

Briefing

# Costs and charges disclosure in trust-based DC schemes

A high-level practical guide on how to comply

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New regulations<sup>1</sup> and accompanying statutory guidance compel trustees to produce detailed analyses of the costs and charges incurred by scheme members on their money purchase benefits. This paper outlines why these requirements have come about, what they are, and the steps that trustees will need to take in order to comply.

## Why are these requirements being introduced?

The Government remains concerned that the millions of people being brought into pension saving by automatic enrolment might end up in pension schemes that offer poor value for money. As such, it has introduced a series of measures over recent years: capping member-borne charges; banning commission; and introducing a requirement for trustees of defined contribution (DC) schemes to assess the value for money that members get for the costs and charges they bear. The latest set of regulations builds on these requirements.

... The next step may well be an 'all-in' cap on costs and charges, including transaction costs, but we're not quite there yet.

## What is required?

In summary, the new regulations require that trustees provide detailed illustrations reflecting a representative sample of the investment arrangements from which members are able to select. These illustrations will need to provide pounds and pence figures for the total cost of investment, including transaction costs. The illustrations will need to be published on a publicly accessible website, which must be capable of being indexed by search engines.

A major implication of the methodology is that where the trustees have selected an active fund with low expected returns (such as a Diversified Growth Fund with a capital preservation focus), the bare minimum disclosure requirements may cause this fund to look poor, for example, relative to a passively managed fund.

Therefore, trustees may also wish to add additional investment commentary around the disclosure.

## Which schemes are affected?

Any scheme which is already required to produce a chair's statement will also need to meet the new disclosure standards. This amounts to all occupational money purchase pension schemes **except**:

- executive pension schemes
- relevant small schemes (largely SSASs)
- public service pension schemes
- schemes whose only money purchase benefits are AVCs\*
- Some other minor exceptions

\*Note that where AVCs are not the only money purchase benefit, these requirements also extend across the AVCs.

## The requirements

The statutory guidance states that the illustrations “should use a realistic and representative range of combinations of pot size, contribution rates, real terms investment returns, and time and rate of charges and costs.” Therefore in reality, most schemes will need to produce multiple illustrations for each fund being presented in the disclosures in order to meet this requirement.

Each of the illustrations produced will comprise five elements, which are explained further below.

In order to identify typical member cohorts, the elements – particularly pot size and time to retirement – should be considered together.

While undertaking this analysis is somewhat complex, the outcome is that fewer, more meaningful illustrations can then be produced.

1

### Savings pot size

While using median pot size across all the illustrations may be appropriate where members are of a similar age, the requirement to produce a set of illustrations using the youngest scheme member’s time to retirement means that the pounds and pence charges figure is likely to be inflated.

2

### Time

The timescales used must represent the youngest member, as well as a ‘typical’ member. Since it may be that ‘typical’ is not well represented by the median, further illustrations might be required to ensure representativeness.

3

### Contributions

The guidance states that a typical rate of contributions can be used in the illustration. However, if there are markedly different rates of contribution within the scheme, trustees should consider whether it would be appropriate to use more than one rate. Further illustrations will be required for members not in receipt of contributions. It is an option to assume no further contributions will be paid, if it is ‘disproportionately burdensome’ and there are no charges levied on contributions.

4

### Real terms investment return gross of charges

The investment assumptions used in the calculations can be calculated on a similar basis to Statutory Money Purchase Illustrations (SMPI), in line with the Financial Reporting Council’s Actuarial Standard Technical Memorandum. Trustees may want to maintain consistency with any SMPI illustrations to avoid confusion. It is also possible to use assumptions permitted under the Financial Conduct Authority’s Conduct of Business Sourcebook (CoBS).

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### Adjustment for the effect of costs and charges

The investment return assumptions derived under 4 will then be modified by the scheme’s charges, and by the average annual transaction costs as reported by investment managers.

## Suggested process for compliance – producing the illustrations

### Step 1 – Prepare

Taking early action is crucial to ensuring this process runs smoothly; many organisations are still getting to grips with the requirements and it can take time for information to be provided. **The first step will be to determine when the report and accounts and the accompanying chair's statement is needed (no later than 7 months after the scheme year end);** this sets the timeline for all of the following steps.

#### Request from administrators (for each member):

- value of pot, broken down by fund, including ISIN for each fund
- date of birth
- current rate of contributions (assuming contributions are to be included in illustrations). This can be done either as an amount or a percentage of pensionable earnings

#### Request from investment managers (for each fund):

- five years (or maximum available if less) of annual costs and charges, including transaction costs, for each fund available to be used by members. These should be broken down between explicit and implicit costs, and also split between costs and charges (as these need to be reported separately)
- investment commentary explaining performance against objectives, e.g. out- or under-performance of active funds in the reporting period, or performance against volatility targets.
- any additional contextual information the manager is able to provide about the transaction costs including; what information they can't obtain, why this is the case and what the investment provider is doing to ensure this is provided next time (again this need to be reported on)

### Step 2 – Assess membership and identify cohorts

Once membership data has been obtained this needs to be analysed to identify representative cohorts. Examples should cover the requirements in relation to savings pot size, time and contributions set out above. There is no fixed approach for this, but a process should be evidenced. We would suggest the following:

- Identify representative terms to retirement across scheme membership, e.g. 40 years, 30 years, 20 years and 10 years
- Ensure youngest member is covered by this
- Identify representative pot values at these ages. It may be that more than one value is required for shorter terms to retirement, e.g. some members with 10 years to retirement may have substantial funds, others may be relatively new joiners and have smaller funds.

At this point Trustees should ask whether the provider can assist with the production and publication of the illustrations and hosting of these on a publicly available website – see "Publishing the illustrations online"

Trustees should also consider the suitability of the existing fund range. In particular are all funds serving a purpose? Reducing the number of funds available to members will reduce the disclosure requirements, albeit only from the next scheme year.

### Step 3 – choose your funds

Whilst the charges applicable to all funds available to members during the scheme year should be stated, the illustrations only need to cover representative funds. This could include, for example:

- The default investment arrangement, including any 'lifestyle switching'. This is particularly relevant where costs and charges change in the lead up to retirement
- The highest and lowest growth assumptions for wider investment options
- The highest and lowest charges for wider investment options

## Step 4 – produce illustrations

It is important to note that illustrations should be as kept as consistent with other member facing illustrations as possible, in particular it may be appropriate for growth assumptions to follow Statutory Money Purchase Illustrations (SMPI) where applicable and assuming they meet the relevant underlying guidance (such as the TM1 Actuarial Standard or the FCA's Conduct of Business Sourcebook).

## Suggested process for compliance – Publishing the disclosures online

One of the most potentially challenging requirements of the legislation is to publish the illustrations and supporting information on a website for public consumption. This includes:

- A number of representative illustrations accompanied by the assumptions used in preparing those illustrations, including stating the real terms investment return used
- Supporting information relating to value as assessed and reported on in the Chair's statement including:
  - The publication of cost and charge information (split out) for each default and each alternative fund option from which a member is able to select, regardless of the number
  - information on the default investment strategy
  - trustee assessment of value for members
  - statement on any unavailable transaction costs
- In the future (from October 2019 and 2020 respectively) the scheme's Statement of Investment Principles and how this has been acted upon (known as the implementation statement).

This website should be identifiable through internet search engines and information must not be in password restricted areas of the website. In addition the specific web address for site should be included in member annual benefit statements 'appropriately titled' such that it can be readily typed into a browser and signposts the information held on the site.

For many schemes such a facility will not currently be present and employers may not wish to host this information on their corporate website.

If 'bundled' administration and investment services are provided to the scheme there is the possibility the provider will be able to assist, however this will not be offered by all. Providers are very unlikely to agree to host information on any funds they do not provide directly, if multiple providers are used, e.g. separate AVC providers.

We would strongly suggest that trustees engage with providers to understand what support is available.

## Compliance vs best practice

The legislation relating to the publication of this information is currently very compliance focused. A concern for many trustees is likely to be how this information is received – will members understand the information, is there the potential for it to be taken out of context, in particular members negatively focusing on the fact that a charge is being taken?

It will be easy for members and third parties to compare the charges applicable to different schemes, and whilst transparency can have benefits in terms of improving competitiveness of charges, it will not always be the case that the lowest cost investment options available are the most suitable for members or deliver like for like value.

For this reason it is vital that the objectives of the funds relative to the scheme's Statement of Investment Principles are clearly set out, together with how trustees have considered the value these funds provide to members (particularly in relation to any default).

In addition, although the requirement to publish information on a website is driven by the costs and charges disclosure legislation, this is not to say that it needs to be limited to this.

Engagement with members is a crucial part of good scheme governance (as set out in the DC Governance Requirements and the Regulator's DC Code), and this could be an ideal platform to provide information on the options open to members around contribution choices, investment options and retirement decisions.

## How Barnett Waddingham can assist

We have expertise in assisting in all aspects of meeting these requirements, including:

- Assessing Value for Members and assistance with drafting Chair's Statements
- Reviewing investment strategies and performance
- Obtaining information on and calculating the effect of costs and charges relating to investment funds
- Preparing projections to meet the requirements
- Design, hosting and maintenance of websites to meet the disclosure requirements

This document is based on our knowledge of the Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018 and the guidance set out by the Department for Work & Pensions in relation to this: Reporting of costs, charges and other information: guidance for trustees and managers of relevant occupational schemes

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch with Martin Willis, Principal and Senior Client Relationship Manager, via the following:

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