HYMANS # ROBERTSON

Sixty second summary

Expanded VfM obligations for small DC schemes confirmed

Trustees of defined contribution (DC) and hybrid schemes with assets of less than £100m will soon face more-onerous ‘value for members’ (VfM) obligations. In short, they will have to weigh their charges, transaction costs and investment returns against those of larger schemes, and justify (to the Pensions Regulator) their continued existence if they fall short. The changes are part of a wider package of measures that are, generally, set to come into force in October 2021; the augmented VfM obligations will apply to the first scheme year ending after 31 December 2021.

What has happened?

In June 2021, the Department for Work and Pensions (DWP) announced the outcomes of two consultation exercises: *Improving outcomes for members of defined contribution pension schemes* (which ran from September to October 2020), and *Incorporating performance fees within the charge cap* (conducted from March to April 2021).[1] The necessary legislation has been laid before Parliament for its approval, and guidance on the changes published.

What changes are being made?

The draft *Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021*[2] will (assuming they receive Parliament’s approval)—

- require the trustees of defined contribution DC schemes to report net returns on investments in their annual governance ('Chairs'') statements;
- as part of their VfM assessments (which are already a feature of Chairs’ statements), require trustees of schemes with assets of less than £100m to compare their charges and transaction costs, and the return on their investments, with those of three larger schemes, and assess how they are meeting certain administration and governance criteria;
- extend the list of registrable information provided to the Regulator via annual scheme returns so as to require trustees of all schemes to report the value of scheme assets, and oblige trustees of small (<£100m) DC schemes to disclose the outcome of the enhanced VfM assessments outlined previously—where their VfM compared assessment was negative they will need to state whether they propose to transfer members out and wind up, and if not, why not;
- require that transaction costs are taken into account as well as charges when trustees' review the return on their default arrangement(s), as is required under the investment legislation;
- require the preparation of statements of investment principles (SIPs) in respect of default arrangements that carry a third-party benefit promise (this might be the case where a scheme offers a with-profits fund as a default arrangement);

[1] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/995066/response-improving-outcomes-for-members-of-dc-pension-schemes.pdf>.
[2] <www.legislation.gov.uk/ukdsi/2021/9780348224788>.

- extend the exemptions from the SIP requirements that apply to wholly-insured schemes so that the trustees do not have to detail their policies on arrangements with asset managers;
- exclude costs solely attributable to holding physical assets from the charges that are subject to the default arrangement charge cap;
- require trustees to ignore, when pro-rating a charge under a single-charge structure for the purposes of the cap (for example when a member joined or left the scheme part-way through the charges year) any performance fee that falls to be calculated and deducted from the investment value whenever units are bought or sold; and
- allow trustees to smooth performance fees over a multi-year period (up to five years) when assessing compliance with the charge cap.

The changes are set to come into force on 1 October 2021, but there are specific timing provisions in some cases. For example, the first enhanced VfM assessment for small schemes will be required for the first scheme year ending after 31 December 2021. The inclusion of net-return information in Chair's statements and reporting of asset values via scheme returns will apply in respect of the first year-end falling after 1 October 2021. The requirement for default SIPs in respect of funds with a benefit promise will apply from the later of (i) 1 April 2022, and (ii) three months after the first year-end falling after 1 October 2021.

The consultation outcome document confirms that hybrid schemes with total (i.e. DB + DC) assets below £100m will be within the scope of the enhanced value-for-members assessment, but that only the DC section will be subject to the assessment.

Mandatory guidance

The DWP has revised its guidance on *Reporting of Costs, Charges and Other Information*[3] in light of the changes, and published new guidance on *Completing the Annual Value for Members Assessment and Reporting of Net Investment Returns*[4]. Both documents are 'statutory' in the sense that trustees must take the applicable guidance into account when seeking to satisfy the relevant legal obligation. They are effective from 1 October 2021.

Exploring the merits of wider consolidation

The DWP has also issued a call for evidence about the barriers to further consolidation of occupational trust-based DC schemes.[5] It asks for views on how the Government might extend the behavioural 'nudge' toward consolidation to cover schemes with up to £5 billion in assets. The call for evidence remains open until 29 July 2021 (or perhaps 30 July 2021: at the time of writing the closing date given at the top of the webpage for the call for evidence was at odds with the date specified in the linked documents).

The new value-for-members' requirements for DC schemes under £100m in asset size are a clear indication of the strong regulatory appetite for greater DC consolidation, particularly to master trusts. Whilst there is no strict legal requirement for trustees to choose master trusts as the schemes to compare their own schemes against, there are strong hints that it is preferred. We note that a £100m single-trust DC scheme is not necessarily a small scheme in DC terms, and may often be well governed with reasonable charges. Paradoxically, smaller DC sections of hybrid schemes, which might escape the new rules by being over £100m in combined size, may well be struggling to offer good value but will not be subject to the same encouragement to consolidate.

---

[3] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994605/reporting-of-costs-charges-and-other-information-guidance-for-trustees-and-managers-october-2021.pdf>.

[4] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994897/completing-the-annual-value-for-members-assessment-and-reporting-of-net-investment-returns.pdf>.

[5] *Future of the Defined Contribution Pension Market: The Case for Greater Consolidation*, <www.gov.uk/government/consultations/future-of-the-defined-contribution-pension-market-the-case-for-greater-consolidation>.

This communication has been compiled by Hymans Robertson LLP, and is based upon their understanding of legislation and events as at the date of publication. It is designed to be a general information summary and may be subject to change. It is not a definitive analysis of the subject covered or specific to the circumstances of any particular employer, pension scheme or individual. The information contained is not intended to constitute advice, and should not be considered a substitute for specific advice in relation to individual circumstances. Where the subject of this document involves legal issues you may wish to take legal advice. Hymans Robertson LLP accepts no liability for errors or omissions or reliance on any statement or opinion.

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global. © Hymans Robertson LLP.