

EXPLANATORY MEMORANDUM TO
THE PENSION PROTECTION FUND (PENSIONABLE SERVICE) AND
OCCUPATIONAL PENSION SCHEMES (INVESTMENT AND DISCLOSURE)
(AMENDMENT AND MODIFICATION) REGULATIONS 2018

2018 No. 988

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument makes amendments to regulations governing compensation from the Pension Protection Fund (PPF), and also to the investment principles and disclosure requirements for occupational pension schemes.

2.2 The amendments have two main purposes:

- to ensure that a relevant fixed pension¹ that was derived from service in another scheme is treated as attributable pensionable service for the purpose of calculating PPF compensation (except for the purposes of applying a single compensation cap). This will ensure that the PPF have the legal basis to pay survivor benefits and to index and revalue payments, and;
- they amend the requirements on occupational pension scheme trustees, concerning the statement of investment principles (SIP) and the publication of other relevant information which will, amongst other purposes, assist in comparing costs and charges.

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 the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is Great Britain.

4.2 The territorial application of this instrument is Great Britain.

4.3 We anticipate Northern Ireland will be making separate, parallel provisions.

¹ A pension transfer in the form of a lump sum determined at the time the transfer payment was received and which is not attributable to a pension credit, or payable as a result of a person's death. In Regulation 2, the phrase 'initial annual amount' is used, which here is taken to mean the annual amount of the pension that was specified at the time the transfer was made. This is the starting rate and would have increased, in accordance with the scheme rules, had it come into payment in the transferring scheme.

5. European Convention on Human Rights

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

6. Legislative Context

6.1 This instrument makes amendments to four sets of regulations:

- The Pension Protection Fund (Compensation) Regulations 2005² (“the Compensation Regulations”);
- The Pension Protection Fund (Multi-employer Schemes) (Modification) Regulations 2005³;
- The Occupational Pension Schemes (Investment) Regulations 2005⁴ (“the Investment Regulations”); and
- The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013⁵ (“the Disclosure Regulations”).

The PPF compensation regime

6.2 The Pensions Act 2004 (“the 2004 Act”)⁶ established the PPF, Schedule 7⁷ of the 2004 Act sets out how the Board of the PPF should determine the compensation payable to individuals within the PPF, including provision for compensation to be subject to an overall cap in certain cases.

6.3 In the recent High Court case of *Anthony Beaton v The Board of the PPF*⁸, Mr Beaton successfully contested how the PPF compensation cap should apply to his compensation. Mr Beaton argued that, as his ‘relevant fixed pension’ was derived from a transfer into a predecessor scheme it should be treated separately from his pensionable service within his current scheme and, therefore, should be subject to its own cap. The Court agreed that a relevant fixed pension arising from the transfer payment was not “attributable pensionable service” under the relevant scheme and therefore could not be aggregated with a member’s main pension for the purposes of the cap.

6.4 The High Court judgment has led to the legislation being interpreted in a way that does not reflect PPF practice or the policy intent, in relation to schemes where a person is entitled or has rights to a relevant fixed pension. This instrument amends the Compensation Regulations to modify Schedule 7 to the 2004 Act in its application to such schemes in order to remedy certain consequences of the High Court judgment by ensuring that (except as set out below) the relevant fixed pension is treated as attributable to pensionable service.

6.5 The Court of Justice of the European Union (CJEU) handed down its judgment in the case of *Grenville Hampshire (C - 17/17)* (the Hampshire judgment) on 6 September⁹.

² SI 2005 No. 670; <http://www.legislation.gov.uk/ukxi/2005/670/made>

³ SI 2005 No. 441 <http://www.legislation.gov.uk/ukxi/2005/441/contents/made>

⁴ SI 2005 No. 3378 <http://www.legislation.gov.uk/ukxi/2005/3378/contents>

⁵ SI 2005 No. 2734 <http://www.legislation.gov.uk/ukxi/2013/2734/contents>

⁶ <http://www.legislation.gov.uk/ukpga/2004/35/contents>

⁷ <http://www.legislation.gov.uk/ukpga/2004/35/schedule/7>

⁸ *Anthony Beaton v The Board of the Pension Protection Fund* [2017] EWHC 2623 (Ch)

⁹ The CJEU judgment in Hampshire, <http://curia.europa.eu/juris/document/document.jsf?text=&docid=205405&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=737862>

In summary, the CJEU concluded that Article 8 of the Insolvency Directive 2008/94/EC requires that an individual's expected old-age pension benefits must be protected to a minimum level of 50% in the event of insolvency. In light of this judgement, these Regulations do not apply for the purposes of the restriction on the amount of compensation in paragraph 26 of Schedule 7 to the 2004 Act; a person's pensionable service and any relevant fixed pension will continue to be treated separately under two 'caps', in accordance with the High Court judgment.

Trustees' investment and disclosure duties

Investment policies

- 6.6 The Investment Regulations, amongst other things, require trustees to prepare a Statement of Investment Principles (SIP) which set out the scheme's investment strategy, including the approach to financially material factors.
- 6.7 The Law Commission has made recommendations in two separate reports^{10,11} to address concerns that the content of the SIP, prescribed by the Investment Regulations, was causing confusion for some trustees and discouraging them from fulfilling their fiduciary duty¹² appropriately. Regulation 4 of the instrument will make some important clarifications to the content of the SIP for occupational pension schemes¹³.

Disclosure

- 6.8 Section 113 of the Pensions Schemes Act 1993 ("the 1993 Act") authorises the Secretary of State to make regulations requiring the disclosure of information to keep specified categories of individuals informed about scheme administration and finances, and requiring the publication of relevant information to assist in making comparison of scheme costs and charges.
- 6.9 The permitted methods of communication to those relevant persons are set out in Part 9 of the Disclosure Regulations (giving information and documents), principally regulations 26, 29 and 29A. Regulation 5 of this instrument provides that trustees of occupational pension schemes disclose on request the SIP and a statement on how the policies in the SIP have been implemented. Where information is provided under regulation 26, it is provided to an individual, or category of individuals, rather than to the public in general. There is nothing to prevent schemes from requiring the payment of a charge to provide the required information or from restricting access by requiring a user name or password,
- 6.10 The provisions of regulation 29A, unlike the provisions of regulation 26, require relevant schemes to make certain information available to the world at large, as opposed to specified individuals or categories of individuals. To facilitate transparency, the policy is that access is free of charge for all those who wish to view the information. Regulation 5 of this instrument also amends regulation 29A of the

¹⁰ Fiduciary Duties of Investment Intermediaries, <https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/>

¹¹ Pension Funds and Social Investment, <https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/>

¹² The requirement to act in the best interest of another i.e. their members.

¹³ "occupational pension scheme" is defined in the 1993 Act. In broad terms it is a trust-based scheme established by an employer, the trustees of which have a fiduciary duty to their members.

Disclosure Regulations to require relevant schemes¹⁴ with 100 or more members to publish the statement of investment principles and the implementation statement on a website. This ensures that relevant scheme trustees provide the SIP and implementation statement to the public at large for free. In so doing, it enables greater public comparison. Broadly, the publication requirement covers most occupational pension schemes with at least 100 members offering money purchase benefits¹⁵.

- 6.11 Section 113(2A) of the 1993 Act provides that, in complying with the regulations made under that section, a person may be required to have regard to any guidance that is prepared from time to time by the Secretary of State.

7. Policy background

What is being done and why

The PPF compensation regime

- 7.1 The PPF provides compensation to members of defined benefit occupational pension schemes where the sponsoring employer becomes insolvent and the scheme's assets are insufficient to provide all the scheme members with benefits at least equivalent to the amount of compensation that would be paid by the PPF.
- 7.2 When a person joins a new defined benefit pension scheme, they can opt to transfer their accrued benefits in their previous scheme to the new scheme. Typically this is done by converting the accrued benefits into additional years in the new scheme. Alternatively some individuals may be entitled to convert their accrued benefits from the previous scheme into a 'fixed pension' amount, termed a 'relevant fixed pension' and accrue pensionable service separately in the new scheme.
- 7.3 In the event of an insolvency the Government's policy intention is that a person's relevant fixed pension and any other pensionable service within the new scheme should be added together for the purposes of determining their PPF compensation payment, and applying the cap, where relevant.
- 7.4 However, the practical effect of the Beaton High Court judgment is that individuals with a relevant fixed pension will receive a higher rate of PPF compensation, as they will benefit from two caps- one for their relevant fixed pension benefits and another for any remaining pension benefits. The judgment also has wider negative implications beyond the application of the compensation cap, which would result in some individuals seeing their PPF compensation payments being reduced or stopped altogether. This is because the fixed pension cannot be treated as pensionable service for the purposes of working out the PPF compensation. This affects some vulnerable groups such as widows, widowers and eligible dependent children in receipt of survivor benefits derived wholly or in part from a relevant fixed pension.
- 7.5 To ensure that the PPF can continue to administer the compensation regime as intended, Regulation 2(3) inserts a new Regulation 30 into the Compensation

¹⁴ "relevant schemes" as defined in the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

¹⁵ "money purchase benefits" are defined in sections 181 and 181B of the Pension Schemes Act 1993. Broadly speaking they are benefits where the member's pension is solely based on their contribution and investment return, less costs and charges.

Regulations. This will ensure that in respect of relevant fixed pensions, PPF have the legal basis to:

- pay survivor benefits;
- revalue PPF compensation not yet in payment;
- apply inflationary increases to compensation payments; and;
- include a relevant fixed pension in the application of the 90 per cent level of compensation (subject to the cap) for those already receiving their pension and who were below normal pensionable age (NPA) at the assessment date.

- 7.6 Following the Hampshire CJEU judgment delivered on 6 September, the Government has provided for an exception to new Regulation 30(5) so that the Regulations do not aggregate benefits for the purpose of restricting the amount of compensation (the cap) paid to deferred and active members below NPA at the assessment date. The practical effect of this is that a person's relevant fixed pension will be treated separately from their pensionable service within the scheme, and therefore will be subject to two separate caps. These individuals will receive more PPF compensation than someone whose pension benefits were made up entirely of actual pensionable service. This is not the Government's intention and we had intended to remedy this anomaly as part of this instrument. However, there is a risk that proceeding with this change may result in individuals inadvertently receiving less than 50% of their expected pension benefits within the PPF, which would run counter to the Hampshire judgment. Given the urgent need to protect compensation payments to vulnerable individuals, the Government has decided to proceed to promptly modify the Compensation Regulations to ensure that the PPF have the legal basis to continue making compensation payments to these groups.
- 7.7 Once the Government has carefully considered the CJEU judgment in the Hampshire case, we will seek to fully remedy the negative effects of the Beaton judgment, to ensure that the PPF compensation regime operates in the way intended whilst meeting the requirements of the Insolvency Directive, as interpreted by the CJEU in the Hampshire case.
- 7.8 The PPF provisions are due to come into force on the 2 October 2018. While this will allow 21 calendar days for scrutiny, due to autumn recess timings this is less than would typically be provided for a negative instrument. In light of the urgent need to protect compensation payments to vulnerable individuals, it was decided that it would not be appropriate to delay their coming into force.

Trustees' investment and disclosure duties

Investment policies

- 7.9 The purpose of the Statement of Investment Principles (SIP) is to require trustees to set out, in writing, their strategic approach to investment. It does not determine trustees' investment duties. However, the existing requirements of the SIP are not clearly aligned with trustees' fiduciary duty. This has discouraged some trustees from considering risks and opportunities that may be financially material over the long term, and from acting as engaged asset owners, even where they have a duty to do so.
- 7.10 As pension schemes are often invested for many decades, it is appropriate that trustees should consider the long-term sustainability of investments and take responsibility for looking after their investments through the exercise of voting rights and other engagement activities (known collectively as stewardship). The types of engagement

activities that trustees or their asset managers may consider include meeting with or writing to the firms in which they invest – either one-to-one or collectively alongside shareholders – to influence decisions. The existing requirements of the SIP have given trustees the impression these things are optional, which they are not.

- 7.11 The Law Commission has twice recommended that the requirements of the SIP be updated to reflect more accurately the investment duties that trustees have. Updated guidance from the Pensions Regulator^{16, 17} has not been sufficient to correct current practice by trustees. Similar recommendations have been made by the Parliamentary Environmental Audit Committee¹⁸ and the Green Finance Taskforce¹⁹.
- 7.12 These amendments are not intended to encourage or support boycotts or divestment campaigns. When it comes to taking account of members’ views trustees are only permitted to do this when there is a broad consensus. Where an investment issue is contested, as divestment from fossil fuels or from some regimes will generally be, the trustees should focus exclusively on financially material risks and opportunities, rather than seek to weigh up the relative strengths of views.
- 7.13 Regulation 4 of this instrument:
- amends the requirements of the SIP so that by 1 October 2019 schemes must include in the SIP their policy in relation to:
 - financially material considerations such as environmental, social and governance considerations, including climate change;
 - the extent (if at all) to which members’ views are taken into consideration; and
 - the stewardship of investments.
 - amends the requirements in relation to the default arrangement²⁰ so that by 1 October 2019 schemes must set out their policy in relation to:
 - financially material considerations such as environmental, social and governance considerations, including climate change; and
 - the stewardship of investments, where the scheme has at least 100 members.

Disclosure

- 7.14 The overall effectiveness of SIPs have been questioned by a wide range of stakeholders, with reports that SIPs often contain generic text and do not vary between schemes that share the same investment advisers. Trustees relying on standardised SIPs risk investment decisions that may be inappropriate for their members. For schemes offering money purchase benefits (broadly, relevant

¹⁶ Managing DC benefits: Investment Governance – July 2016 -

<http://www.thepensionsregulator.gov.uk/trustees/investment-management-in-your-dc-scheme.aspx>

¹⁷ DB Investment: Investing to fund DB – March 2017 - <http://www.thepensionsregulator.gov.uk/guidance/db-investment-two-strategy.aspx>

¹⁸ Greening finance, recommendation in paras 34 and 35,

https://publications.parliament.uk/pa/cm201719/cmselect/cmenvaud/1063/106305.htm#_idTextAnchor009

¹⁹ Accelerating green finance, recommendations 16, 17 and 19, pages 53-55,

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/703816/green-finance-taskforce-accelerating-green-finance-report.pdf

²⁰ “default arrangement” is defined by Regulation 2A of the Investment Regulations and broadly describes a fund or group of funds to which the member has contributed without making an active choice.

schemes²¹), it is the members who bear the risk of poor investment practices. For these types of schemes, improved practices are likely to follow if members and trustees have access to other schemes' SIPs. By reviewing examples of robust, well-tailored SIPs and statements about how those SIPs have been implemented, members and other interested parties will be able to compare schemes and trustees will be able to embed best practice in developing their own policies, and improve overall investment governance.

- 7.15 Regulation 5 of this instrument therefore extends the requirements for trustees of relevant schemes so that:
- by 1 October 2019, they must publish their SIP online and include a link to this information in the members' annual benefit statement;
 - from 1 October 2020, when they produce their annual report, they will be required to:
 - prepare a statement setting out how they have implemented the policies in the SIP, explaining and giving reasons for any change made;
 - include this implementation statement in the annual report and a link to it in the annual benefit statement sent to members.
- 7.16 Regulation 5 also updates the requirements of the annual statement, for all schemes required to produce a SIP, to reflect the amended drafting for polices on financially material considerations, non-financial matters and stewardship.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

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

9. Consolidation

- 9.1 Informal consolidated text of instruments is available to the public free of charge online at www.legislation.gov.uk.

10. Consultation outcome

The PPF compensation regime

- 10.1 The Government publicly consulted on draft regulations between 3 July and 24 July 2018 and received a total of nine responses from trade bodies, pension professionals and one member of the public.
- 10.2 Seven respondents commented on the regulations and six agreed that the Regulations as drafted would operate as intended. The seventh respondent was unsure the drafted Regulations would completely achieve the policy intent because they would only remedy the situation prospectively i.e. from the date that the Regulations come into force.
- 10.3 Four respondents highlighted some potential operational issues resulting from the draft regulations, including how the PPF would take relevant fixed pensions into account when determining if a person were eligible for the long service cap, and how

²¹ "relevant schemes" is defined by the Occupational Pension Schemes (Scheme Administration) Regulations 1996 and covers most occupational pension schemes offering money purchase benefits.

they would apply revaluation and indexation. The Government considers that PPF's current practices on these matters are sufficient and no further changes are required to the Compensation Regulations. One respondent suggested we amend the PPF (Multi-employer Schemes) (Modification) Regulations 2005 so that these Regulations also use the definition of pensionable service within the Pensions Act 2004. After careful consideration, we have decided to incorporate this change into this instrument (Regulation 3).

- 10.4 Following the Hampshire judgment delivered on 6 September, the Government has provided for an exception to new Regulation 30(5) so that the Regulations do not aggregate benefits for the purpose of restricting the amount of compensation (the cap) paid to deferred and active members below NPA at the assessment date. The practical effect of this is that a person's relevant fixed pension will be treated separately from their pensionable service within the scheme and therefore will be subject to two separate caps. This is to ensure that these Regulations do not result in individuals inadvertently receiving less than 50% of their expected pension benefits within the PPF, which would run counter to the Hampshire judgment.
- 10.5 The exception to new Regulation 30(5) (and the associated new Regulation 30(4)) have been inserted as a result of the recent Hampshire judgment and therefore did not form part of the July public consultation. The Secretary of State considers in this case that, by reason of urgency, it would be inexpedient to run a further public consultation on the amended regulations. This is in light of the significant negative impacts for affected PPF members, who would see their PPF compensation reduced, and in some cases stopped altogether, if this instrument was delayed.
- 10.6 The Government's response to the public consultation can be found at: <https://www.gov.uk/government/consultations/changes-to-the-pension-protection-fund-ppf-compensation-regulations>

Trustees' investment and disclosure duties

- 10.7 The Government publicly consulted on the policy proposals between 18 June and 16 July 2018. The four-week consultation period was considered appropriate because considerable engagement was carried out in the development of the proposals and the recommendations of the most recent Law Commission report had been publicly available for a full year. The consultation, which also covered changes to the statutory guidance referred to in section 11, was supported by meetings with approximately 30 pensions and investment industry experts. The consultation received 89 responses from trustees, consultants, investment managers, law firms, actuaries, campaign groups and trade bodies and associations.
- 10.8 DWP also carried out a survey by way of an online questionnaire aimed at individual members to help understand their experiences of finding out how their pension scheme was invested. The Department received 3432 responses from individuals.
- 10.9 The majority of investment and disclosure proposals received support from at least 60% of respondents. Some respondents made technical drafting suggestions. Changes were made to the final regulations as a result.
- 10.10 The proposal in relation to how trustees will consider members' views caused most concern. The consultation proposed that all schemes would have to set out how they incorporate members' views in the development of investment policies. Whilst many supported the principles of member engagement the proposed drafting was widely

misunderstood as requiring trustees to survey members or even defer to members for investment decision making. Even those who had not inferred this were concerned that trustees would do so. Several respondents suggested revised drafting which could more clearly represent the policy intent. Changes were made to the regulations, incorporating this feedback, to include instead an optional policy on how members' views will be considered.

- 10.11 One response highlighted that, as originally drafted, the requirement to have a policy on the stewardship of investments would not apply to all default arrangements. This is a concern because over 90% of members are in the default arrangement. Therefore, the regulations were redrafted to extend the stewardship requirement to cover the default arrangement of relevant schemes²² with at least 100 members.
- 10.12 The Government's detailed response to the consultation can be found at: <https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties>

11. Guidance

- 11.1 The Disclosure Regulations require the trustees and managers of relevant schemes to have regard to guidance to comply with transaction costs and charges' reporting²³. This guidance has been updated to inform trustees and managers of relevant schemes about how to satisfy the amended publication requirements.
- 11.2 The PPF will publish guidance on its website and amend its member notifications as appropriate.

12. Impact

- 12.1 The impact of the amendments to the Investment and the Disclosure Regulations on business, charities or voluntary bodies will apply to trustees and managers of occupational pension schemes. The impact of these changes is estimated to be £21.77m in the first year and £1.06m in subsequent years. The estimated annual net direct cost to business (EANDCB) over the policy period is £3.5m.
- 12.2 An Impact Assessment for the amendments to the Investment and the Disclosure Regulations is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website.
- 12.3 There is no significant impact on the public sector, apart from as a result of the changes made in new Regulation 30(5) on the PPF itself. They will be required to take the steps necessary to implement the changes in the PPF compensation rules for capped members.

13. Regulating small business

- 13.1 The Investment and the Disclosure amendments apply to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

²² "relevant schemes" as defined in the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

²³ Statutory guidance: Reporting of costs, charges and other information: guidance for trustees and managers of relevant occupational schemes. <https://www.gov.uk/government/publications/reporting-costs-charges-and-other-information-guidance-for-trustees-and-managers-of-occupational-pension-schemes>

13.3 We do not anticipate any negative effects on small and micro-businesses. These requirements apply to the PPF and to pension schemes, not employers. Most small businesses do not administer their own pension scheme and instead use an external provider to meet their duty to provide a pension scheme to eligible employees.

14. Monitoring & review

14.1 Guy Opperman MP, Parliamentary Under Secretary of State for Department for Work and Pensions, has made the following statement under section 28(2)(b) of the Small Business, Enterprise and Employment Act 2015²⁴.

14.2 “Having had regard to the Statutory Review Guidance for Departments²⁵ published under section 31(3) of the Small Business, Enterprise and Employment Act 2015, in my view, it is not appropriate to make provision for review in the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018.

14.3 The annualised net impact on business is less than +/- £5 million, therefore a statutory review clause is considered inappropriate and disproportionate for this instrument.”

14.4 The operation of these Regulations will be monitored on an on-going basis by means of representation and feedback from the pensions community. In addition, suitable and proportionate arrangements for monitoring the changes will be agreed with the PPF and The Pensions Regulator.

14.5 In relation to the Investment and Disclosure amendments, it will be made easier for Regulators, Government and others to monitor quality of due to the requirement on relevant schemes to publish a range of information.

15. Contact

15.1 Rosemary Tolhurst or David Farrar at the Department for Work and Pensions can answer queries regarding the instrument. Regarding the PPF provisions - Telephone: 0207 449 5961 or email: Rosemary.Tolhurst@dwpgsi.gov.uk. Regarding the Investment and Disclosure provisions - Telephone: 0207 7449 7610 or email: David.Farrar@dwpgsi.gov.uk.

15.2 Ronan O’Connor, Senior Civil Servant at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.3 Guy Opperman MP, Minister for Pensions and Financial Inclusion at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

²⁴<http://www.legislation.gov.uk/ukpga/2015/26/section/28>

²⁵https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/674755/small-business-act-s31-statutory-review-requirements.pdf