Department for Work & Pensions

Improving outcomes for members of defined contribution pension schemes

Government Response to the September 2020 consultation on draft regulations and statutory guidance to deliver better value for money for members of DC schemes

Government Response to the March 2021 consultation 'Incorporating performance fees within the charge cap' on draft regulations on performance fee smoothing and a call for evidence on the issue of look-through

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Contents

Contents

Ministerial Foreword 3
Chapter 1: Background and Summary 5
Chapter 2: Consolidation 7
Chapter 3: Performance Fees 15
Chapter 4: Look-through.. 19
Chapter 5: Costs and Charges Disclosure and Illustration 31
Chapter 6: Default SIPs and Wholly-insured schemes 38
Annex A: List of respondents to ‘Improving outcomes for members of defined contribution pension schemes’ 43
Annex B: List of respondents to ‘Incorporating performance fees within the charge cap’... 44

Ministerial Foreword

Our mission is to make pensions safer, better and greener. Over the past 12 months, the Government has set out a series of measures to prepare the Defined Contribution (DC) occupational pensions market for the opportunities ahead.

The Government's ambition is to drive better outcomes for members of DC pension schemes to help ensure all savers achieve the best possible retirement. In September 2020, we consulted on new proposals to drive consolidation of the DC market at the lower-end, requiring all schemes to publish their net returns, not just their costs, and removing property-holding costs from the charge cap.

In March 2021, as part of the consultation 'Incorporating performance fees within the charge cap', I reaffirmed the Government's ambition to improve outcomes for savers. This consultation also included a call for evidence on the treatment of look-through costs and any barriers to schemes investing in illiquid assets.

This is the Government's response to these two important consultations on occupational DC pension schemes' investments and overall governance.

We will move forward with new regulations which will come into force in October 2021. These measures will challenge some 1,800 smaller DC schemes to demonstrate that they continue to offer value for members and that that value is comparable to larger schemes. I have no doubt trustees will either rise to this challenge or act decisively in their member's best interests to wind up and move their members into a scheme that offers better value.

With the great work ongoing in the Productive Finance Working Group, DWP is committed to removing significant barriers to greater allocations to productive assets. I was pleased to see almost unanimous support for the proposed regulations to allow smoothing of performance fees, giving trustees greater confidence to make the leap into private equity funds within the charge cap. The cap itself continues to offer members' important protections against high or unfair charges. However, costs should not be the sole factor in determining overall value for members. I want to see schemes considering overall performance and returns on investments for members as well as costs. That is why these regulations require all relevant schemes to publish net returns, which I see as a next step in creating a competitive, future-proof DC market acting in members' interests.

While the focus of these regulations is on schemes with assets of less than £100 million, the principle of ensuring value to members applies to all schemes. The call for evidence published alongside this document begins the next conversation on what best value looks like for the millions of pension savers in medium and large schemes that are not in scope of the new value for members' assessment.

I am particularly keen to understand how the creation of greater scale in the DC market can benefit members through economies of scale and access to alternative investments. The call for evidence also asks to what extent pension schemes can provide additional benefit for their members, and play a role in economic growth through investment in new businesses, infrastructure and the commitments to net zero emissions. It asks whether a lack of scale currently limits schemes' ability to play this role. This evidence will help the Government understand the opportunities for schemes and whether there are barriers to greater consolidation.

Guy Opperman MP

Minister for Pensions and Financial Inclusion

Chapter 1: Background and Summary

About this Government Response

1. This document includes:

    - the Government's response to Chapters 2, 5 and 6 of our September 2020 consultation 'Improving outcomes for members of defined contribution pension schemes' (a response to Chapter 3 was issued in March 2021, Chapter 4 contained proposals that are not being taken forward);
    - the Government's response to our March 2021 consultation 'Incorporating performance fees within the charge cap; and
    - a summary of the evidence received as a result of the call for evidence included in 'Incorporating performance fees within the charge cap' on the topic of look-through.

2. The two statutory guidance documents that accompany the final draft regulations have also been published at the same time. 'Reporting of costs, charges and other information: guidance for trustees and managers of occupational schemes' will be effective from 1 October 2021. 'Completing the annual Value for Members assessment and Reporting Investment Returns: Guidance for trustees of relevant occupational DC schemes' will be effective from 1 October 2021, subject to approval of corresponding draft regulations by Parliament.

Improving outcomes for members of defined contribution pension schemes consultation

3. On 11 September 2020, the DWP published 'Improving outcomes for members of defined contribution pension schemes' setting out a response to the February 2019 consultation, 'Investment Innovation and Future Consolidation' (the 2019 Consultation). It also included a further consultation on changes to regulations and statutory guidance intended to improve DC pension scheme governance, facilitate the diversification of investment portfolios and to signal the government's commitment to transparent disclosure to scheme members.

4. We received 60 responses – a full list of respondents is disclosed in Annex A to this document.

5. This document contains the government's response to the proposals on:

    - Net returns and total assets publication requirements (Q1);
    - Additional value for members assessment for specified schemes, including new statutory guidance (Q2 and Q3);
    - Revised statutory guidance and regulations on costs and charges disclosure and illustrations (Q10 and Q12);
    - Ensuring schemes 'with a promise' produce a Default Statement of Investment Principles (SIP) (Q11); and
    - Exempting wholly-insured schemes from the requirement to produce certain sections of the SIP (Q13).

6. A response to Q4-Q9 on performance fee proposals and the exclusion of property-holding costs can be found in the March 2021 consultation 'Incorporating performance fees in the charge cap'.

Incorporating performance fees within the charge cap consultation

7. We received 35 responses to the consultation Incorporating performance fees within the charge cap published in March 2021 – a full list of respondents is disclosed in Annex B. This consultation included draft regulations on performance fee smoothing. The consultation also included a call for evidence on the issue of look-through. A summary of this evidence and next steps for the government can be found in Chapter 4.

Chapter 2: Consolidation

Summary of proposals

Reporting of net returns and new 'Value for members assessment

8. Below is a summary of the proposals we outlined in the 'Improving outcomes for members of defined contribution pension schemes' consultation on the reporting of net investment (performance) returns by all relevant DC schemes, and a new value for member assessment for smaller DC schemes.

Summary of original proposals

- Trustees of all 'relevant schemes' regardless of size, would be required to state in the chair's statement the net investment (performance) returns for their default(s) and self-selected funds.
- Trustees of DC schemes with total assets of less than £100 million and that have been operating for at least three years will be required to assess key elements of the value achieved by their scheme on behalf of members.
- Trustees will need to report on the outcome of the value for member assessment in their annual chair's statement and to the Pensions Regulator via the next scheme return. This includes outlining next steps, where trustees conclude that their scheme does not provide good value for members, either immediate improvement or consolidation/wind-up.
- Schemes with assets of £100million or more to continue to comply with the current requirements for assessing 'value for members by reviewing the extent to which member-borne costs and charges represent good value for members, although they will be able to choose to voluntarily adopt the new form of assessment.

Stakeholder Responses

Reporting of net returns

Q1. We would welcome your views on the reporting of net returns - how many past years of net returns figures should be taken into consideration and reported on to give an effective indication of past fund performance?

9. The majority of stakeholders responded in favour of the requirement for trustees of all relevant DC schemes to state the net returns on investment performance for their default and self-select funds in the annual chair's statement. Most acknowledged that net returns are a natural continuation to the existing duty on trustees to assess and explain each year the extent to which charges and transaction costs represent good value for.

   "We strongly support the decision to ask for net reporting for all DC schemes. This will help provide greater accountability for DC investment design and help scheme members answer the fundamental question of whether their scheme is delivering Value for members".

   Investment Association

   "Trustees are already required to assess and review past performance and we see this as a natural step to disclose this information to members alongside costs and charges".

   Legal and General

10. Several stakeholders suggested a preference for net returns to be assessed on a triennial rather than yearly basis. We also received suggestions from several stakeholders that risk adjusted net performance or internal rates of return would be a more effective assessment of performance.

    "A 3-year period would represent the minimum timeframe over which to properly judge performance of the default strategy and other funds available to members. This aligns with the required triennial review of the default strategy".

    Investment Association

    "Reporting should not just be focused on returns but measures of 'risk' (e.g. volatility and capital loss/drawdown) compared over the same periods".

    Aon

11. The majority of respondents agreed that a minimum of five years presented a sensible time-period/benchmark. Among the most common reasons given for this was that this time period gives a good indication of short, medium and longer-term performance, and that a minimum five-year period will often reflect a fair indication of the schemes investment strategy success, taking into account different market conditions, and generally how private markets assess performance of the assets.

    "Performance over previous 5 years and 10 years strikes a reasonable balance. Avoids focusing on too short-term performance and at same time avoids looking at historic periods which are no guide to current or potential future performance"

    Aegon

12. Several stakeholders commented that trustees would welcome further guidance on how this information should be presented to members. This included both for single employer schemes as well as master trusts which may have multiple charging structures, and whether schemes should include the performance of closed default arrangements for the period they are reporting.

    "Schemes have different charging bases and it will be challenging to take account of these in a consistent way when reporting net returns"

    Institute and Faculty of Actuaries

13. Many stakeholders flagged the biggest challenge would be trustees ability to obtain data, especially in the first year of reporting, with many citing performance return data is typically provided by investment managers who may use different timeframes on which to report.

    "We think it will be challenging for schemes to obtain historical net returns from 2015 especially where investment strategies or funds themselves have changed in time and hope there will be some leeway where the historical data is not available"

    Lane, Clark and Peacock

14. In response to the proposal set out in statutory guidance for net returns to be calculated by geometric averaging over the period reported, most stakeholders commented that this was a sensible approach, at the same time suggesting guidance would be helpful for trustees unfamiliar with this concept.

    "Use of annual geometric averages to measure net returns is sensible – however will require clear explanation both to those preparing the reports and those receiving since do not believe the mathematical concept is widely understood"

    Pensions Management Institute

'Value for members (VfM) assessment

Q2. Do you think that the amending regulations achieve the policy aims of encouraging smaller schemes to consolidate into larger schemes when they do not present good value for members?

Q3. Do you believe that the statutory guidance increases clarity about the minimum expectations on assessing and reporting on value for members for specified schemes? Are there any areas where further clarity might be required?

15. Stakeholders on the whole reported satisfaction with the drafting of the new regulations, in relation to the value for members assessment with many stating they thought it achieved the policy intent of requesting trustees of smaller schemes continuously consider the value of the scheme offer to members.

"Amending the regulations will encourage trustees to reflect on the value their scheme has delivered for members against alternative schemes. Whilst past performance is not a guide to future performance, it will help encourage consolidation in badly governed and expensive schemes where value is poor"

Willis Towers Watson

"By clarifying which schemes are most at risk of under-performing and providing a framework for schemes to measure themselves against relevant schemes in certain criteria, the regulations bring a sense of urgency and quantifiability to the remaining consolidation process".

Nest

16. Some stakeholders suggested the new regulations would help meet the government's objectives to remove barriers to greater allocation to illiquid assets by DC schemes.

"The regulations will reduce the long tail of DC schemes who struggle to present data to third parties in a timely way. This is of importance to the delivery of the pensions dashboard. It will also serve to give larger schemes greater scope to invest in patient capital and reduces the numbers stranded in smaller schemes missing out on investment into illiquids".

AgeWage

17. A few stakeholders suggested that the new value for member requirements should be applied to all DC schemes irrespective of size.

"We would suggest applying the principle of relative value for members to all single employer schemes would achieve the policy aim of encouraging schemes to consolidate, regardless of scheme size".

Independent Trustee Service

18. A significant number of stakeholders asked for clarification in the regulations and the accompanying statutory guidance as to whether hybrid schemes – those that have both a defined benefit and a defined contribution element within the same scheme – were in scope of the new value for member assessment or not.

19. In respect to undertaking certain aspects of the assessment by comparison with others schemes, several stakeholders expressed a concern that net return data may not be available for the first assessment and this could present a problem.

"The comparison of net returns against three comparison schemes would potentially be a problem for some schemes (depending on the timing of their end of scheme year) because of the lack of published information on net returns in the first year of the new requirements"

Association of Consulting Actuaries

20. Other stakeholders did not foresee access to data as a problem citing the probability that master trusts would be able to provide this for the purpose of the assessment.

21. Most stakeholders reserved their comments to the effectiveness of the statutory guidance. Some stakeholders thought the guidance would help trustees carry out their value for money assessment in a comprehensive but proportionate way.

    “Guidance is very helpful and gives trustees clarity on how to carry out the assessment. We are also supportive of the emphasis in the guidance on assessment by the trustees based on a holistic consideration of the three relevant areas over the long term, rather than based on a short term focus”.

    Association of Pension Lawyers

22. It was however in the area of further guidance where the vast majority of stakeholders called for more advice to help trustees complete the new assessment.

23. There were concerns about the level and extent of information that the new requirements would place on trustees to include in chair’s statement with guidance requested on making this as clear as possible.

24. Several stakeholders also highlighted some concern around the ability of trustees to find suitable and appropriate schemes for comparison.

    “Clarity is required as to the requirements for hybrid schemes, comparator schemes/transfers, and consultation. We also suggest trustees should have more detailed guidance on ‘year 1’ reporting, either from the government or TPR, including on how to choose comparator schemes”.

    Allen & Overy

25. There were also requests for clarity in the guidance on the role of the sponsoring employer and how they should be consulted. Several stakeholders commented that it is not a given that employers will automatically agree with the trustees that wind up and consolidation is the best course of action.

    “Guidance should require trustees to consult with the employer and potentially members regarding any decisions made on the future of the scheme and take their views into account. TPR DC code of practice expects trustees to make efforts to understand members’ preference”.

    Legal and General

26. A few stakeholders drew attention to the important role of the Pensions Regulator (TPR) in how they would assess the value for member assessments, and also with respect to the enforcement role if schemes do not wind up the scheme after a poor assessment.

"We suggest that the government reconsiders whether it will make changes to the current penalty framework in the final regulations, to allow TPR greater discretion in deciding whether to impose a penalty for failure to comply with requirements (to cover both the first year of new reporting requirements, and on an ongoing basis)"

Allen & Overy

27. Similarly, a few stakeholders asked what would be expected of smaller schemes that had already indicated that they were in the process of wind up, as to whether they would be required to do the new value for member assessment given this fact.

"We welcome clarification of the position where a scheme has entered wind-up. Currently a standard chairs statement is required where the wind up will not be completed by the statutory deadline. We do not think it makes sense for a scheme to go through a holistic assessment if they are already heading to a wind up".

Sackers

Government Response

Reporting of net returns

28. We are pleased with the level of support we received for our proposals to require all relevant schemes, regardless of size, to state the net returns members achieved.

29. Overall, stakeholders agreed that investment returns are important for two reasons. Firstly, in terms of providing transparency to members on what they are achieving on their pension savings. Currently, there is a strong focus on cost– but this is only side of the equation. Returns can vary much more than costs and so members deserve to understand this information.

30. Secondly, the regulations will allow competition on performance to develop through comparison and benchmarking. This would benefit employers, consultants and even trustees as they seek to make the best decision for their members in line with their fiduciary duty.

31. While the reporting of net returns is a new requirement for many schemes, trustees must make every effort to complete this task each year. We have set out in the accompanying statutory guidance helpful assistance in how net returns can be calculated and then reported in the chair statement.

32. We have also advised in the guidance that trustees may use measures such as the individual rate of return or risk adjusted returns if they consider this will help explain performance more easily **in addition to** the net returns disclosure the

guidance sets out. This is so we can ensure a consistency of approach with schemes comparing net returns with three other larger schemes as part of the new value for member assessment.

Value for members assessment and regulations

33. We are equally pleased with the support we received for the new requirements on smaller schemes to undertake a more thorough examination of whether their scheme offers value to members. There was a general acceptance that where the small scheme is proven not to offer comparable value with other schemes operating in the market, the trustees should consider winding up the scheme and transferring members into a scheme that demonstrates better value. Evaluating the schemes' performance should be part of a trustee's ongoing fiduciary duty.

34. In response to the potential challenges highlighted by stakeholders in the consultation, we have made some changes to the regulations.

35. Firstly, we have pushed back the implementation date for the application of the value for member assessment from October, as previously indicated, to instead the end of this year. This means the first value for member assessment will apply for schemes for their first year ending after 31 December 2021. This will give schemes extra time to access the necessary net return and costs and charges data, particularly in the first year of reporting.

36. Secondly, we have clarified the position on hybrid schemes. A hybrid scheme where the total assets (DC and DB together) are below £100 million are in scope. We have further clarified that it is only the DC element of the scheme that will be subject to the assessment.

37. Thirdly, we have included in the revised statutory guidance a reminder that TPR may be of help on comparator vehicles as they hold a list of authorised master trusts.

38. Fourthly, while still requiring that schemes choose larger schemes that are potential consolidators, we have amended the previous requirement that there must be "reasonable grounds" to believe that at least one of the larger schemes would accept a transfer in of the smaller schemes members. We have amended this so that at least one of the larger schemes chosen must 'have had discussions' with the smaller scheme over a potential transfer. This is in recognition that schemes may not always be able to agree in principle to the terms of transfer.

39. Fifthly, in response to stakeholder feedback we have introduced a notable exemption in the regulations so that smaller schemes that would ordinarily have been in scope will be exempt if they have informed TPR at any time before the next chair statement is due that they are in the process of wind up. This notification must be in accordance with existing section 62(4) of the Pensions Act

2004. More advice on this exemption is included in the revised statutory guidance. TPR also has existing guidance on the necessary steps that must be taken around wind-up.

40. The government is committed to increasing the pace of consolidation in the DC pensions market to create greater scale. We will review the £100million threshold at regular intervals to see if the new value for member assessment is achieving the required effect of ensuring members are in schemes that offer tangible value. More immediately, we welcome stakeholder input to the proposals to speed up consolidation for DC schemes above £100million via our call for evidence published alongside this response.

Chapter 3: Performance Fees

Background

41. In the consultation ‘Incorporating performance fees within the charge cap’, the Government consulted on draft regulations to allow schemes to smooth the performance fee element of their charges regime over five years.

42. The motivation behind this proposal is to remove an identified barrier to investing in illiquid asset classes that generate performance fees. allowing schemes to accommodate the ‘ebb and flow’ sometimes associated with the performance of these assets and still remain within the charge cap.

43. We proposed that these amendments would form part of The Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 coming into force from 1 October 2021.

Summary of original proposal

The Government proposed amendments to Regulations 7 and 8 of the Occupational Pensions Scheme (Charges and Governance) Regulations 2015 to allow defined contribution pension schemes to smooth performance fees over a five-year period.

We asked:

Are the performance fee regulations: a) clear; b) likely to be taken up by trustees; c) going to make a difference to trustees’ confidence to invest in illiquids?

Stakeholder Responses

44. Of the 35 responses we received to this question, the overwhelming majority of respondents supported the objective to provide trustees with flexibility when it comes to incorporating performance fees within the charge cap and believed that the draft regulations would go some way to achieving the policy intent.

“Broadly support the rationale behind this measure, which may allow some flattening out of carried interest or fee payments for the purposes of the charge cap calculation, thereby providing some protection against year-on-year variations.”

British Venture Capital and Private Equity Association (BVCA)

“The proposals to smooth performance fees with a five-year moving average within the charge cap are sound and the regulations proposed are clear and they reach the policy intent.”

Association of British Insurers (ABI)

45. However, many respondents suggested that the change, if implemented, would introduce complexity to the way in which charges are calculated and communicated to members.

"The suggested introduction of multi-year smoothing of fees adds unnecessary complexity in the regulations and exacerbates the over-emphasis on charges rather than overall value for members."

Hymans Robertson

"Some trustees may also be wary of using the new calculation due to complications around communicating charges to members in a simplified way and explaining why charges might vary over different years."

Pensions and Lifetime Savings Association

46. Overall, whilst recognising the positive intent from the Government many respondents believed this change would have limited impact on trustees' investing in illiquid assets.

"The regulations may provide greater confidence to invest in illiquids, but this alone is unlikely to drive a change in market perception."

XPS

"We are supportive of the proposals to allow for multi-year smoothing of performance fees and believe that the regulations are clear. However, we do not believe that this alone will make a difference to trustees' confidence to invest in illiquids."

Legal & General

47. Many other respondents, including fund managers, proposed alternative or additional relaxations of regulations that they felt would go further to eliminating barriers to trustees choosing illiquid investments to diversify their portfolio. This included complete or partial removal of performance fees from the charge cap.

"One impactful change that would significantly increase trustee confidence to invest in illiquids is to have performance fees not subject to the charge cap. In our view performance fees are more akin to a profit share mechanism and should not be categorised in the same way as other fees and charges within the cap."

Partners Group

"Strongly of the view that where performance fees relate to VC/GE investments, they should be excluded from the charge cap completely. Only performance fees relating to non-VC/GE investments should operate within your proposed smoothing framework."

Legal & General

"We therefore recommend an alternative option that may help to balance these two objectives: placing a limit on the proportion of a workplace pension schemes' portfolio that can be invested in strategies that use performance fees – for example at 35%, which is in our experience around the top end of clients' target allocations – while excluding performance fees from the charge cap calculation."

BlackRock

48. However, other organisations believed other factors outside the charge cap would make a greater difference to trustee's confidence in investing in illiquid assets.

"Our central point is that constraints in the workplace pensions market mean that investing in more expensive asset classes is not viable for master trust pension schemes. The charge cap does not figure in this calculation and, as such, changing the charge cap will not affect schemes' ability to invest in more expensive asset classes."

B&CE

We note that consolidation and pooling of assets should assist with increased investment in illiquid investment, but currently we have seen that a significant proportion of schemes looking to consolidate through a master trust arrangement focus on cost, rather than value and member outcomes.

Mercer

49. Many respondents including pension schemes, rejected the premise that the payment of performance fees is necessary.

"We see no evidence to suggest that performance fees improve customer outcomes and we do not see a need for performance fees to be permitted in default funds."

Scottish Widows

"DWP has inadvertently given the impression that it sees the high fees charged by some asset managers as reasonable. Like other large market participants, we are unwilling to pay "2 and 20" as, aside from the aforementioned constraints imposed by the workplace pensions market, we are not sure that this represents fair costs for schemes and more importantly good value for members."

B&CE

"There is no natural linkage between illiquid investments and performance fees."

Brighton Rock Group

Government Response

50. We are pleased with the almost unanimous support for the clarity and the intent of the Government's proposed change to the charge cap regulations to allow

schemes to smooth performance fees over five years. We have taken on board drafting changes to the regulations that provide even greater clarity. We will now proceed with making these regulations laying them in June 2021, to come into force on 1 October 2021.

51. The Government recognises that the flexibility we are introducing will have *an* impact on trustee confidence to invest in illiquid assets that generate performance-fees but that this is only part of the picture. We thank respondents for suggestions for stimulating further demand. The Productive Finance Working Group through the development of a Long Term Asset Fund and wider work on the barriers to DC allocation to productive investments will help provide greater confidence.

52. The Government agrees that performance fees are not necessary to access illiquid investments. However, where trustees pay such fees because they believe investing in particular assets classes will positively impact member outcomes, they should do so with the necessary member protections in place. Greater economies of scale leverage and expertise achieved through scheme consolidation mean that larger schemes can more easily negotiate fee levels that are appropriate and operationally workable within the features of a DC scheme.

53. Some respondents proposed complete or partial removal of performance fees from the charge cap. However, Government believes that carried interest is a cost and should be subject to a cap in the same way as other investment costs. Some respondents suggested that the Government should therefore not cap a cost that is only incurred when members receive higher net returns. We have concluded that the charge cap and inclusion of performance fees within it protect members from high fees that do not improve value for money. Evidence received showed that this can happen given that the annual charge element of a traditional 2:20 performance fee is payable even if a private equity or venture capital investment underperforms. This high annual management fee is something that stakeholders have told us should continue to be capped until the industry can develop private equity fee models suitable for both investors and investment managers. We will not be making changes to the status of carried interest or other performance fees within the charge cap at this stage.

54. It is important to stress that investment decisions are for trustees to make. The Government does not wish to decide whether performance fees should be paid and at what level. We encourage the industry to enter constructive discussions to find fee structures that fit better within DC schemes' default arrangements, in order to facilitate investments which may unlock potential higher returns for pensions savers.

Chapter 4: Look-through

Background

55. The performance fee consultation ‘Incorporating performance fees within the charge cap’ also included a call for evidence on look-through costs.

56. The current position is that trustees of occupational DC pension schemes should ‘look-through’ closed-ended funds or pooled investment vehicles. This means that trustees should not just incorporate the costs of investing in the pooled vehicle but look-through this structure and consider the costs paid by the pooled vehicle manager as it invests in other funds, known as the underlying investments.

57. As trustees explore investments in illiquid asset classes, they will need to understand how look-through costs should be treated when making allocations to certain funds. In previous consultations some stakeholders outlined that look-through can drive up the overall cost of investing in this type of vehicle to such an extent as to make it commercially unviable. Therefore, we welcomed views in this consultation to further understand whether look-through would be a strong barrier to investment into illiquids assets and what role the government could play in clarifying any issues or remove barriers.

58. Whilst considering look-through as a barrier to investment in illiquids, we also sought views from stakeholders to understand any other significant barriers to investing in venture capital and growth equity. In addition, we put forward questions to gather stakeholder views on what the government could do to clarify or remove any barriers.

59. We also wanted to get views on whether making changes to the look-through position in relation to either specific asset classes or specific mechanisms for structuring investments may create perverse incentives.

60. The call for evidence also asked stakeholders about specific terminology of different assets to identify whether there is a common understanding across the industry and if not, whether government should develop a shared definition, so that stakeholders recognise which assets are referred to.

61. In addition, respondents were given the opportunity to make any further broader recommendations.

Summary of evidence

62. Below you will find a summary analysis of the stakeholder responses. As this was a call for evidence, we summarise the evidence submitted and include the government's next steps.

Q2. What is the likely appetite that pension scheme trustees have for investment in venture capital and/or growth equity?

63. On the whole there was agreement that DC pension scheme trustees would be interested in investing in a diversified portfolio of assets and that scheme members would benefit. However, some stakeholders outlined why they did not have a strong interest in investing into illiquids specifically. These respondents suggested that they did not have a large appetite for investing into venture capital and growth equity because of the practical difficulties of investing, fee considerations and high risk.

    "Given the operational complexity and fee load considerations of doing this in practice, we believe that scheme managers' reticence to allocate to private markets, and private equity in particular is legitimate".

    Nest

    "Within our trustee client base to date, we have not seen any significant appetite for investing specifically in venture capital and/or growth equity".

    Association of Consulting Actuaries

64. Larger schemes were particularly in favour of the potential to invest in venture capital and growth equity and commented that this appetite existed because stakeholders would benefit from the additional return received for the additional risk of tying up capital in illiquid assets.

    "There is a lot of interest amongst DC schemes and trustees to harvest the illiquidity premium for the benefit of DC members, who have very long investment time horizons".

    Aon

65. Furthermore, respondents noted that assets which demonstrated ESG credentials, for example, private equity linked with climate change initiatives, would be an attractive prospect for trustees.

"We believe there is great appetite, not only for the diversification and higher potential returns, but also based on the potential for trustees to implement their responsible investment goals for members".

Hymans Robertson

"We are finding increasing appetite for assets which demonstrate strong Environmental, Social and Governance considerations. This extends to assets with a specific focus on climate change. We feel that private equity can readily align to these desirable principles, which will be attractive to trustees".

XPS Pensions

66. Many stakeholders highlighted that larger schemes would have the capability to invest in illiquids and that there was a lot of appetite from them to invest in venture capital/growth equity. However, some stakeholders also noted that investment into these assets would be out of bounds for smaller schemes.

"Larger schemes are already demonstrating some appetite for venture capital/growth equity as part of a broader portfolio...Smaller schemes may struggle to access this market whatever the rules".

Pinsent Masons

67. Stakeholders also highlighted the current barriers that DC pension schemes face if they want to invest in venture capital and growth equity, such as operational complexity. One key barrier which respondents noted was fees. Stakeholders stated that investing in venture capital and growth equity would attract higher fees, which in turn deter pension schemes from choosing to invest in these assets.

"DC schemes have different barriers to investing in venture capital, of which fee structures versus fee caps is one".

The Society of Pension Professionals

68. In addition to that, some stakeholders have noted that the 'prudent purpose rule', set out by TPR as acting "in the way that a prudent person would in their own affairs", has prevented schemes from investing in venture capital and growth equity. This is because the nature of these assets has meant that it is harder to undertake full due diligence and so this test cannot be met.

"Private market assets are, by definition, more difficult to monitor than those traded on public exchanges. This makes it more challenging for trustees to do appropriate due diligence and satisfy themselves that they have acted in accordance with the 'prudent person' rule. Revised guidance in this area could help to give Trustees more confidence to invest in illiquid assets".

Lane Clark and Peacock

Q3. How do you currently treat look-through when calculating the charges regime of the scheme?

69. The majority of responses said they did not believe there is a clear and consistent basis in legislation, regulation, or guidance for assessing look through costs. Many called for legislation or more detailed guidance to be introduced that would provide clarity.

    “There is legal uncertainty because the concept of "look-through" appears nowhere in the Charges and Governance Regulations 2015 nor in the definition of "administration charge" in Schedule 18 to the Pensions Act 2014”.

    British Private Equity and Venture Capital Association

    “The concept of look through appears only in guidance and not in legislation. Preferable if it was set out in legislation so that pension schemes trustees can invest with more confidence. Legislation could specify when look through applies in relation to particularly investment vehicles”.

    Pinsent Masons

70. Some respondents answered that they disclosed look-through costs of investing regardless of whether the fund is an open-end or closed-end fund.

71. Several stakeholders reported that DC schemes’ look-through costs are included in the fund's total expense ratio (TER) cap calculations and therefore included the charges regime, in line with the cost transparency initiative. Other stakeholders explained that they excluded investments in comingled funds and fund of funds that had performance fees or carried interest.

    “We view fees at the pooled vehicle level and assess the Total Expense Ratio or Ongoing Charges Figure, as the key factor in assessing costs and charge cap requirements. We approach it this way as a means to ensure that members’ interests remain protected and within the charge cap”.

    XPS Pensions

72. Stakeholders also highlighted that in practice, it may be difficult to disclose look-through costs because they are unable to gather the necessary information.

    “Attempts to apply the current DWP guidance and consultations can produce very arbitrary results, seemingly requiring or not requiring look-through depending on the investment vehicle used for otherwise similar investments. In addition, even if trustees do conclude that "look-through" should apply in such circumstances, it may be very difficult for trustees to obtain accurate and timely information about any underlying costs”.

    The Society of Pension Professionals

"It is often difficult to obtain accurate information on underlying costs of this sort from fund managers, which hinders the ability of Trustees and their advisors to incorporate such costs into their charges regime. At present, most managers treat listed assets, including investment trusts and (REITS) as stock holdings".

Lane Clark and Peacock

Q4. Does look-through act as a significant barrier to investment into investment vehicles that allocate to VC/GE?

73. The vast majority of stakeholders answered that look-through could act as a significant barrier to investing in venture capital/growth equity depending on how managers treat these costs. They noted that trustees were put off from investing into these assets because of the lack of transparency and uncertainty around look-through on the part of the investment managers.

"With regards to if this acted as a significant barrier; this would be determined by the extent to which investment managers provide visibility of underlying fees within their products at the outset. A lack of transparency would increase the burden on trustees/advisors and would make it more difficult for stakeholders to agree to use illiquid assets".

XPS Pensions

74. Stakeholders also noted that a lack of clarity from the government on how look-through should be treated created confusion, which then prevents investment into illiquids.

"Yes, in our experience it can act as a significant barrier to investment. Trustees will generally be hesitant to make an investment if there is uncertainty around whether "look-through" applies at all, how far through an investment structure they are required to look, what types of costs are properly in scope, and how the relevant information can be obtained.

The Society of Pension Professionals

75. A large number of respondents called for the government to issue guidance which would provide information about look-through. They suggest that greater clarity and certainty would encourage investment into venture capital/growth equity.

"We would welcome further guidance and clarity on how trustees are expected to look-through to underlying costs in general, how far trustees should look-through in a given structure, how to obtain accurate and timely information about any relevant underlying costs and whether to incorporate such costs into the charge cap framework. In the absence of clear guidance, practices will vary across the industry as trustee assess the costs based on their own individual approach".

Pensions and Lifetime Saving Association

Q5. Are there more significant barriers to the success of pooled illiquid investment vehicles than look-through? If so, what are they?

76. Whilst many stakeholders agreed that look-through was a barrier to investment in venture capital/growth equity, some stakeholders highlighted that this was not the greatest barrier to investment into these investment vehicles.

“Our view is that the look-through requirements are not a current significant barrier to the current lack of appetite”.

Association of Consulting Actuaries

“We do not believe it will be enough of a problem to create a barrier from entry into the asset class. If these vehicles are accessible and trustees are convinced of their investment case, then look-through is not likely to prevent that”.

Aon

77. Several stakeholders responded to this question outlining various factors that they believed were significant barriers to investment in VC/GE compared to the look-through requirement. The number one barrier that stakeholders repeatedly identified was liquidity.

“Other barriers to investment in pooled illiquid investment vehicles include how to effectively manage liquidity (e.g. when DC members transfer out or make an investment switch), how to value such investments on a regular basis, and how to obtain agreement from commercial fund providers to fee structures which trustees can be confident are compliant with the charge cap”.

The Society of Pension Professionals

“Liquidity—the vast majority of DC schemes invest through platforms, which require daily pricing of funds. In addition, recent experiences of property fund trading suspensions (gating) have made trustees increasingly wary of the risk of their members not being able to access their funds”.

Aon

78. The other significant barrier that was cited by multiple stakeholders was costs associated with investing into these assets. Stakeholders said that costs were an issue due to competition and the focus on low costs by pension schemes.

“The principle barrier is the difficulty of accessing illiquid assets at costs that are consistent with a total TER that remains competitive in a market place that is currently prioritising low price over value. It is currently only large Master Trusts that have been able to access illiquid assets at a price consistent with competitive default fund TERs and the limited investment budgets that go with them”.

Cushon

“Look-through is not the most significant barrier to the success of pooled illiquid investment vehicles and to investment in illiquids more generally. One of the main barriers is the way in which scheme trustees put their primary focus on low cost investments…Pension schemes value the headroom this affords them as it enables increased sophistication and innovation in their default investment strategies. In theory this headroom could be utilised to invest in illiquid or other alternative assets which typically carry a higher management fee. But perhaps more importantly, there is a structural issue that in a consolidating and competitive market, the focus of employers and savers is on lower fees for provision of services”.

Pensions and Lifetime Savings Association

79. Stakeholders also identified other important barriers to investment in illiquids. These were related more with the nature and structure of the funds. For example, investing into VC/GE holds a higher risk. Therefore, it’s risk to investment return ratio may dissuade trustees from seeking this type of investment.

“Risk: The higher risk and levels of volatility of some illiquid investments may deter trustees from investing, or certainly influence its role in default strategy”.

XPS Pensions

80. In addition to that, a small number of stakeholders suggested that the lack of knowledge around this type of investment asset was in itself another significant barrier to investing in VC/GE.

“The barriers to investing in less liquid assets for DC scheme trustees have, to date, not been the implementation or monitoring of performance fee structures. Rather, the lack of confidence stems from…Variable knowledge levels on trustee boards, combined with a governance budget (in terms of both time and financial resources) that is already stretched thinly”.

Association of Consulting Actuaries

Q6. If perceived as a significant barrier, how can the Government act to ensure it is removed whilst maintaining member protection/the objectives of the charge cap? Should this change be a regulatory one or in guidance?

81. It is clear from the evidence presented so far that fund managers believe look-through requirements limit the commercial viability of funds that invest in VC/PE. The most widely-held view is that the current position on look-through was either ineffective or unclear.

82. There was greater support from stakeholders to implement change (if change was to be made) via guidance, rather than through legislation. Some respondents were keen to note that revised guidance should not reduce the options available to DC pensions and that the guidance should draw pension schemes' focus to gaining the best outcomes for their members.

"Instead we believe that more can be done through guidance to the asset managers to be more transparent on fees. This approach is likely to have more success rather than regulatory change".

XPS Pensions

"We would urge that at the least, the guidance is revised to be consistent and complementary to legislation, and crucially that it doesn't serve to shrink the investible universe for DC schemes, which we believe would be entirely contrary to wider policy goals outlined by the DWP and HMT".

Nest

83. There were some respondents who suggested that DWP guidance should remove references to the look-through requirement and that member protection would be maintained because of the fiduciary role that trustees hold. This is because as part of their fiduciary duties, trustees would already be taking into account due regard for underlying costs when investing.

"One alternative would be to amend the DWP's guidance to clearly state that "look through" is not required, and there is a good argument that this would better reflect the current position under the charge cap legislation. We consider that trustees' existing fiduciary duties could provide a suitable safeguard in respect of taking into account underlying costs within an investment structure.

The Society of Pension Professionals

"One approach which might significantly simplify this issue would be for the DWP's guidance to be amended to state that "look-through" is not required. Trustees are already required under their fiduciary duties (and could be encouraged by guidance) to have due regard to underlying investment costs when making an investment, but these costs would not need to be incorporated formally into charge cap calculations.

Association of Pension Lawyers

84. Most stakeholders stated the importance of the charge cap in protecting members but some respondents suggested that investment would be encouraged if performance fees were removed.

"The Government should continue to act to maintain member protection, through measures such as the charge cap".

Pensions and Lifetime Savings Association

Q7. Is there a risk of arbitrage? How can this be mitigated?

85. The majority of stakeholders responded that there is the risk of arbitrage if there is a difference in the treatment of costs, depending whether the scheme invests directly or through a fund or fund of funds.

“Requiring "look-through" in respect of some classes of investment but not others would, other things being equal, seem to potentially increase the risk of arbitrage in the sense that we expect trustees would be more likely to invest through a vehicle if they could be confident that "look-through" does not apply to it as compared to a substantively similar investment where "look-through" does apply”.

The Society of Pension Professionals

86. There were calls to this effect that if look through is to be removed, it needs to apply to both private and public markets and in respect to all classes of investment.

“In our view unless look-through were to be removed for all asset classes and fund structures this would inevitably provide arbitrage opportunities and create unfairness between private markets and public markets funds”.

Partners Group

Q8. Are there recognised industry definitions of venture capital and growth equity?

87. There is agreement across the board that no standard definition exists within the industry in defining venture capital and growth equity.

88. Most stakeholders have utilised definitions put forward by financial organisations, such as the Chartered Financial Analyst Society of the UK (CFA) and British Private Equity & Venture Capital Association (BVCA), with the majority using the former’s definition as found in the CFA Institute’s Investment Foundations programme. However, this is not a formal industry standard definition. Other stakeholders have formulated their own definitions. On the whole, all the definitions align with each other. However, stakeholders highlighted that whereas the meaning of venture capital is well understood, growth equity is interpreted differently across the private sector.

“The meaning of venture capital is well understood. The CFA Institute, which is the preeminent global investment qualification, has a glossary that defines it as: Private equity investment in development stage companies. Investors in venture equity would see it as having a high return potential but also high risk, so would seek diversification, quite probably through a fund of funds. There is much less clarity and agreement around what is meant by Growth Equity and its meaning is likely context specific. It is not a term defined by the CFA glossary".

The Society of Pension Professionals

89. A few stakeholders commented that whilst there is no industry standard in defining venture capital and growth equity, this is not a barrier or issue.

"Similarly, guidance on specific definitions, for venture capital and growth equity, may result in it excluding certain investment opportunities where it is unclear whether they meet a precise definition. Therefore, although there is no recognised industry definition, this is not necessarily problematic".

Pensions and Lifetime Savings Association

Q9. Are there any other proposals that the Government should consider to allow greater investment in venture capital or growth equity?

90. Several stakeholders responded with proposals they had outlined in previous answers, which they believed would encourage greater investment in venture capital and growth equity.

91. Stakeholders suggested that a consolidation drive may result in schemes with significant asset sizes being able to take advantage of illiquid investments and so welcome the Government's current activities to bring forward greater consolidation into the DC pensions market.

"We believe that it is not pragmatic for funds with less than £500m to consider illiquid investments at all. The work which the Government is leading to drive scheme consolidation will in turn create larger funds, and those larger funds will make it possible for DC schemes to invest in illiquids, but only for a small proportion of scheme assets".

Scottish Widows

"Cushon believes that further consolidation in the DC provider market place is broadly in the interests of members. It therefore sees no urgent need for any significant changes to be made to facilitate further investment in these asset classes as the status quo may stimulate more innovation. Should the Government wish to act more urgently, it could extend the requirement for trustees (and IGCs) to explicitly evaluate exposure to illiquids in value for money/member assessments. Consolidation is itself likely to increase exposure to these asset classes".

Cushon

92. Some stakeholders called for the government to publish guidance to help clarify to trustees how they should assess investment opportunities. Other stakeholders repeated revising existing DWP guidance to remove look-through as a requirement arguing that member protections will still be in place because of the fiduciary responsibility that trustees have.

“We would therefore support any initiatives or guidance which support trustees in how they review, implement, monitor and communicate such investments. In respect of communications in particular, the relatively complex nature of these investments means that communications in relation to the risks involved may be challenging and (if not done well) could lead to members claiming that they had been misled as to the aims of the investment”.

Association of Consulting Actuaries

Next steps

93. The government recognises that overall stakeholders view the requirement to look-through closed-ended investment companies as adding to the administrative complexity of calculating the charges regime of a scheme and that this could dissuade schemes from exploring investment in such vehicles. Given the government’s wider productive finance focus, we are eager not to limit the propensity for closed-ended investment companies that invest in illiquid assets to form part of a defined contribution default arrangement and indeed ensure trustees have as many options as possible to diversify their portfolio and improve member outcomes.

94. The call for evidence also highlights that any solution that the government brings forward should take into account evidence submitted on the risk of creating incentives to structure investment in a certain way and the impact that might have on trustees’ investment decisions.

95. Overall, the evidence shows that, as a minimum, the current requirement needs to be clarified and may need to change to remove the requirement to look-through. Respondents were divided on whether this should be done in guidance or via regulations – the government intends to work through options with industry and other partners over the coming months.

96. The government will aim to announce our revised position on look-through before the Houses of Parliament rise for Summer recess. This announcement will not bring a new policy into force at that time but will set out any formal next steps, be it revised guidance or regulatory reform, and a timeline for when any revised position would come into force.

97. We are committed to developing a policy that is in line with our wider priorities including the Productive Finance agenda. Indeed, a key driver for this timeline is to ensure that new Long-Term Asset Fund structure proposed by the FCA can be launched by fund managers with a clear, effective position on look through costs.

98. Trustees and fund managers should continue to follow guidance and the existing position laid out in the consultation 'Incorporating performance fees within the charge cap' i.e. looking through fund of funds, both open-ended and closed-ended except in relation to costs incurred by investee firms which have a general commercial or industrial purpose.

Chapter 5: Costs and Charges Disclosure and Illustration

Summary of proposals

99. We have previously received queries and feedback on the production and presentation of compounding costs and charges illustrations. To provide clarification, we proposed draft amendments to the statutory guidance on “Reporting of costs, charges and other information: guidance for trustees and managers of relevant occupational schemes” as part of the consultation ‘Improving outcomes for members of defined contribution pension schemes’.

100. Proposed updates are concerned with preventing unintended interpretations of the guidance therefore resulting in unnecessary anxiety for trustees. Production of information in levels of complexity and volume are not required and may be unhelpful for some scheme members. We proposed updates to both the ‘Production of an illustration’ and the ‘Publication of costs, charges and other information’ sections of the guidance as follows:

Summary of original proposals

Production of an illustration

- a distinction between schemes with a single price for scheme members of all employers, and schemes with multiple defaults and variable charges;
- as a minimum, trustees need to identify the default arrangement(s), lowest charging and highest charging self-select funds in which members are invested;
- where charging levels or defaults vary by employer, each part of the scheme with a different default or charging level should be treated as a separate scheme; and
- where schemes have multiple defaults or variable charges, the savings pot size used should be a median across the whole scheme, rather than producing a median for each default, or for each employer.

Publication of costs, charges and other information

- to make clear that all the information - not just costs and charges compounding illustrations - under regulation 29A of the Occupational and

Personal Pension Schemes (Disclosure of Information) Regulations 2013 can be published over a number of linked documents or pages,

- a diagram with supporting notes, to provide a visual representation of how documents can be produced as a series of interlinked documents which is compliant with regulation 29A.

Stakeholder Responses

Q10. Do you believe that the proposed updates to the statutory guidance increases clarity about the minimum expectations on both the production and publication of costs and charges information?

Are there any areas where further clarity might be required?

101. The majority of respondents welcomed the proposed clarifications in the statutory guidance and agreed with the proposed updates and clarifications made.

Median Pot size

102. However, some stakeholders raised concerns about the guidance in relation to the savings pot size used in the illustrations. The guidance states that the 'median' pot size in the scheme should be used as a benchmark by which to set the value of the savings pot used for the illustrations. Some stakeholders felt that it was inappropriate to use the median pot size as a starting point particularly for younger scheme members.

"We recognise that some aspects help simplify the production of illustrations, such as using the medium pot size across the whole section of the scheme; however, if the illustration is still required based on the duration to retirement of the youngest member in the scheme, the projection using the median pot as a starting point for younger members may not be appropriate as this would likely not be representative of their estimated retirement pot and the effect of cost and charges over time"

Aon

Permissiveness of the statutory guidance

103. One respondent commented on the permissiveness of the statutory guidance.

"Paragraph 35 of statutory guidance states "Schemes are free to use a variety of different approaches" when presenting the illustrations. However, in our experience scheme legal advisers are very reluctant to endorse any deviation from the guidance. Therefore, we ask that the DWP guidance is made more strongly permissive".

Lane Clark Peacock

Number of illustrations

104. Although most respondents agreed that the proposed updates to the guidance helped set out the minimum expectations regarding the volume of illustrations, a couple of stakeholders sought further clarification.

“We like the fact that we only need to produce a single illustration for multi-employer schemes where they use the same default that could have different charges. We also like that there is clarity in terms of what comparison funds should be used (lowest cost and highest cost funds)”.

Aon

105. Clarity was also sought about the illustrations that best served members of pooled funds and Retirement Date Funds (RDFs). It was highlighted that in this scenario, members stay in one fund based on the date at which they are likely to retire. The investment strategy then changes as they approach retirement and as a result the costs vary.

“‘RDF’ corresponds to the year members are expected to retire, currently NEST has approximately 50 RDFs. Transaction costs for the RDFs are between 0.000 and 0.062 per cent. Nest currently produce three illustrations in respect of the RDFs, based on the member’s age at joining Nest (i.e. age 22,45 and 55) this approach enables us to illustrate the effect of costs and charges on a member’s fund”.

Nest

Alignment with the Financial Conduct Authority (FCA)

106. A few stakeholders asked for assurances around the alignment between aspects of this guidance and the information contained within equivalent FCA products.

Publication of costs, charges and other information

107. The majority of stakeholders welcomed the additional detail and clarification included in the statutory guidance. However, further clarification was sought on some elements of publishing.

108. Several raised an issue about signed scheme documents being published and the potential this has for the fraudulent use of the signatures. They asked that clarification on the use of signatures be included in the guidance.

Government Response

Production of an illustration

Median pot size

109. The median pot size was added to the guidance to make clear for master trusts that the ‘median’ should be a median across the whole scheme, not employer by employer. This was in the interest of simplifying the production of illustrations. However, the government acknowledges the issues raised by stakeholders and agrees with respondents’ comments on use of ‘median’.

110. Therefore, a word change has been made in statutory guidance at paragraph 44, replacing ‘should’ with ‘could’, to allow schemes greater flexibility.

111. We have also addressed the concerns raised regarding the impact of using a median pot size, particularly for younger scheme members at paragraph 45 of the Cost and Charges Statutory Guidance. The guidance now makes it clear that trustees and managers should also consider the age of members and other such factors when determining the pot size schemes could use to demonstrate the compounding effect of charges to members.

Permissive nature of the Guidance

112. The Occupational Pension Schemes (Scheme Administration) Regulations 1996 (the Administration Regulations) state that in complying with the requirements for illustration(s), trustees and managers must have regard to the statutory guidance. When considering the illustrations outlined in the guidance, schemes can choose to use an illustration that is different to those set out in statutory guidance but should have good reason to do so.

113. The examples in the guidance are not wholly prescriptive and are presented as a visual model of the minimum that may be required. Therefore, when trustees or managers are deciding how best to present the data, they may go further in the disclosure of additional illustrations and are free to use a variety of different approaches which they believe to be more suitable for their scheme membership.

Number of illustrations

114. The guidance makes clear that schemes with both a large number of employers and a range of different charges for each of those employers do not have to provide an illustration for every single fund offered by the scheme.

115. However, the government acknowledges the concerns around the number of illustrations. To provide further easement, but still provide a sample of other funds as well as the default for members, the guidance has been amended at paragraph 31. This clarifies that the illustrations for the highest and lowest self-

select funds in which members are invested, should be at scheme level; it is not necessary to illustrate them by employer.

116. We acknowledge that historically and technically stakeholders may have different interpretations of funds that they categorise as 'defaults'. It is particularly important for members who didn't make an active choice as to which fund they have been placed in by their employer to see a costs illustration, as they are bearing the costs of being invested in that respective fund. Additionally, it is important that they are able to see what they are likely to pay in costs over a saving lifetime as a result.

117. We therefore encourage schemes to consider this when producing their illustrations. We have also amended paragraph 30 in the guidance to state that illustrations should identify all default arrangement(s), regardless of how or when they became default arrangements.

118. We have considered the issues raised by stakeholders of schemes using RDFs and pooled funds. We agree that the current method of illustrations at certain age points is both sensible and understandable for their members. We have amended paragraph 33 of our statutory guidance to reflect this.

Alignment with the Financial Conduct Authority

119. We appreciate the areas highlighted by stakeholders where updates and alignment needed to be checked with the FCA. In doing this, we have made the necessary amendments to ensure the statutory guidance is aligned, and provided revised wording in the footnote attached to paragraph 74 under the 'Optional Elements' section regarding negative transaction costs, which has been approved by the FCA.

Other changes

120. Whilst making the overarching updates to the statutory guidance, we have considered the need for the reference to decumulation. We understand that schemes have well established processes for producing illustrations as part of the Annual Benefit Statement and the Statutory Money Purchase Illustration (the SMPI) but those only make provision for accumulation phase, not decumulation. Decumulation offerings in the occupational pensions space are also relatively rare.

121. We have therefore amended the 'Guidance' section and removed the reference to it 'being used in both the accumulation and decumulation phases'. We have also removed the previous paragraph 49 under the 'Contributions' section which referred to flexi-access drawdown. Therefore, schemes can choose not to consider decumulation aspects in the production of illustrations.

Publication of costs, charges and other information

122. We want to ensure the guidance provides the clarity required so that trustees, managers and their representatives are clear on the duties placed upon them to disclose and publish the information required under regulation 29A of the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (the Disclosure Regulations). To this end, we have reproduced the flow chart at figure 3. of the guidance and included more detail in the notes to support this, outlining again, the mandatory and discretionary publication requirements.

123. Furthermore, from paragraph 80 to 83 the guidance sets out both the 'required' elements and 'optional' elements for presenting the information. This also makes clear the options to either publish and present the full chairs statement or just the required extracts in line with Disclosure Regulation 29A.

124. It should be noted that our statutory guidance supports the publishing of information duty of the disclosure regulations 29A. Trustees and managers are also encouraged to refer to guidance on the Chair's Statement provided by TPR when publishing and presenting information.

125. We acknowledge the concerns raised by a number of stakeholders about the potential fraudulent use of the signatures on scheme documents, if made available on line. We have therefore included a paragraph in the statutory guidance at paragraph 81, which states that it is not necessary for schemes to publish a signed version of documents.

Summary of government response:

Amendments have been made in Statutory Guidance relating to:

The production of illustrations -

- Use of the median pot size <u>could</u> be used by trustees and managers along with the consideration of other determining factors (particularly for younger scheme members)
- Easement to illustrate self-select funds at scheme level
- Clarity around the types of defaults to be considered
- The treatment of Retirement Date Funds (RDF) and pooled funds
- Alignment with FCA information
- Removal of the requirement to consider decumulation aspects.

The publication of costs, charges and other information -

- Figure 3. and the supporting narrative around presenting and publishing information
- The new requirements for net returns and the value for members assessment
- The removal of the need for Trustee and Managers to publish a signed versions of scheme documents.

Chapter 6: Default SIPs and Wholly-insured schemes

Summary of proposals

Default SIPs

126. In our consultation we explained that because of the way the regulations providing for a default SIP requirement were originally drafted, no DC scheme with a promise (a scheme which provides a commitment to the member that they will receive a certain pension from the scheme) is currently required to produce a default SIP.

127. However, we wish to clarify that the policy is:

Schemes which offer with profits fund/s as a default arrangement are required to:

- document their aims and objectives;
- explain how the selection of 'with profits' is intended ensuring that assets are invested in the best interests of beneficiaries; and
- regularly review its performance and appropriateness.

128. Therefore, we proposed to make a change to regulations which would require schemes for which the default arrangement would (were it not for regulation 3(6) in the Occupational Pension Schemes (Charges and Governance) Regulations 2015) be a fund with a promise to be required to meet all the requirements in regulation 2A and produce a default SIP.

129. We asked for views on our proposal that DC schemes that offer a 'with profits' arrangement as a default fund should be required to complete a Statement of Investment Principles (SIP). This involves explaining how 'with profit' schemes will ensure assets are invested in the best interest of their beneficiaries and performance appropriateness and producing a default SIP. We proposed that this form of 'default SIP' should be produced within 3 months of the end of the first scheme year to end after the coming into force date.

Reporting costs and charges for funds which are no longer offered

130. The Occupational Pension Schemes (Scheme Administration) Regulations 1996 require schemes to state the level of charges and transaction costs for the default arrangements offered by relevant schemes, as well as "self-select funds" – the funds which members are able to actively choose.

131. In our consultation we explained our intention that every member invested in the scheme would be able to identify the charges and transaction costs which they had paid for the funds in which they were invested. Therefore, we want to ensure that schemes state the charges and transaction costs for each fund in which assets relating to all members are invested during the scheme year and which members are able to select or have historically been able to select.

132. In order to address this and the alternative interpretations we had been made aware of, (that schemes are not required to show costs and charges for funds which members have previously actively selected but are now not available to select) we proposed a change to the Administration Regulations at regulation 23(1)(c)(ii).

Wholly-insured schemes

133. The government proposed to extend the exemption for wholly-insured schemes to include new sections of the SIP introduced through the SRD II regulations.

134. The amendment to the regulations that bring into law the SRD II regulations ensures that the requirement for the trustees to state policies about asset managers is removed. In wholly-insured arrangements, it is the responsibility of the insurers, not the trustees themselves, to manage investments, make decisions about strategy and work closely with asset managers. To put this requirement of trustees on such schemes would be an unnecessary and impractical burden.

135. Only wholly-insured schemes are in scope of the amendment. Trustees of DC schemes investing via unit-linked contracts are still required to set out, in relation to the default fund or funds, policies on investments choices and where to view them. This is because the trustees are free to enter different insurance contracts in order to change the investments which make up the default.

Stakeholder Responses

Default SIPs

Q11. We propose that where the default arrangement includes a promise, the trustees of the scheme should be required to produce a default SIP. We propose that this should be produced within 3 months of the end of the first scheme year to end after the coming into force date. (a) Do you agree with this policy? (b) Do you agree that the legislation achieves the policy?

136. Respondents were broadly supportive of the need for trustees of such schemes, to produce a 'default SIP', agreeing with the proposed change.

137. However, some respondents cited concerns about the timeline with many suggesting that the government should extend the timeline for implementation.

"We request that the timescale for implementation is slightly modified to be "the later of six months after the coming into force date or three months of the end of the first scheme year to end after that date". This is to give schemes whose year-end is, by chance, close to the coming into force date a little bit longer to prepare a document which can take significant time to produce from scratch".
Lane Clark & Peacock

Reporting costs and charges for funds which are no longer offered

Q12. We are proposing that, for relevant schemes, charges and transaction costs should be disclosed for any fund which members are (or were) able to select and in which assets relating to members are invested during the scheme year.

(a) Do you agree with this policy?
(b) Do you agree that the legislation achieves the policy?

138. The majority of stakeholders agreed with the amendment proposed.

139. However, comments from a few stakeholders indicated possible misinterpretation of 'each fund which members are, or were, able to select.'

"Yes, agree it is best practice that all charges and costs are disclosed for funds that were utilised by members within the year. It could be interpreted that only funds that were available for selection within the year in question, perhaps include "ever" after were".

The Law Society of Scotland

140. One respondent raised a query regarding the scope of the regulation suggesting that not every member is necessarily covered by Administration Regulation 23(1)(c)(i) and the proposed (ii).

"It is not clear to us that every member is necessarily covered by Administration Regulation 23(1)(c)(i) and the proposed (ii). For instance, there may be members who did not select their funds but who aren't in defaults. Examples might include arrangements to which no contributions have been made since 6 April 2015, and some AVC-only arrangements".

Mercer

141. Although not related to our recent minor amendment to this regulation, a few stakeholders suggested that it may be helpful to clarify the meaning of "assets related to members are invested". They suggest that instead of interpreting this to mean any assets held in a fund during the period, it could be interpreted to mean

"new contributions" i.e. making investments or the act of allocating contributions into a particular investment.

Wholly-insured schemes

Q13. Do you agree with this proposed change? Do you have any other comments on this topic?

142. The majority of respondents welcomed the policy change and broadly agreed with our regulations to extend the exemption for wholly-insured schemes introduced through the SRD II regulations.

"Agreed. Extension of this exemption for wholly insured schemes is sensible and in-keeping with trustees' expectations."
XPS

143. A few respondents stated that the arguments for exempting these schemes from the SIP requirements extends to parts of the implementation statement trustees must produce outlining how they have sourced putting their investment principles into place with asset managers.

Government Response

Default SIPs

144. The government will give trustees of these schemes more time to complete a default SIP. We will amend Regulation 4(2) and (3) of the Investment Regulations in relation to an occupational pension scheme so that these schemes must produce a default SIP from 1 October 2021, or after the end of six months beginning with the day on which these Regulations come into force, whichever is later. This change would bring the timing in line with the more traditional six-month minimum timescale that the DWP has offered, giving trustees the extra time they require to source the information to produce the default SIP document.

Reporting costs and charges for funds which are no longer offered

145. It is clear from some responses that there is still some misinterpretation of the revised wording of the regulations. For example, it could be interpreted to mean that disclosure applies only to funds that were available for selection within the year in question. This is not the case, as previously stated our policy intention is that cost and charges disclosures cover funds that members would have been able to select in the past in any year, not just during the scheme year.

146. Therefore, a further amendment has been made at Regulation 2(2)(a)(ii).

147. With reference to the scope of member coverage of this regulation the definition of "default arrangement", as used in regulation 23(1)(c)(i) of the Administration Regulations is intended to cover arrangements where contributions ceased before 6 April 2015. If, prior to 6 April 2015, all funds were in practice capable of being selected, then such a fund could alternatively be covered by regulation 23(1)(c)(ii). This means that all arrangements are covered by regulation 23(1)(c).

148. On a related point, a fund "in which assets relating to members are invested during the scheme year" (reg 23(1)(c)(ii) of the Administration Regulations) is intended to cover a fund which holds assets during the scheme year, rather than a fund to which assets have been added during the scheme year. Deferred member benefits are therefore subject to the requirements of the regulations in this regard.

Wholly-insured schemes

149. The government agrees that we have missed a key cross-reference. The regulations related to implementation statements contained within the Disclosure Regulations, include the requirement for trustees to lay out the degree to which the policies that are required to be set out have been put into place with asset managers. We have exempted trustees of wholly-insured schemes from the requirement to have such policies so, naturally, we should exempt them from the requirement to disclose how these policies are followed.

150. We will exempt wholly-insured schemes from the entirety of sub-paragraphs (ca) and (d) of paragraph 30 of Part 5 of Schedule 3 of the Disclosure Regulations.

Annex A: List of respondents to 'Improving outcomes for members of defined contribution pension schemes'

A.A (Individual)
ABI (Association of British Insurers)
ACA (Association of Consulting Actuaries)
Aegon
AgeWage
AIC (Association of Investment Companies)
Allen & Overy
Aon
APL (Association of Pension Lawyers)
AREF (Association of Real Estate Funds)
Aviva
Barnett Waddingham
Buck
BVCA (British Private Equity & Venture Capital Association)
Caritas International Independent
CFA Society UK
Creative Pension Trust
Dalriada Trustees
Eversheds Sutherland
Gowling WLG
Hymans Robertson
ICAEW (Institute for Chartered Accountants in England and Wales)
IfoA (Institute and Faculty of Actuaries)
Investment Association
Isio Group
ITS (Independent Trustee Services)
John Forbes Consulting
Kerr Henderson
Lane Clark and Peacock
Legal and General
M.E (Individual)
Mercer
Nest
Now Pensions
Octopus
Partners Group
Pensions Management Institute
Phoenix Group
Pinsent Masons
PLSA (Pensions and Lifetime Savings Association)
Punter Southall
Royal Mail Group
Secure Pensions Solutions
Smart Pensions
SPP (Society of Pension Professionals)
Standard Life Aberdeen
Suas Pension Scheme
UK BioIndustry Association
USS (Universities Superannuation Scheme)
Willis Towers Watson

Annex B: List of respondents to 'Incorporating performance fees within the charge cap'

ABI (Association of British Insurers)

ACA (Association of Consulting Actuaries)

AgeWage

AIC (Association of Investment Companies)

AIMA and ACC (Alternative Investment Management Association and Alternative Credit Council)

Amadeus Capital Partners

Aon

APL (Association of Pension Lawyers)

AREF (Association of Real Estate Funds)

Baillie Gifford & Co

B&CE

BGF

Blackrock

Brighton Rock

BVCA (British Private Equity & Venture Capital Association)

CFA Society UK

Cushon

Hymans Robertson

Janus Henderson Investment

John Forbes Consulting

Lane Clark and Peacock

Legal and General

Mercer

Nest

Partners Group

P.B (Individual)

Pinsent Masons

PLSA (Pensions and Lifetime Savings Association)

Scottish Widows

SPP (Society of Pension Professionals)

Standard Life Aberdeen

SUI (ScaleUp Institute)

USS (Universities Superannuation Scheme)

XPS Pensions