The DC deluge

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Introduction

With all eyes on the possible publication of the single code, on 30 January 2023 the DWP published a package of documents including one consultation response (on broadening investment opportunities), statutory guidance (on asset allocation reporting, performance-based fees and the charge cap), together with a new consultation on extending CDC and a call for evidence addressing deferred small DC pots. It also issued a joint consultation on value for money with TPR and the FCA.

Key points

- The DWP published:
  - a response to its consultation on "Broadening the investment opportunities of [DC] pension schemes", together with statutory guidance for trustees on "Disclose and Explain asset allocation reporting and performance-based fees and the charge cap"
  - a consultation on "Extending opportunities for [CDC] pension schemes"
  - a call for evidence on "Addressing the challenge of deferred small pots".
- The DWP, FCA and TPR published a joint consultation on "Value for money: A framework on metrics, standards, and disclosures".

Broadening DC investment opportunities

Following a consultation in October 2022, the DWP has decided to make changes to DC investment disclosure requirements and the charge cap. These are intended to be "an important step" towards ensuring DC schemes can take advantage of the opportunities illiquid asset classes can bring to pension savers, as well as helping to unlock pension fund investments that can benefit the wider UK economy.

Disclose and explain policies on illiquid investments

Regulations will require most occupational schemes providing DC benefits (exceptions include schemes whose only DC benefits are AVCs) to:

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

Trustees will be required to action the new asset allocation disclosure requirements in their chair's statement for the first scheme year which ends after 1 October 2023. The new illiquid investment policy disclosures will be required to be added to the default SIP / main SIP the first time that it is revised after 1 October 2023, or by 1 October 2024 at the latest.

Exclusion from the charge cap

Regulations will exempt certain performance-based fees from the charge cap from 6 April 2023. The charge cap applies to default funds in DC schemes used for AE and CDC schemes used for AE. The driver here is that the charge cap is seen as a barrier to trustees considering certain illiquid assets.

The change is intended to give schemes the option to incur "well-designed" performance-based fees. 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.

Certain minor changes have been made following consultation. For example, the regulations will be updated to ensure that fund of fund / collective investment arrangements can benefit from the change, and that profit-sharing arrangements that include carried interest arrangements are explicitly covered in the definition of a specified performance-based fee.

Statutory guidance

Trustees must have regard to the statutory guidance when complying with their obligations under the regulations. It is intended to help them with the calculation and format of asset allocation disclosures, and to provide support on the broad range of performance-based fee structures that exist, together with an understanding of the merits of these structures.

The DWP will work with TPR to consider how best additional guidance on SIP reporting could be provided.

Value for Money ("VFM")

Over the last two years, the DWP, TPR and the FCA have been working closely to establish a common assessment framework for VFM across the DC market. This consultation represents the culmination of that work. It seeks views on policy proposals to require trustees and managers of DC occupational pension schemes, as well as the providers and IGCs of workplace personal pension schemes, to disclose, assess and compare the VFM of their schemes.

For the purposes of the consultation, “VFM” means that “pension savers’ contributions are well invested in the best interests of savers, and savings are not eroded by high costs and charges in the context of the market today”.

The new framework, which will look across the key elements of investment performance, costs and charges, and quality of services, is intended to:

- encourage greater transparency and standardisation of reporting across the DC pensions market, allowing trustees to make more informed investment and governance decisions and employers to better compare the value and performance between DC schemes when deciding where to automatically enrol their employees
- drive and support the further consolidation of schemes, where this is in savers’ best interests.

In October 2021, the DWP introduced a more detailed "value for members" assessment for occupational DC schemes with less than £100m in assets under management. The ultimate aim is that these assessments will be replaced by the new VFM framework, as it will require all schemes to report on wider value metrics and to use this data to assess the value of their offering against market comparisons.

Phased approach

A phased approach is proposed, to allow time to “test and learn”, and to “build the trust and confidence of industry and savers”.

Initially, the framework will apply to “default arrangements” as defined by the DWP and the FCA, except for those with “very small numbers of savers invested or assets under management below a particular threshold, including some defaults that can arise when savers are moved after contributions to some investments are suspended”. Pension arrangements where 80% or more of pension savers were enrolled will be included (as is the case for the DC charge cap) and legacy schemes will also be in scope.

In phase two, the framework may be extended to self-select options, non-workplace pensions, and DC pensions in decumulation.

Disclosure

To allow trustees and IGCs to use the data from other schemes for the VFM assessments, the consultation proposes to require that all framework data be published by the end of the first quarter of a calendar year. An end point for net returns data of 30 June of the previous year is proposed to ensure comparable investment performance data is provided.

Both contract-based and trust-based schemes will be required to publish their VFM assessment results by the end of October. However, IGCs will be required to include theirs in their chair’s report but, due to timing, occupational pension schemes will not include theirs in their chair’s statement. The interaction between the VFM framework and the chair’s statement is under consideration, with one option being to split the chair’s statement into a member-facing document and a separate purely governance document.

The consultation suggests the disclosure requirements will focus on investment performance, costs and charges, with a lighter touch approach to disclosures on service and engagement. Although most of the investment performance data under the VFM framework would be backward-looking, the disclosure requirements would include new “simple” forward-looking performance and risk metrics, with the consultation seeking views on calculation approaches. It is not yet clear whether there will be a prescribed template for findings to be reported, or if the framework data will have to be published on providers' websites, or via a centralised portal.

Outcome

Trustees and IGCs will need to conclude that their scheme is either:

- VFM
- Not currently VFM but with identified actions to improve in certain areas that would deliver VFM
- Not VFM.

Whether to mandate certain actions (such as a duty to consider transfers and wind-up) following assessments is under consideration, as is giving TPR powers to enforce wind-up and consolidation, where doing so would be in savers' best interests.

Extending opportunities for CDC

Regulations came into force on 1 August 2022 setting out the authorisation and supervision regime for CDC schemes, but only where there is a single employer or multiple employers which are financially connected (ie part of the same corporate group).

Responding to industry interest, the DWP's consultation looks at the possibility of extending the CDC reach to include unconnected multi-employer arrangements offering whole-life benefits, as well as CDC decumulation-only arrangements. It focuses specifically on how the existing CDC authorisation and supervision regime might be harnessed to accommodate these new designs, the challenges involved, and legislative changes that might be required.

CDC schemes – a quick reminder

CDC is a type of DC arrangement where member and employer contributions are invested in a single collective fund, rather than individual pots. Unless a member chooses otherwise, a CDC scheme will provide a pension from the scheme at retirement based on the value of assets in the scheme. As they offer a target level of pension benefits, as opposed to a guarantee, the government considers CDC to be a "third way" between traditional DB and DC schemes.

Many of the existing requirements already in place for single and connected multi-employer CDC schemes will apply equally to any new design. This includes the need to offer such benefits through a trust-based environment, TPR authorisation and supervision, and annual valuations and adjustments.

Unconnected multi-employer CDC schemes offering whole life benefits

Some of the key challenges identified by the DWP relating to this type of CDC design include what features should be required or conversely excluded, and when might sectionalisation be appropriate. Additional concerns relate to who should be allowed to establish such a scheme, and how to ensure their long-term resilience and sustainability.

Given the likely commercial setting for this type of CDC scheme, the consultation acknowledges that several adaptations might be needed to the existing regime. Unsurprisingly, therefore, it draws more heavily in parts on the master trusts authorisation and supervision regime, exploring issues such as:

- the possibility of prohibiting a pre-agreement between a provider and prospective employer before a scheme is authorised, which is consistent with the line taken in connection with master trusts
- how to identify the right people for carrying out the "fit and proper persons" test, and how the requirements in relation to scheme funder should and could apply in a CDC context. The DWP asks whether replicating the master trust requirements might help to inform its approach here
- the possible need for a business plan setting out a commercial CDC scheme's strategy, including expected growth in membership and contributions
- the need to adapt triggering events, as this type of CDC scheme will involve unconnected employers, the insolvency of one will be less significant than it would be in a single or connected multi-employer scheme.

Decumulation-only CDC

There is apparently "considerable interest" in this type of arrangement, which would entail a member transferring to the scheme at the point of decumulation, and the pension income the member might receive being determined by the size of pot involved. This is seen as having the potential to "help improve member choice and outcomes", by providing "those approaching retirement with an income product that allows them to share investment and longevity risk".

However, as "decumulation products have historically been regulated by the FCA", a trust-based decumulation-only CDC arrangement would be breaking new ground. The DWP is therefore keen "to understand what potential gaps exist and develop adequate member protections, striking an appropriate balance between commercial interests and protecting the interests of members". Key areas where it is seeking views are:

- "seed capital" – ie who would provide the initial funding (as this should not fall on members "beyond paying the administration charges"), as well as ongoing operating costs where member-borne charges are insufficient
- how will sufficient scale be achieved and maintained – being a decumulation-only vehicle will involve attracting sufficient transfers in. However, as the consultation notes, there "are a lot of small pension pots in the occupational pensions market"
- pricing and the potential for mortality underwriting – the DWP wants to ensure that individuals "are treated fairly" and acknowledges that "rules will need to be developed regarding the pricing mechanism, so a consistent approach is taken". This should not disadvantage existing members or risk creating "excessive cross-subsidies"
- as with whole-life CDC schemes, the need for clear communications and marketing about the benefits being provided. The DWP is also mindful of managing "the risk of over-promising".

Addressing the challenge of small pots

Last but not least, the DWP has issued a call for evidence to "deepen the evidence base around the scale and characteristics of the growth in the number of deferred small pots". It considers two large-scale automated consolidation solutions, a default consolidator model and pot follows member. However, it also recognises other actions could help mitigate the growth in the number of small pots, such as greater member engagement. In addition, "member exchange" is considered, potentially as part of a hybrid model alongside one of the large-scale solutions. Having already undergone limited testing, this involves a third party carrying out regular checks to “match” deferred small pots in one master trust with active pots in another.

The call for evidence asks some key questions designed to help determine which pots should be in scope for automatic consolidation. For example, what is a small pot? Should there be a minimum as well as a maximum pot size? What does "deferred" mean?

Next steps

The consultations and call for evidence all close on 27 March 2023, with the regulations to implement the changes to investment disclosure and the charge cap due to be brought into force in April 2023.

The statutory guidance, dealing with the charge cap exclusion of performance-based fees, will apply from the date the regulations come into force, while the guidance on the new disclose and explain requirements will be effective from 1 October 2023.

The FCA and DWP each aim to carry out further consultations in relation to the VFM proposals, on changes to the FCA rules and regulations respectively. No timeframe is given for these next steps.

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