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Broadening the investment opportunities of DC schemes

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Over the past few years, the government has increased the level of investment-related disclosure of information required by pension schemes.

The DWP is now consulting on draft regulations and statutory guidance that seeks to increase the disclosure of asset allocations and exempt performance-based fees from the DC charge cap where this is in members' best interests.

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Background

The consultation document considers two policy areas.

1. The response to a consultation earlier this year on investment in illiquid assets, which introduces proposals for a 'Disclose and Explain' policy and consults on draft regulations and guidance to achieve the policy intent.
2. A consultation on draft regulations and guidance on the exemption of performance-based fees from the regulatory charge cap proposals designed to stimulate illiquid investment by occupational DC pension schemes, as announced in the then government's 'mini-Budget' in September.

The consultation began on 6 October 2022 and will run until 10 November 2022. The intention is for the regulations to come into force in April 2023.

'Disclose and Explain' on illiquid asset investment

The government remains committed to finding ways to drive greater diversification in investment by UK institutional investors, particularly through investment in less liquid assets because of their potential to deliver higher long-term returns to savers as part of a diversified investment portfolio.

The statement of investment principles (SIP) of a relevant DC scheme's default arrangement will need to disclose and explain their policies on illiquid investment.

Relevant DC schemes will also need to publicly disclose and explain their default asset class allocation in their annual chair's statement.

(As a reminder, relevant DC schemes are occupational pension schemes (or sections of schemes) which have to produce a DC chair's statement.)

What is meant by 'illiquid investments'?

The DWP is defining illiquid assets as "assets which cannot easily or quickly be sold or exchanged for cash and, where assets are invested in a collective investment scheme, includes any such assets held by the collective investment scheme".

When will trustees need to comply with these new requirements?

The default SIP will need to include an illiquid investments policy when the SIP is first updated after 1 October 2023 (or by 1 October 2024 at the latest).

The chair's statement prepared for the first scheme year ending after 1 October 2023 needs to include the disclosures on asset class allocation.

What's behind this?

The government wants to encourage industry-wide transparency and standardised disclosure as well as greater public accountability for the investment decisions made by trustees on behalf of their automatically enrolled members.

The government is not looking for trustees to change their asset allocation, but rather to encourage reflection on the decisions they have already made, and the decisions they will make, as part of their ongoing fiduciary duty to create an investment approach that works in the best interests of their members.

The government believes that the disclosure of a scheme's policies on illiquid investments and asset allocations will improve the availability of investment information to members and employers and provide them with the certainty that the scheme is providing members with the best possible value. It will also help to ensure that trustees are properly considering a wider range of investment opportunities and allow trustees of schemes that may be considering illiquid investments, and any scheme that has already invested in this way, to compare the impact their respective asset allocations have on investment returns.

Performance fees and the charge cap

Since 2015, the default arrangements within DC pension schemes used by employers to meet their automatic enrolment duties, have been subject to a cap on the charges which may be borne by members. The charge cap is 0.75% of funds under management within the default arrangement, or an equivalent combination charge. The cap applies to all scheme and investment administration charges, excluding transaction costs and a small number of other specified costs and charges.

The DWP has previously considered proposals to remove performance-based fees from the charge cap that applies to the default funds of occupational DC pension schemes used for automatic enrolment. (A performance fee is a payment made to an investment manager for generating positive returns. This contrasts with a management fee, which is charged without regard to returns.)

The DWP is to exempt well-designed performance fees that are linked directly to investment performance from the charge cap for default funds in schemes used for automatic enrolment.

Trustees of such schemes will be required to amend the chair's statement by:

- Disclosing any performance-based fees that members are subject to as other member-borne costs and charges are disclosed; and
- Accounting for any performance-based fees when assessing value for members.

The regulations are still to be finalised, but it is expected that with effect from the first scheme year ending after 6 April 2023, the chair's statement will have to include these new disclosures.

Draft statutory guidance

The DWP has published draft statutory guidance to assist trustees in calculating and formatting asset allocation disclosures and understanding the performance-based fees to be excluded from the charge cap.

The guidance should be read alongside the regulations and with legal advice as the trustees see fit.

Comment

The government has devoted a great deal of attention in the past couple of years to facilitating greater illiquid asset investment. The attraction of greater investment by pension schemes in assets such as infrastructure seems clear to the government, but the immediate benefit to many pension schemes is less obvious. It remains to be seen how widespread illiquid asset investment will become and whether these changes will drive that change.

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