EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (MASTER TRUSTS) REGULATIONS 2018

2018 No. 1030

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.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument will fully commence the authorisation and supervision regime for Master Trust pension schemes (Master Trust schemes) under the provisions of the Pension Schemes Act 2017 (the 2017 Act). It is intended to commence all provisions of the 2017 Act which have yet to come into force, on the day that the regulations are made.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 These are affirmative regulations. They were originally laid before Parliament with a provision (regulation 30) which should not have been included. The draft regulations were withdrawn and re-laid before Parliament without regulation 30 and Parliament debated and approved the re-laid correct Regulations.

3.2 On 5 September 2018 a version of the Regulations was then made on behalf of the Secretary of State. Unfortunately, that version which was made and published (S.I. 2018/983) was the original incorrect version of the Regulations containing the provision in regulation 30. This was due to an administrative error within the Department for Work and Pensions: the wrong version of the Regulations was mistakenly placed before the Minister to sign.

3.3 These Regulations which have now been made are the version of the instrument as it was laid before, debated and approved by Parliament. These Regulations replace S.I. 2018/983 which has been withdrawn by the Stationery Office and has been removed from the Government's legislation website (www.legislation.gov.uk).

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)

3.4 The territorial application of this instrument includes Scotland.

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 expect Northern Ireland to make separate parallel legislation.

5. European Convention on Human Rights

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

5.2 "In my view the provisions of the Occupational Pension Schemes (Master Trusts) Regulations 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 These regulations have been made using powers under the 2017 Act. Some of the powers in the Act require use of the negative procedure. Others require the affirmative procedure either in the first instance only or on an ongoing basis. To assist with the understanding of how the whole framework will operate, we have combined all the regulations being made under the 2017 Act in this instance to form a single set of affirmative procedure regulations. Together, these regulations will fully commence the powers in the 2017 Act to provide for a new authorisation and supervision regime for Master Trusts. In particular, the regulations provide the detail of the decisions and actions required from the Pensions Regulator (the Regulator) and people involved in the operation of a Master Trust scheme.

6.2 Section 38(3) of the 2017 Act gives the Secretary of State the power to make consequential amendments to subordinate legislation as well as the provision of any Act made prior to or in the same session as the 2017 Act. We are using this power to deal with the issue below.

6.3 One of the criteria that schemes will have to meet in order to be authorised, is that they are financially sustainable. As part of this, there is the need to ensure that the requirement for the submission of fully audited accounts can apply to all scheme funders and that extra burdens are not placed on auditors. Therefore, rather than use the powers in the 2017 Act to set out standalone requirements for accounts in these regulations it will be easier to understand by amending the relevant provisions contained in the Companies Act 2006.

7. Policy background

What is being done and why?

7.1 The Pensions Act 2008 made it compulsory for employers to automatically enrol eligible workers into a qualifying workplace pension scheme. An estimated 9.7 million people have now been automatically enrolled.

7.2 The majority of employers have chosen to enrol their workers into a Master Trust scheme rather than setting up their own pension scheme. A Master Trust scheme is one which is used by more than one employer, provides money purchase pensions[1], and is not a public sector scheme or used only by connected employers (for example, by one profession or a group of companies).

7.3 This has led to a considerable expansion of the Master Trust market. Membership of Master Trust schemes grew from around 0.2 million in 2010 to currently around 9.9 million.

7.4 Master Trust scheme structures create specific risks that are not addressed by current legislation which was designed for other types of pension scheme. These risk factors

[1] As defined in section 181 of the Pension Schemes Act 1993.

include the size and scope of the schemes, the relative lack of employer engagement, diverse business models and other factors that influence their financial resilience and viability.

7.5 These regulations recognise the new and evolving nature of the Master Trust market. They aim to address the potential impact of the risks for Master Trust scheme members by providing an authorisation and supervision regime that will be administered by the Regulator. They have been drafted to allow flexibility in applying the new authorisation regime to the wide range of different Master Trust scheme business models and to enable the Regulator to provide more practical details of what will be required in its Code of Practice.

7.6 The authorisation regime will require all Master Trust schemes that wish to remain in or join the Master Trust market to be authorised by the Regulator. Any Master Trust scheme that does not apply for authorisation, or applies but fails to meet the authorisation criteria specified in the 2017 Act, will be required to transfer its members to another authorised Master Trust scheme and wind up.

7.7 The Regulator's ongoing supervision regime will ensure that Master Trust schemes continue to meet the authorisation criteria. It also gives the Regulator greater powers to engage with and, if appropriate, intervene if a Master Trust scheme is in danger of failing to meet the authorisation criteria.

7.8 The 2017 Act has transitional provisions which commenced in October 2016. These apply elements of the supervision regime (such as the requirement to inform the Regulator if a triggering event[2] occurs, and the prohibition on increasing charges during a triggering event period) to Master Trust schemes operating before the full authorisation and supervision regime commences. These early controls were introduced to reduce the risk of Master Trust schemes that decide, or have to leave the market doing so in a way that might put their members' interests and savings at risk.

Scope

7.9 These regulations specify the pension schemes that the authorisation and supervision regime will apply to. We have disapplied the authorisation regime to some types of schemes that have specific characteristics which mean that while they would technically fall within the definition in the 2017 Act, they do not face the same risks as Master Trust schemes. For example, in certain small schemes where the members are only investing for themselves such schemes will only have authorisation disapplied if they only have a single member or if the majority of the trustees are members of the scheme.

Authorisation Process

7.10 The Regulator will assess each Master Trust scheme against five authorisation criteria aimed at addressing the risks specific to Master Trusts. These are:

- The persons involved in running the scheme are fit and proper;
- The scheme is financially sustainable;
- Each scheme funder meets specific requirements. A scheme funder is a legal person (a corporate body or partnership) responsible for financing the Master

[2] Triggering events are events that would put the scheme at risk of needing to wind up and are listed in the 2017 Act.

Trust scheme where its administration charges are not enough to cover its costs, or who is entitled to receive profits where the scheme's income exceeds its expenditure. While there is no legal requirement for a Master Trust to have a scheme funder it is expected that in the majority of Master Trust schemes there will be one or more persons that come within this definition. Schemes that do not have a scheme funder will be expected to show how their business model meets the financial sustainability criteria;

- The systems and processes used in running the scheme are sufficient to ensure that it is run effectively; and
- The scheme has an adequate continuity strategy – a document showing that the scheme's trustees and strategist have thought about what actions and decisions they would need to take should their scheme experience a triggering event.

7.11 Authorisation will be a one-off application process with the onus on the Master Trust scheme to provide all the information needed to satisfy the Regulator that they meet all of the authorisation criteria. These regulations include the detail of what Master Trust schemes must include in their application for each of the criteria.

7.12 The application for authorisation will incur a fee. The fee is necessary to enable the Regulator to recover the costs of processing applications without indirectly placing these costs on the wider pensions industry. These regulations set out the applicable fees of £41,000 for existing schemes and £23,000 for new schemes. The two levels of fee represent the different amounts of work the Regulator will need to do to process applications from the two scheme types. A new scheme is likely to have significantly less evidence for the Regulator to assess. As such, the Regulator's assessment will not be as complex as for an established scheme which is already in operation, and where there will be historical data to review and assess

Supervision Regime

7.13 Once authorised, Master Trust schemes will be required to continue to meet the authorisation criteria. The 2017 Act puts in place processes for the Regulator to monitor compliance and specifies the actions to be taken should a Master Trust scheme experience any events that might stop it complying with the authorisation criteria.

7.14 Master Trust schemes will be required to keep the Regulator informed of any changes by providing revised business plans and continuity strategies and their annual accounts. The Regulator will also be able to require trustees to provide certain information in the form of a supervisory return. The regulations set out the information which the Regulator may require to be included in the supervisory return. This could include details of how the trustees' competence is being maintained and details of the scheme's current position in relation to its objectives in the business plan.

7.15 As part of the supervision regime, Master Trust schemes will be required to notify the Regulator of any significant events as detailed in these regulations. This could be where a trustee is convicted of an offence or a failure of the systems and processes used in running the scheme.

7.16 Where a person fails to comply with a request for information, the Regulator can impose fixed and escalating penalties. These regulations set the fixed penalty at £500 and the escalating penalty starting at £1,000, then escalating by £1,000 a day to a maximum of £10,000 per day. This is broadly consistent with other penalties which can be imposed by the Regulator.

7.17 The 2017 Act also requires Master Trust scheme trustees to notify both the Regulator and the employers using their scheme that a triggering event has occurred. If the triggering event is a scheme being refused authorisation or having its authorisation withdrawn, its trustees must pursue continuity option 1 and transfer their members to another suitable pension scheme and wind up. If a Master Trust scheme experiences one of the other triggering events, for example a scheme funder decides to end its relationship with the scheme, its trustees can decide to pursue continuity option 1 or continuity option 2. Under continuity option 2, trustees must attempt to resolve the triggering event and notify the Regulator when they consider it has been resolved.

7.18 These regulations set the deadline for these notifications to take place and the information to be included in them.

7.19 If a triggering event has occurred, schemes are required to submit an implementation strategy to the Regulator setting out the actions they are going to take to either resolve the situation or transfer their members to another scheme and wind up. These regulations detail the information that the implementation strategy must include and require that it is submitted within 28 days of the triggering event having occurred.

7.20 Administration charges in relation to members are restricted during this period to protect members from having their pension "pots" used to pay for the additional costs that the scheme has as a result of having a triggering event. Schemes are required to provide information on their administration charges in both their continuity and implementation strategies. The regulations give more detail on what information must be included in both strategies and how it should be presented.

7.21 Once the Regulator has approved a Master Trust scheme's implementation strategy the scheme's trustees will be required to submit regular periodic reports detailing the actions and decisions they have taken to progress their

7.22 implementation strategy. These regulations give the deadline by which they must submit their first periodic report and the information to be included in it.

Transfer out and winding up

7.23 The regulations set out the steps the trustees will need to take to bulk transfer scheme members, without their consent, to another authorised Master Trust scheme where this is appropriate. These requirements aim to ensure that members' interests are protected and their pension "pots" are moved out of the scheme as quickly and safely as possible. This includes requiring that employers and members are kept informed and know what their options are.

7.24 The regulations also give the Regulator the power to direct the trustees to take certain actions if they consider members' rights are being put at risk through failure to comply with the regulations.

Fraud Compensation Fund (FCF)

7.25 The regulations make adjustments to the FCF to make it more applicable to Master Trust schemes. Instead of all the employers having to be insolvent for the Master Trust scheme to make an application to the FCF, only the scheme funder has to be insolvent.

7.26 All occupational pension schemes pay a levy that funds the Fraud Compensation Fund. Legislation currently sets a cap on the fraud compensation levy of 75p per member for occupational pension schemes. The regulations introduce a lower cap of 30p per member for authorised pension schemes.

8. Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 No further consolidation of the regulations is planned We have worked closely with the Regulator and stakeholders in the development of the 2017 Act and these regulations.

10. Consultation outcome

10.1 The regulations were published in draft on 30 November 2017. A launch event, hosted by the Minister for Pensions and Financial Inclusion, was attended by over 80 representatives from the pensions industry. The regulations were subject to a 6 week public consultation which concluded on 12 January 2018. Master Trust scheme representatives were also directly engaged with Government officials prior to and during this period. The consultation document can be found at: Master Trust regulations consultation.[3]

10.2 62 written responses were received. There was overall agreement with the approach identified in the consultation document and that the draft regulations largely met their intended purpose. There were some challenges on policy approach to some aspects of the regulations, drafting and minor technical points, and requests for clarification on some aspects.

10.3 The Government's response to the consultation was published on 19 March 2018. It can be found at: Master Trust regulations consultation response.[4]

10.4 There are some areas where the Government agreed with respondents that further clarification was needed and, where appropriate, changes to reflect consultation feedback were made along with technical amendments to improve the effectiveness of the regulations. Many of the issues raised through the consultation were about the practical application of the regulations. We have referred these matters to the Regulator so that they can be clarified through its Code of Practice.

10.5 There were some issues of significant concern raised by a number of respondents. The Government has considered each of these but believes it is appropriate to maintain the policy positions set out in the draft regulations, for example:

- Some insurance backed schemes and some not-for-profit / industry-specific pension schemes continued to lobby to be exempted from the authorisation regime entirely. It has always been the Government's intention that the broad market of multi-employer money-purchase benefit schemes should be captured to ensure that an appropriate breadth of member protection is achieved. While the risks these schemes face will not necessarily be as great as

[3] https://www.gov.uk/government/consultations/draft-occupational-pension-schemes-master-trusts-regulations-2018

[4] https://www.gov.uk/government/consultations/draft-occupational-pension-schemes-master-trusts-regulations-2018

those for a large-scale commercial Master Trust, the Government considers that it is appropriate that they should be required to demonstrate that they are well run and financially sustainable to ensure adequate protection for their members' benefits.

10.6 Many respondents raised concerns about the proposal that there should be a different fee for an existing Master Trust schemes than for new Master Trust schemes. In particular, concerns were raised about the affordability of authorisation for some schemes and whether new Master Trusts will be less rigorously assessed. The regulations identify the level of the fees which will be £41,000 for existing schemes and £23,000 for new schemes. The fees have been set at a level to ensure they only recover the additional costs of the Regulator processing the application.

10.7 Some schemes where the scheme funder is also regulated as an insurance company by the Prudential Regulation Authority (PRA) or as a financial services company by the Financial Conduct Authority (FCA) raised concerns that there was unnecessary duplication in requiring them to provide the Regulator with additional evidence of their financial sustainability. The Government's view is that while compliance with the existing PRA and FCA regulatory regimes will be strong evidence that any funding arrangements are sound, they do not provide the specific assurance that the Regulator will need to be satisfied that a Master Trust scheme is financially sustainable. The Government has made some amendments to the regulations to clarify how this information should refer to existing authorisations or other regulatory compliance.

10.8 Some schemes expressed concern that they should have to demonstrate that they meet the financial sustainability requirement where their business model relies on participating employers alone to make up any shortfall in funding. The Government does not consider that it is appropriate for money purchase schemes to rely solely on the employers to meet future wind up costs. The removal of funding by those employers is likely to be the reason for a wind up. There is not, as in a defined benefits scheme, the option of using money from the scheme's fund without introducing new charges on members, nor is the Pension Protection Fund available. The regulations, therefore, retain the requirement for the Regulator to adequately assess and supervise the financial sustainability of these sorts of scheme as part of the authorisation and supervision regime.

10.9 The Government has made changes in the regulations so that it is more likely that Master Trust schemes can claim from the Fraud Compensation Fund (FCF). In the draft regulations we proposed a 30p per member cap on the FCF levy charges for authorised Master Trust schemes (reduced from a 75p cap). Some of the larger Master Trusts expressed a strong view that they should be charged at 25% of whatever is charged to other schemes rather than having a cap on the fee level. The Government has some sympathy with their case; however, it is restricted by the primary legislation and cannot amend the levy in this way.

11. Guidance

11.1 The Regulator has consulted with the pensions industry in developing its draft Code of Practice. The Code has been laid in Parliament and is expected to come into effect on 15 October A copy of the draft Code can be found at [Code of Practice] consultation.[5] The Regulator will also make available supporting code related guidance in due course.

12. Impact

12.1 An assessment of the impact of these Regulations has been made. The key cost will be for existing and future Master Trust schemes that will need to make changes to be authorised by the Regulator. These costs will include those associated with meeting scheme requirements, the cost of the fee for applying for authorisation and familiarisation costs. There is a cost to business to fund the Regulator to conduct the new authorisation and supervision process and on-going levy charges for supervision made on all Master Trusts.

12.2 The authorisation regime may lead to some Master Trusts pre-emptively leaving the market as they no longer believe it commercially viable to remain. Therefore, there will be costs associated with winding up the scheme and transferring members. These costs will also be faced by schemes that are not authorised by the Regulator. The main beneficiaries of the authorisation regime are members of Master Trust schemes who will benefit from better protection of their assets.

12.3 The total cost to business is estimated to be under £5 million annually. The equivalent annual cost to business is estimated at £2.7million.

12.4 There is no impact on the public sector.

12.5 An Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 The 2017 Act deliberately did not set a minimum limit on Master Trust scheme size as it was felt this could be used as a way for some schemes to avoid the authorisation regime. Also, the risk to members remains regardless of the size of the scheme. Master Trust schemes may employ relatively small numbers of staff and be responsible for the savings of many tens of thousands of savers' pensions, potentially worth £ billions.

13.3 The Government agrees that some small schemes, in which all members are also trustees and which are often used by small businesses should not be subject to the authorisation regime. In these schemes, members are not subject to the same risk as in Master Trust schemes. Therefore, as long as the members make up more than 50% of the trustee board then relevant small schemes will not come under the Master Trust authorisation regime.

14. Monitoring & review

14.1 The Master Trust market is expected to stabilise over time. The Regulator’s forecast is that there will be few new entrants to the market, potentially as few as one or two a year.

[5] http://www.thepensionsregulator.gov.uk/doc-library/master-trust-code-consultation-2018.aspx

14.2 Guy Opperman, Minister for Pension and Financial Inclusion for the Department of Work and Pensions, has made the following statement under section 28(2)(b) of the Small Business, Enterprise and Employment Act 2015:

"Having had regard to the Statutory Review Guidance for Departments 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 Occupational Pension Schemes (Master Trusts) Regulations 2018. A review of these regulations would be disproportionate, taking into account the economic impact of the regulations on the activities of the Master Trust market, and would be undesirable for the particular reasons set out below."

14.3 Given the technical nature and focussed application of these regulations, it would be disproportionate in these circumstances to make statutory provision for a review. The Department for Work and Pensions will, however, continue to work closely with its stakeholders, including industry bodies and employer organisations, to keep these policies under review and should any issue arise with these policies, it will assess the evidence and, if appropriate, consider whether any changes may be necessary.

15. Contact

15.1 Mike Moore at the Department for Work and Pensions; telephone: 020 7449 6021 or email: mike.moore@dwp.gsi.gov.uk can answer any queries regarding this Instrument.

15.2 Fiona Walker, Deputy Director at the Department for Work and Pensions can confirm that that this Explanatory Memorandum meets the required standard.

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