Another step towards improving DC member outcomes

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With small pots and small schemes hot topics once again, the Department of Work and Pensions (DWP) has published a response to its February 2019 consultation on 'Investment Innovation and Future Consolidation'.

In it, the Government proposes changes intended to accelerate the pace of defined contribution (DC) consolidation. It also sets out a new consultation aimed at improving governance, promoting investment diversification and signalling its commitment to transparent disclosure to members.

Moving towards consolidation

We are beginning to see a move towards consolidation of the DC market, with the Government noting a 12% fall in DC scheme numbers in the past year. However, the trend amongst smaller schemes is slower.

In its consultation response, the Government stated that it believes DC consolidation is "the most effective way to ensure that all savers are receiving the best value from well governed schemes that can achieve economies of scale". It sees consolidation as offering greater opportunities to access a diverse range of investment products and investment strategies to the benefit of both pension savers and the UK economy.

The Government acknowledges that "many trustees of smaller schemes work diligently to protect the interests of scheme members" but that smaller schemes can "struggle to achieve the economies of scale or to access the services and investment strategies offered" to larger ones. It is these 'smaller schemes' that are the focus of the Government's proposals.

New annual value assessment

Subject to certain exceptions, trustees of DC or hybrid schemes with less than £100 million in DC assets will be required to undertake a new 'more holistic' annual value assessment and report on it in their chair's statement and scheme return.

When assessing their scheme, the proposed factors trustees will need to consider are:

- costs and charges (assessed in comparison to other large schemes)
- net investment returns
- measures of administration and governance.

Where schemes cannot demonstrate value for members, the Government will expect them to wind-up and consolidate into a larger, better value scheme. Only in exceptional circumstances - where trustees are realistically confident that improvements can be made rapidly and cost-effectively, where it may be more expensive to wind-up or where valuable guarantees would be lost on consolidation - could a scheme seek to improve first.

Other changes to note

The response sets out further proposed changes that trustees should keep an eye on. Amongst other things, these include requirements for 'Relevant Schemes' to publish in their chair's statements net returns for their default and self-select funds and the level of charges and transaction costs for all funds in which members are invested, including those no longer offered.

Looking ahead

The new consultation closes at the end of October and the DWP intends the requirements to come into force on 5 October 2021.

Trustees should take note that if, once in force, the changes do not drive consolidation at a 'sufficient pace', the Government intends to legislate to mandate it where necessary.