ALLEN & OVERY

14 September 2020

DC governance, investment and consolidation: more changes ahead

A new government consultation proposes numerous changes to DC governance and reporting requirements, aimed at improving outcomes for DC members. Although some of the changes will affect schemes of a specific size or narrow category only, others will apply more broadly.

What is the government proposing?

Last year, the government consulted on facilitating DC investments in less liquid assets, and encouraging consolidation of smaller DC schemes – it has now published its response, and a further consultation on draft regulations and guidance to implement its proposals. The proposals include: changes to requirements for the annual Chair's statement (including related disclosure obligations); new obligations to report information to the Pensions Regulator (TPR) via the annual scheme return; and changes to the statutory charge cap. The proposed implementation date for the relevant changes to regulations is 5 October 2021.

However, the government is not proceeding with an earlier proposal for large relevant schemes to state their policy on illiquid investments in their statement of investment principles (SIP) and to report holdings in illiquid investments in the implementation statement. It will continue to monitor this, and to review diversification of investment approaches (with a focus on the largest DC pension schemes). The government also plans to continue exploring how it 'can best enable trustees to invest in a diverse range of assets, including less liquid products, to deliver the best outcomes for members'.

There are a number of changes to improve scheme governance and transparency for members, and smaller relevant schemes (with assets of less than £100 million) will be subject to specific obligations designed to encourage (or force) under-performing schemes to consolidate and wind up (see 2 below). Accelerating DC consolidation is a government priority – if the changes do not drive consolidation at a sufficient pace, it will mandate consolidation.

1. New reporting and disclosure obligations

First, the government plans to require all schemes to report, via the scheme return, the value of assets held by the scheme for the purpose of providing benefits to members (calculated on the last day of the most recent scheme year). As drafted, the proposed amendment applies this requirement to all schemes, not just to relevant schemes that are required to produce a Chair's statement.

Secondly, there are planned changes in relation to the annual DC Chair's statement:

- All schemes would be required to report on the return on investments (ROI) of default and member-selected funds in the annual Chair's statement, having regard to statutory guidance.

  Draft statutory guidance has been published as part of the consultation and sets out expectations on how returns should be shown, as well as example presentations of data. Returns should be shown from April 2015 as a minimum (or the start of the scheme, if later).

- The government is also clarifying that the costs and ROI disclosure requirements in the statement (and related publication requirements) apply to self-select funds that are no longer available for selection (but in which assets relating to members are invested during the scheme year).
- Smaller schemes will be required to complete a new value for members (VFM) assessment, as part of the move to drive underperforming schemes to wind up (see 2 below).

The government is also consulting on updating the statutory guidance on disclosure of costs and charges information to clarify certain matters including:

- which schemes are obliged to publish their SIP and implementation statement online;
- how to produce illustrations where defaults/charges vary by employer; and
- expressly stating that the information required to be published under regulation 29A of the Disclosure Regulations can be published over a number of linked documents or pages (rather than having to be produced as a single web-page or PDF document).

2. Consolidation of under-performing DC schemes

To encourage under-performing DC schemes to improve or consolidate, the government plans to impose different reporting requirements on relevant schemes with assets below £100 million that have been operating for three or more years, namely:

1. To report against a more tightly regulated set of VFM requirements as part of the Chair's statement. Trustees would be required to have regard to statutory guidance when producing the assessment (draft guidance is included in the consultation). The assessment would include:
    - costs/charges and net investment returns, to be measured against at least three comparator schemes; and
    - how particular governance and administration criteria have been met: the promptness and accuracy of core financial transactions; the quality of record-keeping, investment governance and member communication; the appropriateness of the default investment strategy; trustee knowledge, understanding and skills; and the management of conflict of interests.
2. To report, via the scheme return, on whether the scheme provides good VFM and (if not) whether the trustees propose to wind up the scheme, or their reasons for not winding up with proposed improvements to ensure it provides good VFM.

    The government's view is that, where VFM is not demonstrated, it is only in exceptional cases where trustees have good reason to believe that they can make all the required improvements cost-effectively and efficiently that it would expect trustees to seek to improve the scheme (within a reasonable period) rather than to initiate wind up. Where schemes are not providing VFM and TPR is not convinced by the trustees' proposals (or subsequent action), the implication is that TPR could use its statutory powers (as appropriate) to order specific improvements, remove or appoint trustees, or wind up the scheme.

3. Auto-enrolment: charge cap for default funds

The government proposes changes to the calculation of costs and charges as part of its bid to encourage investment in less liquid assets such as venture capital. It will amend the statutory charge cap to provide more flexibility in relation to performance fees in some circumstances by smoothing the calculation over a year (and potentially introducing a multi-year smoothing mechanism). It will also expressly exclude costs solely attributable to holding physical assets. As well as draft regulations, the consultation includes an updated version of a list of costs and charges, setting out whether the government considers these to be within or excluded from the cap. The government's review of the scope and operation of the cap is due to be published towards the end of the year.

4. Other investment governance changes

The government also plans to require 'with profits' schemes to produce a default SIP, and to provide that a SIP for 'wholly-insured schemes' is not required to cover the trustee's policy on arrangements with asset managers (read more here). These policies are required to be in place by 1 October 2020, but the proposed amendment would come into force in October 2021. The consultation notes that TPR is aware of this issue and is not prioritising action in this area pending the planned change.

Comment

The government is continuing its policy push to remove potential barriers to investing in technological, social and environmental infrastructure, and to increase DC consolidation. The measures are a mixture of clarifications and tweaks to existing materials, and new measures designed to drive behavioural change and improve scheme quality for savers.

There are some issues with the consultation materials that we would expect to be clarified or corrected as part of the consultation. It is perhaps surprising that, although the government is making amendments to the DC Chair's statement requirements, it has not taken the opportunity to replace the much-criticised mandatory penalty framework (read more in Producing the Chair's statement: what can go wrong). Trustees who have spent significant time and resource dealing with recent (and upcoming) changes to investment governance and related disclosure requirements (read more here and here) will be relieved that the government will not be implementing its earlier proposals on SIP changes for illiquid assets in 2021; however, schemes that fall within the scope of the new VFM assessment requirement may find the additional compliance burdensome. The precise scope of that new requirement may be clarified following consultation.

We will respond to this consultation – if you have feedback that you would like to be incorporated on an anonymous basis, please contact your usual A&O adviser by 15 October 2020. The consultation closes on 30 October 2020.

Contact information

Helen Powell
PSL Counsel, London
020 3088 4827
helen.powell@allenovery.com

Ruth Emsden
PSL (Australian lawyer), London
020 3088 4507
ruth.emsden@allenovery.com

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2020. This document is for general guidance only and does not constitute definitive advice.

allenovery.com