme, and that protection should remain if they were subsequently moved again. Consultation respondents were very supportive of the proposals overall, but suggested a number of specific changes.
- 8.5 The following paragraphs detail the changes to our original proposals suggested by respondents to the consultation, which we accept and have incorporated into this instrument.
- 8.6 Many respondents believed that the proposed conditions against which advisers could be judged independent were too stringent given the relatively consolidated nature of the advisory industry, and frequent adviser moves between companies. These

¹⁸ <https://www.gov.uk/government/consultations/bulk-transfers-of-defined-contribution-pensions-without-member-consent>

¹⁹ <https://www.gov.uk/government/consultations/bulk-transfers-of-defined-contribution-pensions-without-member-consent-draft-regulations>

requirements have been recast to reflect the operating environment while continuing to protect members from risk.

- 8.7 A few respondents highlighted that bulk transfers also take place between schemes whose sponsoring employers are connected through a common ownership structure and have a controlling position in their own schemes – for example, where two firms merge and wish to consolidate their pension schemes. A third route for bulk transfers without consent has been introduced for this scenario.
- 8.8 Several respondents suggested that the current complex process including the actuarial certificates and the scheme relationship test should no longer be available for transfers between DC schemes without guarantees. We have decided to remove this option for transfers which fall in scope of the new regulations, after a transitional period.
- 8.9 Most respondents were supportive of our original proposals for cap protection continuing when members protected by the cap were transferred without consent to another scheme. Some respondents expressed concern about the treatment within legislation of self-selectors – members who previously made an active choice to contribute to a particular investment arrangement, which was uncapped. As described in paragraph 7.14, we have adjusted the approach for members who made an active choice of funds in the last 5 years.
- 8.10 We have also made several minor technical changes in response to consultee feedback.

9. Guidance

- 9.1 These regulations are complete in themselves and do not refer to any statutory guidance. In response to consultation, however, we will work with both stakeholders and the Regulator to produce high-level non-statutory guidance for pension scheme trustees to support these regulations, and ensure that trustees are aware of factors they can and should be taking into account when they consider whether a transfer is in members' best interests, and how they communicate the transfer to members.

10. Impact

- 10.1 The impact on business, charities or voluntary bodies will mainly be felt by trustees of pension schemes, investment consultancies, and to a lesser extent, the actuarial profession. Pension scheme trustees will need to familiarise themselves with the revised conditions for transfer, at the point they are considering a move of scheme members.
- 10.2 The estimated cost to business in the first year is £0.001m, and the estimated saving to business in all subsequent years is £0.62m. The estimated Equivalised Annual Net Direct Cost to Businesses (EANDCB) is -£0.5m per year.
- 10.3 There is some uncertainty around these figures as we have limited evidence to inform some of our assumptions. The assumptions that are likely to have the greatest impact on the cost/savings of the appraisal are the total number of bulk transfer per year and the costs of an actuarial certificate and of an appropriate adviser. However, our assessment of the best current evidence suggests that measures will be deregulatory with a small saving to industry each year.
- 10.4 Indirectly, the impact of this instrument may be felt by investment consultancies, as they may see a small increase in business resulting from being the industry most

likely to be consulted by trustees on the suitability of a receiving scheme. An additional indirect impact may be felt by the actuarial profession as they may see a slight decrease in work resulting from the removal of the requirement to produce certificates in this type of transfer.

- 10.5 The impact on the public sector is low, as this amendment is aimed at the pension industry. Within the public sector, the only money purchase arrangements which exist are AVCs²⁰, most of which are personal pensions, and those AVCs which are occupational pensions also contain valuable guarantees, so are out of scope of this instrument.
- 10.6 An Impact Assessment is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 11.3 The impact on small businesses is anticipated to be deregulatory. These regulations are wholly permissive and allow trustees and managers of smaller money purchase occupational schemes without guarantees or promises (which tend to be sponsored by smaller employers) to transfer members and consolidate if they wish to do so more easily. Smaller employers who sponsor smaller schemes will therefore find it easier to stop running them under this proposed amendment.

12. Monitoring & review

- 12.1 The operation of these regulations will be monitored on an on-going basis by means of representation and feedback from the pensions community, including trustees of pension schemes, employers, investment consultants, and pension providers, as well as The Pensions Regulator.
- 12.2 As this measure is deregulatory, no exceptions exist which make it necessary to include a review clause, and it is expected to have an annualised net impact on business of less than +/- £5 million. A statutory review clause is considered to be disproportionate for this instrument.

13. Contact

- 13.1 Liz Roebuck at the Department for Work and Pensions Telephone: 0113 232 7203 or email: liz.roebuck@dwpgsi.gov.uk can answer any queries regarding the instrument.

²⁰ A money purchase AVC is an arrangement for making additional contributions to build up a separate retirement fund.