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THE PENSION PROTECTION FUND (PENSIONABLE SERVICE) AND OCCUPATIONAL PENSION SCHEMES (INVESTMENT AND DISCLOSURE) (AMENDMENT AND MODIFICATION) REGULATIONS (NORTHERN IRELAND) 2018

CLARIFYING AND STRENGTHENING TRUSTEES' INVESTMENT DUTIES

REGULATORY IMPACT ASSESSMENT

INVESTOR IN PEOPLE

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

Background

Occupational and personal pension schemes:

1. Private pensions can be either occupational (usually trust based) or personal pensions, including group or workplace personal pensions (which are usually contract-based). The category into which they fall affects which regulations they must comply with and which body is responsible for regulating them.

2. The policy measures proposed in this impact assessment affect occupational pension schemes and these are regulated by The Pensions Regulator (TPR).

3. Occupational pension schemes are set up by an employer to provide retirement benefits for their employees. These can be:

   - defined benefit, where the amount paid out depends on years of service with the employer and the salary that's been paid;
   - defined contribution, where the amount paid out depends on the contributions paid into it and investment performance;
   - hybrid, which have elements of both defined benefit and defined contribution pensions.

Trust-based schemes and fiduciary duty

4. Occupational pension schemes are usually trust-based schemes. Each trust-based scheme has trustees, who are separate from the employer, and who hold the assets of the pension scheme for the benefit of the beneficiaries of the scheme. Trustees

are responsible for ensuring that the pension scheme is run properly and that the members' benefits are secure.

5. Trustees have a fiduciary duty to pension scheme members – this means a duty of undivided loyalty to act for the purposes of the trust – most commonly this means acting in beneficiaries' best interests.

6. A code of practice has been issued by TPR explaining what trustees need to do in order to comply with the law in this area.

Statement of Investment Principles

7. A Statement of Investment Principles (SIP) is a written statement governing decisions about investments for the purposes of an occupational pension scheme.

8. Trustees of most occupational schemes must prepare, maintain and periodically revise the SIP. A review of the SIP must take place at least every three years and without delay after any significant change in investment policy.

The policy issue and rationale for intervention

9. There has long been concern about how fiduciary duties are interpreted in the context of pension investment. For example, some trustees believe that fiduciary duties required pension trustees to maximise returns over a short time frame precluding consideration of long-term factors. The Pensions Regulator has issued non-statutory guidance on this issue but, as found through the second Law Commission report (more details below) and through stakeholder engagement, it has not been effective.

10. This confusion and uncertainty may result in sub-optimal investment decisions being made on behalf of the members of trust based pension schemes. This may mean that the benefits of longer term investment are not maximised or it may, for example, mean trustees are unaware that they could respond to members' ethical beliefs through the way that their pension savings are invested.

11. In 2013 the Law Commission was asked to review the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstandings on the part of trustees and advisers.

12. The Law Commission reported[1] in 2014 that trustees should take into account factors which are financially material to the performance of the investment, whatever the source. They also concluded that trustees could make investment decisions based

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[1] Fiduciary Duties of Investment Intermediaries (LC350) - July 2014 - https://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/

on members' views subject to a 2-stage test being met (even if these related to issues that were not financially material)[2].

13. The Law Commission proposed that the Government make changes to the regulations to clarify the law in this area. The Government consulted on several of the proposals in 2015[3] but did not find a compelling case for legislation at that time[4]. Instead, The Pensions Regulator (TPR) amended their guidance to address these issues.

14. In 2017 the Law Commission published its findings on, amongst other things, the extent to which the law allows pension funds to select an investment because it would make a positive social impact. This work concluded that, in most cases, barriers to social investment by pension funds were structural and behavioural rather than legal or regulatory[5]. The Commission made further recommendations (broadly similar to those made in its 2014 report) which could be implemented to reduce the impact of these barriers.

15. In December 2017, the Government indicated that it was minded to accept the Law Commission's proposals for changes to regulations and would consult on these in 2018[6].

16. The evidence shows that despite guidance having been issued by TPR, there remains confusion and misapprehension over trustees' responsibilities in this area. Whilst there are clearly some trustees who understand the issues, are actively engaging with them and are reviewing and where necessary amending their investment strategies accordingly, good practice appears to be far from universal.

17. As was noted in the Government's interim response, there is also evidence of trustee misunderstanding, with a commonly held view being that environmental, social and governance (ESG) risks are irrelevant to, or run counter to, financially material concerns. Research by the law firm Sackers[7] found that:

> "[Trustees] also consider ESG (Environmental, Social and Corporate Governance factors) and external governance reviews to be low priorities. Some participants were not sure what ESG meant… Some see ESG as a distraction or potentially detrimental to achieving the scheme's goals."

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[2] The 2-stage test is based on case law which establishes that scheme trustees are allowed to take account of non-financial factors, though there is never an obligation to, if 1) trustees have good reason to think the scheme members share the concern and 2) the decision does not involve a significant financial detriment.

[3] Consultation on changes to the Investment Regulations following the Law Commission's report 'Fiduciary Duties of Investment Intermediaries' - February 2015 - https://www.gov.uk/government/consultations/changes-to-the-law-on-investments-in-occupational-pension-schemes

[4] Better Workplace Pensions: Reducing regulatory burdens, minor regulation changes, and response to consultation on the investment regulations – November 2015 - https://www.gov.uk/government/consultations/occupational-pensions-reducing-regulatory-burdens-and-minor-regulation-changes

[5] Pension Funds and Social Investment (LC374) – June 2017 - https://www.lawcom.gov.uk/project/pension-funds-and-social-investment/

[6] Pension funds and social investment: interim response – December 2017 - https://www.gov.uk/government/publications/pension-funds-and-social-investment-interim-response.

[7] Effective Governance – the Art of Balance (2017). Sackers/Winmark. - https://www.sackers.com/publication/effective-governance-the-art-of-balance

18. A recent reader poll by the trade publication Professional Pensions[8] found that more than half of respondents did not take ESG factors into account when making or advising on investment decisions, or think of climate change as a financially material risk to their investments or those of their clients. This was a relatively small self-selecting survey but its findings were consistent with those from other sources.

19. Hermes Investment Management conducted a survey[9] with institutional investors which echoed the findings in the Professional Pensions poll. They explain that there is confusion about the nature of ESG and that many investment managers see consideration of these factors as a tick box exercise rather than a prompt to consider the true long term needs of their clients:

> "Investment managers need to think about the society they are building with their saving and understand the laws of small numbers. There is no point striving for a wealthy retirement if society has been destroyed by the ill-considered actions of companies who have been insufficiently held to account by their shareholders."

Policy objectives and intended effects

20. The policy objectives are to improve understanding and practice by trustees so that they:

    - take account of financially material risks, whether these stem from investee firms' traditional financial reporting, or from broader factors covered in non-financial reporting or elsewhere;
    - fulfil the responsibilities associated with holding the investments in members' best interests – whether directly or through others acting on their behalf - not just through voting, but the full range of stewardship activities, such as monitoring, engagement and sponsoring or co-sponsoring shareholder resolutions;
    - have an agreed approach on the extent, if at all, to which they will take account of non-financial matters, including the ethical views which members hold; and
    - use the Statement of Investment Principles as a real, effective and regularly-reviewed guide to investment strategy and not as a generic 'box-ticking' document.

21. The intended effects are to improve the pension investment decision making by trustees, to ensure that trustees explain how (if at all) they take account of members' ethical views, and to ensure that they regularly review their scheme's investment performance.

22. Requiring trustees of relevant schemes to publish the Statement of Investment Principles and implementation statement is intended to build a greater degree of transparency into the system and will help engaged members understand their investments.

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[8] https://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry

[9] Responsible Investing: the Persistent Myth of Investor Sacrifice – October 2017 - https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2017/10/Hermes_responsible_capitalism_paper.pdf

23. Trustees will also have a better understanding of the meaning of ESG and this should improve their ability to utilise a wider spectrum of investments.

Policy options considered, including alternatives to regulation

Option 1 - Do nothing

24. In July 2014 the Law Commission proposed changes to clarify the law on fiduciary duties with respect to investment decision making. At the time the Government concluded that the right response was to update non-statutory guidance on this issue produced by The Pensions Regulator (TPR) rather than moving straight to legislative intervention. Subsequently, TPR issued guidance via the trustee toolkit and also through separate Defined Contribution and Defined Benefit trustee guidance.

25. In 2017 the Law Commission reviewed the barriers to social investment and through a call for evidence concluded that despite the additional guidance from TPR, there is still confusion and misapprehension over trustees' responsibilities. The Law Commission recommended legislative changes again in its 2017 report which were broadly similar to those made in 2014.

26. It is therefore clear that an alternative approach to regulation has been attempted. The evidence shows that this has failed to sufficiently address the current shortfall in trustee understanding of how to discharge their fiduciary duty in this respect, as evidenced by:

- the Law Commission's findings as set out in their 2017 report;
- research by Hermes Investment Management[10], the law firm Sackers[11], the publications Professional Pensions[12] and Portfolio Institutional[13];
- stakeholder feedback from round table events run by the DWP.

27. To continue to do nothing means that the confusion and misapprehension that has been found will continue and members' best long term outcomes may not be achieved.

Option 2 – Review and update guidance

28. As referred to in Option 1, in 2016 TPR issued non-statutory guidance to address the issues arising from the 2014 Law Commission's report. In 2017 the Law Commission

10 https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2017/10/Hermes_responsible_capitalism_paper.pdf

11 Effective Governance – the Art of Balance (2017). Sackers/Winmark. - https://www.sackers.com/publication/effective-governance-the-art-of-balance

12 https://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry

13 http://www.portfolio-institutional.co.uk/news-analysis/pensions/esg-important-criterion-well-intentioned-window-dressing-institutional-investors/

report concluded that, despite these efforts, there is still widespread misunderstanding.

29. TPR guidance for occupational schemes is voluntary and at present the wording of the current regulations on investments has proven to undermine the message in the guidance by equating financially material concerns with ethical concerns. As regulations carry more weight in the courts it is clear why trustees would err on the side of existing regulations rather than the guidance.

30. For these reasons this is being rejected as a viable option at this time.

<u>Option 3 – Issue statutory guidance</u>

31. Statutory guidance is the middle ground between non-statutory guidance and regulation. This guidance can only be issued when there are primary powers to do so and at this time such powers do not exist.

32. Therefore this option is not viable at this time.

<u>Option 4 – Regulate to include additional information within a Statement of Investment Principles</u>

33. By October 2019:

a. require trustees of occupational pension schemes with 100 members or more to update their Statement of Investment Principles to set out how they take account of financially material considerations. And for trustees of relevant DC occupational schemes – broadly, schemes offering money purchase benefits, subject to a few exceptions – regardless of scheme size, to update their default SIP to set out how they take account of financially material considerations. This will include (but not be limited to) those arising from Environmental, Social and Governance (ESG) considerations including climate change, in the selection, retention and realisation of investments;

b. require trustees of the same range of schemes to document their existing policy on the extent to which (if at all) they take account of non-financial matters, including members' ethical considerations, social impact and quality of life matters;

c. require trustees of occupational pension schemes with 100 or more members to update their Statement of Investment Principles (and for trustees of relevant DC occupational schemes with 100 or more members, to update their default SIP) to set out their policies in relation to the stewardship of the investments, including engagement with investee firms and the exercise of the voting rights associated with the investment.

Option 5 – Option 4 plus regulate to produce an implementation statement and publish this document and the SIP

34. Require trustees of relevant occupational pension schemes (broadly, schemes offering money purchase benefits, subject to a few exceptions) from October 2019 to:

   a. publish the Statement of Investment Principles on a website so that it can be found and read by both scheme members and interested members of the public;

   b. inform scheme members of the availability of the SIP via the annual benefit statement.

35. Require trustees of relevant occupational pension schemes from October 2020 to:

   a. produce an implementation statement setting out how they acted on the principles set out in the SIP and explain any change made to the SIP;

   b. publish that implementation statement and inform members of its availability via the annual benefit statement.

Expected level of business impact

36. For options 4 and 5 there will be costs to pension schemes and trustees.

Monetised and non-monetised costs and benefits

Volumes of schemes affected:

37. Different schemes are affected by parts of these regulations so the next table shows the volumes affected by each measure.

Table 1: Volumes of schemes impacted by the regulations

Stewardship Occupational Pension Schemes with 100 or more members	Defined Contribution (DC) [14]	1,050
	Defined Benefit (DB)[15]	3,638
	Total schemes	**4,688**
Financially material considerations and non-financial matters Occupational Pension Schemes with 100 or more members and DC trust-based schemes regardless of size	DC and DB with 100+ members[14,15]	4,688
	All DC trust-based schemes with fewer than 100 members[14]	31,660
	…less executive pension plans[16]	*-1,750*
	…less other relevant small schemes[17]	*-26,177*
	Total schemes[18]	**8,421**
Implementation statement, and publish this document alongside the SIP Relevant occupational pension schemes (broadly schemes offering money purchase benefits with a few exceptions[19])	**DC Occupational Pension Schemes with 100+ members**	**1,050**

Option 4

Direct cost to pension schemes

Familiarisation costs

38. There will be costs to all the scheme trustees to familiarise themselves with the new regulations[20]. It is assumed this all happens in policy year one.

[14] http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx
[15] http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx
[16] Analysis by The Pensions Regulator based on scheme returns data.
[17] Imputation from table 5.4 in http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx
[18] Data from The Pensions Regulator shows that there are a very small number of hybrid schemes which offer DC Additional Voluntary Contributions and those that offer only AVCs as DC benefits will be smaller so there has been no reduction applied to the relevant schemes volumes.
[19] It is assumed that these are all DC schemes with at least 100 members. This excludes hybrid schemes which offer AVCs as the only part of the DC section, as these are not relevant schemes for the purposes of the regulations. Data from The Pensions Regulator indicates these would be negligible volumes.
[20] Responses to the consultation stated that it might not always be the trustees that reads these and may instead be read by a pensions manager or adviser. It is assumed that the cost to a scheme will be the same though and for simplicity refer to trustee in this section.

39. The trustees will need to read around one page of regulations for each of the three measures in this option. Based on a speed of one minute to read 300 words it is assumed a trustee will take around 10 minutes to read and digest the information at an hourly rate of £25.44[21] for each trustee.

40. Note that there are types of trustees who do not receive payment for their work such as lay trustees. However, since a lot of these may be member nominated or employer nominated trustees it is still assumed that there may be a cost to business as they may be allowed work time to carry out these duties.

41. It is not known if there is any information about the total number of trustees that will need to be familiarised with these new regulations. A TPR survey in 2015 showed a mean average of three trustees per scheme[22]. They found quite a diversity in trustee numbers though, for example, defined benefit schemes tended to have more trustees than defined contribution. In addition a subsequent TPR survey in 2017[23] shows that professional trustees sit on a median average of seven trustee boards. This means if the average number of trustees is multiplied by the number of schemes the total number of trustees might be overestimated. These trustees only need to familiarise with the regulations once and not per scheme for which they are on the board.

42. However, for simplicity and because the familiarisation costs are small no attempt will be made to weight the costs by type of scheme and likely trustee structure to calculate a more accurate costing estimate. It is assumed that there are an average of three trustees per scheme to be familiarised with the new rules as per the 2015 TPR survey.

Table 2: Costs of familiarisation

Part of measure	Number of schemes	Cost
Financially material considerations	8,421	**£107,100** (10mins*£25.44 * 8,421*3)
Stewardship	4,688	**£ 59,600**(10mins * £25.44 * 4,688*3)
Non-financial matters	8,421	**£107,100** (10mins * £25.44 * 8,421*3)

43. This gives a **one-off cost of £273,800 in 2018/19**.

[21] Annual Survey of Hours and Earnings 2017 provisional data for professionals with a 27% overheads uplift as stated in the previous Green Book (the overheads uplift is not stated in the more recent Green Book so this assumption will continue to be used as per previous DWP impact assessments).

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

[23] http://www.thepensionsregulator.gov.uk/docs/professional-trustee-survey-june-2017.pdf

44. It is assumed there is no on-going cost since new trustees will have to familiarise themselves with the proposed set of regulations and guidance rather than the previous regulations and guidance in the counterfactual.

Rules for financially material considerations

45. Current case law shows that trustees have a fiduciary duty to take into account financially material factors when making investment decisions, whatever the source.

46. Under existing regulations the SIP should already be stating the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments. Note, however, that this conflates factors which may be financially material (social, environmental considerations) with those which are generally not financially material (ethical).

47. In 2015 The Pensions Regulator issued guidance via its trustee toolkit and subsequently updated its DC and DB trustee investment guidance documents to ensure trustees are aware of these responsibilities.

48. The measure proposed does not require trustees to create a new policy in relation to financially material considerations, including Environmental, Social, Governance or climate change. Instead, it requires trustees to state their existing policies about financially material considerations (including environmental, social and governance including climate change) in the SIP from October 2019. In practice, schemes may choose to enhance their existing policies in these areas or to take into account factors that they did not previously consider. This is their own choice and not a requirement of the legislation.

Rules for stewardship

49. The Financial Reporting Council (FRC) has a Stewardship Code[24] which trustees can follow. Despite the number of pension scheme signatories to the code being relatively low, expert views from The Pensions Regulator are that most schemes will have a policy on stewardship.

50. The measure proposed does not require trustees to create a policy in relation to stewardship. It requires trustees to state their existing policies in the SIP by October 2019. In practice, schemes may choose to enhance their existing policies in these areas or to take into account factors that they did not previously consider.

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[24] https://www.frc.org.uk/investors/uk-stewardship-code

Rules for non-financial matters

51. In addition to financially material factors, trustees can (but are not required to) take account of non-financial matters, including members' ethical views. The Law Commission set out in its report a 2-stage test based on case law, which must be met before trustees can take account of these factors. These are that the trustees should have a good reason to think the members hold the concern and secondly, that the decision should not involve significant financial detriment.

52. The proposed measure requires trustees of schemes to state their policy in relation to the extent, if at all, they take account of non-financial matters, including members' ethical views, social impact or quality of life matters. It does not require the scheme trustees to take account of any non-financial matters, including their actual members' views, and in many cases this could be very much harder given the low levels of member engagement (having information from a very small proportion of members would make it more difficult for trustees to meet the 2-stage test set out in the Law Commission's report with confidence). However, the trustees would have clarification that they can take members' views into account should they wish to providing the 2-stage test is met. This could for example, be in the situation where the trustees can use knowledge about the views of similar demographics of the population to their members and infer that the knowledge applies to their members[25].

53. The measure does not require scheme trustees to create a policy on taking into account members' ethical views or any other non-financial matters, and it is entirely appropriate for a scheme to state that they do not take any non-financial matters into consideration. However, it may be that schemes will choose to enhance their existing policy in this area.

Costs to review and where necessary update the SIP and default SIP for financially material considerations, non-financial matters and stewardship

54. Existing regulations require SIPs to be reviewed and where necessary updated at least every three years. This is referred to as a triennial cycle.

55. It is expected that all schemes will tend to have a policy on these three factors to comply with case law, legislation and TPR guidance. It may be that schemes have a policy of "no policy". In the case of the policies on financially material considerations and stewardship, a policy of "no policy" would need to be justified, but these regulations will not require them to newly develop policies where the existing justification still holds (and is appropriately evidenced).

[25] The Law Commission use the decision not to invest in the manufacture of cluster bombs as an example of this. The fact that the Convention on Cluster Munitions, which prohibits cluster bombs, has been ratified by the UK could give trustees reason to believe most people would consider them wrong.

56. In the case of the policy on non-financial matters, a policy of not taking account of such matters would not need justification and there is no requirement to develop a fresh policy.

Schemes who need a SIP update outside the usual triennial SIP review

57. Some pension schemes, especially Defined Benefit schemes, choose to align the triennial cycle for updating their SIP with the triennial actuarial valuation, which they are also obliged to carry out. They may wish to maintain the alignment of these cycles.

58. A maximum[26] of two thirds of the schemes will face costs to update their SIP and default SIP outside of the normal course of triennial updates (those with usual triennial updates expected between October 2019 and October 2021) to ensure they have updated the SIP by October 2019.

59. Estimates from stakeholders[27] stated that the cost to update a SIP is usually in the range of £2,000 to £5,000 and the average of these estimates was £3,166. These updates would involve reviewing all the information within the SIP.

60. It is assumed that these “out of cycle” updates only need to concentrate on adding documentation of the policies for the three factors to the SIP and will not need to be a complete update of the rest of the whole document. It is also thought that the work to update the default SIP for a scheme would be part of the same costs.

61. It is estimated that updating SIPs purely for the additional requirements would cost each scheme £3,166.

Therefore the cost to update the SIP outside of a usual triennial update would be 8,421 x 2/3 x £3,166 = **£18.0 million** in the first year of the policy (October 2018 to October 2019).

Schemes who include the additional requirements within their next triennial SIP review

62. A third of schemes are likely to have their usual triennial SIP review between October 2018 and October 2019. Trustees of schemes in this situation will already have to incur expense to review and potentially update their SIP and existing case law requires them to consider financially material factors, and if they have a policy on them, non-financial factors and stewardship.

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[26] Maximum since some schemes may update their SIP more often than every three years so there may be additional ones updating in the normal course of events before October 2019.

[27] Stakeholders covered a variety of expertise from large master trusts to trustee consultancy firms.

63. Responses to the consultation suggest that these schemes might have a slight additional average cost of about £1,250 to review and update their SIP on this occasion. This will result in a cost of 8,421*1/3 *£1,250 = **£3.5 million in 2018/19**.

64. It is assumed that there are no on-going direct costs to business. The financially and non-financially material considerations will be considered as part of the usual revision and possible updating of the SIP and once an effective policy of stewardship which meets trustees' duties has been stated, the scale of change is likely to be relatively small.

65. The total costs to update and revise the SIP to take account of these additional factors is £21.5 million.

Indirect cost to pension schemes

66. In practice, it is likely that pension schemes will choose to enhance their existing policies as a result of this clarification of responsibilities through regulations. At present some schemes might have no explicit policy on ESG or stewardship and might subsequently develop policies.

67. Information received from stakeholders before the consultation indicates that they expect the main costs from this measure to be in the area of developing policies with costs expected to be in the region of £20k to £50k per scheme that chooses to do this. This was reiterated by the responses to the consultation.

68. Since schemes will have to state their policy on how they take into account members' views it may be that they will conduct engagement activities to better understand these views. These activities could be costly, depending on the approach chosen. For example, stakeholders have stated that running postal surveys could cost in the region of £millions or that market testing of amendments to SIPs could be in the region of £10k. However, it is for individual schemes to determine what will satisfy the trustees and not a requirement of the regulations.

69. Responses to the consultation indicate that there could be quite a high proportion of schemes who will develop their policies in this area. However, it is not known how many schemes will develop their policies in these areas so an overall monetised indirect cost to pension schemes has not been provided.

Direct benefits to pension schemes

70. The Law Commission found that there was confusion around the reporting of financially material risks and opportunities and often conflation with non-financial considerations under current regulations.

71. There is confusion with some trustees about whether issues such as climate change are purely ethical considerations. Also the wording of the current regulations appears to limit the broader financial considerations that can be taken into account.

72. The regulation changes will clarify the duty on trustees to take account of financially material issues, including Environmental, Social and Governance (including climate change), to make it easier for trustees to make better decisions about the broad spectrum of financially material factors.

73. It would be disproportionate to estimate the size of these direct benefits so they have not been included in the EANDCB calculation.

Indirect benefits to pension schemes

74. One response to the consultation suggested that those pension schemes who do sustainable and responsible investment well will gain a competitive edge in the market by retaining members or attracting new employers, their advisers or members to the scheme.

Indirect benefits to members

75. The clarification of trustees' duty should result in all financially material considerations being factored into investment decisions. This should lead to better investment decisions and returns for the scheme members, ultimately delivering higher retirement income.

76. There could be an indirect benefit to members because their views on investments could be better taken into account. Research by the Defined Contribution Investment Forum found that 40% of those surveyed would contribute more to their pension saving if they knew it was being used for responsible investments[28]. 56% would have more trust in their DC pensions and 57% would engage more.

77. It would be incorrect to assert that this policy would definitely result in these outcomes due to the low level of member engagement and knowledge about pensions. However, where members are engaged, they could benefit from increased trust, engagement and contributions and this policy could result in an increase in the proportion of engaged pension savers.

78. The change in investment profile as a result of taking into account members' views could result in slight variations in returns but should not be significantly detrimental to members so as to pass the Law Commission's 2-stage test.

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[28] Survey base is all UK adults aged 22-65 with a DC pension. https://www.dcif.co.uk/wp-content/uploads/2018/04/navigating-esg-final-lo-res.pdf.

79. It would be disproportionate to estimate these potential indirect benefits so they have not been included in the EANDCB calculation.

Costs to the Pensions Regulator

80. The Pensions Regulator will need to update their guidance to trustees. They have indicated that this cost will be minimal since there is a planned review of guidance which would cover this issue.

Option 5

Direct costs to pension schemes

Familiarisation

81. There are trustees of 1,050 relevant schemes that will need to be familiar with the new regulations. It is assumed this all happens in 2018/19 after the regulations are laid and this will take around 10 minutes of a trustees' time at an hourly rate of £25.4421 (1 page of writing at an average of 600 words per page and a reading speed of 300 words per minute) and three trustees per scheme as detailed previously. This gives a one-off cost of £13,400 in 2018/19.

Publish the SIP

82. All relevant schemes will need to publish their current SIP.

83. These schemes already have to make information on costs and charges available online so they will already have a suitable web hosting arrangement and process for uploading information[29]. It is assumed that this will take 20 minutes[30] at an administrator's wage of £19.48 an hour[31].

84. The SIP has to be published from October 2019 so it is assumed they all publish in the first year of the policy when they have revised the SIP in order to be compliant on 1 October 2019. They will then need to re-publish whenever they revise the SIP. Schemes already have to review the SIP at least every three years and revise it where appropriate. It is assumed that all schemes will have to re-publish every three years though in reality some will not have to and some might have to publish more often. The estimated costs incurred are small and so sensitivity analysis is considered to be disproportionate.

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[29] S.R 2018 No. 53: The Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations (Northern Ireland) 2018 http://www.legislation.gov.uk/nisr/2018/53/contents/made

[30] This is consistent with the assumption in the disclosure of costs and charges impact assessment [as Annex to the Explanatory Memorandum], http://www.legislation.gov.uk/nisr/2018/53/pdfs/nisrem_20180053_en.pdf. This is also consistent with DWP stakeholder feedback gathered about the process which stated from no cost to 2 hours of work.

[31] Annual Survey of Hours and Earnings 2017 provisional data for administrators with a 27% overheads uplift as stated in the Green Book.

85. This gives an overall **cost to publish SIPs of £6,800 in the first year of the policy and then £2,700 every year after that**.

Updating the annual benefit statement for the SIP link

86. Each of the 1,050 relevant schemes will need to update members' annual benefit statement with a line informing members of the location of the latest SIP. Consistent with the assumptions used in the simplification of advice requirements regulations[32] and disclosure of costs and charges30 it is assumed this takes 10 minutes of a pension administrator's time at £19.48 an hour.

87. The total cost to update the annual benefit statement is **£3,400 in the first year of the policy**. There is no on-going cost.

Creating and publishing an implementation statement

88. The trustees of each of the 1,050 relevant schemes will need to create an implementation statement which they will then publish from October 2020.

89. Initially views were obtained from a small group of stakeholders and they were quite varied about the amount of time this will take and the cost. From "very little" to 10 to 20 hours internal time plus between £5k and £10k in fees (total c. £5,250 to £10,500 at £25.44 an hour21).

90. Since that sample was small the consultation impact assessment was based on another method. In 2015 there was a change to the charges and governance regulations which required schemes to review their default strategies and the underlying performances of the funds. Engagement with industry stakeholders resulted in an estimate of £1,000 being used to comply with regulations but acknowledging that there could be higher costs for schemes that may go over and above the requirements. Since this is likely to be a similar task it has been assumed that it will cost £1,000 to produce an implementation statement based on evaluating performance[33] but some sensitivities were considered.

91. Following the consultation it was decided not to revise this. A small number of respondents thought that this estimate was on the low side but other respondents suggested that their schemes are already regularly reviewing and publishing their progress against investment principles so will not have much additional burden.

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[32] http://www.legislation.gov.uk/nisr/2018/46/pdfs/nisrem_20180046_en.pdf

[33] Consistent with the charges and governance regulation changes in 2015 which considered a review of performance of the DC default schemes every three years. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/364324/better-workplace-pensions-impact-assessment.pdf.

92. Largely, respondents either agreed with the assumptions in the consultation impact assessment or at least did not disagree with them and so this provides further evidence that the estimate used is a good central estimate.

93. **This leads to costs of £1,050,000 in policy year two and each subsequent year to create the implementation statement**.

94. Using the same assumptions for publication as in Option 4 the costs to publish the implementation statement are **£6,800 in policy year two and each subsequent year**.

Updating the annual benefit statement with a link to the implementation statement

95. Using the same assumptions for updating the annual benefit statements for the SIP the costs to update the annual benefit statements is **£3,400 in policy year two** (one year later than for the SIP).

Costs to the Pensions Regulator

96. The Pensions Regulator will need to update their guidance to trustees. They have indicated that this cost will be minimal since there is a planned review of guidance which would cover this issue.

Summary

97. Table 3 sets out all the direct costs to business. The estimated annual net direct cost to business (EANDCB) for option 4 is £2.5m and for option 5 is an additional £0.9m. **The total EANDCB for option 5 is £3.5m**.

Table3: Summary of Direct costs to Business (in £millions)

Policy year	1	2	3	4	5	6	7	8	9	10
	Oct 18 – Sep 19	**Oct 19 – Sep 20**	**Oct 20 – Sep 21**	**Oct 21 – Sep 22**	**Oct 22 – Sep 23**	**Oct 23 – Sep 24**	**Oct 24 – Sep 25**	**Oct 25 – Sep 26**	**Oct 26 – Sep 27**	**Oct 27 – Sep 28**
Familiarisation (option 4 only)	0.27	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Updating the SIP for financially material considerations, non-financial matters and stewardship	22.47	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Option 4	21.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Familiarisation (additional for option 5 only)	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Publishing the SIP	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Inserting a line in the Annual Benefit Statement to point to the SIP	0.003	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Creating implementation report	0.00	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
Publishing the implementation report	0.00	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Inserting a line in the Annual Benefit Statement to point to the implementation report	0.000	0.003	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Total additional for Option 5	0.02	1.06	1.06	1.06	1.06	1.06	1.06	1.06	1.06	1.06
Total cost for Option 5	21.77	1.06	1.06	1.06	1.06	1.06	1.06	1.06	1.06	1.06

Sensitivities

Compliance assumed in the baseline

98. It may be that some scheme trustees are not fully compliant with their fiduciary obligations at present if they are not taking into account long term financially material factors. So there could be schemes which will sustain additional costs to comply with the counterfactual to the policy. These costs are excluded from this impact assessment.

Volume of schemes affected

99. There has been a consistent reduction in the volumes of trust-based schemes since 2009. There were 1,660 DC trust-based schemes with 100 or more members in 2009 and this reduced to 1,050 in 2017[34]. This is due to consolidation of schemes. Indications are that this will continue, particularly in the short term as there is evidence that there will be further consolidation of single employer schemes into master trusts. The number of master trusts is also expected to decline this year as a result of the introduction of a new authorisation and supervisory regime in this sector of the market. This means that the volumes of schemes that will be affected by the policy is likely to be lower than this assessment shows. However, there is no information about how much lower it will be and so no attempt is made to forecast the reduction in volume.

Variance around costs of producing an implementation statement

100. A small number of stakeholders were approached for evidence to feed into the consultation impact assessment. These may not have been representative of the full population of schemes. In particular it is believed that the costs of updating a SIP were likely to vary depending on issues such as whether external advisers or internal trustees produce the SIP and the level of detail that is within them. Responses from the consultation suggested that the estimate for updating the SIP was in the right ball-park and additional information was used to obtain the estimate of £3,166 that has been used in this final report.

101. An assumption of £1,000 for a scheme to produce an implementation statement was used in the consultation impact assessment. This was based on the assumption used for schemes to review their default SIP from previous impact assessment analysis. The amounts given from a small group of stakeholders for the production of an implementation statement varied from "very little" to £5k to £10k" (where reference to actual amounts was given), each of these from relatively large schemes.

[34] http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2018.aspx

102. Many respondents to the consultation either explicitly agreed with the assumptions (or did not disagree with them after reading the impact assessment). There was one response from the 89 which said that this implementation statement figure was a bit low and could be as high as £5,000 in the first year and £2,000 in subsequent years though this depends on the level of the content expected. Another respondent suggested they already regularly reviewed their investment principles anyway so should not be very much additional cost. The view taken on this issue is that there is a variety of existing practice in the industry which make estimating the actual impact of the regulation difficult but it is believed £1,000 seems reasonable for a central estimate.

103. In the consultation impact assessment some sensitivity analysis was used to understand what the impact would be on the EANDCB if the £1,000 was in fact £2,500.

104. If the true average cost was the estimate received from the respondent of £5,000 plus VAT for the first report and £2,000 plus VAT for subsequent reports then the average over the ten year policy life would be around £2,700 which is quite close to the sensitivity analysis that was carried out.

105. The sensitivity analysis of £2,500 for the implementation statement instead of £1,000 shows that the EANDCB for option 5 would be an additional £2.3m on top of option 4 costs instead of the best estimate of an additional £0.9m. The total EANDCB for option 5 would be £4.8m.

Small and Micro Business Assessment

106. Small and micro businesses, where they run their own pension schemes, are only impacted by the inclusion of a statement in DC schemes' default SIP about the financially material factors including ESG and climate change and non-financially material factors (including the extent, if at all, that members' views are taken into consideration) which the scheme takes into consideration when making investment decisions. They are excluded from the rest of the policy as this only applies to schemes with 100 or more members.

107. The vast majority of small and micro businesses that are required to enrol staff into a pension scheme because of automatic enrolment use master trust pension schemes, rather than running their own occupational scheme[35]. The smaller the scheme, the more likely the employer is to use a DC scheme and the more likely this is to be a

[35] Up to March 2017, 92% of the schemes used for AE by employers with 1-4 staff members were DC trust based schemes compared to 53% for schemes used for AE by employers with more than 30 staff members. 99.8% of the DC trust based schemes used for AE by employers with fewer than 30 staff members were master trusts compared to 97.8% for those with more than 30 staff members. http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-commentary-analysis-2017.pdf

master trust. Government has also legislated[36] to make it easier for trustees and sponsoring employers of DC schemes to close.

108. The smallest DB schemes are out of scope of these regulations altogether.

109. Anecdotally, trustees of smaller schemes are amongst those who are confused about the issues raised by the Law Commission. It is essential they have clarity on their long term investment decision making to ensure their members, who are their current or former employees, are in properly governed schemes.

110. In addition most employers' pension contributions to their employees' pension pots are conditional on the member joining the employer's nominated scheme, effectively prohibiting member choice. Extending the measures to smaller schemes ensures that members of these schemes are not disadvantaged by delays to the improvements in scheme governance which are expected to follow from consideration of longer-term financially material factors.

Monitoring and Evaluation

111. The importance of monitoring and evaluation is recognised, but for such a small measure it is considered disproportionate to commit to a formal programme of evaluation. However, the intention is that work will continue with stakeholders across the pensions industry to keep this policy under review and should any issue arise with the policy, the evidence will be assessed and, if appropriate, it will be considered whether any changes may be necessary.

Other Impacts

Equality

112. In accordance with its duty under section 75 of the Northern Ireland Act 1998, the Department has conducted a screening exercise on the legislative proposals for the Regulations and, as they are largely technical in nature and have little implication for any of the section 75 categories, has concluded that they would not have significant implications for equality of opportunity and considers that an Equality Impact Assessment is not necessary.

Environmental

113. There are no implications.

[36] http://www.legislation.gov.uk/nisr/2018/54/contents/made

Rural proofing

114. There are no implications.

Health

115. There are no implications.

Human rights

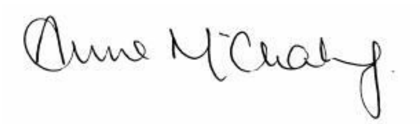
116. The Department considers that the regulations are compliant with the Human Rights Act 1998.

Competition

117. 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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