DC briefing, July 2021 – New responsibilities for trustees of small DC schemes

The DWP has issued an update on planned changes around small DC trust-based schemes and DC sections of hybrid schemes. This briefing focuses on those areas requiring immediate attention – the annual value for money assessment and chair statement that Trustees are required to prepare.

See also **our recent briefing on small DC trust-based schemes** for further details.

Background

Both the Department for Work and Pensions (DWP) and The Pensions Regulator (TPR) have been clear they wish to see substantial consolidation in the trust-based DC market, particularly for small schemes, believing that this will offer better member outcomes.

The DWP carried out two consultations in September 2020 and March 2021, presenting and refining its proposals for a more detailed oversight regime for small schemes. In June 2021, the DWP published its response, in the form of final proposals.

Value for members assessment

Chair's statements, for scheme years ending after 31 December 2021, will need a significantly more onerous member value assessment, covering:

- Reported costs and charges
- Net fund performance
- Scheme governance and administration.

Each area should be assessed, and the scheme benchmarked against three alternative DC arrangements with assets of more than £100m. Trustees can choose the comparator schemes but must explain the choice and be confident that at least one of them would accept the assets on wind-up.

Costs and charges

Trustees should consider all costs and charges, reviewing them against the three chosen comparators. The guidance outlines how to do this, factors to consider and how to present the results.

Trustees should consider the costs and charges across the default and self-select fund range (giving more weight to the default). Costs lower than the comparator schemes indicate good value. Poor value should be assumed if they are higher, with no mitigating circumstances such as better performance.

Fund performance

Trustees should report net investment returns (returns minus scheme specific costs and charges) for the default option and all self-select funds for scheme years ending after 31 December 2021. There are specific requirements on how the returns are assessed and the results presented.

The default option returns will be compared with the defaults for other DC schemes, which may not have the same asset allocation. Self-select funds should be compared on a more like-for-like basis.

Better performance, giving weight to the default, demonstrates good value. Worse performance without a clear strategic reason indicates poor value.

Governance and administration

Administration remains the responsibility of the trustees whether undertaken in-house or outsourced. As such, the performance of the administrator and other service providers should be monitored using the following key metrics:

1. Promptness and accuracy of core financial transactions
2. Quality of record keeping
3. Appropriateness of default investment strategy
4. Quality of investment governance
5. Level of trustee knowledge, understanding and skills to operate the scheme effectively

6. Quality of member communication
7. Effectiveness of conflict of interest management

Trustees should demonstrate the presence of robust policies and procedures, with a conflicts register and risk controls in place.

To demonstrate that the scheme provides good value for members, it is expected that all the above metrics will have been met, and that the scheme is at least as good as the comparator schemes. If not, trustees should 'seriously consider' the impact of this.

Outcome of the value for members assessment

For trustees to demonstrate good value for members, they must show that the scheme delivers on **all three** aspects of the assessment, without undue weight placed on charges. Good long-term governance and investment performance are just as important.

TPR expects to see a detailed, evidential approach with all aspects of the review fully documented.

If the scheme is deemed not to provide good value for money, the trustees should consider wind-up. If not done immediately, they must explain why. Improvements needed should be minimal and lead to a better outcome than wind-up. The cost of scheme wind-up is not material to the basis of comparison.

Trustees should not wait to make improvements or wind-up, and should start any work immediately. If improvements are not made within a reasonable timeframe, TPR will expect them to wind up and consolidate without further delay.

TPR expectations

TPR's stated aim is to encourage the consolidation of the occupational DC scheme sector, and they have substantially raised the level of oversight required by trustees. A full, documented, evidence-based assessment must be undertaken each year, including a critical comparison with three other providers.

TPR expects trustees to seriously consider whether their DC schemes can pass these new tests, and whether they are prepared to meet any cost of compliance and accompanying oversight. TPR also expects improvements to be made ahead of the assessments and reported in scheme accounts.

While schemes with assets of more than £100m are currently excluded, this could change in the future. The DWP is currently reviewing how it can improve member outcomes by considering consolidation across schemes with assets between £100m–£5bn.

Next steps

Trustees need to consider their strategy as the DWP intends to introduce the new rules for scheme years ending after 31 December 2021. These new assessments will be included in Chair's statements being submitted within seven months of this date.

There is talk of a 'capacity crunch' in the market, with the expectation that a considerable proportion of small schemes will wind-up. In light of the accelerated schedule for some reporting requirements, trustees may wish to consider their approach to these new requirements sooner rather than later, and realistically consider whether they can meet the new standards.

We believe the landscape is fundamentally changing, and as a result trustees will need to discuss the future of the scheme with the sponsoring employer to agree the appropriate route to take.

How First Actuarial can help

This decision is complicated and involves in-depth considerations around resourcing, timescales and implications for other benefits. Given how soon the new rules are to take effect, time is critical and addressing the issue now will bring benefits for members sooner rather than later.

We have significant experience working with trustees and scheme sponsors. We provide oversight to ensure regulatory compliance and help with scheme terminations and wind-ups.

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.


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