EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (ADMINISTRATION, INVESTMENT, CHARGES AND GOVERNANCE) AND PENSIONS DASHBOARDS (AMENDMENT) REGULATIONS 2023

2023 No. 399

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 His Majesty.

2. Purpose of the instrument

2.1 The instrument amends regulations to require trustees or managers of most defined contribution occupational pension schemes to publish their policies on investment in illiquid assets[1] and information about the types of assets in which the scheme has investments.

2.2 The instrument also provides that "specified performance-based fees" will fall outside of the regulatory charge cap calculation[2].

2.3 This instrument also corrects a drafting error in Part 1 of Schedule 2 to The Pensions Dashboards Regulations 2022.[3]

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is Great Britain.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is Great Britain.

5. European Convention on Human Rights

5.1 The Parliamentary Under Secretary, at the Department for Work and Pensions, Laura Trott MBE, has made the following statement regarding Human Rights:

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[1] An asset that cannot easily or quickly be sold or exchanged for cash

[2] Default investment arrangements (that is, investment arrangements used by members who have not actively chosen an investment fund) within certain pension schemes used by employers to meet their automatic enrolment duties are subject to a cap on the charges which may be borne by scheme members. The charge cap is 0.75% of funds under management within the default arrangement, or an equivalent combination charge. The cap applies to all scheme and investment administration charges, excluding transaction costs and a small number of other specified costs and charges.

[3] https://www.legislation.gov.uk/uksi/2022/1220/contents/made

"In my view the provisions of the Occupational Pensions Schemes (Administration, Investment, Charges and Governance) and Pensions Dashboards (Amendment) Regulations 2023 are compatible with the Convention rights."

6. Legislative Context

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

Amendments to the Charges and Governance Regulations

6.2 Regulation 2 of the instrument amends the Occupational Pension Schemes (Charges and Governance) Regulations 2015 (S.I. 2015/879)[4] ("the Charges and Governance Regulations") to add "specified performance-based fees" to the list of charges that fall outside the charge cap. Regulation 2 adds a tight conditions-based definition of what can be considered a well-designed, "specified performance-based fee". The new exemption of "specified performance-based fees" from the charge cap will be available to schemes from 6 April 2023.

6.3 Regulation 2 also repeals regulations allowing schemes to pro-rate performance fees for part years or smooth them over multiple years, for the purpose of compliance with the charge cap. These are no longer needed if "specified performance-based fees" fall outside the charge cap. Transitional arrangements are provided for schemes currently making use of the smoothing option.

Amendments to the Investment Regulations

6.4 Regulation 3 amends the Occupational Pension Schemes (Investment) Regulations 2005[5] (S.I. 2005/3378) ("the Investment Regulations"), to require trustees of "relevant schemes" to include an explanation of their policies on investing in illiquid assets in the statement of investment principles[6] that they are required to produce under regulation 2A of the Investment Regulations in relation to their default investment arrangements. The amendments made by regulation 3 set out the proposed aspects of a scheme's policy on illiquid investments that trustees will be required to disclose, including an explanation of the types of illiquid assets in which investments will be held, and define "illiquid assets" for the purposes of the regulations.

6.5 Regulation 3 also amends the Investment Regulations to require trustees of qualifying collective money purchase[7] schemes to include an explanation of their policies on investing in illiquid assets in the statement of investment principles that they are required to produce under section 35 of the Pensions Act 1995[8]. The amendments made in relation to collective money purchase schemes reflect the fact that collective money purchase schemes do not have default investment funds.

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[4] https://www.legislation.gov.uk/ukdsi/2015/9780111128329/contents

[5] https://www.legislation.gov.uk/uksi/2005/3378/contents/made

[6] The statement of investment principles (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 (or on a default fund's) investment strategy and policies towards environmental, social and governance considerations, amongst other information as to how members' savings are invested.

[7] Collective money purchase benefits are a sub-set of money purchase benefits.

[8] https://www.legislation.gov.uk/ukpga/1995/26/contents/enacted

6.6 The instrument sets out that that this information must be included by trustees in the first updated version of their statement of investment principles to be produced after 1 October 2023 or by 1 October 2024 at the latest.

Amendments to the Scheme Administration Regulations

6.7 Regulation 4 of this instrument amends The Occupational Pension Schemes (Scheme Administration) Regulations 1996 (S.I. 1996/1715)[9] ("the Administration Regulations") to require trustees or managers of relevant occupational pension schemes to report in their annual chair's statement[10] on the percentage of assets allocated to different investment asset classes within their default arrangements (or, in the case of collective money purchase schemes, within the whole scheme). Trustees or managers will need to comply with this from the first scheme year ending after 1 October 2023.

6.8 Regulation 4 also amends the Administration Regulations to require schemes in scope to calculate and disclose in the annual chair's statement any specified performance-based fees incurred in the scheme year. This applies from the first scheme year to end after 6 April 2023.

Amendments to the Disclosure Regulations

6.9 Regulation 5 amends The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (S.I. 2013/2734)[11] ("the Disclosure Regulations") to require relevant occupational schemes to publish the section of the annual chair's statement which covers the new disclosures about asset allocation and specified performance-based fees on a free to access website.

The Pensions Dashboards Regulations 2022

6.10 This instrument also amends a drafting error within The Pensions Dashboards Regulations 2022 (SI 2022/1220)[12] which came into force on 12 December 2022 and introduced requirements that will bring pensions dashboard services into operation.

7. Policy background

What is being done and why?

Administration, investment charges and governance (regulations 2 to 5)

7.1 It is the Government's priority to explore ways to help facilitate greater investment by UK institutional investors in illiquid assets, because of their potential to deliver higher long-term returns to investors as part of a diversified investment portfolio.

7.2 The Pension Charges Survey 2020[13] showed two-thirds of defined contribution occupational pension schemes had no direct investment in illiquid assets in their default funds. As defined contribution pension schemes continue to grow and mature,

[9] https://www.legislation.gov.uk/uksi/1996/1715/contents
[10] Annual statement regarding governance which they are required to produce under regulation 23 of the Administration Regulations.
[11] https://www.legislation.gov.uk/uksi/2013/2734/contents/made
[12] https://www.legislation.gov.uk/uksi/2022/1220/contents/made
[13] https://www.gov.uk/government/publications/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes

helped by the success of the automatic enrolment[14] policy, increasingly schemes will be looking to broaden their range of investment opportunities. The Government wants to make sure there are no obvious structural barriers now or in the future that would limit or dissuade them from considering illiquid asset investments which have the potential to deliver higher returns for pension savers' retirement outcomes. Pension schemes investment in illiquid assets like renewable energy projects, other infrastructure and UK start-up businesses will also help contribute to economic growth and in areas that can help with the transition to net zero.

7.3 The use of performance fees, which commonly come with investments in certain illiquid assets such as venture capital and private equity has been cited as a significant barrier for many trustees of defined contribution pension schemes considering these investments, because of the higher charges passed onto members that risk taking them close to or over the charge cap[15]. Allowing for fees to be excluded from the charge cap calculation will create a regulatory environment that allows pension scheme trustees to invest in certain assets that come with fees where they think they can achieve better value for members. It also encourages genuine innovation and competition on fees, including on the part of investment fund managers.

7.4 Requiring schemes to disclose their policies on investment in illiquid assets and their overall asset allocations will improve the availability of investment information for members and employers and ensure trustees and managers of the schemes are giving full consideration to the range of investment opportunities there are which can achieve best value for pension savers. Drivers designed to ensure pension schemes are delivering value for their members come in the form of transparency to members on the investment decisions their schemes are making, and the standardisation of information so that meaningful disclosure and value for money comparisons can be made.

Administration, investment, charges, and governance (regulations 2 to 5) - Explanations

<u>What did any law do before the changes to be made by this instrument?</u>

7.5 Before the changes to be made by this instrument, trustees and managers of occupational defined contribution pension schemes were not required to disclose their asset allocations or explain their policies on investing in illiquid assets.

7.6 Performance fees were included as part of the costs and charges which were subject to the charge cap of 0.75% of assets under management or equivalent combination charge, so the amount of performance fees that could be charged to members was limited.

7.7 The Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 (S.I. 2021/1070)[16] introduced easements to enable performance fees to be managed more easily for the purposes of compliance with the charge cap, but performance fees remained subject to the cap.

[14] Under the Pensions Act 2008 https://www.legislation.gov.uk/ukpga/2008/30/contents, employers are required to automatically enrol (or re-enrol) eligible employees into a qualifying workplace pension scheme.

[15] The charge cap applies to limit the amount of charges that may be passed on to members invested in the default arrangements of most defined contribution occupational pension schemes (default arrangements are used by members who have not actively chosen an investment fund).

[16] https://www.legislation.gov.uk/ukdsi/2021/9780348224788/contents

Why is it being changed?

7.8 As trustees and managers of schemes explore illiquid asset investments, it will be beneficial to other schemes, members, employers, and regulators to understand their rationale behind choosing to invest (or not) in these asset classes. In a changing investment environment, we are following industry movement and evolution.

7.9 Adding "specified performance-based fees" where the members only pay fees when they have received a net return on their investments to the list of charges that are outside the scope of the cap, is an important enabler now, and in the future, as the defined contribution market continues to grow, gains scale and seeks to broaden out their investment strategies.

What will it now do?

7.10 This instrument will make amendments to require trustees or managers of relevant occupational pension schemes to disclose the percentage of assets allocated in their default arrangements to specified asset classes. The instrument lists these in eight main categories recognisable by trustees and managers of schemes. Where a relevant scheme is a qualifying collective money purchase scheme, this breakdown will be required in respect of the asset classes held by the scheme.

7.11 The regulations will also require schemes to state their policies on investment in illiquid assets in their default statement of investment principles document (or, in the case of collective money purchase schemes, in their main statement of investment principles).

7.12 The impact of these measures will be to encourage industry-wide transparency and standardised disclosure as well as greater public accountability for the investment decisions made by trustees on behalf of their members.

7.13 The regulations by excluding "specified performance-based fees" (paid in relation to an investment fund in which a pension scheme invests) from the list of charges that fall within the regulatory charge cap, will open up greater opportunities for schemes to access a more diverse range of asset classes for the financial benefit of their members.

The Pensions Dashboards regulations (regulation 6)

7.14 This instrument amends the Pensions Dashboards Regulations 2022[17], in which a minor drafting error exists in Part 1 of Schedule 2. At cohort 1(b) of the staging profile, the row for 'master trust schemes that provide money purchase benefits only' with a deadline to connect by 30 September 2023 sets the number of relevant members as '10,999–19,999', whereas it should read '10,000–19,999' relevant members.

7.15 Part 4 of the Pension Schemes Act 2021[18] amended the Pensions Act 2004[19] to include powers to legislate to make pensions dashboards a reality. The Pensions Dashboards Regulations 2022 are an important milestone in delivering pensions dashboards. Part 3 of the Regulations includes requirements on occupational pension schemes to connect to the Money and Pensions Service and be ready to respond to data requests. Schedule 2 to the Regulations provides for the phased connection (or 'staging') of occupational pension schemes, according to their size and type.

[17] https://www.legislation.gov.uk/uksi/2022/1220/contents/made
[18] https://www.legislation.gov.uk/ukpga/2021/1/contents/enacted
[19] https://www.legislation.gov.uk/ukpga/2004/35/contents

7.16 The drafting error means that any master trust schemes that provide money purchase benefits only, with between 10,000 and 10,998 relevant members at the reference date, would not be required to stage in line with our policy intent (by 30 September 2023). Their staging deadline would instead fall to 31 March 2024 (cohort 1g), which captures any remaining money purchase schemes of that size.

7.17 A 'relevant member' is a member of an occupational pension scheme who is an active, deferred or pension credit member. The 'reference date' means the scheme year end date falling between 1 April 2020 and 31 March 2021, inclusive.

7.18 Based on the latest scheme data returns received by the Pensions Regulator for the reference date, there were no schemes that had between 10,000 and 10,998 relevant members. This amendment ensures, however, that the policy intent is maintained should for any reason it later emerges that a scheme does fall within this group.

8. European Union Withdrawal and Future Relationship

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 via 'The National Archives' website www.legislation.gov.uk.

10. Consultation outcome

Regulations 2 to 5

10.1 The Government consulted in November 2021[20], on a proposal to exclude well designed performance-based fees from the charge cap.

10.2 In March 2022[21], we provided feedback on the views we had received to this proposed reform. We also consulted on proposals to require trustees of schemes to disclose and explain their policies on investment in illiquid assets and their asset allocation percentages.

10.3 In October 2022[22], we invited views on draft regulations and statutory guidance covering proposals for trustees to explain their policies on investment in illiquid assets and disclose the types of assets in which the scheme has investments and on proposals to exclude specified performance-based fees from the charge cap.

10.4 We received 40 responses to the consultation on draft regulations and guidance including from pension schemes and service providers, pension members and beneficiaries, industry bodies and professionals, civil society organisations and other interested stakeholders.

10.5 Most respondents were supportive and expressed the view that our regulatory changes delivered the policy intent. With respect to requiring schemes to disclose and explain their policy on investment in illiquid assets and asset allocations, most stakeholders

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[20] https://www.gov.uk/government/consultations/enabling-investment-in-productive-finance

[21] https://www.gov.uk/government/consultations/facilitating-investment-in-illiquid-assets-by-defined-contribution-pension-schemes

[22] https://www.gov.uk/government/consultations/broadening-the-investment-opportunities-of-defined-contribution-pension-schemes

did not see this introduced overly burdensome requirements on schemes. With respect to the exemption of "specified performance-based fees" from the charge cap, most stakeholders considered this to be positioned correctly in terms of not being overly prescriptive, yet at the same time having in place sufficient safeguards for schemes and members to protect them from excessive charges.

10.6 During the formulation of the policies and draft regulations and guidance, we consulted with, and sought expert advice from The Pensions Regulator, the Financial Conduct Authority and His Majesty's Treasury.

10.7 The feedback we received from all interested stakeholders has been taken on board and relevant suggestions included in this instrument and the accompanying statutory guidance.

10.8 The full consultation response 'Broadening the investment opportunities of Defined Contribution pension schemes'[23] has been published on gov.uk.

The Pensions Dashboards regulations

10.9 It has not been necessary to consult on the provision to amend the Pensions Dashboards Regulations 2022[24]. These Regulations were subject to extensive consultation prior to being laid and this correction seeks to ensure the Regulations fully reflect the policy intent.

11. Guidance

11.1 In complying with the new requirements to disclose their asset allocations, and when trustees and managers exclude "specified performance-based fees" from the charge cap, trustees and managers must have regard to any guidance issued by the Secretary of State by virtue of paragraphs 1 and 2 of Schedule 18 to the Pensions Act 2014[25] and section 113(3A) of the Pension Schemes Act 1993[26].

11.2 This new statutory guidance 'Disclose and Explain asset allocation reporting and performance-based fees and the charge cap'[27] has been published on gov.uk and will come into effect on the coming into force date of this instrument. This guidance will be reviewed as a minimum every three years and updated where required.

11.3 The Pensions Dashboards Regulations 2022 state that additional guidance may be issued from time to time by the Secretary of State, the Money and Pensions Service or the Pensions Regulator. The Pensions Regulator has, for example, published on its website detailed guidance for trustees and managers of occupational pension schemes.

12. Impact

12.1 The impact of the administration, investment, charges, and governance measures in regulations 2 to 5 on business, charities or voluntary bodies is estimated to be £2.3m

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[23] https://www.gov.uk/government/consultations/broadening-the-investment-opportunities-of-defined-contribution-pension-schemes/outcome/government-response-broadening-the-investment-opportunities-of-defined-contribution-pension-schemes
[24] https://www.legislation.gov.uk/uksi/2022/1220/contents/made
[25] https://www.legislation.gov.uk/ukpga/2014/19/contents
[26] https://www.legislation.gov.uk/ukpga/1993/48/contents/enacted
[27] https://www.gov.uk/government/consultations/broadening-the-investment-opportunities-of-defined-contribution-pension-schemes/outcome/statutory-guidance-disclose-and-explain-asset-allocation-reporting-and-performance-based-fees-and-the-charge-cap

(Equivalent Annual Net Direct Cost to Business over a 10-year period). The impacts are principally on the pensions industry, specifically the "relevant schemes" in scope of the requirements to state their policies on investment in illiquid assets and also disclose the types of assets in which the scheme has investments. Impacts to business are primarily driven through familiarisation and reporting costs.

12.2 There is no, or no significant, impact on the public sector.

12.3 A full Impact Assessment 'Broadening investment in illiquid assets'[28] is submitted with this memorandum and published alongside the Explanatory Memorandum on the www.legislation.gov.uk website.

12.4 The provision amending the Pensions Dashboards Regulations 2022 has no impact on business, charities, voluntary bodies, or the public sector.

13. Regulating small business

13.1 The administration, investment, charges, and governance measures apply to activities that are undertaken by small businesses. The impacts are laid out in the impact assessment published alongside the regulations.

13.2 The scope of the proposed amendments is consistent with existing legislation relating to the statement of investment principles, default statement of investment principles, annual chair's statement, and charge cap, i.e., the amendments apply to relevant occupational defined contribution pension schemes. Small, self-administered schemes with fewer than 12 members are excluded. Collective money purchase schemes with fewer than 100 members are excluded from the requirement relating to the illiquid assets investment policy. Therefore, we do not expect small pension schemes will be excessively impacted by these proposals.

13.3 The provision to amend the Pensions Dashboards Regulations 2022 does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 Regulation 7 of this instrument requires the Secretary of State to carry out a review of the administration, investment, charges, and governance measures in regulations 2 to 5 and publish a report setting out the findings of that review every 5 years. The first report must be published by 6 April 2028. The review must assess the extent to which the policy objectives have been achieved and assess whether they remain appropriate.

14.2 The Department is planning a multi-strand monitoring and evaluation strategy in relation to the delivery of pensions dashboards. This is subject to ministerial review and approval.[29]

15. Contact

15.1 Sam Haylen at the Department for Work and Pensions email: sam.haylen@dwp.gov.uk can be contacted with any queries regarding this instrument (save for queries about regulation 6 relating to pensions dashboards).

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[28] https://www.legislation.gov.uk/ukdsi/2023/9780348244113/pdfs/ukdsiod_9780348244113_en.pdf

[29] For further information, see the Explanatory Memorandum for the Pensions Dashboards Regulations 2022, available here: https://www.legislation.gov.uk/uksi/2022/1220/pdfs/uksiem_20221220_en.pdf

15.2 Mary Zvobgo at the Department for Work and Pensions email: mary.zvobgo@dwp.gov.uk can be contacted with any queries regarding regulation 6 relating to pensions dashboards.

15.3 Joanne Gibson, Deputy Director for Automatic Enrolment and Defined Contribution Pensions Policy, at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.

15.4 Laura Trott MBE, Parliamentary Under Secretary of State at the Department for Work and Pensions can confirm that this Explanatory Memorandum meets the required standard.