Sackers

Facilitating investment in illiquid assets by DC schemes

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Introduction

On 30 March 2022 the DWP published a consultation seeking views on proposals and draft regulations to improve the accessibility of illiquid assets for DC pension scheme investment.

Key points

- The DWP proposes to amend the SIP requirements to ensure that DC schemes, and the DC section of hybrid schemes, disclose and explain their policies on illiquid investments. In addition, DC schemes with over £100m in total assets may be required to publicly disclose and explain their default asset class allocation in their annual chair's statement.
- The current restrictions on employer-related investments look set to be amended for authorised master trusts with 500 or more active participating employers.
- Having "taken on board" the "mixed reaction" to its 2021 consultation on exempting certain performance-based fees from the charge cap, the DWP will consider how to address the concerns raised and intends to consult on principle-based draft guidance alongside any proposed consultation on draft regulations.
- In addition, following its call for evidence on the case for greater consolidation, the DWP has decided not to introduce any new regulatory requirements with the sole purpose of consolidating the market in 2022.

Background

Since 2020, the DWP has issued several consultations aimed at facilitating the diversification of DC investment portfolios and/or encouraging greater DC consolidation. This consultation sets out the next steps of the DWP's plan, with particular focus on opening illiquid asset classes to DC schemes.

New disclose and explain requirements

The DWP is proposing two amendments to DC disclosure requirements which it believes will encourage greater competition and innovation based on overall value for money in the DC market, as well as complementing the work of the FCA and TPR to create a single framework for value for money in DC pensions.

SIP requirements

In future, relevant DC pension schemes, and the DC sections of hybrid schemes, will need to disclose and explain their policies on illiquid investment in relation to default arrangements. DB-only schemes and self-select funds will not be affected under the current proposals. The SIP would need to include reference to certain matters, such as (among others):

- what illiquid assets are (the consultation calls for input on how these are defined)
- whether trustees choose to invest in illiquid assets and what factors they consider when deciding whether to invest in them
- which members will be holding illiquid assets, eg does the scheme lifestyle members in and out of illiquid assets and at roughly what age?

Chair's statements

The DWP also proposes amending the requirements for a chair's statement for schemes with over £100m in assets under management based on the scheme's latest audited accounts (for hybrid schemes, total assets would take into account both DB and DC assets). Such schemes will have to disclose the percentage of assets allocated in the default fund to seven main asset classes: cash, bonds, listed equities, private equity (including venture capital and growth equity), property, infrastructure, and private debt. Guidance would be issued to describe the way in which the information should be disclosed, including addressing age-specific disclosures and averaging of allocations across the year.

The DWP believes this change would complement the requirement for trustees to disclose net investment returns from the first scheme year ending after 1 October 2021, since this would mean members have access to one metric that will encompass both the price and the performance of DC benefits and better enable comparisons between DC providers. Of course, trustees are ultimately responsible for the scheme's investments, and the DWP is at pains to make clear that it is not requiring trustees to change asset allocations or to mandate investment in certain assets.

Changes to employer-related investment restrictions

Since the 1990s, trustees of occupational pension schemes have been subject to restrictions on investments that are connected with employers that sponsor or participate in the scheme ("employer-related investments" or "ERI"). Broadly, this has the dual aim of reducing the risk of a sponsoring employer misappropriating scheme funds through loans and investments from the pension scheme, and preventing a concentration of investment risk for scheme members.

At present, the restrictions:

- with limited exceptions, ban certain loans of a scheme's assets to an employer (or a connected or associated person) that participates in the pension scheme
- limit trustees and managers investing more than 5% of a scheme's assets in ERI
- for multi-employer schemes, limit trustees and managers investing more than 5% of a scheme's assets in any one participating employer or associated employers, with a cap of 20% on the total amount of a scheme's assets that are invested in ERI.

Breach of the restrictions by trustees or managers is a criminal offence and as such can potentially lead to a fine and/or imprisonment.

The DWP believes that, in the relatively new context of authorised DC master trusts, the ERI restrictions go beyond their initial policy intent. Large DC master trusts are used by multiple, generally unconnected, participating employers, often as a means of complying with their AE obligations, with the employers operating entirely separately and at arm's length to the scheme. As such, there is a negligible risk of participating employers influencing the scheme's investment strategy.

Designed to make it easier for authorised master trusts to access private credit markets, the DWP has published draft regulations which will amend the way in which the ERI restrictions apply to master trusts with 500 or more active participating employers. The ERI restrictions will no longer apply in relation to each participating employer but instead will apply in relation to the scheme funder and scheme strategist, or persons associated with or connected to them. The draft regulations will also make consequential changes to the disclosure requirements related to ERI.

Based on data provided by TPR, 13 authorised master trusts would be in scope of these changes. The draft regulations contain easements allowing trustees time to adjust their investment strategy if the number of active participating employers drops below 500, including a two-year transition period and an ability to retain investments if divestment is not possible for contractual or other legal reasons.

The amendments will not apply to smaller master trusts, as the DWP considers that the cost of monitoring ERI breaches is manageable for schemes with less than 500 active participating employers. It also believes that the risks of an employer having undue influence on investments increases the smaller the number of participating employers.

An alternative to changing the legislation, considered by the DWP in its impact assessment, is for TPR to issue a 'Letter of Comfort' or statement to reassure trustees of authorised master trusts that it is likely to take a "generous, light-touch" enforcement approach. However, this is not the DWP's preferred approach because it would not have the definitive impact of legislation and could lead to ambiguity.

Next steps

The consultation closes on 11 May 2022, with the ERI changes scheduled to come into force on 1 October 2022. No timescale has been given for when the changes to the SIP and chair's statement would come into force.

As it remains concerned that the risk of poorer member outcomes is increased with smaller schemes, the DWP "will work closely with TPR to monitor the impact" of the new value for members' assessment for DC or hybrid schemes with less than £100m in total assets, and will also continue to work with TPR and the FCA to develop a framework "that will enable comparison and encourage competition on overall value".

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