

DC pension schemes—DWP consultation on broadening investment opportunities in illiquid assets

Pensions analysis: The Department for Work and Pensions (DWP) is consulting on draft regulations implementing a range of measures designed to encourage defined contribution (DC) pension schemes to invest in illiquid assets. Duncan Watson, counsel (Scottish qualified), and Katherine Carter, professional support lawyer, at Mayer Brown International LLP consider the consultation on broadening investment opportunities, the government’s response to its consultation on facilitating investment in illiquid assets, and the implications on occupational pension schemes.

This analysis was first published on Lexis®PSL on 2 November 2022 and can be found [here](#) (subscription required).

What was the background to the DWP’s latest consultation on broadening the investment opportunities of DC pension schemes?

Trustees of all schemes, including collective money purchase (CMP) schemes, are required to prepare a statement of investment principles (SIP) setting out their policies on a range of investment matters. Trustees of schemes that provide DC benefits other than additional voluntary contributions (relevant schemes) must also prepare a SIP in relation to the scheme’s default arrangement. Both types of SIP must be reviewed triennially and after any significant change in investment policy. Trustees of relevant schemes and of CMP schemes that are being used for automatic enrolment (qualifying CMP schemes) must also prepare an annual statement detailing a range of governance matters (the annual governance statement).

Member-borne charges in qualifying CMP schemes and in the default arrangement(s) of relevant schemes that are being used for automatic enrolment (qualifying schemes) must not exceed a specified annual cap—broadly, 0.75% of the value of the member’s pot (the charge cap).

One of the DWP’s key priorities is enabling DC occupational pension schemes to take advantage of long-term illiquid investment opportunities in long-term illiquid assets. In November 2021, the [DWP consulted](#) on a broad policy proposal of exempting performance fees from the scope of the default fund charge cap as their inclusion was seen as a barrier to the ability of schemes to invest in illiquid assets. To further encourage schemes to diversify their investment portfolios and invest in illiquid assets, the [DWP consulted](#) in March 2022 on broad policy proposals to require trustees of relevant schemes and qualifying CMP schemes to disclose and explain their policy on investment in illiquid assets and their asset allocation.

What was the DWP’s response to Chapter 2 of its March 2022 consultation on ‘Facilitating investment in illiquid assets’, concerning ‘disclose and explain’ policy proposals?

The [DWP’s response](#) noted that it had received broad support for its ‘disclose and explain’ proposals and that it would therefore proceed with them. The DWP expects transparency around trustee investment decisions and comparability across schemes will increase as a result of the proposals which will in turn contribute to an increased focus on value for members.

What is the DWP proposing in its latest consultation and what are the key aspects?

The DWP is now [consulting](#) on [draft regulations](#) to implement the broad policy proposals.

Investment in illiquid assets

Under the draft regulations, trustees of relevant schemes will be required to state in the default arrangement SIP whether or not the investments held by the default arrangement include illiquid assets.

If the investments do include illiquid assets, the default arrangement SIP must also include:

- a description of the age profile of those members in respect of whom investments are held in illiquid assets
- an explanation of whether investments are held directly in illiquid assets or via a collective investment scheme
- an explanation of the types of illiquid assets in which investments are held
- an explanation of why the trustees have chosen to invest in illiquid assets, including their assessment of the advantages to members of investing in illiquid assets when compared to investing in other classes of asset
- an explanation of whether the trustees have any plans to increase their investment in illiquid assets in the future

If the default arrangement investments do not include illiquid assets, the SIP must include:

- an explanation of why the trustees have chosen not to invest in illiquid assets
- an explanation of whether the trustees have any plans to invest in illiquid assets in the future

Identical requirements will apply to qualifying CMP schemes, but in relation to the main scheme SIP.

Asset allocation

Under the draft regulations, trustees of relevant schemes will be required to carry out an annual calculation of the percentage of assets in the default arrangement(s) allocated to each of the following asset classes:

- cash
- corporate bonds and UK gilts
- listed equities
- private equity
- infrastructure

- property/real estate
- private debt
- any other assets

The results of the calculation must be included in the annual governance statement. That section of the statement must be published on a website that is publicly available free of charge.

Again, identical requirements will apply to trustees of qualifying CMP schemes, but in relation to all scheme assets.

These requirements will apply to all relevant schemes and qualifying CMP schemes rather than just to schemes with over £100m in assets as was proposed in the March 2022 consultation.

Performance fees

The draft regulations will amend the definition of ‘charges’ for the purposes of the charge cap to exclude certain ‘specified performance fees’. A performance fee will be a specified performance fee if it meets the following conditions:

- it is payable by the trustees to a fund manager in relation to investments managed by the fund manager for the purposes of the scheme
- it is calculated only by reference to investment performance, whether in terms of capital appreciation of those investments, the income produced by those investments or otherwise
- it is only payable when (a) investment performance exceeds a pre-agreed fixed or variable rate or (b) the value of the investments exceeds a pre-agreed amount
- it is calculated over a pre-agreed time period
- it is subject to pre-agreed terms designed to mitigate the effects of short-term fluctuations in the investment performance or the value of the investments

In addition, trustees of qualifying schemes must carry out an annual calculation of any specified performance fees incurred in relation to the default arrangement(s) during the scheme year and assess the extent to which those fees represent good value for members. They must also set out the amount of any specified performance fees incurred in relation to the default arrangement(s) in the annual governance statement. That section of the statement must be published on a website that is publicly available free of charge.

Once again, identical requirements will apply for qualifying CMP schemes, but with regard to any specified performance fees incurred in relation to the entire scheme during the scheme year.

Statutory guidance

Trustees will be required to have regard to statutory guidance produced by the government in complying with the asset allocation requirements and the exclusion of performance fees from the charge cap. The government is consulting on a draft version of this guidance, which is designed to ensure that trustees have a comprehensive understanding of the new requirements.

What are the implications for occupational pension schemes? What happens next?

The requirements will further expand the governance obligations of DC schemes. While the policy in relation to investment in illiquid assets is to be included in the SIP and broadly therefore only needs to be reviewed triennially, the calculations and accompanying disclosures in relation to asset allocation

and performance fees will need to be carried out annually. Trustees will also need to assess the extent to which the fees charged by their investment funds are performance fees, both when the exemption comes into force and when any changes are made to those funds' fee structure or when new funds are introduced.

The consultation closes on 10 November 2022. The consultation document, and details of how to respond, are available at: ['Broadening the investment opportunities of defined contribution pension schemes'](#).

The requirements in relation to investment in illiquid assets will apply from the earlier of (a) the first occasion that the default arrangement SIP (or the main SIP for CMP schemes) is updated after 1 October 2023 and (b) 1 October 2024. The requirements in relation to asset allocation will apply for the first scheme year ending on or after 1 October 2023. The exemption of performance fees from the default fund charge cap is expected to come into force on 6 April 2023. The disclosure requirements in relation to performance fees will apply for the first scheme year ending on or after 6 April 2023.

Interviewed by Banita Kalia

Duncan Watson is a Scottish qualified lawyer and counsel in the Pensions practice at Mayer Brown International LLP. Duncan leads the Pensions Investment team and has extensive experience in advising institutional pension funds, institutional investors and asset managers on investment management work, including all kinds of investment funds, liability-driven investment mandates, custody and stock lending. Duncan is a member of the Association of Pension Lawyers Investment and Defined Contribution Committee.

Katherine Carter is a professional support lawyer in the Pensions practice at Mayer Brown International LLP. Katherine has wide-ranging experience of advising employers and trustees on all aspects of occupational pension scheme provision, including ongoing administration and compliance, investment issues, the pensions aspects of corporate transactions and scheme mergers and winding ups.

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