Defined Contribution Schemes

An update

March 2023

Introduction

The Government continues to focus on defined contribution schemes to ensure they provide good value for members and pension savers.

This short note summarises new regulations and consultations that are underway which will influence the way defined contribution schemes will be governed going forward. It will cover:

- New draft regulations governing the use of illiquid assets in a portfolio with changes to:
    - the disclosure of asset allocations in the Chair's Statement and the Statement of Investment Principles (SIP)
    - the removal of performance-based fees (often part of the fee basis for illiquid investment strategies charged by investment managers) in relation to the charge cap for default investment strategies.
- Three new consultations and calls for evidence on:
    - Value for members
    - Small pots solutions
    - Collective Defined Contribution (CDC)
- Changes to the Statutory Money Purchase Illustration (SMPI) assumptions from 1 October 2023
- The Pension Regulator's guidance on life styling
- Auto-enrolment parameters

Illiquid assets

The Department for Work and Pensions (DWP) launched a consultation on draft regulations, which would require defined contribution (DC) trustees to disclose and explain their policies on illiquid investment in their SIP. This closed in November last year.

The draft regulations include requirements for schemes to disclose and explain the percentage of assets in the default funds allocated to different asset classes in their annual Chair's Statement. In scope occupational pension schemes will be required to include the new asset allocation disclosure requirements in their Chair's Statement for the first scheme year ending after 1 October 2023.

In addition to this, the new illiquid investment policy disclosures will be required to be added to the SIP of in scope schemes published after 1 October 2023, and at the latest by 1 October 2024.

Trustees will also be required to look through diversified growth or multi-asset investment holdings, so that all illiquid exposures are covered in disclosures. This will mean all schemes calculate their asset allocations at an asset class level rather than at a fund level.

The draft regulations also exclude performance-based fees from the regulatory charge cap, in an effort to drive greater uptake of illiquid investments which can often have performance related fees.

Three Government consultations

On 30th January 2023 the Government announced three separate consultations/calls for evidence focussing primarily on defined contribution schemes.

Value for Money (VFM)

Of all the consultations this will be the most significant to schemes. It is a joint consultation between the Financial Conduct Authority and The Pensions Regulator, and builds on an earlier consultation that closed in May 2022 with all parties working towards a common definition of VFM that covers trust-based schemes (as regulated by The Pensions Regulator) and contract-based schemes (as regulated by the Financial Conduct Authority). That said the next stage of the consultations will be split between the two bodies.

The new governance framework will focus on:

- Investment performance
- Costs and charges
- Quality of services.

Investment performance disclosure – this will require providing the performance (net of fees and charges) over the past 1, 3 and 5 years, although this may be longer if data allows to 10 and 15 years. In addition, if schemes use age-related investment strategies, then this would also need to be reviewed by age sub-set for ages 25, 45, 55 and State Pension Age minus 1 day.

The consultation does discuss whether there should also be a forward-looking performance metric disclosed.

Costs and charges – schemes will be expected to disclose:

- total charges (not just member borne charges under the current VFM regime)
- total amount of administration costs (excluding investment costs).

Quality of services – this is a little harder to define but is intended to capture the extra benefits provided in the scheme's management. An important metric will be across communications where either a measure of member engagement (e.g., how often members make investment choices or complete Expression of Wish forms) or member satisfaction (captured via a survey) will be used. In addition, the quality of scheme administration will be reviewed, considering the promptness and accuracy of financial transactions and the quality of record keeping. These metrics will be familiar to schemes with less than £100m of assets as these will already be part of Value for Money assessments.

Assessment and disclosure – the consultation discusses, without clear conclusion, whether schemes will be measured against regulator defined metrics or industry benchmarks. It also proposes that schemes will need to publish their findings with clear results of delivering VFM, not delivering VFM with actions or not delivering VFM. The document also discusses that the Pensions Regulator may be given the power to wind-up consistently under-achieving schemes. In what may be pleasing news, the Chair's Statement is also up for review with proposals including whether to divide this into a member friendly version and more detailed governance document, or even whether it remains relevant.

Broadstone comment – these are significant changes to the way defined contribution schemes will operate. Of course, smaller schemes will have been dealing with this recently, but their own experience is limited and inconsistent and the changes and extension to the whole market is going to create a lot of work (particularly for multi-employer schemes).

The consultation, which closes on 27 March 2023, does also note that the strategy for next steps will be split - the initial focus will be on the industry but the second phase will focus on raising awareness of VFM with members so that they may engage with their schemes to improve the standards of governance.

Small pots - call for evidence

The issue of small pots which members lose touch with and are then eroded by fees has been one the Government has tried to address before. While it is good to see this back on the agenda, 'pot follows member' regulations were put on the statute book in 2013, where they have remained untouched. This call for evidence is designed to understand the size and scope of the issue, and also to look for solutions to deal with the pots that exist and how to stop their proliferation.

Two key solutions are being discussed, namely:

- pot follows member – a semi-automatic transfer from one employer scheme to the next.
- Default consolidator – pots of a size (to be determined) are transferred to one or more default consolidators.

A proposal to allow refunds of "micro" pots is also discussed.

As with all things pensions there is a fly in the ointment, and this concerns the issue of protected pension ages which may exist in a scheme (i.e. the right to take benefits under minimum pension age currently 55 but moving to 57 in April 2028) and would need to be retained in the receiving scheme, whether they want to manage that or not.

Broadstone comment – this is good news, and we would like to see swift action taken to put proposals in place and hope the pensions dashboard can be leveraged to assist in connecting members to their lost pots. In our view the solution should be one that provides the best outcome for members over providers.

Collective Defined Contribution (CDC)

Legislation has already been passed to allow single-employer CDC schemes to be established and we know that Royal Mail are working on their scheme. The Government has always intended to allow multi-employer CDC schemes to operate, and this consultation looks at the way these schemes would be set up and regulated. There is also the possibility of "decumulation only" CDC schemes, so these would only have members in receipt of their pension, and these too are discussed.

Broadstone comment – the potential multi-employer and decumulation CDC models could broaden the options open to employers and individuals in establishing the correct retirement structure. Its continued introduction is a welcome addition. Whether the latent market exists to use this option over traditional defined contribution and drawdown options remains to be seen.

SMPI rules

New SMPI rules have been confirmed which all schemes will have to comply with for SMPI statements issued from 1 October 2023 onwards.

The assumptions in the growth and payment phases will almost certainly be different to those in previous SMPI statements and Trustees will need to consider how best to explain this to members who may see very different numbers.

Growth – this will be set by the Financial Reporting Council across a range of volatility groups.

Payment – the annuity rate being disclosed should be single life, nil increasing with 5-year guarantee. This may differ from previous years' assumptions.

Broadstone comment - It is disappointing that some of these changes have been imposed despite opposition, but we will now need to prepare accordingly for the next round of SMPI statements to be issued on this basis.

The Pensions Regulator guidance

In light of the volatility in the gilt market throughout 2022, but in particular around September and October, the Pensions Regulator issued some guidance in January highlighting actions Trustees should take to ensure members are informed about the impact on their fund values and retirement plans. This would be most keenly felt by schemes using life styling strategies for their members, which would sell equity like growth assets to mirror an annuity profile with a higher proportion in gilts and cash.

Members in similar strategies would have seen their fund values fall dramatically.

The guidance, which can be accessed here, looked at reviewing governance and how best to support savers via communication. If you think your scheme members may have been negatively impacted by the events last year, this guidance, including actions that can be taken, should be reviewed urgently.

Auto-enrolment parameters 2023/2024

The Government has confirmed that the auto-enrolment parameters for 2023/2024 remained unchanged as follows. As salaries increase more savers will be entered into the auto-enrolment system:

2023/2024 tax year	Annual
Lower level of qualifying earnings	£6,240
Earnings trigger	£10,000
Upper level of qualifying earnings	£50,270

Full details can be found here.

Broadstone

Find out more.

For more information on how Broadstone can help you, please contact your Broadstone consultant or use the details below.

David Brooks
Head of Policy

+44 (0) 20 3869 6830
+44 (0) 7976 198 044
david.brooks@broadstone.co.uk

David Pye
Client Consulting Director

+44 (0) 114 256 7704
+44 (0) 7583 326 340
david.pye@broadstone.co.uk

Contact

020 3869 6900

corporate@broadstone.co.uk

broadstone.co.uk

@Broadstone_Ltd

company/thebroadstonegroup

Bristol / Glasgow / Liverpool / London
Manchester / Redditch / Sheffield /
York

BN238