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The elements that you
need to know

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The second quarter of 2021 was a busy period for defined contribution (DC) pensions!

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Trustee elements



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Trustee elements

Improving member outcomes

On 21 June 2021, the Department for Work and Pensions (DWP) published the [outcome](#) on its consultation - 'Improving outcomes for members of defined contribution pension schemes'.

Two key requirements confirmed by the consultation outcome are:

- Reporting net investment returns, to provide transparency to members and to aid comparison and benchmarking. This applies to all 'relevant schemes' (DC and hybrid schemes), for scheme years ending after 1 October 2021.
- Changes to the 'Value for Member' (VFM) assessment, to drive consolidation of smaller DC schemes. This applies to 'specified schemes' (relevant schemes with total assets below £100m that have been operating for at least three years), for scheme years ending after 31 December 2021.

Details of the new requirements are set out in [statutory guidance](#), effective from 1 October 2021.

On the same date, the DWP published a [call for evidence](#) with a focus on driving consolidation across larger DC schemes (those with between £100m and £5bn of assets). The call for evidence welcomes views on the barriers and opportunities for greater consolidation.

Reporting net investment returns

- Applicable to all relevant schemes; i.e. DC and hybrid schemes, regardless of size
- Applicable for scheme years ending after 1 October 2021
- Trustees will be required to report net investment returns of all default strategies and funds in which members invest via the annual chair's statement and the information publically accessible online
- As a minimum, the disclosures should include the net return for the scheme year, with net returns dating back five years recommended. Where data is available, trustees should look to include net returns dating back even longer; e.g. 10, 15 or even 20 years
- For illustrative purposes, trustees may decide to show returns on a £10,000 lump sum allocation to a fund, with no subsequent contributions
- Guidance for investment options where the net returns vary by age; e.g. lifestyle strategies and target date funds, and for the presentation of the data

New VFM approach

- New VFM approach applicable for specified schemes; i.e. relevant schemes with total assets (DC and any DB) below £100 million that have been operating for at least three years
- Applicable for scheme years ending after 31 December 2021
- Trustees will be exempt of the new VFM approach if they have informed The Pensions Regulator (TPR) before the chair's statement is due that the winding up of the scheme has commenced. In such an event, the current VFM approach continues to apply up to the point that winding up is completed
- Trustees of impacted schemes will be required to follow a new VFM assessment framework, based on three core areas:

1. Costs and charges: a relative assessment against three comparator schemes:

- Comparison of costs and charges in respect of default investment arrangements (even though these may not be identical in approach) as well as the most popular self-select funds against the nearest comparable funds

in the comparator schemes (or the defaults of the comparator schemes where there are no comparable funds)

- Greater weight to be given to default arrangements;
- A majority of costs and charges that are lower or 'closely comparable' with the average for the comparator schemes may represent good value. Where charges are higher, consideration could be made to take into account potential mitigating circumstances such as higher investment performance

2. Investment returns - a relative assessment of net returns against three comparator schemes:

- Comparison of net returns in respect of default arrangements (even though these may not be identical in approach) as well as the most popular self-select funds against the nearest comparable funds in the comparator schemes (or the defaults of the comparator schemes where there are no comparable funds)
- Trustees should compare net returns both in the short term (one-year period) and over a longer, more sustained period for which broadly comparable data can be found (preferably 5, 10 and 15 years)
- Greater weight to be given to default arrangements
- A majority of net returns that are 'closely comparable' with, or better than, the average for the comparator schemes may represent good value

3. Governance and administration: an absolute assessment; i.e. within the scheme itself:

- Assessment across seven metrics
 - Promptness and accuracy of core financial transactions
 - Quality of record keeping
 - Appropriateness of the default strategy
 - Quality of investment governance
 - Level of trustee knowledge, understanding and skills
 - Quality of communications
 - Effectiveness of conflicts management
- Expectation that all of the metrics should be satisfied to represent satisfactory value for members, otherwise trustees should seriously consider the impact of this on the overall quality of administration and governance
- ‘Comparator schemes’ may be occupational schemes with assets equal to or greater than £100 million or contract-based schemes. Trustees should have a clear rationale for the comparator schemes they choose and they must have had discussions with at least one comparator scheme over a potential transfer
- For the overall assessment, trustees are expected to give more weight to net investment returns and to governance and administration, rather than overly focusing on costs and charges. However, where costs and charges are significantly higher than those for the comparator schemes without any mitigating material difference in governance and/or net return, expectation that trustees conclude that the scheme does not deliver VFM
- If trustees conclude that the scheme does not deliver VFM, they should look to transfer members’ benefits into a larger occupational or contract-based scheme, or set out the immediate action they will take to make improvements to the existing scheme. Trustees may consider wind-up costs and exit penalties but these should not be an automatic barrier to consolidation
- As well as via the chair’s statement and information publicly accessible online, trustees will be required to report the outcome of the current and previous VFM assessments in the annual scheme return. Where trustees have concluded that the scheme is not delivering VFM, they will be expected to set out in the annual scheme return what actions they intend to take

Review of the chair’s statement

In April 2021, the DWP published its [statutory review of the chair’s statement](#). The review found that, whilst the chair’s statement had been effective for ensuring minimum governance standards, it had not been effective in achieving the multiple policy goals of scheme governance and member engagement.

The key conclusions were:

- The Government and TPR should consider the audience and role of the chair’s statement
- The information contained in the chair’s statement should be revisited

The review also suggested that consideration be given to amending the legislative requirement for TPR to issue mandatory fines in relation to the chair’s statement, to allow TPR to use its discretion.

New Code of Practice

On 17 March 2021, TPR published a [consultation](#) on the first phase of consolidating its existing codes of practice. This brings together 10 of its 15 current codes in 51 concise modules, with the aim of creating a clearer, more accessible single code of practice.

From a DC perspective, the proposed new code incorporates current Code of Practice 13 (“the DC Code”), as well as more general content from other current codes; e.g. in terms of internal controls and reporting late payment of contributions. The proposed new code includes new content in a number of areas, such as climate change, stewardship and cyber controls, as well as the requirement for trustees of schemes with more than 100 members to undertake an annual ‘own risk assessment’ of how well governance systems are working, and the way potential risks are managed.

The social element of ESG investing

On 24 March 2021, the DWP published a [call for evidence](#), seeking views on how trustees understand social factors and how they look to include them into their environmental, social and governance (ESG) policies.

It is widely recognised that ESG factors should be taken into account when designing investment strategies. However, attention to date has been more focused on environmental, and to some extent governance, factors.

There are a number of ways in which trustees could take account of social factors, e.g. excluding companies that have a poor track record on social issues. Another approach is through social impact investing; i.e. including companies that make a positive social impact, like providing social housing.

This appears to be the beginning of a greater focus on social factors and could eventually lead to the sort of disclosures now being required for climate change.

Long Term Asset Fund

On 7 May 2021 the Financial Conduct Authority (FCA) launched a [consultation](#) on a new category of UK authorised vehicle allowing for greater access to illiquid assets, called the Long Term Asset Fund (LTAF). The rules for the LTAF include greater disclosure requirements, with strong governance being a priority. This, together with liquidity management, mean that this could be a suitable investment option for DC schemes.

One of the main drivers for launching the LTAF is to provide long-term capital to support investment and growth within the UK economy. In assessing the suitability for their schemes, trustees will need to consider how to practically manage the relatively low liquidity and potentially higher charges.

Other elements

Incorporating performance fees within the charge cap

The DWP's [consultation outcome](#) on 'Improving outcomes for members of defined contribution pension schemes', published on 21 June 2021, included its conclusions on

incorporating performance fees in the charge cap. This was part of its wider work to make it easier for DC schemes to invest in illiquid asset classes, such as venture capital, private markets and infrastructure.

The regulations, which set out measures to allow schemes to smooth performance fees over five years when testing against the charge cap, are expected to come into force on 1 October 2021.

Some respondents to the consultation proposed complete or partial removal of performance fees from the charge cap. However, the Government have concluded that the charge cap and inclusion of performance fees within it protects members from high fees that do not improve value for money.

This, alongside the innovation we are seeing in terms of illiquid funds coming to the market, (e.g. the LTAF), is a step towards including illiquid assets within DC investment strategies. A remaining key barrier is the need for daily dealing by platform providers, though liquidity management solutions can be deployed to address this. In addition, pension scheme administrators will need to evolve their practices to administer funds with performance fees.

Permitted charges for default arrangements

On 24 May 2021, the DWP published a [consultation](#) on permitted charges for default arrangements of workplace pension schemes; i.e. those subject to the charge cap.

The consultation seeks views on the implementation of a de minimis pot size of £100, below which flat fees cannot be charged, to protect members with small pots from the risk of erosion. This measure is expected to come into effect in April 2022.

To enable better member understanding of the charges they pay and to aid comparison, the consultation also seeks views on moving to a universal charging basis, i.e. the existing rights charge based on the value of a member's pot. The consultation acknowledges that the other types of permitted charge (contribution charges and flat fees) are used by a number of providers, including NEST.

Consumer pensions journey

On 18 May 2021, TPR and the FCA launched a [call for input](#) asking how consumers make decisions about their pension at key points throughout their working lives.

The call for input acknowledges the shift in the pensions landscape since the launch of automatic enrolment, with 15 times as many savers in accumulation within DC schemes than in accumulation within defined benefit schemes. This shift means savers carry more of the risk in planning for their retirement and have more decisions to make.

As a result, the regulators are working to explore the factors affecting how consumers save for their retirement and to find ways to improve the journey from joining the workforce to retirement. The aim is to prompt a broad discussion with industry and gain insights that will help shape future targeted regulatory interventions.

Pension scams

On 14 May 2021, the DWP published a [consultation](#) on draft regulations that will require occupational and personal pension schemes to check at least one of four conditions is met before they act on a pension transfer request from a scheme member. The Government intends to introduce the regulations in autumn 2021 and expects the regulations to be supported by guidance from TPR and the FCA.

The first condition is simply that the receiving scheme is a public service pension scheme, authorised master trust or personal pension scheme (provider is authorised and regulated by the FCA). Future provision is also made for authorised collective money purchase schemes.

For the other conditions, trustees and scheme managers will be given the power to request information from the member in relation to the transfer to help them identify whether they are at risk of a scam.

Simpler annual benefit statements

On 17 May 2021, the DWP published a [consultation](#) on draft regulations and statutory guidance for simpler annual benefit statements from 6 April 2022 for DC workplace pension schemes used for automatic enrolment.

The draft statutory guidance sets out how information may be structured and presented in a statement not exceeding one double-sided sheet of A4 paper, so that there is consistency between schemes. Trustees and scheme managers must have regard to the statutory guidance when designing their own statements.

Retirement income adequacy

On 9 June 2021, the Pensions Policy Institute published a [report](#) exploring retirement income adequacy, how those approaching retirement might meet different adequacy targets and how landscape changes may affect the way adequacy is viewed in the future.

The report concludes that a consensus on adequacy is required, which takes into account both the need for a steady income and for capital to call on in retirement. This will require buy-in from employers, industry, unions and other key stakeholders in order to be successful.

The Pensions and Lifetime Savings Association has backed the call for a national consensus, saying this "is needed so as to guide the level of automatic-enrolment contributions, the value of the State Pension, and the fiscal support for additional pension saving."

Support for pension withdrawals

On 16 June 2021, the Association of British Insurers published a [report](#) focussing on pension withdrawals, stating that these are the key remaining challenge in helping people to navigate pension freedoms.

With current retirees, concerns about unsustainable withdrawals are mitigated by many having other sources of income. Future retirees will be much less likely to have other income to rely on, and people need far more support than most are currently getting.

The report explores how approaches to sustainable withdrawal rates could be delivered, taking into account the risks customers face when making withdrawals without receiving advice. It describes how providers currently help their customers navigate decisions about pension withdrawals and what more they could do in the future with the right regulatory changes.

Guidance on providing support with financial matters

On 30 March 2021, the FCA updated its [guidance](#) to employers and trustees on providing support to employees and scheme members with financial matters. This helps to clarify what employers and trustees are allowed to do without needing to be authorised by the FCA or potentially being considered as providing financial advice.

Provider news

In June 2021, Cushon, who acquired the Salvus Master Trust in 2020, announced the acquisition of Construction First Limited, scheme funder for the Workers Pension Trust, an authorised master trust operating in Northern Ireland.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact Mark Futcher, Partner and Head of DC via the following:

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