XPS DC

XPS DC Briefing

August 2023

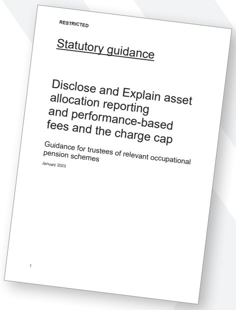
The case for illiquid assets and the new requirements for trustees

Illiquid assets are those which cannot easily or quickly be exchanged for cash. Their appeal in a Defined Contribution (DC) context is:

- **diversification from equities;**
- **potential to earn an 'illiquidity premium';**
- **potential for inflation linkage; and**
- **potential alignment with Environmental, Social and Governance (ESG) policies.**

What is changing?

To encourage DC investments in illiquid assets, the Government has issued statutory guidance on the amendments to disclosure and reporting requirements. The guidance follows the consultation outcome on Broadening the investment opportunities of defined contribution pension schemes.


RESTRICTED

Statutory guidance

Disclose and Explain asset allocation reporting and performance-based fees and the charge cap

Guidance for trustees of relevant occupational pension schemes

Click here to view the statutory guidance

Actions for trustees

Where?	What?	When?
Default SIP	Disclose and explain policies on illiquid investments.	First SIP review after 1 October 2023 and in any case by 1 October 2024.
Chair's Statement	Report (and publish) the amount of any performance-based fees which have been excluded from the charge cap.	First scheme year ending after 6 April 2023.
	Report on (and publish) underlying asset allocations of default arrangement(s).	First scheme year ending after 1 October 2023.
Value for Member assessment	Schemes with more than £100m assets must assess the value of any performance-based fees.	First scheme year ending after 6 April 2023.

Enhancing member investment outcomes is a key priority for all trustees. We are supportive of the ongoing encouragement for trustees to consider all asset classes and the new requirement to formulate policies on illiquid assets in particular.

Mark Searle – Partner, Head of DC Investment

More detail: Statement of Investment Principles

Trustees will be required to **disclose and explain policies on illiquid investments for their default arrangement(s).** This includes all default arrangements and is not restricted to those where members did not make an investment choice.

For relevant schemes (i.e. most schemes with DC benefits, other than where they relate only to AVCs), trustees will be required to include within their default SIP:

- a statement on whether or not investments held for the purposes of the default arrangement(s) will include illiquid assets; and
- an explanation of whether the trustees have any plans to invest in illiquid assets or increase their investment in illiquid assets, in the future.

In addition where illiquid assets are included, the following information will be required:

- a description of the age profile of those members in respect of whom investments will be held in illiquid assets;
- an explanation of whether investments will be held directly in illiquid assets, or through a collective investment scheme;
- an explanation of the types of illiquid assets in which investments will be held; and
- an explanation of why the trustees or managers have a policy of investing in illiquid assets including their assessment of the advantages to members of investing in illiquid assets, when compared to investments in other classes of assets.

Where illiquid assets will not be included, the SIP must provide an explanation of why the trustees or managers have a policy of not investing in illiquid assets.

These requirements must be included from 1 October 2024 at the very latest; any default SIPs reviewed after 1 October 2023 will also be captured.

Chair's Statement

Trustees will be required to **disclose the amount of any performance-based fees which have been excluded from the regulatory charge cap** within their Chair's Statement. This must be disclosed in the **first scheme year ending after 6 April 2023.**

Specified performance-based fees are those which can be excluded from a default charge cap. In simple terms, specified performance-based fees are considered to be designed in a way such that the fee is incurred when a fund's performance exceeds a pre-agreed investment return in a specified period.

The regulations stipulate that the amount of any performance-based fees incurred in relation to each default arrangement (if any) should be stated as a percentage of the average value of the assets held by that default arrangement during the scheme year.

Schemes investing in funds with performance fees should be working closely with their investment advisers to understand the return profile of these assets.

Trustees are also required to **report on underlying asset allocations. For the first scheme year ending after 1 October 2023** trustees will have to calculate the percentage of the default fund allocated to each of the asset classes:

a) cash;
b) corporate or Government bonds;
c) shares listed on a recognised stock exchange;
d) shares which are not listed on a recognised stock exchange;
e) infrastructure;
f) property which does not fall within (e);
g) instruments creating or acknowledging indebtedness which do not fall within (b); and
h) any other assets which do not fall within (a) to (g).

The Guidance makes it clear that trustees should look through the ownership structure of a fund vehicle to the allocation of the underlying assets. However, there does appear to be an element of discretion within the Guidance. For example, Real Estate Investment Trusts (REITs) may be included as property due to the underlying assets. However, if the REITs are held as part of an equity portfolio then they may be assigned to shares (listed or unlisted as appropriate).

Value for members

Trustees of relevant occupational DC schemes that pay specified performance-based fees must assess the extent to which these represent good value for members. However, schemes with under £100m in assets are not required to include this additional information as part of their extended value for member comparison against larger schemes.

How can we help?

Trustees should act now to establish their policies on illiquid assets and understand the new requirements.

XPS are well positioned to:

- **Provide** training on the new requirements concerning illiquid assets disclosure.
- **Explore** the types of iliquid assets, how they might benefit your members and help formulate your policy.
- **Consider** the scope to enhance your investment strategy and explore methods to manage the illiquidity.
- **Assist** with both regulatory and supplemental disclosures.

About us

XPS Pensions Group is a leading independent pension consulting and administration business focussed on UK pension schemes. XPS combines expertise, insight and technology to address the needs of over 1,500 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over one million members and provide advisory services to schemes and corporate sponsors in respect of schemes of all sizes, including 81 with assets over £1bn.

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.

If you'd like to find out more about the requirements for your DC scheme, please get in touch with Mark Searle or Christopher Barnes or speak to your usual XPS Pensions contact.

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