



Employer-related investments

Government response to the consultation on proposed regulations for the lifting of certain employer-related investment restrictions for authorised defined contribution Master Trust pension schemes

July 2022

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Ministerial Foreword

I am delighted to be able to publish the government's response to our consultation on removing certain restrictions on employer-related investments that currently apply to large authorised defined contribution Master Trusts, making compliance significantly easier.

I am grateful to those organisations and individuals who responded to the consultation on our draft Regulations. I'm pleased that the significant majority expressed their support and welcomed our proposals.

The success of automatic enrolment has seen the emergence of the Master Trust market and although still in its infancy it is right to update the employer-related investment regulations to reflect the evolving pensions landscape which now includes Master Trusts.

We are committed to ensuring proportionate member protection is maintained whilst disproportionate red tape is removed.



Guy Opperman MP, Minister for Pensions and Financial Inclusion

Introduction

1. This document forms the government's response to chapter 3 of the Department for Work and Pensions publication 'Facilitating investment in illiquid assets', in which we sought views on draft regulations to lift certain employer-related investment (ERI) restrictions from large authorised defined contribution (DC) Master Trust pension schemes by amending the Occupational Pension Schemes (Investment) Regulations 2005 ("2005 Regulations").
2. The consultation on ERI posed three questions and invited responses from pension scheme trustees and managers, particularly those from DC Master Trusts, pension scheme service providers, other industry bodies and professionals and any other interested stakeholders.
3. The consultation ended on 11 May 2022. Annex A lists the 28 respondents to the consultation. The government is grateful to all those who responded for their views, comments and suggestions.
4. The government welcomes the expressions of support provided by the majority of respondents. We have provided a summary of the responses received and taken

into consideration the comments and suggestions made by respondents when finalising the Occupational Pension Schemes (Investment) (Employer-related investments by Master Trusts) (Amendment) Regulations 2022 (“the Amendment Regulations”) and noted where changes have been made to the regulations.

5. The Amendment Regulations will be published on Legislation.gov.uk.
6. The impact assessment for the Amendment Regulations will be published on Legislation.gov.uk to coincide with the laying of the Amendment Regulations.
7. As pensions policy is reserved in Wales and Scotland, the Amendment Regulations and this response applies to England, Wales and Scotland, save for a consequential amendment to the Application of Pension Legislation to the National Employment Savings Trust Corporation Regulations 2010, which applies to England and Wales, Scotland and Northern Ireland.
8. The government is grateful to the Pensions Regulator for their assistance and advice on the development of these Regulations.

Consultation questions and our responses

9. In the consultation we asked three questions on: whether current legislation about employer-related investments creates a barrier to expansion of investment strategies of Master Trust pension schemes regarding private debt/credit; the framing of the draft Regulations; and if respondents agreed with the information presented in the impact assessment. The following summarises the replies we received and sets out our response, including where the Regulations have been amended.

Question 1: Do you think the current regulations relating to ERI in the 2005 Regulations present a barrier to Master Trusts expanding investment strategies to include private debt/credit?

10. The majority of responses were supportive and welcomed our proposed changes and the rationale for intervention outlined in our consultation paper, that the current regulations relating to ERI in the 2005 Regulations either do present a barrier or could be a barrier to Master Trusts pension schemes (Master Trusts) expanding their investment strategies.
11. A number of those respondents who provided more detail cited compliance with the 2005 Regulations for schemes with a large number of participating employers as costly and impractical. One respondent stated that the resource and cost of checking potential private credit investments against the list of thousands of unrelated companies, including their connected and associated parties, is a

burdensome ongoing task, particularly if then required to be monitored throughout the life of the investment.

12. Another stated that the breadth of the current ERI regulations, in particular the fact that they apply to all scheme employers, and any person connected or associated with any employer means that in practice it can be difficult for a Master Trust to conclude with sufficient certainty, that a potential private debt/credit investment would not involve the risk of an inadvertent breach of the employer-related loan restrictions.
13. A number of respondents echoed this point stating that any breach of the 2005 Regulations, even a minor and unintended one, is a criminal offence and can therefore dissuade Master Trusts from making investments in private debt/credit.
14. Some agreed that the law in this area should reflect the changes in the nature of pension provision since the 2005 Regulations were introduced and that although the ERI restrictions may currently present a small barrier they do expect the barrier to grow over time.
15. A few respondents noted their support that the Amendment Regulations will apply only to the larger Master Trust market and that the old regime will continue to apply as before for other pension schemes as intended by the 2005 Regulations.
16. A small number of respondents highlighted that the current ERI restrictions are not the sole reason why Master Trusts do not generally invest in private debt/credit identifying other barriers typically cost and market competitiveness. They did, however, accept that the draft regulations would improve flexibility regarding investment strategies of Master Trusts.
17. Only three respondents did not see the current ERI restrictions as a barrier to investment in private debt/credit. One of the respondents stated that they were not convinced that Master Trusts were restricted but did admit the pensions landscape has changed significantly. Another stated that they expected that Master Trusts “should be able to do a look-through of their holdings to assess exposures which are more than 5% of total assets”. The other respondent although not agreeing that the current ERI restrictions were a barrier to investment strategies, did accept that there was a cost to monitoring compliance.

Question 2: Do the draft regulations achieve our policy intent?
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18. The majority of responses were again supportive of the draft regulations agreeing that they deliver our policy intent.
19. A small number raised queries and/or made suggestions regarding certain elements of the draft regulations.

Threshold

20. The threshold of 500 participating employers prompted the most comment, with most of those that provided an answer to this question agreeing that the threshold was set at a sensible level. One respondent who acknowledged that the regulations did indeed deliver the policy intent, requested that the threshold be lowered slightly. Another requested the threshold be much lower and three questioned the need for a threshold.
21. As stated in our consultation on draft regulations for ERI, we considered the data provided by TPR regarding the number of participating employers, assets, and members for the 36 Master Trusts currently listed as authorised Master Trusts when determining an appropriate figure to set the threshold.
22. The data showed a gap between those Master Trusts with 500 or more participating employers and the next scheme below the 500 threshold. The threshold was set at 500 to avoid the schemes falling in and out of scope of this amendment.
23. We also stated we believe the risks of a single participating employer having influence over the investment approach increases the smaller the number of participating employers there are in a Master Trust scheme and diminishes the greater the number of participating employers. We believe 500 is the appropriate threshold beyond which that risk dissipates to a negligible level.
24. We will continue to monitor the impact of these changes and will work closely with industry stakeholders to keep these regulations under review, and should any issue arise with this policy, we will assess the evidence and if appropriate, consider whether any changes may be necessary.

Connected and associated definition

25. A small number of respondents queried the continued use of the ‘connected or associated’ test. The respondents with this query proposed the same solution, namely, to use the definitions in the Companies Act 2006 for ‘holding company’ and ‘subsidiary’ as they believe these definitions to be less complex.
26. We have considered the suggestions made but have concluded they fall outside of the policy intent of these regulations which introduce regulations to update the 2005 Regulations to reflect the current pensions landscape that includes the emergence of the Master Trust market.
27. Existing ERI legislation restricts investments relating to the employer or “any person who is connected with, or an associate of, the employer”. Section 123 of the Pensions Act 1995 provides that the definitions of associated and connected parties set out in the Insolvency Act 1996 apply.
28. Any changes to the definitions in one area of the 2005 Regulations would introduce a level of inconsistency. Furthermore, as this would be a significant change, which only a small number of recipients have raised it may require further consultation.

29. We have therefore concluded that a change to the current definitions in the 2005 Regulations would be inappropriate at this time.

Consequential amendments

30. A small number of respondents noted that the wholesale removal of paragraph (b) of regulation 4 of the Application of Pension Legislation to the National Employment Savings Trust Corporation Regulations 2010, which includes a provision to the effect that government bonds are not to be regarded as employer-related investments in respect of Nest, may not be necessary.

31. We have considered these responses and agree that this clarification remains helpful. We have therefore amended the part which refers to the 20% easement and reinstated the provision regarding government bonds.

Other issues raised

32. A few further points were raised by a very small number of respondents. These include one query as to the need to remove the overall 20% cap on ERI for multi-employer schemes, seeing it as a 'helpful backstop'.

33. One respondent queried that the regulations do not appear to carve out employers with deferred/pensioner members. We specified in the consultation that the draft regulations apply to authorised Master Trusts (as defined in the 2017 Act) with 500 or more employers of active members.

34. This is reflected in the draft regulations themselves in Regulation 16A(c) which states that the regulations apply to Master Trusts 'used' by 500 or more employers with at least one active scheme member.

35. One respondent suggested that in the interests of consistency the regulations should carry across references to 'managers' where 'trustees' are mentioned. We agree and have amended accordingly.

36. A small number of respondents queried the drafting of the transitional arrangements asking for the arrangements to be made more explicit that they also apply to employer-related loans. We have amended accordingly.

37. Two respondents offered suggestions for an alternative option to our ERI proposals put forward in chapter 3 of our 'Facilitating investment in illiquid assets' publication. As their suggestions diverged significantly from our proposals and the draft regulations we have consulted on, we would not be able to take either of their suggestions forward without further consultation.

<p>Question 3: Do you agree with the information presented in the impact assessment?</p>

38. The responses to question 3 were limited with most respondents either leaving this question unanswered or stating they had no comment to make.

39. Three respondents gave a more detailed response regarding the possible impacts of these regulations.
40. Two respondents stated that the benefits to members were overstated, that it was unlikely that the administrative burden had been a major contributor to Master Trusts not pursuing other projects and that it was unlikely that any cost savings would be sufficient to be passed onto members through lower charges.
41. The third contributor stated that the estimated cost saving benefit to pension schemes in scope for administrative tasks and reporting is underestimated. They provided an example of costs incurred from an investment specialist/consultant to carry out and provide detailed analysis of pooled fund investments. This suggested the saving would be higher than the estimate in the impact assessment if this cost is commonplace for all impacted schemes.
42. We have considered these comments and included additional details in the impact assessment in response, which will be published when the regulations are laid.

Annex A

ABI
ACA
Aegon
AIC
Allspring Global Investments
Avivia
CFA Society of the UK
Association of Pension Lawyers
Connected Asset Management
Cushon
Eversheds-Sutherland
Hymans Robertson
ISIO Group
Lane Clark and Peacock
Legal and General
Mercer
Nest
Partners Group UK Ltd
PLSA
Pinsent Masons
Smart Pensions
Society of Pension Professionals
Standard Life (Part of the Phoenix Group)
Tesco
The Investment Association
The Pensions Management Institute
TISA
XPS