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THE OCCUPATIONAL PENSION SCHEMES (GOVERNANCE) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2018

REGULATORY IMPACT ASSESSMENT

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The costs and savings outlined in this Regulatory Impact Assessment are calculated on a United Kingdom-wide basis.

Evidence Base

The policy issue and rationale for Government intervention

1. EU Directive 2016/2341 (commonly known as IORP[1] II) is a 'recast', or revision, of the 'IORP 1' Directive[2]. The recast directive places greater emphasis on effective corporate governance for pension scheme trustees. The transposition deadline for this directive is 13th January 2019.

2. It is the current cross-Government position that the UK should continue to transpose EU law. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period, the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in the future once the UK has left the EU.

3. This directive is part of the EU's framework for financial regulation, and, as its requirements are aligned with the UK's own priorities, it is sensible to transpose it with a minimal impact approach. This also supports the UK's position in the EU Exit negotiations, particularly in respect of any implementation period.

4. The changes are in line with domestic initiatives for occupational pensions that are designed to improve protection for savers and confidence in financial services. These include:

   - Governance requirements for public service pension schemes.
   - Governance requirements for Defined Contribution (DC) pensions Master Trusts to obtain authorisation.
   - DC Chair's Statement, which must demonstrate a range of activities that comprise adequate scheme governance.
   - Proposals in the recent Defined Benefit (DB) pensions white paper to improve risk management and the governance of decision making following high profile corporate insolvencies which left significant deficits

[1] IORP stands for Institutions for Occupational Retirement Provision – in the UK, a private occupational pension scheme
[2] Directive 2003/41/EC

in DB pension schemes. For example, the Westminster Work and Pensions Committee hearings have reinforced this message, focusing attention on standards of corporate governance on trustee boards, in particular on their ability to identify and manage risks and to ensure the interests of employers are not allowed to override those of savers.

- The Pensions Regulator's "21st Century Trusteeship" and "TPR Futures" initiatives.

Policy objectives and intended effects

5. The EU's position on corporate governance for pension scheme trustees, as set out in IORP II, closely reflects the UK's existing position. This requires that an effective system of governance should be in place in each pension scheme, proportionate for the size and risk profile of each pension scheme. The second of four stated aims for the directive is to ensure good governance and risk management, as set out in the Commission's proposal[3] to recast the IORP directive (para 1.1, page 4 refers). The overarching aim is that all scheme members should be able to have confidence that their retirement savings are being properly managed.

6. The changes being made as part of IORP II transposition will codify what trustees in the UK should already be doing to properly run their schemes. This approach will clarify what is expected from trustees for schemes where the approach is less clearly defined within the UK's regulatory framework. When clear and enforceable legal requirements are in place for all schemes TPR will be able to take more targeted and timely action against schemes that are not properly run.

Policy options considered, including alternatives to regulation

Option 1: Do nothing

7. The option was considered following the Referendum on exiting the European Union in June 2016, when it was unclear whether it would be necessary for the UK to transpose this Directive in January 2019.

8. It is now the confirmed cross-Government position that the UK should continue to transpose EU law. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period, the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in the future once the UK has left the EU.

9. It was then considered whether transposing this directive was disproportionate or inappropriate given the reality of the UK exiting the EU, in line with DExEU legal guidance. The directive does not fall into that category.

[3] Brussels, 27.3.2014 COM(2014) 167 final

10. “Do nothing” is not in line with the UK’s duty of sincere co-operation under article 4 of the Treaty on European Union, and is therefore not in line with the Government’s position on continuing to meet the obligations.

11. The UK pensions industry has been expecting IORP II since 2014 and it would create confusion if it was ignored at this late stage.

Option 2: Non-legislative transposition

12. Non-legislative means – TPR’s Codes of Practice – have been used to transpose some elements of the directive (these are not discussed in this impact assessment). TPR Codes of Practice explain in practical detail what the Regulator expects from trustees in complying with the law. In scenarios where the UK’s existing law is sufficiently close to IORP II, or is sufficiently broad, the UK can transpose those elements of the directive by changing the relevant Code of Practice so it aligns with the directive.

13. It was considered whether it would be possible to transpose the governance elements of the directive purely by such non-legislative means, so as to minimise the amount of legislation brought forth. However, the extent of the change to governance requirements in the recast directive – from one sub-paragraph requiring “adequate internal controls” to ten lengthy articles requiring an effective system of governance – requires a small amendment to be made to legislation in order to fulfil the obligation to transpose.

14. Amending the way that governance requirements are described in legislation will enable all other elements of the IORP II governance elements to be transposed through non-legislative means.

Option 3: A mixture of legislative and non-legislative transposition

15. The existing legal requirement for adequate internal controls is too narrow to allow the entirety of the system of governance set out in the directive to be expressed only in an updated TPR Code of Practice. Doing so would make TPR’s Code of Practice unenforceable and may put the UK in the position of sub-delegating to TPR without a power to do so.

16. Failing to update our legislation to reflect the extent of change in this key area of pension scheme would also make it challenging to demonstrate to the European Commission that the UK had sufficiently transposed this element of the directive. This could also lead to an ‘infringement procedure’ or referral to the Court of Justice.

17. The chosen option is therefore to take a proportionate approach which includes both legislative and non-legislative elements, minimising the legislative component as far as possible.

18. In collaboration with industry stakeholders, a minimum harmonisation approach to these articles has been designed which will minimise any impact on industry. It will formalise the requirement that trustees for all pension schemes with more than 15 members need to satisfy themselves that they have an effective system of governance. Specific requirements for risk management and other

operational matters will be set out for schemes with more than 100 members, proportionate to the complexity and risk profile of the scheme.

19. This approach enables the requirements of the directive to be made proportionate to the different segments of the UK's diverse private occupational pensions landscape.

20. This directive is part of the EU's framework for financial regulation, and, as its requirements are aligned with the UK's own priorities, it is sensible to transpose it with a minimal impact approach. This also supports the UK's position in the EU Exit negotiations, particularly in respect of any implementation period.

21. In the unlikely event that the EU Exit negotiations result in the UK adopting a position where its policy is no longer to transpose such directives, the ability to revoke this legislation is retained.

Expected level of business impact

22. Engagement with Industry suggests that the costs of complying will be minimal. Work has been carried out with a group of key industry stakeholders to develop options for how different types of schemes could achieve an effective system of governance at a proportionate level of cost, and this work will continue during the development of TPR's Code of Practice.

23. The approach to each change is costed in the table below.

24. The changes to scheme governance in IORP II have only occasionally been referred to in the pensions press. It has correctly positioned them as being in line with the UK's existing direction of travel, in particular the current work to drive up standards of governance by TPR under its flagship "21st Century Trustee" initiative.

25. The most recent information provided to industry by professional bodies was supportive of this approach, clearly articulating the narrative[4].

Monetised and non-monetised costs and benefits

Summary

26. The total estimated cost in year 1 is £5.1[5] million and every third year after that £2.7 million. The estimated annual net direct cost to business (EANDCB) in 2016 prices and discounted to 2017 is £1.3 million.

Key assumptions

<u>Scheme volumes</u>

[4] For example: https://www.lcp.uk.com/our-viewpoint/2018/08/pensions-bulletin-201832/
[5] Note: it is assumed that the triennial costs are first incurred in year 1; the £5.1 million figure is the sum of it and the one-off / initial costs (which are all incurred in year 1) – see table 2 below for more detail.

27. Public Service schemes, Master Trust schemes, and schemes with less than 15 members are excluded from the volumes as the regulations will not apply to them.

Table1: Volumes of schemes to be used in the estimates.

Number of scheme members	Defined benefit (DB) & hybrid	Defined contribution (DC)	**Total**
15-99[6]	1,760	920	**2,680**
100+	3,638[7]	400[8]	**4,038**

Trustee numbers

28. All trustees need to familiarise themselves with the new regulations. There is no definitive figure for the total number of trustees that will be impacted so it is necessary to estimate this. For simplicity a methodology was applied of the average number of trustees per scheme multiplied by the number of schemes to calculate the total number of trustees. However, there are different types of trustees including lay and professional and many professional trustees offer services to more than one scheme. Therefore this methodology will give a higher estimate than a central figure. However, it is appreciated that the pensions landscape is complex and there are other people in the pensions system who will also need to familiarise with new regulations, such as consultants and legal advisers, and so this higher figure captures other affected people. It would be a disproportionate cost to estimate this in more depth. Therefore throughout this impact assessment references to trustees include other impacted parties as well.

29. It is estimated from TPR research that there are an average 3.4 trustees per scheme with more than 100 members[9] and 3.6 trustees in schemes with 100-999 members. This research also shows that small schemes with under 100 members have an average 2.4 trustees per scheme.

Wage assumptions

30. The average hourly wage for a trustee is £35.46[10]. For the purposes of simplicity and being prudent in the presence of uncertainty it is assumed the same rate for a documenter as well.

Length of regulations

[6] Estimated from the PPF Purple Book 2017 and the DC Trust Statistics 2017/18, Table 1.8.
[7] PPF Purple Book 2017: https://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx
[8] DC trust statistics, 2017/18. Excluding hybrids. Table 1.8: http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx
[9] TPR 2015 research shows that there are an average of 3.6 trustees for schemes with 100 – 999 members and 3.0 trustees with 1,000+ schemes. We have created a weighted average using the volume of schemes in these brackets to get 3.4 average for schemes with 100+ members http://webarchive.nationalarchives.gov.uk/20170712122409/http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf
[10] The mean hourly wage for a corporate manager or director is £27.92 in the Annual Survey of Hours and Earnings 2017 provisional, Table 2.5. This is uplifted by 27% for overheads from the archived Green Book. https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2

31. The regulations, which all schemes with more than 14 members (incl. small ones – 15 to 99 members) will have to be familiar with, are estimated to be a total of 4-5 pages long. Schemes with 100 and more members will have more detailed requirements set out for them and will need to familiarize themselves with more pages of regulations – as discussed in the paragraphs below.

Calculation of familiarization costs

32. In principle, familiarisation costs are worked out by multiplying the assumed average hourly wage rate by the number of people involved in familiarisation and by the number of hours that each person, on average, will have to spend familiarising. The assumed numbers of hours to be spent is a judgement call based on considerations of number of pages to be read and expected level of complexity involved.

Estimated direct costs – schemes with 15 to 99 members

Table 2: estimated impacts for schemes with 15 to 99 members

	Schemes	Cost	How often?	Assumptions	Rationale
System of Governance					
Familiarisation with regulations	DB and DC (2,680)	£456,300	One-off	2.4 trustees taking two hours per scheme	Estimated 4-5 pages of regulations and short time to consider these. As response should be proportionate and none of the further regulations apply to schemes of this size only a short time is estimated

1. Note that familiarisation with the system of governance regulations is required for schemes with 100+ members as well but there are more detailed requirements setting out what their system of governance must comprise. Therefore familiarisation costs have been allocated to these more detailed parts of the regulations, below.

Estimated direct costs – schemes with 100 or more members

Table 3: estimated impacts for schemes with 100 or more members.

	Schemes	Cost	How often?	Assumptions	Rationale
1. Risk assessment function					
Familiarisation with regulations and appointing the risk assessment function holder	DB & DC (4,038)	£486,800	One-off	One hour each of 3.4 trustees per scheme	All trustees to read one page of regulations with a short discussion to appoint the risk function holder. As all these schemes will have risk assessments in one form this is expected to be straightforward
To document strategies on:					
a. Underwriting and reserving; securitisations and similar commitments; asset-liability management; investment, in particular derivatives; liquidity and concentration risk management.	DB (3,638)	-			Requirement to consider as part of the DB Funding Strategy already, so no cost to these regulations

b.	Operational risks	DB & DC (4,038)	£277,900[11]	Every 3 years	Trustees (3.6) of 25% of smaller DB schemes (100-999 memberships) take half a day (3.5 hours)	DC schemes consider this under the Regulator's existing DC code so no burden. DB schemes need to consider business continuity in relation to data to comply with the General Data Protection Regulator (GDPR). Evidence from stakeholders confirmed that most schemes would have an existing process to comply with all business continuity issues under GDPR compliance. There could be some schemes with additional business continuity arrangements that go beyond those required for GDPR compliance. This might include particular skilled individuals or institutional knowledge. These are likely to be in smaller schemes. The assumption of 25% is to show there are a small number that will be impacted but the sensitivity below indicates how this could impact the total figure. *Sensitivity: If all the smaller DB schemes had to spend half a day this would cost £1,111,600*
c.	Insurance and other risk - mitigation techniques	DB & DC (4,038)	£35,800	Every 3 years	1 risk function holder taking 15 minutes	The risk function holder (or a trustee) will only have to write what they already have in relation to these so should be a quick process
d.	ESG risks relating to the investment portfolio and the management thereof.	DB & DC (4,038)	-			Transposed by the Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure)(Amendment and Modification) Regulations (Northern Ireland) 2018
e.	Where members bear risks, the risk management system must also consider those risks from their perspective.	DC (400)	-			Implicit in existing fiduciary duty so no additional cost. Schemes are not expected to go further than already required to in terms of assessing risk from the perspective of individual or segments of membership, beyond what is required to meet their existing fiduciary duty.

[11] Number of smaller DB (100-999 members) schemes is 2,488.

Documenting the risk assessment:					
Description of how risk assessment is part of scheme management & decision making;	DB & DC (4,038)	£150,300 (year 1) £35,800 (every subsequent third year)	Every 3 years	1 function holder **Yr 1**: DB schemes 1 hour, DC schemes: 50% taking 1 hour and 50% taking 2 hours **Subsequent years** all take 15 minutes	DB already has to consider this to some extent if taking an Integrated Risk Management approach to scheme funding. DC may or may not currently do this. *Sensitivity: 0% to 100% DC schemes taking 2 hours in the first year gives +/- £7,000 so small impact*
Assessment of the effectiveness of the risk-management system;	DB & DC (4,038)	£1,573,800	Every 3 years	DB schemes, 3.4 trustees, 3 hours each plus one documenter taking 2 hours.	DC considered as chair statement review. It is assumed that the trustees will all have to meet together to discuss this for approximately three hours. The documenter will write this up and then the trustees will review the document together for another hour each.
If the same person/provider carries out the same key function(s) at the employer, a description of how conflicts of interest are prevented	DB & DC (4,038)	£11,900	Every 3 years	10 mins, 1 trustee, 50% have conflict of interest	It is not known how many conflicts of interest there will be (as it is not known how many schemes will choose to use a person carrying out the function at the employer) so 50% has been chosen. *Sensitivity: If all schemes had a conflict of interest then the cost would be £17,000*
Assessment of the funding needs of the scheme, including a description of the recovery plan where applicable;	DB (3,638)	-			Covered by part 4 of the Pensions (NI) Order 2005 or the scheme funding regulations
Assessment of the risks to paying out member's retirement benefits and the effectiveness of any remedial action	DB (3,638)	-			Covered by part 4 of the Pensions (NI) Order 2005 or the scheme funding regulations
Qualitative assessment of the operational risks;	DB & DC (4,038)	£486,800	Every 3 years	3.4 trustees, 1 hour each	Short time needed for trustees to confirm in writing that operational risks have been assessed (identified above)

If ESG factors are considered in investment decisions, an assessment of risks related to climate change, use of resources and the environment, social risks and risks related to the depreciation of assets due to regulatory change.	DB & DC (4,038)	-			Covered by the 2018 regulations on Clarifying and strengthening trustee's fiduciary investment duties
2. Evaluating adequacy and effectiveness					
Familiarisation with regulations and appointing the evaluation function holder	DB & DC (4,038)	£486,800	One-off	3.4 trustees, 1 hour each	All trustees to read one page of regulations and jointly discuss and agree the approach they will take to evaluating the adequacy and effectiveness of their system of governance and then to appoint an appropriate function holder. This will involve considering the expectations for compliance that are illustrated in the Regulator's Governance Code of Practice. Discussed below*
Cost to comply with code of practice	DB & DC (4,038)	-			*Discussed below
3. Actuarial function					
Familiarisation with regulations and appointing the actuarial function holder	DB (3,638)	£219,300	One-off	3.4 trustees per scheme, 30 mins	All trustees of DB schemes to read around 1 page of regulations. These schemes will already have an actuary to carry out these duties, so providing written confirmation of this should be straightforward and should not require any new appointment to provide actuarial services.
Documenting the policy	DB (3,638)	£21,500	Every three years	1 function holder per scheme, 10 mins	The actuarial function holder will only need to provide documentation pointing at the existing actuarial contract and terms.
4. Outsourcing					
Familiarisation with regulations	DB & DC (4,038)	£243,400	One-off	3.4 trustees per scheme, 30 mins	All trustees to read, as schemes will already have decided which functions to outsource and why, so will not require discussion.
Documenting outsourcing	DB & DC (4,038)	£143,200	Every three years	1 person per scheme, 1 hour	One person will need to identify the documents that exist for outsourcing

5. Remuneration					
Familiarisation with regulations	DB & DC (4,038)	£365,100	One-off	3.4 trustees per scheme, 45 mins each	It is likely that all trustees would need to read the regulations and explanation and expectations set out in the Code of Practice, and discuss what it means for the scheme
Documenting remuneration policy	DB and DC (4,038)	£143,200	Every three years	1 person per scheme, 1 hour each	One person will need to document the remuneration policy and set out how outsourced providers also meet it, if applicable
<u>Total Cost - Central Scenario</u>					
One-off costs		**£2,372,200**[12]	One-off		
Triennial Cost[13]		**£2,729,900**	Every three years		
EANDCB		**£1,300,000**	Annual avg.		
<u>Total Cost - Worst Case Scenario</u>					
One-off costs		**£2,379,200**	One-off		
Triennial Cost[15]		**£3,568,700**	Every three years		
EANDCB		**£1,600,000**	Annual avg.		

[12] (= 456,300+ 486,800 + (150,300-35,800) +486,800 + 219,300 +243,400 + 365,100).
[13]Note: This triennial cost occurs in the first year alongside the initial cost and then subsequently every three years.

*Evaluating the adequacy and effectiveness of the system of governance

33. The previous IORP directive required adequate internal controls, and it also required actuarial work for on scheme valuations and funding strategies. UK domestic law has added requirements for UK pension schemes to carry out risk assessments on key areas of risk for each type of scheme.

34. The recast directive now positions such activities within an overarching system of governance, and it has set out three key functions to deliver parts of this system. The addition of a specific function to evaluate the system of governance represents the most material change for schemes and therefore further information about how it will be approached and costed is provided below. The three key functions are as follows:

- A function to assess and manage risk. Any changes to the existing risk management requirements will be set out in TPR's Code of Practice.

- A function to provide actuarial work on scheme valuations, funding, and risk management. This requirement only applies to schemes that must already appoint a scheme actuary to carry out this work.

- A function to evaluate the adequacy and effectiveness of the system of governance. This function requires trustees to evaluate the internal control system and other elements of the system of governance, including, where applicable, outsourced activities. Stakeholders have advised while that many large schemes already carry out such evaluations, there is currently no requirement in the UK's regulatory framework for single-employer DC or DB schemes to do so.

35. Legislation will not prescribe the method pension schemes must use to conduct their evaluation. Guidance on appropriate approaches will be developed as part of the development of TPR's code. This will enable a variety of proportionate and cost effective approaches to be used as appropriate by schemes.

36. The aim is to encourage consolidation of schemes and innovation in the development of new, targeted risk management and evaluation solutions. Some complex or larger schemes may already conduct formal internal audits, and others may need to do so in order to effectively fulfil this function. It would also be proportionate for less complex arrangements to satisfy themselves that they are achieving value for their members in this regard. For example, this might involve establishing whether their outsourced scheme administrator or other service providers have achieved recognised independent assurance standards.

37. Providing information about acceptable approaches to this function within the code of practice will enable the UK to support continued innovation in its pensions industry as the market continues to evolve over the next several years. It will also allow IORPs and the Pensions Regulator to determine the most proportionate and effective method of evaluating effective governance for the particular characteristics and risk profile of each scheme.

38. The code issued by TPR will be produced with the involvement of DWP and an industry working group to ensure cost appropriate solutions are developed and clearly explained,

so that IORPs understand what is expected of them. At this stage therefore no set of activities is available that will be required under the Code for which the cost can be estimated.

39. The impact of the Code of Practice will be estimated by The Pensions Regulator in due course and will be subject to scrutiny at that point.

Sensitivities

40. The table above discusses the sensitivities around the assumptions. In the worst case scenario the total one-off cost would be around £7,000 higher than in the central scenario; and the total cost incurred every 3 years would be around £839,000 higher than in the central scenario[14]. EANDCB estimate in this worst case scenario would be equal to £1.6 million.

Small and Micro Business Assessment

41. Compliance with the regulations is expected to be proportionate to the size of the scheme. No schemes with fewer than 15 members are impacted. Those with between 15 and 99 members are expected to read the regulations but it is not expected they will need to take any further action unless they deem it proportionate to do so.

Monitoring and Evaluation

42. The importance of monitoring and evaluation is recognised, but for such a small measure it would be disproportionate to commit to a formal programme of evaluation. However, interested stakeholders across the pensions industry will continue to be engaged to keep this policy under review. Should any issue arise with the policy, the evidence will be assessed and, if appropriate, consideration will be given as to whether any changes may be necessary.

Other Impacts

Equality

43. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on these legislative proposals and, as they make mainly technical amendments to implement the EU Directive, has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

Environmental

44. There are no implications.

Rural proofing

45. There are no implications.

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[14] Every 3 years = (1,111,600 – 277,900) + (17,000 - 11,900) and costs being £7,000 higher in the first year if all DC schemes take 2 hours.

Health

46. There are no implications.

Human rights

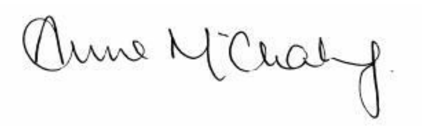
47. The Department considers that the regulations are compliant with the Human Rights Act 1998.

Competition

48. There are no implications.

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed for the Department for Communities



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