THE SOCIETY OF PENSION PROFESSIONALS
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Circular 2926

MINUTES OF A MEETING OF
THE DEFINED CONTRIBUTION COMMITTEE
HELD ON THURSDAY, 16TH DECEMBER 2021
AT 1030 VIA MICROSOFT TEAMS

Present:	Tim	Box (Chair)	LCP
	Rhiannon	Barnsley	ARC Pensions Law LLP
	Jennifer	Bell	CMS
	Tim	Box	LCP
	Jane	Briggs	Squire Patton Boggs (UK) LLP
	Gordon	Bown	XPS Pensions Group
	Madalena	Cain	Aon
	Fred	Emden	Society of Pension Professionals
	Simon	Hankin	Willis Towers Watson
	Paul	Hodges	Clyde & Co LLP
	David	James	Travers Smith LLP
	Marcus	Kealey	Linklaters LLP
	Olivia	Kennedy	State Street Global Advisors
	Paul	McBride	HSBC Retirement Solutions Limited
	Ian	Neale	Aries Pension & Insurance Systems Ltd
	Gail	Philippart	Mercer Limited
	Nick	Phillips	Fidelity International
	Mark	Riordan	Capita Pension Solutions Limited
	Liz	Short	M&G
	Henry	Tham	PwC
	Simon	Tyler	Pinsent Masons LLP
	Giannis	Waymouth	Norton Rose Fulbright LLP
	Dave	Whitehair	Janus Henderson Investors
	Martin	Willis	Barnett Waddingham LLP

1. APOLOGIES

Apologies were received from Chris Barnes, Colin Clarke, Michael Hames, Simon Mayho, Robin Nimmo, Roshni Patel and Nicola Rondel. Gordon Bown is substituting for Chris Barnes, and Henry Tham is substituting for Roshni Patel.

Thanks to Giannis Waymouth for taking the minutes.

2. THANKS TO TIM BOX, OUTGOING DC COMMITTEE CHAIR

TB was thanked for his service to the DC Committee. TB reflected on his time as chair over a period in which the DC Committee has thrived, particularly during the pandemic. The membership of the committee is now in a good place with members proactively volunteering. TB encouraged everyone to take part and noted the potential benefit to personal profiles e.g. from press coverage and engagement with government. TB handed over the role of chair to MW and thanked FE and Carla Smidt for their unending help during the year.

3. <u>MINUTES OF THE DEFINED CONTRIBUTION COMMITTEE MEETING HELD ON 18TH NOVEMBER 2021 (CIRCULAR 2917)</u>

The minutes were agreed with one change to reflect GW's apologies for that meeting. **This will be updated (ACTION Carla Smidt)**

4. <u>MATTERS ARISING</u>

i. <u>SPP response to TPR/FCA Discussion paper: Value for Money</u>

The Committee noted the response and the good press coverage which came out of it for the SPP and thanked NR, ST, PMcB and TB.

ii. <u>Committee scope - post-retirement, decumulation, financial wellbeing – update</u>

TB reported that the SPP Council had approved the inclusion of post-retirement, decumulation and financial wellbeing issues within the scope of the DC Committee as clearly aligned to the Committee's core focus of DC. FE passed on the thanks of the Council to MW and DJ attending the last meeting to brief on the proposed change.

5. <u>DWP CONSULTATION ON REMOVING PERFORMANCE FEES FROM DC CHARGE CAP</u>

TB gave an overview of the consultation which follows an announcement in the Autumn budget. The purpose is to remove barriers to investment in asset classes that would be beneficial to savers, where there are well designed performance fees (but only those). The DWP has expressed concern over the risk of asset managers gaming the system and about bias to investment managers.

The changes proposed represent a U-turn from the DWP – if performance fees are exempt then the new easements coming in from October 2021 will not be needed and will be removed. DWP is to consult on draft regulations early 2022 with legislation to be in force by Autumn 2022.

General comments:

- A dialled back in "Build Back Britain" approach. Master Trusts were abstaining from investment in this area and the approach was more measured even if with the same message.

- Public perception may be cynical – equates to fund managers making more money, while the protection of members is relaxed to achieve other economic aims. Messaging will be critical.

- Communication challenge in different treatment: if providers explain the charge in the same way to members as for other funds – if say charge is X, but then good performance, charge is supposed to increase. But members have been told the charge is X so the provider can't take any more from the member's pot. Volatility brings charges with performance which have to be absorbed by provider.

- Charge cap is not the real problem. What counts as a charge: key for charge cap, headroom.

- Consultation paper has not covered look-through – how far must trustees look through funds to find the charges. The legal position is scant with conflicting views. Is it just the charges at the top investment level? This lack of certainty creates risk and puts off consumers from making investments.

- Not covered – approach to charges when an authorised master trust experiences a triggering event – the trustee cannot increase charges during that period so how is a performance fee to be dealt with?

Q1a: Would adding performance fees to exemptions increase capacity and appetite?

Yes, in that it won't decrease appetite. But is it actually the reason these investments are not being taken up? Other issues in play which need to be addressed for trustees to be willing:

- Pricing requirements– it needs to be a sustainable investment. Surveys show the chance of outperformance lessening in the next 10 years.

- How to control ESG needs with these investments?

- Risk of confusion of messages to members around the cost cap.

- Any appetite for private equity would in any event have to be limited for liquidity reasons.

- If Master Trusts are publicly saying that they won't go into this market, why should other schemes?

- The inconsistent approach to look-through remains a problem.

Conclusion: the changes won't massively increase investment. Will help but not solve risk. Schemes need to be convinced an investment will lead to better member outcomes first via higher returns, notwithstanding 5/10% charges. Members are becoming the investors here.

Noted that the appetite for private equity does exist – large Canadian pension schemes have their own PE arm. But there is a lot of risk in these investments and concerned trustees will not take the risk for members.

Action: call for evidence – committee members are asked to provide what they can.

Q1b: Would adding performance fees to exemptions incentivise PE and VC managers to change their fee structures?

Not clear. It was noted that PE and VC managers will always talk to the biggest providers which can put pressure on fees as part of a big initial investment and a longer term promise of future investment blocks. Managers may then be willing to look at a change of fee structure to access those funds, but as a general rule PE/VC rule managers do not actually need the pension fund market.

Q1c:What might be a more effective solution?

Basic supply and demand may influence change. The DC market is getting very large now.

If that resulted in a huge market for PE/VC assets then managers may be driven to look at how to tap it. So managers would need to adapt, rather than schemes. That might result in IMs agreeing not to operate performance-related fees. The AMC would not be significantly affected if IMs charged a high fee in the first place instead, so they could drop performance fees.

Issue that if schemes can only invest with those managers which agree to that pricing model, it will be a severely limited market. It might not be in members' best interest if only the worst managers are willing to flex. This was the case with active management – now most common only to have an active overlay on passive defaults. Active fund managers might actually want to adapt.

It was noted that this was a sophisticated market where trustees will need proper advice to get a good deal where the manager's interests are genuinely aligned with the trustee. Trustees should not be trying to do deals before being upskilled.

There is a possible trend of managers actually moving away from performance fees to get within the master trust fund space. BNP Paribas has done this with NEST. DWP's attention should be drawn to what is happening in the PE space. However any regulatory charge cap is, for master trusts, effectively a commercial charge cap as well, not just default charge cap. So master trusts may simply not be interested.

Q2: How can we ensure members are protected?

Operate the charge cap.

This is a difficult question. Should performance fees only kick in when there is a really successful return? If there are high returns, then it really doesn't matter about cost. But this is a hard message to present. DWP not themselves convinced.

Investors want to know which fund is doing best but the answer is complex as a result of conflicting needs e.g. ESG, volatility control. Every fund sets its own composite benchmark, which is the equivalent of marking your own homework.

Q2a: Suggestions for ensuring fees are only paid when genuine realised outperformance is achieved?

None identified.

Q3: Which conditions should the Government apply? Any others? Would this plus guidance give confidence?

It was noted that guidance does help with the risk. But this solution is targeted at standard occupational pension schemes, when logically the focus should be on master trusts with scale to lead the way.

Comment that it was easier for a very big scheme to use this option. There is some appetite from the biggest master trusts which are the only ones to break that ground. The smaller ones are likely to wait. If DWP wants the master trusts to lead, there is still the issue that any statutory cap also becomes a commercial cap.

Below master trust level, the average trustee board will find the market too complex and not a comfortable arena in which to operate. Why should conventional occupational schemes invest if master trusts won't? If the DWP want to attract mid-market schemes the trustees will need more support.

Noted that there has been extensive research on how to structure fees but the outcome in reality results from a battle between managers and investors – DWP need to talk to the managers as well. The PE industry still lacks public confidence and any push to encourage high fees is likely to provoke a public backlash about the profits of asset managers.

The DWP's focus on exploiting default funds (the largest share of the market, but the most regulated) is part of problem.

Exempting performance fees may present badly to members. Disclosing a very high fee to a fund manager looks poor, but if left subject to the cap in reality the impact on the overall cap will be small – PE would only be a fraction of the overall fund. So schemes can invest in PE within the funding cap for default funds. They could say what the cap is at the start with the provider having to absorb any extra cost. But if taken outside the cap the percentage charge would be disproportionate by comparison to charges subject to the cap. DWP should be cautious about going down this route.

Overall sense from the consultation paper that DWP accepts the problems with what it proposes and is effectively inviting the market not to support it. Response should therefore be cautious around conditions.

It was recognised that the DWP needed to very clearly limit the asset classes affected by any exemption so that managers of other assets don't jump in and convert to performance fees to exploit the exemption and undo all the protections of the past.

Q4: Do you agree about disclosure of performance fees? Should that be in the same way as transaction fees? What additional financial costs might arise?

In theory inclusion in the chair's statement is a sensible approach. But there are significant practical obstacles to effective transparency:

- The current chair's statement approach is acknowledged to be flawed and under review – any treatment of performance fees should fall within that wider root and branch review of the purpose and effectiveness of transparency.

- Members do not read the chair's statement.

- It is already hard for trustees to obtain the current raft of required information for chair's statements and asset managers are already not achieving that level of disclosure.

- Conceptually hard to explain in terms that members can easily grasp.

- Is disclosure actually useful? The onus is on the trustee to make sure assets are generating value for members, not the members.

Q5a: If performance fees are exempt, should the smoothing mechanism and pro-rating easement go?

Yes.

Q5b: Are transitional protection arrangements needed for firms which have been using performance smoothing mechanism? If so, what?

The transitional protections are too recent for removal to have any real impact.

Observation that where a default fund is a mix of vanilla assets plus PE and charges remain high despite poor performance by the vanilla assets because the PE element was successful, it will be hard to justify those fees. Disclosure may be easier if PE can also be chosen as a self-select fund where the net return is visible in its own right.

The deadline for a response is 18 January 2022. MW to lead the review with DJ.

Action: Other committee members are asked to volunteer to support.

6. FCA CONSULTATION: PROPOSED DEFAULT INVESTMENT OPTION FOR NON-WORKPLACE PENSIONS

TB outlined the proposals made. Non-advised customers should be offered a default investment option which should include a lifestyle or target date approach. However customers would not be automatically enrolled into it. Instead NWP providers must warn all consumers holding high levels of cash as a trigger to discuss movement to a default. Should lead to better outcomes

Noted that the proposal should also apply to legacy NWP – the purpose is to protect consumers. Recognised that this would create extra cost, but there are significant legacy books without charging caps.

Some conspicuous, but questionable exceptions: e.g. SIPPs and stakeholder (although the latter has some existing protection).

Caution needed around 1990s DC pension accumulation funds – this is a minefield. Form of fair value for old schemes. Even cash funds banking accounts have guarantees.

Deadline for response 18 February 2022. Agreed that as it relates to NWPs, FSR Committee will lead and draft – DC Committee to review at next meeting or after that meeting.

Actions:

- **FE to ask FSR Committee to provide a first draft before the next DC Committee meeting.**

7. FCA'S FINAL RULES ABOUT STRONGER NUDGE

The Committee noted the final rules had been published and would take effect on 1 June 2022. Providers must refer consumers to Pension Wise and make an appointment or offer enough support to book one. The additional inherent administrative cost to providers has not been recognised by the FCA.

TB noted that the DWP's equivalent consultation is still awaited. The intention had been for the OPS equivalent to apply from April 2022 – would it be pushed back to June 2022 to align with the FCA equivalent?

8. FORTHCOMING DC EVENTS

Being arranged for January or March 2022: seminar on new Long-Term Asset Funds (LTAFs) for DC schemes. Michael Aherne leading with an investment consultant (WTW) and an investment manager (LGIM).

9. SPP EVENTS UPDATE AND POLLING SUGGESTIONS

January 2022: seminar on Mitchells & Butlers judgement being finalised – speakers to be lawyers with an actuary chair.

Inflation and interest rates

Early career professionals event possibly in Q2 2022.

Two seminars planned on the covenant element of ESG risks, one focussing on the "E" including climate change, and one on the "S" and the "G".

Possible topic: Decumulation, but what angle to cover? To discuss further early 2022.

10. DATE OF NEXT MEETING

The Committee noted that its next meeting was due on 20th January 2022, at 1030. It was expected that this would be a virtual meeting.

11. MINUTE TAKER

Jennifer Bell

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