

## EXPLANATORY MEMORANDUM TO

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

2021 No. [XXXX]

#### 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 places new administration and governance requirements on trustees of occupational defined contribution (DC) pension schemes, in particular to require trustees of certain DC pension schemes to disclose their investment returns and demonstrate that they are providing value for their members. It also increases flexibility for DC schemes to take account of performance fees payable to fund managers when calculating the cap on charges that applies to default investment arrangements. Finally, it makes other minor technical changes, including to the ways in which specific types of pension schemes must comply with the requirements to produce a statement of investment principles.

#### 3. Matters of special interest to Parliament

*Matters of special interest to the [Joint Committee on Statutory Instruments]*

- 3.1 None.

*Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)*

- 3.2 The territorial application of this instrument includes Scotland.

#### 4. Extent and Territorial Application

- 4.1 The extent of this instrument is Great Britain.
- 4.2 The territorial application of this instrument is Great Britain.
- 4.3 The Department for Communities in Northern Ireland will be producing its own legislation replicating this instrument for Northern Ireland.

#### 5. European Convention on Human Rights

- 5.1 Guy Opperman MP, Minister for Pensions and Financial Inclusion, has made the following statement regarding Human Rights:

“In my view the provisions of The Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 are compatible with the Convention rights.”

## 6. Legislative Context

6.1 This instrument amends existing secondary legislation relating to the administration and governance of occupational pension schemes as follows:

- The Occupational Pension Schemes (Scheme Administration) Regulations 1996 (S.I. 1996/1715)<sup>1</sup> (“the Administration Regulations”) are amended to require trustees or managers of “relevant schemes”, a term which covers most occupational DC pension schemes, to include additional information in the annual statement regarding governance which they are required to produce under regulation 23 of the Administration Regulations<sup>2</sup>. A further amendment is made in relation to trustees or managers of “relevant schemes” with total assets of less than £100 million, which have been operating for at least three years, which will require them to assess and report on the value which their schemes provide for their members.
- The Register of Occupational and Personal Pension Schemes Regulations 2005 (S.I. 2005/597)<sup>3</sup> (the “Register Regulations”) are amended, to add to the list of “registrable information” which pension schemes must provide to the Pensions Regulator, in their annual scheme return.
- The Occupational Pension Schemes (Investment) Regulations 2005 (S.I. 2005/3378<sup>4</sup>) (“the Investment Regulations”) impose requirements on trustees of occupational pension schemes in relation to the statement of investment principles (SIP) required under section 35 of the Pensions Act 1995<sup>5</sup>. They are amended to clarify the SIP requirements for default investment funds, i.e. those into which members are placed without choice by the scheme, and for wholly-insured pension schemes, i.e. schemes that have no investment other than specified qualifying insurance policies.
- The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (S.I. 2013/2734)<sup>6</sup> (“the Disclosure Regulations”), which set out information that must be published by most occupational pension schemes on a publicly available website, are amended to reflect changes made to the Administration Regulations and to the Investment Regulations by this instrument.
- The Occupational Pension Schemes (Charges and Governance) Regulations 2015 (S.I. 2015/879)<sup>7</sup> (“the Charges and Governance Regulations”) impose obligations on trustees and managers of certain occupational pension schemes in relation to charges imposed by and governance of those schemes. In particular, they impose a limit on the charges that can be applied to default investment funds often referred to as the “charge cap”. The charge cap is a limit on member charges, set at 0.75% of the funds under management each year, or an equivalent combination charge, that applies to all default arrangements. Default arrangements are funds which a pension scheme member is automatically placed in, not one they have expressly selected. This

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<sup>1</sup> <https://www.legislation.gov.uk/uksi/1996/1715/contents>

<sup>2</sup> <https://www.legislation.gov.uk/uksi/1996/1715/regulation/23>

<sup>3</sup> <https://www.legislation.gov.uk/uksi/2005/597/contents/made>

<sup>4</sup> <https://www.legislation.gov.uk/uksi/2005/3378/contents/made>

<sup>5</sup> <https://www.legislation.gov.uk/ukpga/1995/26/section/35/enacted>

<sup>6</sup> <https://www.legislation.gov.uk/uksi/2013/2734/contents/made>

<sup>7</sup> <https://www.legislation.gov.uk/uksi/2015/879/contents/made>

instrument makes an amendment to the definition of “charges” and makes changes to the way that performance fees may be taken into account when assessing whether or not a scheme complies with the charge cap.

## 7. Policy background

### *What is being done and why?*

#### Improving outcomes for members of DC pension schemes

- 7.1 The Government wishes to ensure that all occupational DC pension scheme members benefit from efficient and operationally resilient administration, first class investment governance, and access to innovative and diversified investment strategies.
- 7.2 The Law Commission’s review of Pension Funds and Social Investment in June 2017<sup>8</sup> made a number of recommendations for further reform of DC schemes. One such recommendation was that Government should consider whether trustees of DC schemes should be required to regularly determine whether their members are disadvantaged in comparison to members of other schemes due to insufficient members or pooled assets.
- 7.3 Research undertaken by the Pensions Regulator (TPR)<sup>9</sup> in 2019 established that around 70% of micro (2 to 11 members) and 60% of small (12 to 99 members) schemes failed to meet any of TPR’s Key Governance Requirements, for example, good communication, efficient record keeping and investment strategies that could achieve increased returns.
- 7.4 The Government is therefore acting to ensure members do not languish in sub-optimal arrangements that do not meet governance requirements and are unable to take full use of investment opportunities, to the benefit of the end saver’s eventual retirement outcome.

#### Net investment (performance) returns, costs and charges and value for members assessment

- 7.5 Regulation 2 of the instrument amends the Administration Regulations to require trustees and managers of relevant DC schemes to state the return on investments and the levels of charges and transaction costs applicable to each fund in their annual statement regarding governance, which trustees and managers are required to prepare under regulation 23 of the Administration Regulations. The Government believes that members of occupational DC schemes should have access to information about the costs and charges they are paying to their pension scheme provider, and the level of investment returns they are receiving.
- 7.6 Regulation 2 also introduces a new “value for members” assessment for trustees and managers of relevant DC schemes holding assets worth less than £100 million and which have been operating for three or more years (“specified schemes”). They are required to compare the charges and transaction costs and the return on investments of their scheme with 3 other schemes. The regulations require these are either schemes with assets worth £100 million or more, or personal pension schemes. Specified schemes are also required to self-assess the extent to which their schemes satisfy

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<sup>8</sup> Pension Funds and Social Investment’, <https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/>

<sup>9</sup> DC Schemes Survey 2019 <https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-research-summary-report-2019.ashx>

certain administration and governance criteria. The results of this new value for members assessment must also be included in the annual statement regarding governance.

- 7.7 The Government believes that where small occupational DC schemes cannot demonstrate good value to members they should look to wind up and consolidate their members into larger better performing DC schemes that can spread the costs of improved governance across a broader base of assets, and that carry the potential to broaden the range of investments that can offer better returns to members.
- 7.8 At Regulation 3 we introduce amendments to the Register Regulations which require trustees of specified schemes to report to TPR whether, on the basis of the value for members assessment, they consider that the scheme provides good value for members. Where the trustees have reported that the scheme does not provide good value for members, they are also required to report whether they propose to wind up the scheme and transfer the members rights into another scheme or explain to TPR why they are not winding up the scheme and what improvements they are planning to make.
- 7.9 Regulation 5 makes a consequential amendment (of Regulation 2) to the Disclosure Regulations to require disclosure of the outcome of the value for members assessment on a publicly available website.

*Information about total scheme assets to be provided to the Pensions Regulator*

- 7.10 For the purpose of ascertaining which schemes are required to undertake the more detailed value for members assessment, and so that TPR can easily distinguish between the smaller and larger schemes and adapt their level of support/intervention accordingly. Regulation 3(2)(a) amends the Register Regulations to require all occupational pension schemes (this includes DC, defined benefit and hybrid schemes – a combination of both), regardless of asset size, to provide TPR with the value of the total assets held in the scheme at the scheme year end.

*Statement of Investment Principles (SIP)*

- 7.11 The SIP is a written statement which sets out the principles governing how decisions about investments held by occupational pension schemes must be made. A SIP provides information to pension scheme members on the scheme's investment strategy and policies towards environmental, social and governance considerations, amongst other information as to how members' savings are invested.
- 7.12 Regulation 4 amends regulation 8(1)(a) of the Investment Regulations to exclude wholly insured schemes (schemes that have no investment other than specified qualifying insurance policies) from some requirements of the SIP. The rationale here is that they do not themselves manage their investments and therefore a requirement to lay out their policies in relation to investments would be inappropriate. Regulation 4 also amends regulation 2A of the Investment regulations to clarify that transaction costs, i.e. costs involved in entering or withdrawing assets from an investment, should be deducted from returns on investments when reviewing the extent to which returns are consistent with the aims and objectives of the trustees or managers in respect of the default arrangement.
- 7.13 Regulation 5 exempts trustees of wholly-insured schemes from the requirement to disclose how they have complied with certain investment policies. This is a

consequential amendment to reflect exemptions that apply for wholly-insured schemes under the Investment Regulations.

- 7.14 Regulation 4 amends regulation 1(2) of the Investment Regulations to extend the requirement to produce a default SIP to ‘with profits’ schemes which were previously incorrectly exempt.

Property holding costs

- 7.15 Section 127 of the Pension Schemes Act 2021 amends the definition of “administration charge” in Schedule 18 to the Pensions Act 2004 to clarify that the range of member-borne costs that can be considered an administration charge, and hence potentially subject to the charge cap, include any use of the pension scheme’s assets to meet the scheme’s administrative expenses, to pay commission or in any other way that does not constitute payment of the member’s pension or moving their pension savings to a different scheme. However, the policy remains that property holding costs should be exempt from the charge cap. Regulation 6, therefore, amends the definition of “charges” in the Charges and Governance Regulations to exclude costs attributable to holding physical assets from the charges which are subject to the charge cap imposed under those Regulations. This is to address concerns amongst some pension schemes that costs far-detached from property investment costs, such as property management fees, would be inadvertently captured by the charge cap, contrary to the policy intent. The intention is to bring the amendments made by section 127 of the Pension Schemes Act 2021 into force before these regulations are made, as the powers to make regulation 6(2)(a) rely on amendments made by section 127.

Performance Fees

- 7.16 Regulation 6 makes a further amendment to the Charges and Governance Regulations to provide an easement to the requirement to pro-rate performance fees, when trustees of DC schemes assess their compliance with the charge cap. Performance fees are payable by a pension scheme to a fund manager if an investment in a fund that holds certain illiquid assets delivers a certain level of returns. This amendment was in response to feedback from stakeholders that where performance fees, which can significantly vary throughout the year, need to be factored into the charge cap, the existing requirements were difficult to satisfy, and may act as a barrier to such investments.
- 7.17 The instrument allows trustees to remove the performance fee from the charge cap calculation when they need to pro-rate charges for those members that have either joined or left the scheme during the charges year.
- 7.18 Regulation 6 of this instrument amends regulations 7 and 8 of the Charges and Governance Regulations, which set out the two methods trustees can use to calculate members’ charges and compliance with the cap. Instead of being required to look back on, or predict, depending on the calculation method used, the performance fees incurred over the course of the 12 months’ period, known as the charges year, trustees can instead use a moving average in its place, spanning across multiple years. This would mean that for some years where schemes may happen to exceed the 0.75% charge cap because performance has been strong, they would not be penalised for doing so, so long as at the end of that multi-year period the mean average of charges across the multiple years was within the charge cap limit. The motivation behind this

is that trustees have a greater incentive, or less of a disincentive, to invest in performance fee-inducing illiquid asset classes.

## **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 2018.

## **9. Consolidation**

- 9.1 Informal consolidated text of instruments is available to the public free of charge via ‘the National Archive’ website<sup>10</sup>.

## **10. Consultation outcome**

- 10.1 Between February and April 2019, we consulted<sup>11</sup> on several governance proposals. We proposed extending the scope of the pre-existing ‘value for members’ assessment to a more holistic assessment of whether small schemes were achieving sufficient value for money for savers’ retirement income, or whether it might be in scheme members’ interests to move to a larger scheme or an authorised master trust. We sought opinion on the size of schemes that should come into scope for this new assessment, how frequently it should be carried out, and the factors that should be considered as part of that assessment.
- 10.2 We received a total of 56 responses from a mix of organisations from across the pensions industry. On the new value for members proposals we received broad support for the policy rationale, with the majority of respondents agreeing that an extended value for members assessment would be a good way to encourage trustees to consider whether scheme members’ interests would be better served by consolidating. Respondents agreed that benefits of consolidation for scheme members included being part of a better governed scheme and having access to a more diverse range of investment opportunities, and in some cases to more competitive charges.
- 10.3 We published a further consultation<sup>12</sup> in September 2020 which consulted on a proposed legislative change to accelerate the process of consolidation in the DC market by extending the new value for member assessment to cover all schemes, up to £100 million in assets. This was a tenfold increase from the £10 million asset threshold that we had consulted on previously, but was necessary to ensure more schemes, which evidence suggested were failing to meet required governance standards, would be required to undertake this assessment.
- 10.4 We also set out in this consultation how trustees of these smaller schemes be required to assess the key factors of costs and charges and investment returns by relative comparison with three other larger schemes, and that the smaller scheme would also be required to undertake a self-assessment of how their scheme met key administration and governance criteria. To aid the completing of the value for members assessment, and introduce transparency to all members invested in schemes, we proposed that all DC schemes regardless of size be required to state and publish the return on investments net of costs and charges. We consulted on new proposed

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<sup>10</sup> <https://www.legislation.gov.uk/>

<sup>11</sup> <https://www.gov.uk/government/consultations/defined-contribution-pensions-investments-and-consolidation>

<sup>12</sup> <https://www.gov.uk/government/consultations/improving-outcomes-for-members-of-defined-contribution-pension-schemes>

statutory guidance to advice trustees and managers of DC schemes on how to complete these proposed requirements.

- 10.5 In this consultation we also consulted on extending the way compliance with the charge cap is measured for performance fees to give trustees greater flexibility in these investment decisions, and we invited views on a proposal to further extend this flexibility with an alternative approach to measurement. We also consulted on the other proposed changes to legislation around the statement of investment principles and excluding property holding costs from the charge cap set out above.
- 10.6 Of the 60 respondents the overwhelming majority were in favour of introducing a more detailed value for members assessment for smaller schemes as proposed in the draft regulations, and agreed it would significantly drive consolidation of the smaller end of the DC market. Clarifications and further support were however requested to assist trustees of all DC schemes compile their disclosures on net investment returns, and for trustees of smaller schemes to comply with the proposed value for members requirements. We have addressed these requests and more in statutory guidance published alongside the consultation response.
- 10.7 In March 2021, we published a further consultation<sup>13</sup> specifically to consult on new proposed regulations to allow schemes to smooth performance fees, over a 5-year moving average as an alternative to the in-year performance fees accrued. The consultation ran for four weeks and closed on 16 April 2021.
- 10.8 We received 35 responses from pension schemes, investment consultants, asset management companies and influential trade bodies. The regulations to allow performance fee smoothing within the charge cap achieved broad support with organisations stating that this is a positive step that would give trustees greater confidence to invest in a wider range of assets. The response to this consultation was published on 21 June 2021 on gov.uk.

## **11. Guidance**

- 11.1 In complying with the new requirement to assess the value for members that their scheme provides, trustees or managers must have regard to any guidance issued by the Secretary of State by virtue of paragraph 2 of Schedule 18 to the Pensions Act 2014<sup>14</sup>.
- 11.2 In complying with the new requirement to report net investment returns, and in complying with requirements to report on costs and charges, trustees or managers must have regard to guidance issued by the Secretary of State under section 113(2A) of the Pension Schemes Act 1993<sup>15</sup>.
- 11.3 New statutory guidance for trustees and managers of occupational DC pension schemes on the reporting of net investment returns and on completing the new value for members assessment will be published online and come into effect on the coming into force date of this instrument.
- 11.4 Existing statutory guidance for trustees and managers on reporting on costs and charges has been updated to reflect amendments made by this instrument. The revised

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<sup>13</sup> <https://www.gov.uk/government/consultations/incorporating-performance-fees-within-the-charge-cap/incorporating-performance-fees-within-the-charge-cap>

<sup>14</sup> <https://www.legislation.gov.uk/ukpga/2014/19/schedule/18>

<sup>15</sup> <https://www.legislation.gov.uk/ukpga/1993/48/section/113/enacted>

guidance has been published on gov.uk and will come into effect on the coming into force date of this instrument.

- 11.5 Statutory guidance will be reviewed every three years, and updated where required.

## **12. Impact**

- 12.1 Two regulatory impact assessments of the potential costs and benefits of this instrument on businesses, charities, the voluntary sector and the public sector have been produced.
- 12.2 For the requirements placed on trustees to report on the net investment returns and conduct the new detailed value for members assessment the impact assessment covered the one-off and ongoing costs to Defined Contribution (DC) ‘specified schemes’ to report on investment returns, and to compile information, carry out the relative assessment and indicate the results of the value for members assessment in the annual statement regarding governance. There was also consideration of the one-off and ongoing costs placed on the Pensions Regulator. The total equivalent annualised net direct cost to business is estimated to be £1.8 million.
- 12.3 For the requirement for DC schemes “with a promise” to publish a statement of investment principles the impact assessment assessed the costs, to the relatively few schemes that would be captured, to be low. The costs of monitoring compliance by the Pensions Regulator are small and will be met within the Regulator’s existing budget. The total equivalent annualised net direct cost to business is estimated to be £0.03 million.
- 12.4 The impact assessments are available from [legislation.gov.uk](http://legislation.gov.uk).

## **13. Regulating small business**

- 13.1 The legislation applies to activities that are undertaken by small businesses. The impacts are laid out in impact assessments published alongside the regulations.

## **14. Monitoring & review**

- 14.1 This instrument does not include a statutory review clause as the costs to business are limited. As set out at paragraph 11.5 above the Secretary of State has committed to conduct a review of the statutory guidance that trustees or managers of DC schemes are advised to give regard to in accordance with this Order.

## **15. Contact**

- 15.1 Andrew Blair at the Department for Work and Pensions. Telephone Number 020 7282 4445 or e-mail: [andrew.blair@dwp.gov.uk](mailto:andrew.blair@dwp.gov.uk) can answer any queries regarding the instrument.
- 15.2 Joanne Gibson, Deputy Director for Automatic Enrolment and Defined Contribution Pensions Policy, at the Department for Work and Pensions can confirm this Explanatory Memorandum meets the required standard.
- 15.3 Minister for Pensions and Financial Inclusion (Parliamentary Under-Secretary of State), Guy Opperman MP at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.