

Consultation - Broadening the investment opportunities of DC schemes



Alert | 11 October 2022

Introduction

On 6 October 2022, the DWP published a [consultation](#) on [draft regulations](#) and [statutory guidance](#) (“the Regulations” and “the Guidance”, respectively) intended to implement certain of the changes proposed in its March 2022 consultation, “[Facilitating investment in illiquid assets](#)” (“the March Consultation”), as well as to exempt performance-based fees from the DC charge cap. The consultation also includes the DWP’s response to the March Consultation.

Key points

- Schemes that provide DC benefits (excluding schemes where the only DC benefits are AVCs) will be required to disclose and explain their policies on illiquid investments in the default arrangement in their scheme. (For CDC schemes, the requirement will apply to the scheme as a whole.)
- DC schemes will also be required to publicly disclose and explain their default asset class allocation in their annual chair’s statement. (For CDC schemes, the requirement will apply to the scheme as a whole.)
- “Well-designed” performance-based fees will be added to the exemptions to the charge cap.
- Trustees will be required to have regard to the Guidance in relation to the asset allocation disclosures in the chair’s statement, and when determining whether a performance-based fee falls within the new charge cap exemption.

Background

Enabling occupational schemes to take advantage of long-term illiquid investment is “one of this government’s key priorities”. With the scale of assets invested in DC expected to double by 2030 and the framework for CDC schemes coming into force this year, the government considers that “it is right that trustees now consider investing in a broader range of assets as part of a diversified portfolio”.

In the March Consultation, the DWP proposed amendments to DC disclosure requirements which it believed would encourage greater competition and innovation based on overall value for money in the DC market. The Regulations and Guidance seek to deliver these changes.

In addition, following a [consultation in November 2021](#) and the announcement in the Chancellor of the Exchequer's recent "[Growth Plan](#)", the Regulations also include measures to remove "well-designed performance-based fees" from the DC charge cap.

Disclose and explain policies on illiquid investments

Under the Regulations, schemes that provide DC benefits (other than DC AVCs) and CDC schemes will need to:

- in respect of the scheme's default arrangement, disclose and explain their policies on illiquid investments in the default SIP (or their policies in respect of the scheme as a whole for CDC schemes)
- publicly disclose and explain the percentage of assets in the default fund (or scheme as a whole for CDC schemes) that are allocated to certain asset classes in their annual chair's statement.

Following consultation, the proposal to exclude schemes with less than £100m in assets under management from the above requirements has been removed.

These disclosures are intended to:

- improve the availability of investment information to members and employers and provide them with the certainty that schemes are providing members with the "best possible value"
- help to ensure that trustees are giving "proper consideration" to a wider range of investment opportunities on offer and allow trustees to compare the impact their respective asset allocations have on investment returns.

"Illiquid assets" are defined in the Regulations as "assets which cannot easily or quickly be sold or exchanged for cash and, where assets are invested in a collective investment scheme, includes any such assets held by the collective investment scheme". The definition aims to be high level enough so that "industry may continue to innovate" but prescriptive enough so that disclosures are "uniform" across schemes.

Timing

Schemes must include a policy on illiquid investments in the default SIP (or main SIP for CDC schemes) on the first occasion that the relevant SIP is revised after 1 October 2023, or by 1 October 2024 at the latest.

The new disclosures relating to asset class allocation must be included in the chair's statement for the first scheme year which ends after 1 October 2023.

Exemption to the charge cap

The Regulations exempt certain performance-based fees from the charge cap, which applies to:

- default funds in DC schemes used for AE
- CDC schemes used for AE.

The changes take effect from the date the Regulations come into force, which is expected to be 6 April 2023. The change is intended to give schemes the option to incur "well-designed" performance-based fees, in the knowledge that those fees would not be subject to the cap. Relevant performance fees include those calculated only by reference to investment performance that are paid when a fund or asset manager

exceeds pre-agreed performance targets. Components of a performance fee structure that are not linked directly to investment performance, such as any fixed rate management fee, will continue to remain subject to the charge cap.

In response to concerns that members could be subject to performance fees during a given period but then not be reimbursed in the instance of poor performance, trustees will need to agree with the fund manager methods to mitigate the risk that the amount of the fee is increased as a result of short-term fluctuations in performance or valuations of the investment.

The Regulations remove the existing ability to smooth the incurrence of performance fees over a five year moving average, but provide transitional arrangements for schemes where this facility is in use.

Disclosure in the chair's statement

Under the Regulations, trustees are required to:

- calculate and disclose any performance-based fee charges that members incur in the chair's statement, in the same way as all other member-borne costs and charges
- take any performance-based fee charges into account in the value for members assessment in the chair's statement.

The section of the chair's statement which covers performance fees will have to be published on a free to access website. The changes to the chair's statement are expected to apply in relation to the first scheme year which ends after 6 April 2023.

Statutory guidance

Trustees must have regard to the Guidance when complying with their obligations under the Regulations. The Guidance is intended to:

- assist trustees of relevant DC schemes in the calculation and format of the asset allocation disclosures in their chair's statement
- ensure that trustees have a fuller understanding of what elements make up a specified performance-based fee and what conditions they must meet if they want to be able to exclude these fees from their charge cap calculations.

The Guidance also expects trustees to seek their own independent professional and legal advice before entering into any agreement which involves the use of performance fees.

Next steps

The consultation closes on 10 November 2022. The Regulations are currently expected to come into force on 6 April 2023.

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