XPS DC

2022: The Year to Decide

To Govern or to Consolidate?

March 2022

Contents

Overview

The Government believes that bigger DC schemes deliver better member outcomes and wants 'smaller' DC schemes to either meet new minimum governance requirements, or consolidate into larger schemes. Those managing smaller DC arrangements will have to choose one of these two options and the Department for Work and Pensions (DWP) expects decisive action. For many schemes, this will mean making some big decisions on whether to make changes to their current approach or to consolidate into other arrangements, making 2022 a key year.

To help **trustees** and **employers** understand the direction of travel, we asked XPS clients that look after DC Trust based schemes how they plan to respond to DWP's call to action and to better understand how the market will evolve over the years.

Included within this report is a summary of our **survey results**, some **key actions that trustees or employers must consider** and a reminder of the regulatory change which has brought this all to the table.

Key findings:

1. Of our respondents, **41% confirmed that they would look to consolidate within the next 5 years, which, acrross the market, could equate to approx 640 schemes.**

2. **52% of the hybrid schemes who responded to our survey confirmed they would continue to govern.**

3. **72% of the closed schemes who responded to our survey confirmed they would continue to govern.**

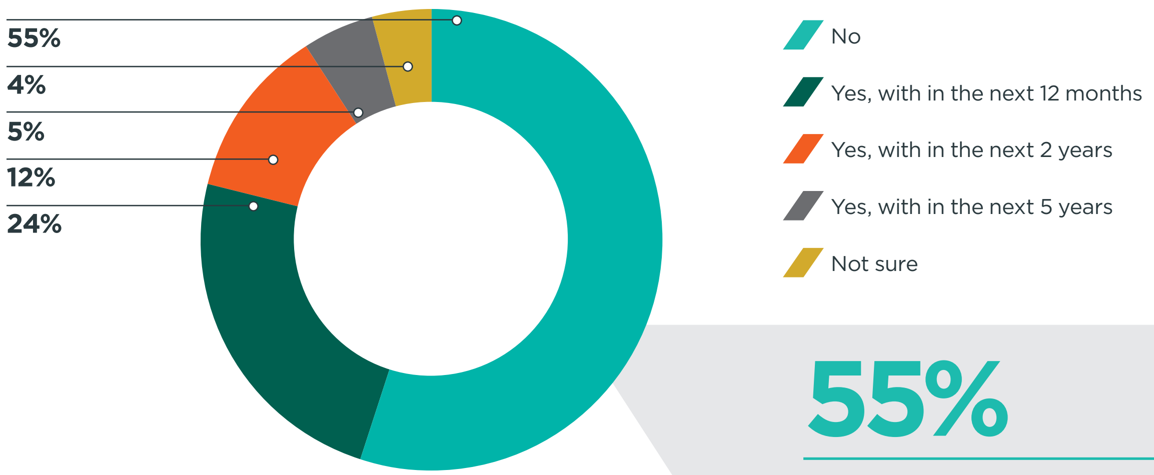
This years' value for money assessment will be the most important assessment schemes will undertake. They need to be prepared for the results and actions that must be taken to ensure compliance, but most importantly, to ensure value for money and good member outcomes.

Sophia Singleton
Partner, Head of DC

The data: what will DC schemes do?

Given the Government's focus on DC governance and the steady increase in requirements over the last 10 years we asked DC schemes how they are feeling. We found that overall, trustees and employers are feeling burdened, but generally accept that the DC governance requirements are needed and are in the best interests of DC savers.

Do you expect to consolidate your trust-based DC scheme?



55%

Of the DC schemes we surveyed are looking to maintain the status quo. Those involved will need to be confident that their arrangements are up to the task.

Source: XPS DC survey results, January 2022

41%

Of the DC schemes we surveyed are looking to consolidate over the next five years which, across the market, **could equate to approximately 640 schemes**. The Government is looking for significantly more schemes to consolidate meaning that the market may fall dramatically short of their expectations.

72%

Of the closed schemes who responded to our survey confirmed they would continue to govern. Again, this statistic is surprising given a driving factor for continuing to govern is to allow for continued employer involvement. It is important to remember that a closed scheme still needs to provide value for money to its members to ensure that they are able to achieve good outcomes irrespective of whether the vehicle is being used for ongoing accrual.

52%

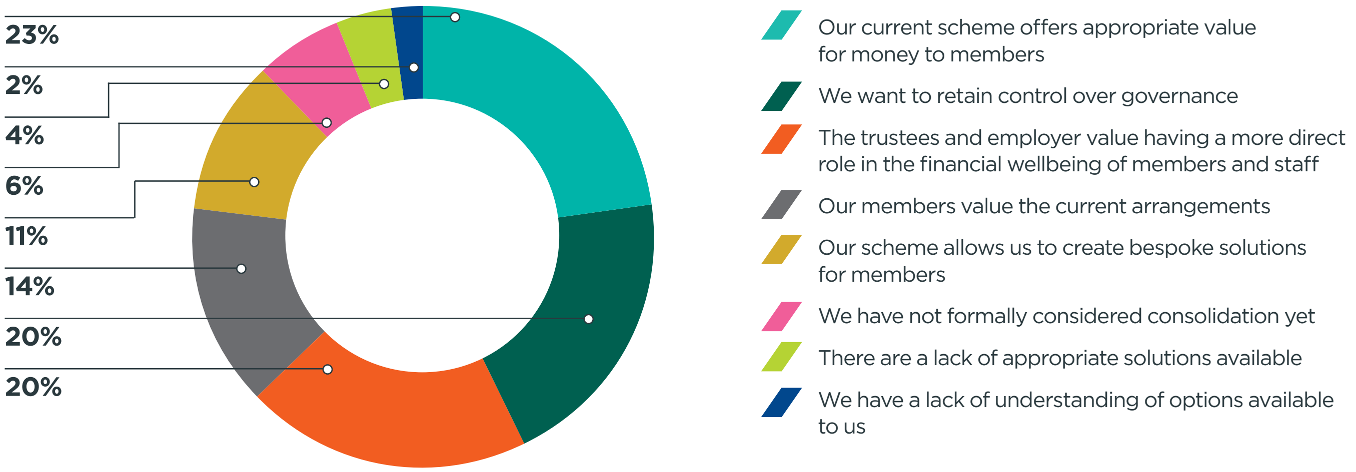
Of the hybrid schemes who responded to our survey confirmed they would continue to govern. This is worrying as DC hybrid schemes usually receive less attention than their DB counterpart; meaning value for money can often be overlooked. As these new regulations will capture fewer hybrid schemes (see page 9 for further details) we implore trustees and employers with hybrid schemes to early adopt these regulations to ensure their members are looked after.

Source: XPS Pensions Group

Maintaining the status quo

Over half of DC schemes we surveyed expect to continue to govern for the next 5 years and beyond. With increased pressure from the Government to consolidate this will get harder but it is possible and feasible.

If you expect to continue to govern your scheme, what are the key drivers for that decision?



Source: XPS DC survey results, January 2022

For those opting to continue to govern their schemes, nearly a quarter are doing so because their current scheme offers appropriate value for money. An additional 20% choosing to continue to govern over concerns that transferring the DC scheme elsewhere would reduce autonomy and the amount of input that the employer would have upon their staff's financial wellbeing.

For many, however, maintaining the status quo will not be enough. DC schemes will have to compare themselves against others and publicly demonstrate that they are delivering good value and good outcomes for members.

Schemes that have total assets of less than £100m need to explain how they deliver on all these areas and decide whether the scheme provides Value for Members. If it doesn't they must either take 'immediate' steps to deliver value for members or wind-up the scheme and transfer members to a larger scheme, such as a master trust.

Schemes with assets over £100m don't need to benchmark their costs, charges and investment performance against 'larger schemes' although best practice would be to do so. These schemes are still required to assess how they are delivering Value for Members, in the same (or very similar) way as for smaller schemes.

> Trustees and employers must understand the importance of not only assessing value for money but also in delivering value for money. Opting to continue to govern is a huge responsibility and one that should not be taken lightly.

Chris Barnes
Senior Consultant

The path to consolidation

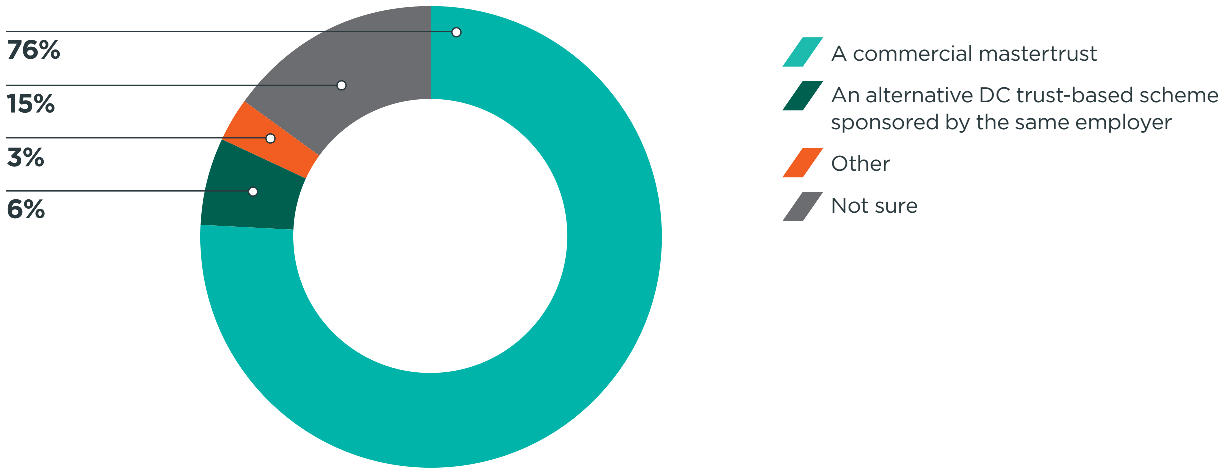
Over 40% of respondents said that they were likely to consolidate within the next 5 years which is the direction of travel for many and is in line with the underlying objective of Government.

- **Half of schemes with assets of less than £100m** expect to consolidate – two thirds of these in the next 12 months
- **One third of schemes with assets of £100m or more** expect to consolidate – most of these in two to five years time

We expect a large number of smaller schemes (i.e. with assets of less than £100m) to consolidate in the short term and most (76%) say they are opting for a commercial master trust.

This focus on master trusts is in line with our expectations, given the main driving factor behind consolidation is to remove governance requirements and improve member outcomes.

If you intend to consolidate your DC pension scheme, which is currently your preferred option?

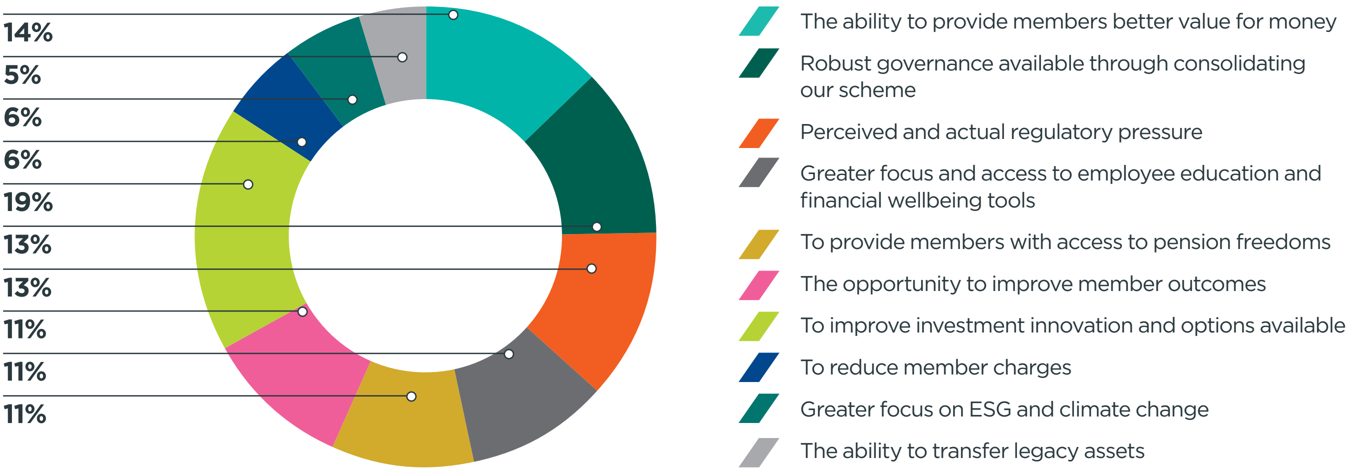


Source: XPS DC survey results, January 2022

The larger schemes (with assets of £100m+) who aren't yet being pushed to consolidate, will no doubt be influenced by the substantial market shift toward master trust provision. Further, in its recent call for evidence the DWP put forward a case for greater consolidation looking at how DC schemes with assets of up to £5bn could be encouraged to consolidate, making it clear what the future regulatory intention will be.

Given the drive to consolidation, we expect that master trust providers are going to be busy, so factors such as provider capacity and access to quality advice could become a stumbling block for some.

If you expect to consolidate at some point over the next 5 years, what are the key drivers for that decision?



Source: XPS DC survey results, January 2022

In addition to the influence of the latest legislation, there are many compelling reasons why trustees and employers are looking to consolidate their scheme into an alternative vehicle such as a master trust, with no one reason dominating.

There are clear benefits to consolidation for members whereby economies of scale can be harnessed for members' benefit to ensure all members are getting value for money through lower charges, access to full flexibilities, a wider range of investments and a tailored member journey – all of which are so important to facilitate good outcomes but are areas which smaller schemes can struggle to secure on their own terms.

From an employer perspective, consolidation can ease governance burdens and advisory costs.

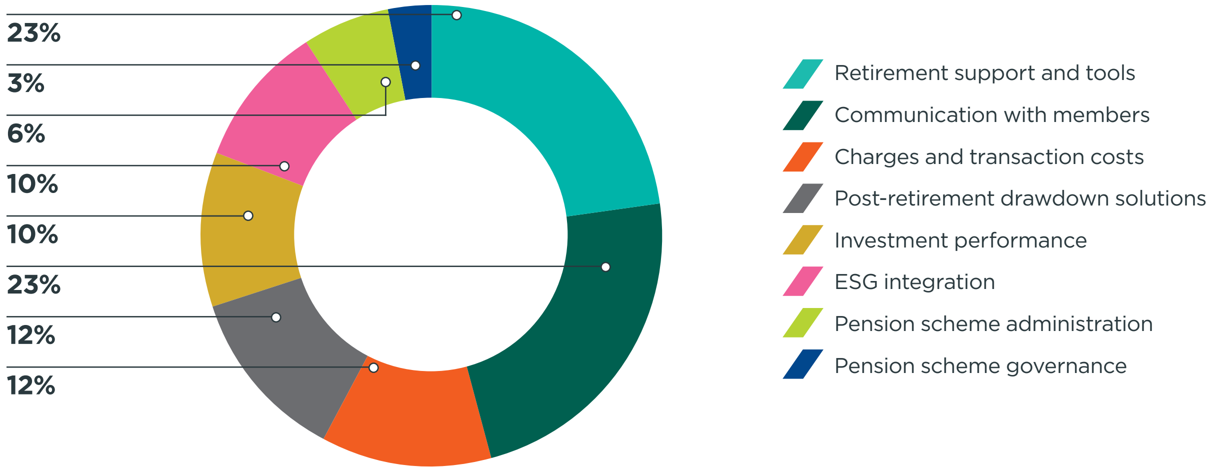
Our respondents show a clear desire to ensure their members are getting the best value for money – something that is vitally important to facilitate good member outcomes.

> We've seen a marked increase in interest from clients wanting to look at our master trust offering, the National Pension Trust. It's clear from our survey this trend will continue to grow as trustees and employers get to grips with the implications of Govern or Consolidate. It's going to be a busy time for clients and advisors so it's important to get your review processes started now to ensure compliance and to avoid potential capacity constraints.

Simon Hazeldine
Business Development Manager

Looking to the future

In relation to DC pensions schemes as a whole, where do you think the industry needs to focus its activity the most?



Source: XPS DC survey results, January 2022

Looking to the future, our research shows there is a need for greater focus on the retirement journey. Members need to be well informed of their options before and at retirement, so they can make the right decisions at key points in time. The road to retirement can be a daunting and confusing experience, therefore it is essential to map out a 10 or 15-year journey to help members accumulate the money they will need.

There is less focus on areas such as administration and good governance – not because they aren't important, but we expect that this is because of the hard work that has already been done in these areas to drive up standards.

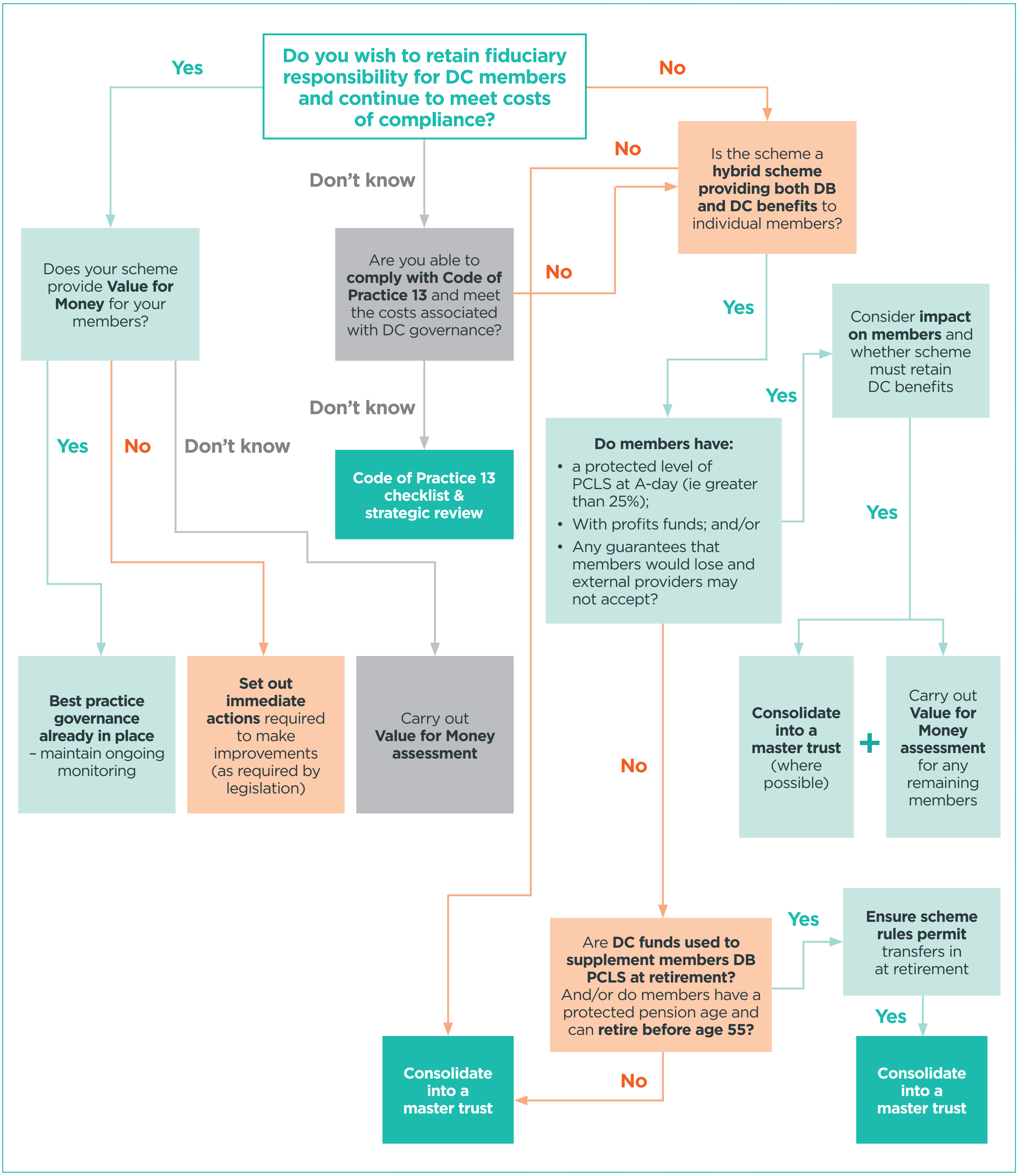
> Whether you're going to consolidate or continue to govern, future proofing your DC scheme is essential. What is clear is that by far the biggest challenge trustees and employers face is how to engage their members.

Hannah Rowden
Pensions Consultant

Appendices

How to choose whether to govern or consolidate

Deciding whether to govern or consolidate is not straightforward. It can be especially complicated for hybrid schemes that provide both DB and DC benefits. The flowchart below has been designed to help those who have not been through the thought process.



A reminder of the legislation

The Government believes that bigger DC schemes give better outcomes. It wants 'smaller' DC schemes to meet new minimum governance requirements, or consolidate into larger schemes. As a result, from 5 October 2021 the Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 introduced an additional requirements for trustees of 'relevant' occupational pension schemes:

- **All relevant schemes** (broadly all occupational DC schemes) regardless of asset size, will have increased reporting requirements via their 'Chair's Statement' to show investment returns net of specified costs and charges. These will also need to be published online;
- **All 'smaller' schemes** (those with assets less than £100m and having been in operation for at least 3 years), must undertake additional annual value for members assessments in defined areas. The results must be included in the annual chair's statement and the Pensions Regulators scheme return.

For 'smaller' schemes, if the new Value for Members assessment determines it is not delivering good value for members, the trustees must take immediate steps to improve the scheme to meet the value for members criteria within a reasonable period or wind-up and consolidate into an alternative arrangement, such as a master trust.

For 'hybrid' arrangements with DB and DC benefits, the 'smaller' scheme requirements will only apply where the combined assets are less than £100m. Again, best practice would be to voluntarily comply with the new Value for Member assessment.

The regulations do not apply to DB schemes that only have DC AVCs. However, trustees have a fiduciary responsibility and are obliged to govern DC AVCs in line with Code of Practice 13. All members should be supported to receive good outcomes – and if this is not the case, trustees should improve support or consider consolidating these benefits into a DC scheme that does.

The main changes

Additional disclosure requirements	All relevant schemes are now required to show the net investment returns (going back 5 years or to the start of the scheme if sooner) on both the default(s) and all self-selected funds in which members are invested. In addition, DWP guidance suggests the reporting period should be beyond 5 years, up to 20 years, where data is available. Results must be included within the chair's statement, which is available via a publicly accessible website.
VFM for 'smaller' schemes – comparator assessment	In addition, relevant smaller schemes are now required to compare their: • net investment returns; and • costs and charges. with those of three 'larger' (over £100m in assets) comparator schemes, on an annual basis. This must include one scheme that the trustees 'have had discussions' with about a transfer of the members rights if the scheme were to be wound up.
VFM for 'smaller' schemes – administration and governance	As well as the comparator assessments, trustees of relevant smaller schemes will need to carry out a self assessment covering the following areas: • promptness and accuracy of core financial transactions • quality of record keeping • appropriateness of the default investment strategy • quality of investment governance • quality of communication with scheme members • level of trustee knowledge, understanding and skills • effectiveness of management of conflicts of interest
VFM for 'smaller' schemes – reporting requirements	The output of the VFM assessment will have to be disclosed in the chair's statements and the annual scheme return, thus giving TPR direct sight of these assessments. If, based on their assessment, trustees do not believe that their scheme is providing VFM then the trustees are required to take immediate action to improve the scheme or, to start winding-up the scheme, with a transfer of assets to a larger arrangement.

About this survey

We carried out our research in December 2021 and January 2022. In this time we had over 80 schemes participating in our survey representing over £25bn assets.

80

Schemes analysed in our survey

>£25bn

Scheme assets represented

About us

XPS Pensions Group is the largest pure pensions consultancy in the UK, specialising in actuarial, investment consulting and administration. The XPS Pensions Group business combines expertise, insight and technology to address the needs of more than 1,500 pension schemes and their sponsoring employers on both an ongoing and project basis. We undertake pensions administration for over 948,000 members and provide advisory services to schemes of all sizes, including 47 with over £1bn of assets each.

We also provide pension advisory and administration services to over 200 defined contribution schemes, with over one million members and combined assets in excess of £15bn.

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