EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL PENSION SCHEMES (MEMBER-NOMINATED TRUSTEES AND DIRECTORS) REGULATIONS 2006

2006 No. 714

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 The regulations provide for exemptions and modifications to the requirements to make arrangements for the appointment of member-nominated trustees and directors under sections 241 to 243 of the Pensions Act 2004

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Background

4.1 Sections 241 to 243 of the Pensions Act 2004 require schemes to make arrangements that provide for at least one third of the trustees in an occupational pension scheme to be member-nominated trustees (MNTs). If the trustee is a company, the arrangements must provide for at least one third of the directors to be member-nominated directors (MNDs).

4.2 These provisions come into force on 6th April 2006, and the purpose of these regulations is to prescribe those types of scheme where the requirements don’t apply, to modify the provisions in certain limited circumstances, and to make transitional provision.

5. Extent

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The requirement for there to be at least one third member-nominated trustees dates back to the Pensions Act 1995. The Pensions Act 1995 arose out of the report of the Pensions Law Review Committee under the chairmanship of Professor Goode, which recommended that occupational pension schemes should have at least one-third MNT, with the option for employers to propose an alternative arrangement if the members agreed.

7.2 The revised requirements introduced by the Pensions Act 2004 arise from the recommendations of the report “A Simpler Way to Better Pensions” produced by Alan Pickering in July 2002.

7.3 The Government accepted the recommendation that all schemes should have member-nominated trustees, and that this should be achieved in a non-prescriptive fashion. The Government agrees that member involvement in the running of their schemes helps promote a sense of ownership, and helps create confidence that the scheme is being run properly

7.4 The primary legislations sets out the basic requirements that trustees must comply with, namely:

> 7.4.1 trustees must make arrangements that provide for at least one third MNTs
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> 7.4.2 those arrangements must be implemented
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> 7.4.3 the nomination process must involve all the active and pensioner members or organisations that represent them
>
> 7.4.4 the selection process must involve at least some of the members.

7.5 The legislation says that this must all be done within a “reasonable time”, but the meaning of “reasonable time” is not prescribed. Instead, it will be included in a Code of Practice issued by the Pensions Regulator under section 90 of the Pensions Act 2004.

7.6 These regulations cover exemptions from the requirements, modifications in prescribed circumstances, and transitional arrangements.

7.7 We received 45 responses to consultation, and made a small number of changes as a result. The most significant change is to exempt small insured schemes from the MNT/MND requirements.

7.8 Comments were largely focused on which schemes would be exempt from the new requirements, and schemes that are exempt from the existing requirements seeking assurance that they would remain exempt. The

Government is content that the regulations meet the policy intent.

7.9 It was also pointed out in consultation that MNTs and MND appointed under the requirements of the Pensions Act 1995 do not necessarily meet the definition under the Pensions Act 2004. This would mean schemes would have to replace their existing MNT/MNDs immediately the Pensions Act 2004 comes into force. We have amended the regulations to allow MNTs and MNDs properly appointed under the Pensions Act 2004 to remain in post for their full term of office.

8. Impact

8.1 A Regulatory Impact Assessment in respect of the Pensions Act 2004 was published in June 2004, and this included an assessment of the impact of the changes to the MNT/MND requirements. A full Regulatory Impact Assessment is not, therefore, necessary.

Changes made to the regulations following consultation, however, will lead to a reduction in the one-off administrative costs published in the RIA, and an increase in the ongoing savings. An assessment of these changes is attached to this memorandum.

8.2 These Regulations impose no new costs on the public sector.

9. Contact

David Hone at the Department for Work and Pensions Tel: 020-7962-8684 or e-mail: david.hone@dwp.gsi.gov.uk can answer any queries regarding the instrument.

Annex A

Extract from the Regulatory Impact Assessment accompanying the Pensions Bill 2004 (Lords)

Published 8th June 2004

3.5 Member-Nominated Trustees (MNTs)

3.5.1 Changes to the legislation on member-nominated trustees were included in the Child Support, Pensions and Social Security Act 2000, but these remain uncommenced pending the outcome of the Pickering review on simplification and flexibility.

Summary of options and impact of consultation

3.5.2 Consultation was undertaken on how to change the MNT requirements to ensure that every scheme has at least one third MNTs, and to simplify the legislation. The current complex and prescriptive legislation would be replaced by minimal requirements in legislation backed by guidance issued by the Regulator. The consultation also covered the issue of whether the basic requirement should be complemented by an additional test that any arrangements for nominating and selecting MNTs should be "fair and open". Responses to this consultation indicated broad agreement that the current legislation is too complex and prescriptive, and that simplification would be welcomed.

3.5.3 The Pension Bill therefore:

• simplifies the existing legislation; and
• provides that every scheme (subject to specific exceptions) must have MNT's by removing the right of the employer to propose alternative arrangements.

3.5.4 The benefits of this are:

greater member involvement in more schemes, which should help to raise standards of governance and increase member confidence; and
• • more flexibility for schemes to adopt arrangements to suit their unique circumstances.

3.5.5 Some concerns were expressed that more flexible and less prescriptive legislation would give unscrupulous schemes the scope to avoid MNTs altogether, or to disenfranchise certain members or groups of members. This was balanced by views that schemes would be free to adopt arrangements to suit their circumstances, and focus more on the outcome than the process. There was widespread concern that enforcing a “fair and open” test would be difficult, time consuming and expensive and lead to vexatious complaints to the regulator.

3.5.6 The outcome of the consultation is that the decision was made to progress with the proposal to simplify the legislation, but not to progress the “fair and open” test.

Costs and Savings of the proposals

3.5.7 The costs and benefits of amending the MNT provisions are difficult to assess with any degree of accuracy because they impact on different schemes in different ways depending on:

- the size of the scheme;
- the route taken by the scheme to meet current statutory requirements; and
- the arrangements the scheme adopts to meet the new requirements.

3.5.8 There will be start-up costs for schemes that do not currently have MNTs. This is likely to be spread across a small number of large schemes, and a large number of small schemes. Schemes with MNTs already may have some costs associated with checking that their arrangements meet any new statutory requirements. Overall, the one-off costs could be in the region of £25 million.

3.5.9 There will be significant on-going savings for most schemes through not having to undertake a statutory consultation procedure, and through having more flexibility to adopt arrangements that suit their own circumstances. These could be in the region of £15 million per year across all schemes. The savings will be greater for large schemes because they have more members to consult, but there is no reason to believe that different business sectors will be affected in greatly different ways.

Securing compliance

3.5.10 Enforcement will be the responsibility of The Pensions Regulator. The full range of proposed powers will be available to investigate any alleged breaches of the requirements and take corrective or punitive action.

Annex B

Member-nominated Trustees and Directors – Changes to the Pensions Bill 2004 Regulatory Impact Assessment

1.1 Sections 241 to 243 of the Pensions Act 2004 introduce new requirements in respect of member-nominated trustees and directors in occupational pension schemes to replace the existing provisions in sections 16 to 21 of the Pensions Act 1995.

1.2 From 6/4/06:

- Every scheme with the exception of a number of prescribed exemptions will be required to have arrangements that provide for at least one third of the trustees to be member-nominated trustees,
- There will no longer be the opportunity for employers to propose alternative arrangements, and
- The legislation will be less prescriptive and easier for trustees to implement in a flexible way

Pensions Act 2004 - Costs and Savings of the proposals

2.1 A Regulatory Impact Assessment for the Pensions Bill 2004 was published in June 2004. The Government pointed out that the costs and benefits of amending the MNT provisions are difficult to assess with any degree of accuracy because they impact on different schemes in different ways depending on:

- the size of the scheme;
- the route taken by the scheme to meet current statutory requirements; and
- the arrangements the trustees choose to adopt to meet the new requirements.

2.2 The RIA was assessed on the assumption that there will be start-up costs for schemes that do not currently have MNTs, and that this is likely to be spread across a small number of large schemes, and a large number of small schemes. Overall, the one-off costs were thought to be in the region of £25 million.

2.3 There will be significant on-going savings for most schemes through not having to undertake a statutory consultation procedure, and through having more flexibility to adopt arrangements that suit their own circumstances. These were estimated to be in the region of £15 million per year across all schemes. The savings will be greater for large schemes because they have more members to consult.

Changes to Regulations

3.1 The Government consulted on regulations under sections 241 to 243 of the Pensions Act 2004 between July and October 2004.

3.2 One of the issues raised in consultation was whether small insured schemes should be exempt from the requirement to have arrangements that provide for one third of the trustees to be member-nominated trustees.

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Options

4.1 Two options were considered in dealing with the request:

1 – do nothing, and

2 – agree to exempt small insured schemes

Costs and benefits

4.2 "Do nothing" is effectively the option covered by the RIA published in June 2004, so there is no impact.

4.3 If there was an exemption for small insured schemes, they would not be required to devise or implement arrangements for nominating and selecting Member-nominated trustees or directors.

4.4 For small schemes, trustees would have the flexibility to devise nomination and selection arrangements that are simple and easy to implement, and with a small number of members, it should not be a huge administrative burden. Nevertheless, it is something that would take time and effort, and therefore cost money.

4.5 In small schemes, the cost of running a nomination and selection process could also be kept low.

4.6 There are however, around 65,000 defined contribution occupational pension scheme, and although the requirements would not apply to all these schemes, the number that would be taken outside the requirements would be significant.

4.7 As with calculating the original financial impact, it is difficult to assess the impact of the change with any degree of certainty. If an additional 30,000 schemes were taken out of the requirements, the one-off costs could be reduced from £25m to around £10m.

4.8 The ongoing costs are unlikely to be significantly different, as we had already assumed that these schemes are likely to include a large proportion that had “opted out” of MNT/MNDs by adopting employer’s alternative arrangements, and that the cost of this would now be saved. There would be some additional savings as there would be no need to implement MNT/MND nomination and selection arrangements, but with few members this was not likely to be a huge cost. We estimate the ongoing savings could increase from £15m to £16m.

Summary

5.1 Following consultation on regulations, the Government has decided to exempt small insured schemes from sections 241 to 243 of the Pensions Act 2004

5.2 As a result of this, the one-off costs published in the Regulatory Impact Assessment published with the Pensions Bill 2004 reduce from £25m to £10m, and the ongoing savings increase from £15m per annum to £16m per annum.