ICAEW
REPRESENTATION 102/20

DWP CONSULTATION ON IMPROVING OUTCOMES FOR MEMBERS OF DEFINED CONTRIBUTION PENSION SCHEMES

Issued 2 November 2020

ICAEW welcomes the opportunity to comment on the DWP consultation on improving outcomes for members of defined contribution pension schemes published by DWP on 11 September 2020, a copy of which is available from this link.

> In our view, flexible and proportionate regulation could be a better tool to encourage consolidation, which would avoid the cost/resource issues for smaller schemes.

This ICAEW response of 2 November 2020 reflects consultation with the Business Law Committee which includes representatives from public practice and the business community. The committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

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MAJOR POINTS

1. We note this consultation contains DWP's response to their 2019 consultation *Investment Innovation and Future Consolidation*, to which the our response can be found in ICAEW REP 38/19, and we would like to make the following general comments, rather than answering all the detailed questions.
2. The proposals will effectively force the winding up of many smaller schemes, and therefore are a significant intervention from Government; whilst we understand the reasoning behind this proposal it is a massive statement. In our view, flexible and proportionate regulation could be a better tool to encourage consolidation (see para 7 below), which would avoid the cost/resource issues for smaller schemes and some of the concerns we have around the practicalities of value for member (VfM) assessments (see para 8 below).
3. If DWP do go ahead with these requirements for enhanced VfM assessments, sufficient guidance needs to be put in place to assist with these new requirements to enable the well governed schemes to be able to continue.
4. Where Regulations are effective from 1 October 2021, it would be helpful to have further clarification of the first scheme year end to which the Regulations would apply. The consultation states the requirements are effective from 5 October 2021, but a specific year end example would help.

ANSWERS TO SPECIFIC QUESTIONS

Chapter 2: Encouraging Consolidation

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?

5. This could be kept in line with current disclosure regulations / requirements for schemes to include performance figures within the Trustees' Report (eg, 12 months / 3 years / 5 years).

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 optimal value for members?

6. We were not supportive of this proposal in 2019. We acknowledged that consolidation can lead to better governance and value for members, but we queried whether this warranted further regulation given this was happening naturally through vehicles such as master trusts. We also note that tPR enforcement powers are being used to encourage consolidation.

7. As mentioned in the consultation paper, consolidation has been slow and we acknowledge there are still a large number of small schemes that are poorly governed and may not want to stretch to consolidate unless "pushed". In our view there is currently an option of flexible and proportionate regulation to encourage consolidation, instead of bringing in these enhanced requirements for VfM assessments. For instance, where a small DC scheme shows compliance issues, the Pensions Regulator could defer disciplinary action for an agreed period. If the scheme transferred to a master-trust, insurer buyout or other consolidated independent provider, a fine or other punishment would not be proportionate but if it continued as a free-standing scheme despite its non-compliance then disciplinary action would be proportionate. Those schemes that believe they continue to offer members adequate protection including optimal value for members, and who comply with their legal obligations, would be left free to operate as now. Given we have concerns around the cost/resource implications for smaller schemes (see our comments at Q2 below) of achieving these standards, it may be preferable in some cases for DWP to use tPR's enforcement approach to achieve consolidation.

8. We are concerned that smaller schemes may encounter practical difficulties, such as when trying to compare themselves to three other schemes, including the scheme that the trustee would potentially consider for consolidation. We also have a number of other concerns such as how will cost be addressed for the wind up if tPR use their powers? Will members have to bear this? Have earmarked schemes been given consideration as they are covered by the Regulations?

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?

9. We acknowledge that, as part of their fiduciary responsibilities, trustees should be looking at member outcomes and, in particular, if there are inefficiencies in the scheme's investments (ie, a scheme's chosen risk and return balance is not being delivered due to high fees or poor governance). VfM is one way to measure this, but we expect that very few trustees would be confident in making the proposed enhanced assessments themselves and if possible would engage with a consultant to provide this assessment, which means they benefit from an independent assessment but this comes at a cost. Many smaller schemes are unlikely to have the resources available to some larger schemes to engage external consultants. We would expect that the cost charged by a consultant would be less after initial assessments, especially if there have been no changes to governance arrangements and no changes to DC funds. However, DWP needs to recognise that the fees charged for a VfM assessment may not scale down proportionally (because some smaller schemes may have a similar investment and governance structure to much larger schemes and so may be charged a similar fee).
10. Any additional statutory guidance would be helpful. In particular, we would welcome any increased clarity of how to define / determine what value represents.
11. The additional chair's statement requirements will be quite extensive and for the reasons stated above some schemes may struggle to comply – again guidance (from tPR / DWP) would help in determining how much to include. With the new investment disclosures / implementation statements requirements as well, some schemes may face significant difficulties in complying. This may well be a further push towards consolidation for some (which we realise is an intended consequence).

Chapter 3: Diversification, performance fees and the default fund charge cap

An in-year adjustment to prorating performance fees

Q4: Do the draft regulations achieve the policy intent of providing an easement from the prorating requirement for performance fees which are calculated each time the value of the asset is calculated?

12. No comments.

Creating a multi-year rolling calculation approach

Q5: What should we consider to ensure a multi-year approach to calculating performance fees works in practice?

13. No comments.

Q6: We are proposing a five-year rolling period. Is this appropriate or would another duration be more helpful?

14. No comments.

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Q7: We are proposing offering a multi-year option as an alternative to an in-year option for schemes. Do you have any suggestions for how to improve this offer?

15. No comments.

Q8: To what extent will providing a multi-year smoothing option give DC trustees more confidence to invest in less liquid assets such as venture capital?

16. No comments.

Costs of holding physical assets

Q9: Do the draft regulations achieve the policy intent? Do you have any comment on the definitions used?

17. No comments

Chapter 4: Using transparency as a prompt

No questions

18. No comments.

Chapter 5: Updates to Statutory Guidance: Reporting costs, charges and other information

Q10: Do you believe that the updated 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?

19. Yes, the Guidance does provide sufficient clarify of what is expected.

Chapter 6: Other changes to legislation

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?

20. Overall, yes. Members still need to have sight of costs and charges in funds they are invested, even if those funds are no longer offered.

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

21. No comments.

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?

22. No comments.

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

23. No comments.

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