DWP consultation response on DC pension schemes—improving outcomes for scheme members and investment in long-term assets

Pensions analysis: The Department for Work and Pensions has responded to two consultations in relation to defined contribution (DC) occupational pension schemes, aimed at improving outcomes for scheme members and encouraging investment in long-term assets. Regulations have been laid before Parliament and guidance has been updated. There will be new governance obligations for trustees and managers of DC schemes and changes to how the charge cap can be applied. Written by Nick White, knowledge counsel at Travers Smith LLP.

This analysis was first published on Lexis®PSL on 13 September 2021 and can be found here (subscription required).

What is the background to these developments?

The government has published the response to its consultation on 'Incorporating performance fees within the charge cap' and parts of its consultation on 'Improving outcomes for members of DC pension schemes'. The response, accompanying final regulations, and new and updated statutory guidance confirm new governance and disclosure requirements for trustees and managers. These apply from 1 October 2021 but with some delayed impact as noted below.

The proposals centre around two government policies. These are:

- reducing the number of poor value, small DC occupational schemes, and
- encouraging DC schemes to invest more in long-term investments

Measures in relation to the first of these involve introducing new governance requirements to put pressure on trustees or managers of such schemes either to make improvements or to consolidate, for example by transferring the assets and liabilities to a master trust.

Measures in relation to the second involve tweaks to the charge cap legislation. They are connected to the government's 'Build Back Better' plans for economic growth and infrastructure improvements, including the intended transition to 'net zero'. The charge cap, applicable to default investment arrangements in DC automatic enrolment schemes, is one reason why trustees and managers find it difficult to invest in certain categories of long-term investment, such as venture capital.

What was the outcome of the consultations?

Consolidation and value for members

In order to encourage the consolidation, where appropriate, of smaller DC schemes, trustees or managers of schemes with less than £100m in assets that have been operating for at least three years will be required to undertake an annual detailed 'value for members' assessment of costs and charges, comparing the scheme with at least three large schemes by reference to prescribed quality criteria.

They will have to report on the assessment in the chair's governance statement in their annual report and also in the annual scheme return to The Pensions Regulator (TPR). If the trustees or managers conclude that the scheme does not offer good value, they must outline what they intend to do about that—for example, make improvements or take steps to consolidate.

Following consultation feedback, the first of these assessments will now not have to be undertaken until trustees or managers report on the first scheme year that ends after 31 December 2021.

Hybrid schemes with defined benefits as well as DC benefits are in scope if their total assets are valued at less than £100m—but in that case the assessment will only be required in relation to the DC element of those benefits.

Schemes in winding-up are exempt but only if they have notified TPR of the winding-up before the chair's statement is due.

All schemes (including defined benefit schemes) will have to report the value of scheme assets to TPR in their annual returns.

Net investment returns

The government will amend legislation to require trustees and managers of 'relevant schemes' (ie schemes providing money purchase benefits other than just from additional voluntary contributions) to state in the annual chair's statement the investment returns net of costs and charges for the default arrangement and also self-selected funds.

Illiquid assets—performance fees and look-through

Amendments to the charge cap regulations will allow DC schemes to smooth certain investment performance fees when assessing their default arrangement charges against the charge cap. The government accepts that this is only part of what is required in order for pension schemes to invest more in illiquid assets.

The charge cap, very broadly 0.75% of assets under management, applies to default investment arrangements in DC automatic enrolment schemes. To help schemes to invest in long-term assets such as venture capital and growth equity (forms of private equity), where there can be performance fees (ie higher fees for returns above a certain level) without exceeding the charges cap, there will now be the option of smoothing such fees over a period of up to five years. This may, however, be of limited assistance—especially in the early years of the investment. Performance fees can also be excluded from any pro-rated calculations (ie normally for part of a year).

Costs solely attributable to the holding of physical assets will be excluded from charge cap calculations.

On the question of 'look-through' for closed-ended funds and pooled investment vehicles (ie the extent, if at all, to which trustees and managers have to consider underlying, rather than just headline, charges), there will be an announcement to Parliament on next steps. The government accepts that 'the current requirement needs to be clarified and may need to change to remove the requirement to look-through'. There have been concerns that the government's guidance does not align with the legislation in expecting trustees and managers to perform look-through calculations.

Costs and charges disclosure guidance

Some further changes are made to the statutory guidance, 'Reporting of costs, charges and other information: guidance for trustees and managers of relevant occupational schemes'. These include the removal of the need to publish signatures.

Implementation of the measures

These measures will be implemented by The Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021, which have been laid before Parliament. Subject to Parliamentary approval, they will come into force on 1 October 2021.

Confirmed new statutory guidance on completing the 'value for members' assessment and the reporting of net investment returns, and the above-mentioned revised statutory guidance on reporting of costs and charges will come into effect on the same date.

What are the key aspects of the further call for evidence on the future of the DC market and the case for greater consolidation?

Alongside the consultation response, the government issued a further call for evidence asking for comments on the barriers to greater scheme consolidation in the DC pension market. This is aimed at schemes with assets between £100m and £5bn.

The Pensions Minister has said that he does not intend to stop at £5bn.

Interviewed by Banita Kalia

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