

DWP response to consultation on broadening DC investment opportunities—key aspects and implications

Pensions Analysis: The Department for Work and Pensions (DWP) has published its response to a recent consultation, and laid regulations before Parliament, in relation to changes that will impact the default fund charge cap and disclosure requirements for the majority of defined contribution (DC) occupational pension schemes. The changes will apply to schemes that provide DC benefits (relevant schemes) other than executive schemes (as defined in legislation), self-administered schemes, public service pension schemes or schemes where the only DC benefits provided derive from additional voluntary contributions (AVCs). They will also apply to collective money purchase (CMP) schemes that are being used for automatic enrolment. Duncan Watson, Scottish qualified lawyer and counsel, Henry Corrigan, senior associate and Katherine Carter, professional support lawyer at Mayer Brown examine the consultation response and its implications.

This analysis was first published on Lexis®PSL on 1 March 2023 and can be found [here](#) (subscription required).

What was the background to the consultation?

The October 2022 consultation sought industry views on draft regulations and statutory guidance to help implement the DWP's objective of enabling DC occupational pension schemes to take advantage of long-term illiquid investment opportunities in long-term illiquid assets.

The consultation followed DWP consultations in November 2021 and March 2022 where the DWP set out its broad proposals to achieve its objectives by:

- requiring trustees of relevant schemes to disclose and explain their policy on investments in illiquid assets in the default arrangement statement of investment principles (SIP) (or in the main scheme SIP for CMP schemes). SIPs must be reviewed triennially and after any significant change in investment policy
- exempting performance fees from the scope of the default fund charge cap. Member-borne charges in the default arrangement(s) of relevant schemes and CMP schemes that are being used for automatic enrolment must not exceed a specified annual cap, broadly, 0.75% of the value of the member's pot
- requiring trustees of relevant schemes and CMP schemes to calculate and disclose in the annual chair's governance statement (a) the percentage of assets in the default arrangement(s) allocated to each of the eight asset classes, and (b) the amount of any performance fees incurred in relation to the default arrangement(s)

The new disclosure requirements were proposed to improve transparency over trustee investment decisions, with the hope that increased comparability across schemes will increase focus on value for members. Exempting performance fees was proposed as their inclusion was seen as a barrier to the ability of schemes to invest in illiquid assets.

What was the outcome?

Responses to the consultation were broadly supportive of the DWP's proposals and policy intent. Therefore, the DWP is proceeding with its proposals with only minor adjustments to the draft regulations and statutory guidance. The changes or points of clarification in the proposed drafts included:

Disclosure requirements

- confirming the intention for the new requirements to apply to all relevant schemes, including those with less than 100 members. They clarified that CMP schemes with fewer than 100 members will not need to state their policy intention in relation to illiquid assets as they are not required to produce a SIP
- introducing a requirement for the DWP to carry out a post-implementation review that will report (within five years) on whether the policy objectives have been achieved
- noting that the DWP will consider with the Pensions Regulator whether to update guidance on SIPs to cover the new requirements

Asset allocation

- updating the statutory guidance to clarify that where a scheme has multiple default funds, the asset allocation should be done for each fund and the percentage of assets reported should be for each fund rather than on a cumulative basis
- updating the statutory guidance to confirm that schemes can attach factsheets (with more in depth breakdown of assets) to their chair's statement if they choose to do so
- updating the statutory guidance to confirm that it is an option for schemes to use an averaging approach to asset allocations where allocations change throughout a year

Charge cap

- amending the regulations to ensure that fund of funds/collective investment arrangements can benefit from the exemption for performance fees and agreed terms with those arrangements can fall within the definition of pre-agreed terms
- updating the statutory guidance to explain when negation of performance fees is permitted for the purposes of the regulations
- updating the statutory guidance to clarify that schemes must assess the extent to which performance fees represent good value for members

As a more general comment in the response to the consultation, the DWP reiterated that trustees will need to ensure that it is in members' best interests to exclude performance fees from the charge cap. They explain that their expectation is that it would only be justifiable for there to be higher fees where the scheme is receiving higher net performance returns for members.

What are the implications for trustees and managers of DC occupational schemes?

The exemption of performance fees from the default fund charge cap will come into force on 6 April 2023.

The disclosure requirements will apply:

- in relation to performance fees, for the first scheme year ending on or after 6 April 2023
- in relation to investment in illiquid assets, from the earlier of:
 - the first occasion that the default arrangement SIP (or the main SIP for CMP schemes) is updated after 1 October 2023, and
 - 1 October 2024
- in relation to asset allocation, for the first scheme year ending on or after 1 October 2023

The requirements will further expand the governance obligations of DC and CMP 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.

What happens next?

Trustees of relevant schemes will need to make arrangements to comply with the new regulations from April and October 2023. When making arrangements to comply with the requirements on performance fees and asset allocation, trustees must have regard to the statutory guidance.

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