Sackers

Consultation — Improving outcomes for members of DC schemes

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Introduction

On 11 September 2020, the DWP published its response to the February 2019 consultation, "Investment Innovation and Future Consolidation" ("the 2019 Consultation"). The response includes a further consultation on changes to regulations and statutory guidance which are intended to improve DC pension scheme governance, promote the diversification of investment portfolios and to signal the Government's commitment to transparent disclosure to scheme members.

Key points

- Subject to certain exceptions, trustees of DC / hybrid schemes with less than £100 million in DC assets ("Smaller Schemes") will be required to undertake a "more holistic" annual value assessment and report on it in their chair's statement and scheme return. Unless improvements can be made rapidly and cost-effectively, the Government will expect those schemes which do not demonstrate value for members to be wound up and consolidated.
- A limited easement is proposed to the measurement of compliance with the default fund charge cap to accommodate performance fees and facilitate investment in illiquid assets. Views are also sought on a further alternative option which would enable investment in less liquid assets such as venture capital.

Background

The Government believes that 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
- will also deliver greater opportunities for members to access a more diverse range of investment products and investment strategies to the benefit of both the pension saver and the broader UK economy.

While "not all small schemes are badly run" and "many trustees of smaller schemes work diligently to protect scheme members", the Government is also determined to do more to ensure the trustees of smaller schemes act in the best interests of members and are able to invest in a broad range of assets.

Encouraging consolidation

Under the proposals, Smaller Schemes (except those in operation for less than three years at the assessment date) will be required to complete a "more holistic" annual value for members assessment and to report on it in their chair's statement. The proposed factors to be assessed, by reference to new statutory guidance are:

- costs and charges — to be assessed relatively, based on comparison with at least three other "large" schemes (ie with assets of £100 million or more) at least one of which should be willing to accept a transfer in of the scheme's members
- net investment returns
- measures of administration and governance — which includes promptness and accuracy of financial transactions, appropriateness of default investment strategy, quality of investment governance, quality of record keeping, quality of communication with members, level of trustee knowledge, understanding and skills to run the scheme effectively, and effectiveness of management of conflicts of interest.

If the trustees conclude that the scheme is not delivering good overall value, the Government expects the scheme to be wound up and consolidated. However, if the trustees are "realistically confident" that required improvements can be made, and/or:

- it may be more expensive to wind up
- valuable guarantees would be lost on consolidation

the scheme may seek to improve first. Trustees will be required to report to TPR, in their next scheme return, the outcome of the assessment and the action they intend to take / are taking (if any).

The current value assessment (ie the extent to which member-borne costs and charges represent good value for members) will continue to apply to those outside of the scope of these changes, although they may choose to have regard to the new assessment.

Other changes to legislation

Chairs' statements

To provide greater transparency, all "Relevant Schemes" (broadly, occupational schemes which provide DC benefits other than AVCs), regardless of size, will be required to publish net returns for their default and self-select funds in their annual chair's statement.

In addition, the DWP intends to update the statutory guidance on reporting costs and charges to clarify the minimum expectations for the provision of costs and charges information, in particular the compounding costs and charges illustrations.

Default arrangements with a "promise"

Currently, arrangements with a third party "promise" as to the level of benefits are carved out from the definition of a default arrangement and, as such, also exempted from the default fund charge cap. As a result, such arrangements are not required to produce a default SIP. In practice, the only commonly found default arrangements which might have guarantees are older with-profits policies.

In recognition of the cost of providing the promise, it remains Government policy that such arrangements are outside the scope of the charge cap. But the Government wants such arrangements to:

- document their aims and objectives
- explain how the selection of with-profits is intended to ensure that the assets are invested in the best interests of beneficiaries
- regularly review their performance and appropriateness.

It is therefore consulting on a change to the regulations which will require them to produce a default SIP.

Reporting costs and charges for funds which are no longer offered

Since 6 April 2018, in their chair's statement, Relevant Schemes must set out the level of charges and transaction costs for all their default arrangements and self-select funds. To ensure every scheme member can identify the costs and charges they have paid for the funds in which they are invested, the DWP is amending the regulations to make clear that the requirement applies to all funds in which members are invested. This will include funds which are no longer offered to members and therefore no longer available for selection.

Wholly-insured schemes

Wholly-insured schemes are exempt from the requirement to produce most sections of the SIP as, typically, a combination of their rules and the terms of their insurance policies mean the trustees have no discretion as to how the scheme's funds are invested. This exemption was not extended to cover recent additions to the contents of the SIP and the DWP now intends to remedy this. However, it makes clear that it still requires "trustees of DC schemes investing via unit-linked contracts" to meet all the SIP requirements. This is because such trustees are free to enter different insurance contracts in order to change the investments which make up the default.

Next steps

The consultation closes on 30 October 2020. The DWP intends the draft regulations to come into force on 5 October 2021.

Should the new requirements not drive consolidation at "sufficient pace", the Government states that it will develop legislation to mandate consolidation.

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