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THE OCCUPATIONAL PENSION SCHEMES (INVESTMENT) (EMPLOYER-RELATED INVESTMENTS BY MASTER TRUSTS) (AMENDMENT) REGULATIONS (NORTHERN IRELAND) 2022

REGULATORY IMPACT ASSESSMENT

INVESTOR IN PEOPLE

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The costs and savings outlined in this Regulatory Impact Assessment (RIA) are calculated on a UK-wide basis.

Evidence Base

The policy background

1. Legislation was introduced in 1995[1] and 2005[2] to prevent the misappropriation of pension scheme funds by the sponsoring employer. This included restrictions on direct loans of a pension scheme's assets to an employer and a limit on trustees and managers investing in any one employer.

2. The pensions landscape has changed significantly since this Employer-Related Investment (ERI) legislation was introduced. The success of automatic enrolment (AE) has resulted in the emergence of authorised defined contribution (DC) Master Trust (MT) pension schemes, a scheme type which enables multiple employers to use the same scheme to enrol their employees into a pension. Authorised Master Trusts account for 20.5 million DC memberships excluding hybrid schemes (94 per cent of total DC memberships excluding hybrid schemes)[3].

Rationale for Intervention

3. The Pension Schemes Act (Northern Ireland) 2021 increased regulation of Master Trusts and introduced an authorisation and supervision regime. However, this did not make changes to the ERI legislation, and therefore Master Trusts face significant burdens in relation to their investment decisions. This means Master Trusts have to closely monitor their investment decisions to ensure the types of investment do not exceed regulations in relation to a single employer who might be using the scheme. The opportunity cost is Master Trusts cannot pursue other projects and innovations which could benefit members and Master Trusts.

4. The intended effect of intervention is to provide schemes with greater flexibility in their investment strategies and reduce their administrative burdens. This could benefit members of schemes in scope through:

    - A reduction in costs to schemes in scope could be passed on to members through lower charges on pension savings.

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[1] The Pensions (Northern Ireland) Order 1995 https://iaccess.communities-ni.gov.uk/sspldbluevolumesinternet/users/internetsearchpage.aspx

[2] The Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005

[3] DC trust: scheme return data 2021 to 2022 | The Pensions Regulator

- Greater flexibility in scheme's investment strategies mean schemes face fewer limits on where they can allocate member's funds, no longer limiting the value of returns members receive on their investments.
- Greater diversification of investments, reducing risk of concentration in a narrow range of asset classes.

Description of options considered

Option 0: Do nothing

5. Existing ERI regulations would continue to apply unchanged, placing unnecessary burden on Master Trusts. All schemes must spend time monitoring each investment and face barriers to where they can invest.

Option 1: Update ERI regulations for Master Trusts with 500 or more participating employers

6. This option would involve reforming existing legislation on employer-related investments for authorised Master Trusts with 500 or more participating employers. The requirements would bring into force a narrower definition of 'employer-related investments' removing the restrictions currently placed on investments relating to participating employers.

7. Legislating would minimise the possibility of ambiguity or misinterpretation and ensure all Master Trusts take the same approach to employer-related investments.

Option 2: Alternative to legislation

8. The Pensions Regulator (TPR) could issue a further 'Letter of Comfort' or statement to reassure trustees of authorised Master Trusts that although the legal requirements remain, TPR is likely to take a generous, light-touch approach to enforcement. A similar letter was issued to some schemes in 2010. However, the impact of a statement or 'Letter of Comfort' could lead to ambiguity as it relies on how different Master Trusts choose to interpret the content. Neither would have the definitive impact of legislation.

Preferred option

9. Option 1 is the preferred option. This option will help reduce unnecessary burdens on schemes in scope and remove barriers preventing schemes from investing member funds in a more efficient manner to improve returns.

Evidence behind the rationale for intervention

10. Existing legislation introduced to prevent the misappropriation of pension scheme funds by the sponsoring employer has not been updated to accommodate the evolving pensions landscape.

11. The restrictions at present are:

- a ban on certain loans of a pension scheme's assets to an employer that participates in the pension scheme (debt)[4]
- a limit on trustees and managers investing more than 5% of a scheme's assets in ERI
- for multi-employer schemes, a limit on trustees and managers investing more than 5% of a scheme's assets in any one participating employer with a cap of 20% on the total amount of a scheme's assets that are invested in ERI. This also applies to 'associates' and 'connected persons' of any participating employer.

12. DC Master Trust schemes must monitor each investment to ensure none of the participating employers and their "associates and connected persons" are invested in by the Master Trust.

13. This means Master Trusts must spend time and money ensuring compliance with ERI restrictions by monitoring any changes to the governance, operations and ownership of companies that could relate to the scheme's participating employers against the underlying holdings of the scheme.

Rationale for Intervention

14. DC Master Trust pension schemes are multi-employer occupational pension schemes which developed to respond to demand to accommodate the legal requirement for employers to automatically enrol their employees into a pension scheme.

15. The regulations have not been updated to recognise the different structure of DC Master Trusts and neither acknowledges nor makes allowances for the altogether distinct relationship between the scheme and the multiple participating employers using the scheme.

16. Master Trusts are therefore restricted in terms of asset classes in which they can invest. For example, if a Master Trust wished to access private debt markets, they would have to ensure each and every one of the recipients of this private credit were not participating employers or in any way connected to them.

17. There is a wider objective of opening up all asset classes to DC schemes, most notably illiquids or private markets, to help maximise investment opportunities for these schemes. In the context of removing barriers to this type of investment, the current ERI regulations have been raised as a potential obstacle.

18. This change in ERI regulations could reduce risk of concentration in a narrow range of asset classes through allowing greater diversification of investments for specified schemes in scope as they face fewer restrictions in the types of asset classes and number of firms they can invest in. However, there is potential for this change to encourage investment in alternative, riskier assets but which may also have greater returns.

19. According to TPR data, there are currently 36 authorised Master Trusts accounting for 20.5 million members and over £78.8 billion in assets, excluding hybrid schemes[5].

[4] Note there are some exemptions to this ban namely corporate bonds issued via a stock exchange.
[5] DC trust: scheme return data 2021 to 2022 | The Pensions Regulator

Counterfactual

20. The counterfactual is the “do nothing” option. The counterfactual assumes that all schemes are currently fulfilling their ERI obligations by checking and reporting any investments relating to employers who are participating in their Master Trust scheme.

21. The size of the impacts to business may vary from scheme to scheme. “Specified schemes” in scope (Master Trusts with 500 or more participating employers) with more participating employers may experience a greater benefit or cost-saving from the change in regulations.

<u>Costs to Pension Schemes in Scope</u>

Familiarisation

22. Only “specified schemes” directly affected will be expected to familiarise themselves with the change in regulations.

23. There will be one-off costs to all ‘specified schemes’ trustees to familiarise themselves with the change in regulations. A pension scheme in scope will experience this one-off cost in the first year only.

24. It is estimated that there are 13 “specified schemes” in scope of the change in regulations and therefore facing a familiarisation cost6.

25. It is estimated that it would take all trustees of in-scope schemes approximately 30 minutes to read and understand the change in regulations. It is assumed that the regulations are 5 pages. It is assumed it would take 6 minutes to read each page.

26. It is estimated that schemes in scope of the proposed requirements will have approximately 3 trustees per scheme, with an estimated average hourly cost (including overheads) of around £29 per hour.

Familiarisation with change in regulations cost

Estimated 13 schemes in scope x 0.5 hours spent familiarising x 3 trustees per scheme x around £29 trustee wage per hour = £600[7]

27. TPR do not expect to add to the DC guidance regarding this change in ERI regulations as it is only relevant to specified schemes in scope.

<u>Benefits to Pension Schemes in Scope</u>

Administrative tasks and reporting

28. There will be an ongoing cost-saving to “specified schemes” as they experience a reduction in administrative tasks and reporting requirements associated with ERI.

29. “Specified schemes” will no longer be required to implement checks and monitor the connections and associations with all participating employers.

[6] Data from The Pensions Regulator.
[7] Where appropriate. figures are rounded to the nearest £100 throughout this document

30. “Specified schemes” will only be required to report investments related to their scheme funder or the scheme funder’s associations and connections should they make any.

31. It is assumed that there is one member of staff responsible for ERI administrative tasks and reporting per scheme with an estimated average hourly cost (including overheads) of around £29 per hour.

32. It is assumed that relevant staff of schemes in scope will spend 2 hours less per month on administrative and reporting tasks following the change in regulations.

33. The total ongoing benefit to all schemes in scope is estimated to be £9,000 per year.

Administrative tasks and reporting benefit

Estimated 13 schemes in scope x 2 hours less spent on administrative tasks and reporting requirements per month x 1 staff per provider x around £29 staff wage per hour = £9,000 per year

<u>Non-monetised impacts</u>

34. “Specified schemes” in scope may have previously been prevented from pursuing other projects due to the time needed to adhere to ERI regulations. The change in regulations mean “specified schemes” can now redirect this time towards such projects or innovations because of the reduced ERI burden. Some of these projects or innovations may be beneficial to both schemes and members.

35. “Specified schemes” in scope may have previously been restricted in terms of asset classes in which they can invest. Following the change in regulations, “specified schemes” will experience a reduction in such restrictions and be able to more easily take advantage of opportunities for further investment.

Impacts on TPR

<u>Non-monetised impacts</u>

Set-up costs

36. There will be a one-off cost to TPR to familiarise themselves with the change in regulations, understand impacts on their duties and implement required changes. TPR will experience this one-off cost in the first year only.

37. It is understood that TPR believe that set-up costs will be negligible. TPR will be incorporating this work into business as usual, and do not anticipate this will have an impact on the General Levy through which TPR is funded.

Other impacts

38. The potential of a reduction in revenue from criminal penalties from ERI breaches received by TPR has been considered. It is understood that TPR’s enforcement team have never received any revenue from penalties as a result of ERI breaches by “specified schemes” in scope.

39. Therefore, it is expected that TPR will not be impacted by reduced penalties as a result of the change in regulations and subsequently this has not been quantified.

40. The potential of an ongoing cost-saving to TPR resulting from a reduction in administrative tasks associated with ERI has been considered. It is understood that TPR has not received any ERI related queries for Master Trusts over the last three years.

41. Therefore, it is expected that TPR will not be impacted by reduced administrative costs as a result of the change in regulations and subsequently this has not been quantified.

Wider Economic and Societal Impacts

Members

42. The potential benefits to members from the change in regulations are discussed qualitatively. These benefits are indirect and not quantifiable as they rely on "specified schemes" in scope taking action.

43. The approximate total number of members of "specified schemes" in scope is 19 million[8].

44. Cost-savings to Master Trusts resulting from the change in regulations could ultimately benefit members in the form of lower charges and enhanced returns on their pension investments. This could result in improved investment outcomes and potentially increased incomes in retirement.

45. Members of "specified schemes" could also receive greater returns on their pension investments as a benefit of the increased flexibility in scheme's investment choices.

46. Members could benefit from increased diversification in their investment portfolios as "specified schemes" in scope face fewer restrictions in the types of asset classes they can invest in.

Employers

47. Participating employers of "specified schemes" in scope may also be impacted by the change in regulations. There will no longer be a limit on how much "specified schemes" can invest in each participating employer. Therefore, there is the possibility that employers will receive greater investment.

48. Given this benefit relies on "specified schemes" in scope taking action, it is not considered proportionate to quantify this indirect, potential impact.

Key Assumptions/Sensitivities/Risks

Sensitivities/risks

Counterfactual

49. The costs and benefits are highly dependent on the counterfactual (how much time schemes currently spend on ERI) which will vary between schemes.

[8] Data from the Pensions Regulator

50. “Specified schemes” with greater numbers of participating employers experience a greater benefit from the change in regulations, than “specified schemes” with fewer participating employers.

Sensitivity Analysis

Pension schemes in scope

Familiarisation

51. It is assumed that it will take 3 trustees per scheme in scope, 30 minutes to familiarise with the regulations in the first year only. When allowing for sensitivity around the time assumption of 50 per cent (i.e. 15 or 45 minutes) holding everything else constant, the familiarisation cost decreases to £300 and increases to £800.

Administrative tasks and reporting

52. It is assumed there will be a time reduction of 2 hours per month for 1 member of staff responsible for ERI administrative tasks per scheme in scope, giving an ongoing cost saving of £9,000 per year. When allowing for sensitivity around this time assumption of 50 per cent (i.e. 1 or 3 hours per month) holding everything else constant, the ongoing cost saving decreases to £4,500 per year and increases to £13,600 per year.

Assumptions for schemes’ familiarisation

53. It is assumed that only “specified schemes” in scope of the change in regulations will need to familiarise themselves. Data from TPR suggests that are 13 schemes which will be affected.

54. It is assumed that an average cost of time for a Trustee is around £29 per hour. This is based on the 2021 Annual Survey of Hours and Earnings (ASHE) data for Corporate Managers and Directors. The median hourly gross pay for corporate managers and directors is around £23[9]. This is uplifted by 27% for overheads from the previous version of the HMT Green Book, no updated estimate is available.

55. It is assumed that there will be 3 trustees per scheme. This is, based on TPR data on ‘Number of Trustees – by scheme type’, which shows the mean number of trustees per large (1000+ members) scheme is 3[10]. All “specified schemes” in scope belong to this large scheme category.

56. For familiarisation costs a reading time of 6 minutes per page for Trustees[11] is assumed.

57. It is assumed that the regulations will be 5 pages.

[9] Earnings and hours worked, occupation by two-digit SOC: ASHE Table 2 - Office for National Statistics (ons.gov.uk) https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2

[10] https://webarchive.nationalarchives.gov.uk/ukgwa/20170712122409/http:/www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf

[11] Consistent with assumptions in previous impact assessments, for example: regulatory Impact assessment: Default SIP for schemes with a default fund that is “with profits” - The Occupational Pension Schemes (Administration, Investment and Charges and Governance) (Amendment) Regulations (NI) 2021

Assumptions for schemes' administrative tasks and reporting

58. It is assumed that only "specified schemes" in scope of the change in regulations will experience a reduction in administrative tasks and reporting associated with ERI. It is estimated that there are 13 schemes which will be affected.

59. It is assumed that the reduction in time spent on administrative tasks and reporting is 2 hours per month.

60. It is assumed that an average cost of time for a Trustee is around £29 per hour. This is based on the 2021 Annual Survey of Hours and Earnings (ASHE) data for Corporate Managers and Directors. The median hourly gross pay for corporate managers and directors is around £23. This is uplifted by 27% for overheads from the previous version of the Green Book, no updated estimate is available.

Assumptions for TPR's set-up cost

61. It is assumed that set-up costs to be negligible and will be incorporated into business as usual.

Impact on Small and Micro Businesses

62. The proposed change in regulations will impact Master Trusts with 500 or more participating employers. Small and micro pension schemes including Executive Pension Plan and Relevant Small Schemes have been identified as out of scope of the change in regulations. These schemes are not currently experiencing the same burdens from existing ERI regulations as "specified schemes".

63. Many small and micro businesses use Master Trusts to fulfil their automatic enrolment obligations. These businesses may benefit from the proposed change in regulations as discussed above.

Monitoring and Evaluation

64. These new regulations remove restrictions on large Master Trusts. They update regulations that at present do not reflect the developments in pensions and do not reflect the current pensions landscape and the emergence of Master Trusts.

65. Once implemented there will be a period of time to allow the updated regulations to 'bed in' and for Master Trusts to take advantage of them when developing their investment strategies. As well as updating legislation these new regulations will open up avenues of investment to enable productive finance. These new regulations should, make it easier for Master Trusts to access private credit markets.

66. There will be an opportunity, along with TPR and the industry to understand and review the post implementation impact.

Summary of Impacts

Pension schemes in scope

Type/Frequency	Schemes in Scope	Cost/Saving	Assumptions
One-off (Year 1)	13	Cost £600	It is assumed that it will take 3 trustees per scheme in scope 30 minutes to familiarise with the regulations.
Ongoing (yearly)		Saving £9,000	It is assumed that there will be a time reduction of 2 hours per month for 1 member of staff responsible for ERI administrative tasks per scheme in scope.
Total Impact	£600 cost in Year 1 and £9,000 saving per year		

Other Impacts

Equality

67. 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 has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

Environmental

68. There are no implications.

Rural proofing

69. There are no implications.

Health

70. There are no implications.

Human rights

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

Competition

72. There are no implications.

Approved by:	Anne McCleary Anne McCleary Director of Social Security Policy, Legislation and Decision Making Services	**Date:**	20 July 2022

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