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DC consolidation

The Government expects all DC schemes to deliver good member outcomes. Those managing own trust DC or hybrid schemes with less than £100m in assets will have to choose either to meet the minimum governance standards or consolidate into larger schemes.

For many trustees, this will mean making some big decisions on whether to make changes to the current approach or to consolidate elsewhere, making the next 12 months a critical time. Opting to continue to govern an own trust DC scheme is a huge responsibility and one that should not be taken lightly.

Background

The initial focus has been on own trust DC schemes with less than £100m of assets. These have seen increasing compliance burdens including additional reporting requirements via their chair's statement by completing the annual Value for Members assessment and Reporting of Net Investment Returns at the end of 2021, together with higher governance requirements with the introduction of The Pensions Regulator's forthcoming single code of practice. In addition, trustees will need to link their scheme to the pensions dashboards ecosystem and ensure ongoing compliance.

If the extended Value for Members assessment determines trustees are not delivering good Value for Members, then trustees are required to inform The Pensions Regulator and must take immediate steps to improve the scheme to meet the Value for Members criteria within a reasonable period or wind-up and consolidate.

Consolidation involves winding up DC arrangements and moving active members and accrued DC pots to larger schemes, which the Government believes tend to be better governed and offer better value for money than smaller schemes and, therefore, will be in members' interests. Typically, the chosen destination will be a master trust – a multi-employer occupational pension scheme which operates on a commercial basis. Master trusts are subject to an authorisation and supervision regime run by The Pensions Regulator.

DC consolidation has been on the Government's agenda for some time. The push to consolidate has ramped up, driven by government policy as well as increased governance and requirements on trustees in turn pushing up the risk and cost to own trust DC schemes as evidenced by The Pensions Regulator's 2022 DC Trust Report. The number of schemes with 12 or more members has declined by 63% since 2012, including 12% in the last year alone. However, this is proving too slow and the DWP has published a call for evidence on how to drive even more consolidation in the DC market to drive better member outcomes through better governance and greater investment in illiquid assets.

With seemingly never-ending change, it is no surprise that employers and trustees are looking at the range of options going forward.

What should trustees and employers be thinking about when considering consolidation?

Member outcomes are determined by the amount of contributions, investment returns net of charges, and informed decision making when taking retirement benefits, all of which can be driven by good member engagement. Trustees should consider which aspects are available under the scheme and which could be improved through consolidation.

Retirement options and their impact on retirement incomes and member decision making. If options are limited, this should be considered by trustees within their scheme when deciding whether to consolidate.

Compliance has been made more transparent by the Government through the requirement to post key information online, for example, most of the information contained in the chair's statement.

Trustees and employers should think about how they are able to meet the increasing compliance requirements.

Valuable guarantees (e.g., guaranteed annuity rates) may be included in certain scheme **i**nvestments or there may be immediate penalties on transfer to an alternative arrangement.

Members' views and input can present an opportunity to help with the trustees' and employer's decision making.

Employers and trustees may conclude that they are better off maintaining their scheme after these key considerations.

What are the key steps to consolidating?

There are a number of key steps when switching to a new DC scheme, such as a master trust, as outlined below.

Step 1: Strategic objectives: Identify which DC scheme type is the best fit for the overall employer and trustee objectives and addresses any benefits complexities.

Step 2: Provider selection: Based on objectives and criteria from stage one, review the DC market for the best provider for any new DC scheme ensuring any bespoke needs can be provided.

Step 3: Communication and Implementation: Dates and timings of member communications are critical and, where appropriate, segment the membership when considering how best to communicate with different groups of members. Consult with all employees on the changes to pension arrangements and then work with the chosen provider to successfully implement and launch the new scheme. Provision of high quality data to the new scheme at outset is key.

Step 4: Consolidation of existing benefits and winding-up the scheme: Undertake a bulk exercise to assist individuals in consolidating existing benefits in the new scheme. Good transition planning involves discussions with providers, fund managers and administrators to agree the most efficient method of moving assets as well as considering out of market risks and costs. Resolve any outstanding liabilities and achieve finalisation through the wind-up of the existing scheme.

Step 5: Governance and employee engagement: Draft governance committee terms of reference, set up the committee, monitor the new scheme to ensure ongoing value for money and engagement with employees to improve outcomes.

Comment

Transferring DC assets into an arrangement, such as a master trust, can be a complex process and should be planned in detail by employers and trustees of schemes contemplating this. In particular, there are some tricky legal and tax hurdles to overcome for hybrid schemes with DB and DC sections and for DC schemes which have any kind of guarantees. There may be other options which should be considered in these cases.

Deciding whether to improve governance or consolidate is not straightforward. What's clear is that decisions should consider the impact on both scheme sponsors and trustees and most importantly, be centred around members' best interests.

It is clear that consolidation is the direction of travel and will be a key theme in years to come. However, employers and trustees should not jump to the conclusion that consolidation is right for them. Many small schemes are well-governed, deliver good value for their members and may also have bespoke features which, for example, a master trust cannot replicate.

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