In Touch technical update

Government announces DC reforms

The government has announced a package of measures for defined contribution (DC) pension schemes.

At a glance…

- New regulations and statutory guidance introduce changes to the DC charge cap, as well as new disclose and explain provisions.
- A joint consultation on proposals for a common value for money (VFM) framework across all workplace DC schemes.
- A call for evidence on addressing the challenge of deferred small pots.

Broadening DC investment opportunities

Following consultation, the government has laid regulations that are intended to encourage trust-based DC schemes to invest in a broader range of assets.

The new legislation will enable trustees to exclude specified performance-based fees from the default fund charge cap calculations. The government's aim is to help schemes deliver better longer-term returns for savers and 'unlock' investment in assets that can benefit the UK economy.

Trustees of 'relevant schemes' (most DC and hybrid schemes - unless the only DC benefits are AVCs) will also be required to:

i. include an explanation of their illiquid asset policy in their default fund statement of investment principles (SIP).

ii. disclose and explain the asset allocation in the default funds (split between eight asset classes and shown separately for different ages) in their annual chair's statement. Statutory guidance must be followed.

Why bring you this note?

The DWP has published a consultation response, with resulting regulations and guidance; and two further consultations on reforms to DC pensions.

Next steps

The regulations are expected to be in force from April 2023.

The consultations will both close on 27 March 2023.

There are also plans to extend collective defined contribution (CDC) to multi-employer schemes, which we have covered in a separate update.

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Value for money for members

The consultation sets out a proposed common VFM framework that will require all DC schemes to disclose key metrics and service standards, shifting the focus from member-borne costs towards a more holistic assessment of value. The framework was developed by the Department for Work and Pensions (DWP) in partnership with the Pensions Regulator (TPR) and the Financial Conduct Authority (FCA), taking account of industry views from an earlier TPR/FCA discussion paper.

The aim is for greater transparency and standardisation of reporting across the DC pension market, to improve comparability, and competition between DC schemes. This is expected to allow trustees and Independent Governance Committees (IGCs) to make more informed investment and governance decisions and employers to better compare value and performance between schemes.

Under the proposals, schemes would have to disclose investment performance, net of all costs and charges as well as two specific risk-adjusted metrics - maximum drawdown and annualised standard deviation of returns. These would all be reported on a backward-looking basis across a specified range of time periods and age cohorts. Further detail of what would be calculated and disclosed will be addressed in further consultation(s) on regulations and FCA rules. Work has also been carried out to consider forward-looking metrics, and the consultation also asks if there should be a requirement to use these (and if so, which of the suggested models should be used).

For schemes with multiple employers, such as master trusts, charges vary by employer. To help trustees and IGCs make comparisons, it is proposed that multiple charges be broken down according to cohorts of employers based on assets under management.

Since October 2021, trust-based DC schemes with less than £100m in assets have been required to complete an annual prescribed value for members assessment. Underperforming schemes are encouraged to consolidate to a larger scheme or take immediate action to improve. The proposed common VFM framework intends to build on and eventually replace this assessment by requiring all trust-based schemes to report on wider value metrics, using this to assess against market comparisons. This aims to drive and support the further consolidation of schemes, where this is in the best interests of members.

The DWP is considering whether TPR should have new powers to enforce wind-up and consolidation where a scheme is consistently not offering value, and if the VFM framework could, where this is in the best interests of members, place a statutory requirement on trust-based schemes to consolidate following repeated ‘underperforming’ assessment results. The FCA is considering a related requirement in its rules for contract-based providers.

Small pots

The call for evidence is intended to deepen the evidence base around the scale and characteristics of the growth in the number of deferred small pots, and possible solutions. It builds on the investigations of the Small Pots Cross-Industry Co-Ordination Group, which did the groundwork on the issues involved but identified that a more detailed analysis was required. The DWP’s focus is now on two large-scale automated consolidation solutions:

- **Default consolidator** - certain deferred pots would automatically be transferred to a small pot consolidator, with members being given an opportunity to opt-out if they want to.
- **Pot follows member** - when a member changes jobs, their pot would automatically be transferred to their new employer’s scheme, if it meets the chosen eligibility criteria.

Solutions will be considered against five key criteria:

i. Delivery of overall net benefits for members through improved value for money outcomes, achieving a meaningful impact on the number of existing, and flow of new, deferred pots.

ii. Complements member engagement on their savings journey/retirement planning.

iii. Supports a competitive, sustainable and more efficient workplace pensions market (trust and contract-based schemes).

iv. Minimising complexity and administrative burdens for employers.

v. Commands confidence in the system for savers and tax payers.

A number of key questions need to be considered, such as what is ‘small’, should there be a minimum pot size for consolidation to happen, and at what point should a pot be considered to be ‘deferred’? It was also felt that members with an unqualified right to access their pension at a certain age would need to retain this.

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