# DC briefing, March 2021
# The end of small DC trust-based schemes (or sections)?

Occasionally, events take place that can significantly change the fate of pension schemes. Recent proposed changes to small DC trust-based schemes (or sections) with less than £100m in assets are a case in point. This briefing explores the background and the decisions that will need to be made – which could result in modifications or wind-up for these schemes and sections.

## 1. Background

The Department for Work and Pensions (DWP) and The Pensions Regulator have been working together for several years on improving oversight of Defined Contribution (DC) pension schemes. This process started in earnest with the governance code in 2013, and the introduction of chair's statements following this. These statements and accompanying disclosures have become significantly more detailed and onerous to complete over time.

The DWP's consultation on *Investment innovation and future consolidation* took place in February 2019. Their response and proposals were issued in the form of another consultation, *Improving outcomes for members of Defined Contribution pension schemes*. This aimed to achieve wider investment diversification for DC schemes as well as further improvements to governance, potentially by consolidating them into larger schemes.

## 2. Changes to oversight requirements

The DWP is proposing that small DC schemes (those with assets of under £100m, and which are more than three years old) will need to complete an enhanced 'value for members' assessment each year. This assessment would look at the scheme holistically, covering aspects such as:

- Costs and charges
- Net investment returns
- Trustee knowledge
- The benefit of any guarantees.

Crucially, the DWP is proposing that these aspects and the overall assessment will be against three larger schemes (with over £100m of assets). At least one of these would be a scheme willing and able to accept the smaller scheme's assets and membership.

As with previous regulations, schemes whose only DC assets are for Additional Voluntary Contributions would be exempt. Surprisingly, it appears that for hybrid schemes (those with both DB and DC sections), the assets considered for the threshold are all scheme assets, not just DC section assets. This is expected to take a number of hybrid schemes out of the remit of the new rules.

Where the scheme is deemed not to provide good value for members, trustees will be expected to make rapid improvements or to wind up the scheme (or section) and consolidate. Trustees will need to outline the improvements they are making in the next scheme return.

The DWP plans to introduce the new rules from 5 October 2021. They will apply scheme years starting after this date, ie scheme years ending from 5 October 2022. The expectation is that improvements will be made before the assessment is due, not after.

Schemes less than three years old or with more than £100m in assets – therefore falling outside of these rules – will be expected to continue following the current requirements.

## 3. Increased investment diversification

The proposals also include measures to encourage increased diversification in the investment classes used by schemes, such as private equity, venture capital and illiquid assets, with a view to generating increased returns.

This would be achieved by easing the charge cap rules which apply to the default investment option. Investments in asset types that pay performance related fees and other types of variable charges would then be possible.

### 4. Other changes

Schemes will be required to include net investment returns for the default and self-select funds in their chair's statements.

They will also have to provide additional details on 'with profits' funds, including a standard statement of investment principles relating specifically to the 'with profits' fund.

### 5. Action for trustees

While the DWP's proposals have been presented in the form of a consultation, their aim is to fine tune the details.

The proposals will increase the pressure on trustees to work towards good outcomes for members. Smaller schemes (or sections) that don't meet the standards delivered by high quality larger schemes will be wound up.

Trustees therefore need to work out whether the new requirements apply to their scheme.

If they do, trustees will need to consider whether to work to meet the new standard, or whether the time has come to wind up the scheme or section.

This decision is complicated and involves several considerations around resourcing, timescales, and implications for any other benefits. And given how soon the new rules are anticipated to take effect, time is of the essence. Addressing the issue now is likely to bring benefits for members sooner rather than later.

## How First Actuarial can help

We have significant experience working with trustees and scheme sponsors in connection with their pension schemes. We provide oversight to ensure compliance with the appropriate regulations, and help with scheme terminations and wind-ups.

If you would like to discuss any of the areas explored in this briefing, please contact your usual First Actuarial consultant or a member of the DC Consulting team.

Simon Redfern
E:simon.redfern@firstactuarial.co.uk
T:01732 207 577 M: 07453 973174

Neil Kempshall
E:neil.kempshall@firstactuarial.co.uk
T:01732 207 533 M: 07877 332 566

Laura Chesson
E:laura.chesson@firstactuarial.co.uk
T:01732 207 513 M: 07490 497 103

Martin Leigh
E:martin.leigh@firstactuarial.co.uk
T:01732 207 517 M: 07308 513077

Jack Lisamore
E:jack.lisamore@firstactuarial.co.uk
T:01732 207 536