Sackers

DC briefing

May 2023

Highlighting the latest developments in DC for trustees, employers and providers

Introduction

Spring, so it seems, is a time for us all to think afresh about some well known DC challenges. Allow us then, to walk you through the headlines in this, our latest DC briefing. Although generally surprises are to be celebrated, if they arrive in the form of unexpected Budgetary tax changes they are not always welcomed with open arms. Never fear though, we've set out below some key points to note.

Next up is this quarter's "spotlight", and centre stage is the quick-step toward the new market-wide framework covering value for money ("VFM"). It is good to see the DWP, TPR and the FCA are working together in their search for a solution that stretches across the industry. In our regular "On the horizon" feature, we set out a handy snapshot of upcoming developments and potential agenda items for your next trustee gathering.

And, finally, we close by looking at TPR's expectations on equality, diversity, and inclusion.

Spring Budget 2023: AA and LTA changes

Labour supply issues and concerns over inadequate pension savings have driven the Government, so it says, to a series of Spring Budget tax changes. It is not the nature of the modifications though that was surprising, more the fact they came at all. And so, with effect from 6 April 2023:

- the lifetime allowance ("LTA") charge will be removed. Note though, that the LTA itself will not be abolished until April 2024 (see below)
- the annual allowance ("AA") (ie the limit on the total tax-relieved pension savings an individual can make each tax year) will be bumped up from £40,000 to £60,000
- the money purchase AA (ie the AA that applies to individuals who have flexibly accessed their DC benefits), will also be increased from £4,000 to £10,000
- similarly, the minimum tapered AA (ie the reduced rate that applies to high earners) was lifted from £4,000 to £10,000. The income threshold at which the taper applies will be raised by £20,000 to £260,000
- the maximum pension commencement lump sum ("PCLS") though, will be frozen at £268,275. This seems an oddly precise figure, but is explained by the fact it represents 25% of the 2022/23 LTA.

It gets a little more complicated for those with pre-existing LTA protections. Fortunately, HMRC's LTA guidance provides us with useful commentary around matters such as PCLS calculations for these members.

Note that the legislation which covers all the details involved in making those changes is still making its way through Parliament. Hiccups are therefore still possible. Once in place, the new provisions will have retrospective effect. Until then, though, trustees will need to act carefully when dealing with anything that risks a member losing valuable LTA protections.

It is also worth remembering that there could be political hurdles to cross before the law is changed to sweep away the LTA from April 2024. So, it may be advisable not to delete all references to the LTA from scheme literature. In the meantime, trustees will still need to keep LTA checks in place when paying benefits, or issuing benefit crystallisation event statements, and take care when speaking with members about LTA issues generally.

Progress towards a common VFM framework

October 2018: TPR and the FCA's first joint regulatory strategy included setting and enforcing clear standards for delivering VFM among its new priority areas for joint action

September 2021: TPR and the FCA published a joint discussion paper on a holistic framework and metrics to assess VFM across DC pension schemes

For a while now, the DC market has been crying out for a consistent VFM framework. And that is precisely what the DWP, TPR and the FCA have been working closely to establish. The proposed new framework covers the key elements of investment performance, costs and charges, and quality of services.

What is "VFM"?

For the purposes of the joint consultation that closed in March 2023 (the "Consultation"), a scheme offering VFM would ensure that "pension savers' contributions are well invested in the best interests of savers, and savings are not eroded by high costs and charges in the context of the market today".

What is the VFM framework aiming to do?

The proposed new VFM framework is an example of the growing overlap between the work of the FCA and TPR as the pensions industry continues to consolidate. Once implemented, all schemes would be required to report on wider value metrics and to use this data to assess the value of their offering against real market comparators. It could:

- encourage greater transparency and standardisation of reporting across the DC market
- give trustees the tools to make more informed investment and governance decisions
- allow employers to better compare the value and performance between DC schemes. Then, when it comes to deciding which automatic enrolment scheme to use, they will be able to make a more informed decision
- drive and support further scheme consolidation, where this is in members' best interests.

Ultimately, it is expected to replace the detailed value for members assessment for occupational DC schemes with less than £100m in assets under management.

How might the VFM framework impact the industry in practice?

In several ways:

1 Chair's statement

Currently, those required to produce DC chair's statements must set out the result of the existing value for members assessment. The DWP is still looking at how the new VFM framework would interact with this requirement.

It is possible that in the future the DWP will split the chair's statement up into a member-facing document and a separate compliance report.

2 Disclosure

If the Consultation is anything to go by, VFM disclosure will focus on investment performance, and costs and charges, with a lighter touch approach to disclosures on service and engagement.

Reporting dates will be mandatory. Disclosed data ("framework data") would need to be published by 31 March, while data on net investment returns would be based on figures from the previous 30 June.

According to the Consultation, aligning dates like this is the only way to ensure consistency and allow meaningful comparisons to be drawn. However, the industry will face a challenge in ensuring that the information required for disclosure is available in the right format and at the right time, and (hopefully) that it is not disproportionately costly to obtain it.

For schemes, both contract and trust-based, VFM assessment results will need to published by the end of October.

For IGCs, results will need to slot into the IGC chair's report, but, owing to the timing, occupational pension schemes will need to publish VFM results separately from their chair's statement.

Organised trustees are starting to add these dates to their diary now as there are many moving parts and proper planning will be key.

3 The actual assessment and comparisons

The proposals have generated a lot of debate and differences of opinion, particularly as some of them could end up duplicating work that has already been undertaken in the past – for example by IGCs. There is also a risk that they won't go far enough to help the schemes that need it most. However, in better news, a detailed, step-by-step process will be in place for trustees and IGCs to follow.

Starting from the first scheme year ending after **31 December 2021**: occupational DC schemes with less than £100m in total assets must undertake and report on annual detailed value for members assessments

May 2022: Responses to the joint discussion paper were published in a feedback statement

December 2022: an update to TPR and the FCA's joint regulatory statement refers to continuing work with the DWP on VFM

January 2023: The DWP, TPR and the FCA consult on a common VFM framework

What will need considering?

Overall performance – investment returns net of all costs, assessed relative to other schemes and industry benchmarks. Plus, there will also be a need to look at reasonable expected future performance, which is potentially controversial given the commercial aspects of some schemes within the DC savings market.

Investment strategy – investment returns net of investment charges. This focusses on the value delivered by the investment strategy, assessed relative to the default asset allocations of other schemes.

Services – including weighing up the quality of services against their cost. The idea here is to look at the value delivered through the member's pension journey, assessed using published metrics "as indicators of quality in particular areas". Again, this will be relative to other schemes and industry benchmarks.

Economies of scale – this one is just a "possible" for now. It would require trustees and IGCs to consider whether their scheme is able to achieve savings and benefits from economies of scale.

What are the possible outcomes?

There are a trio of possible conclusions that trustees / IGCs can reach:

- VFM
- not currently VFM but with identified actions to improve in certain areas that would deliver VFM, or
- not VFM.

If the outcome is "not VFM" the consequences under consideration include:

- imposing a duty to consider transfer and / or wind-up, and
- giving TPR powers to enforce wind-up and consolidation.

What, if anything should we be doing?

The next step – albeit one currently without a timeframe – is for the DWP and the FCA to carry out further consultations on changes to legislation and the FCA rules, respectively. Final legislation could therefore be some way off.

Action

It remains unclear exactly what this will mean for trustees and IGCs but early planning is essential: there will inevitably be complexity both in the analysis and comparisons required.

The Consumer Duty

What is the consumer duty?

The FCA wants to set higher, clearer standards of consumer protection across financial services, requiring firms to put their consumers' needs first. And that cannot be a bad thing.

Technically, occupational pension schemes are regulated by TPR and therefore are not in scope of the consumer duty. But, FCA-authorised firms creating a product and operating pension schemes for occupational pension scheme trustees will need to comply if they can determine or materially influence retail customer outcomes. It is also possible that firms operating their own master trusts will aim to ensure consistency of approach across all of their pension products. That means, in practice, we could see an increasing degree of alignment between some aspects of trust-based and contract-based schemes going forward.

How will the consumer duty interact with the VFM framework?

The VFM proposals are intended to be consistent with the consumer duty's aims, especially as publicly disclosed data and the focus on member outcomes are expected to help firms meet their obligations under the consumer duty.

For workplace personal pension schemes, the VFM assessments carried out by IGCs are embedded in FCA rules for the consumer duty. A provider must use its IGC's VFM assessment in its own VFM assessment. So, it all feeds into the same place.

When does the consumer duty apply?

- For new products and services: 31 July 2023.
- For closed products and services: 31 July 2024.

On the horizon

Pensions dashboards

The DWP has announced plans for a "reset" of the pensions dashboards programme, and is intending to legislate to provide new connection deadlines. A further update is expected before Parliament's summer recess. TPR has updated its initial dashboards guidance to reflect this. In the meantime, we recommend that schemes continue with their preparatory work and keep a close eye on developments.

Broadening the investment opportunities of DC schemes

The DWP has moved ahead with changes to investment disclosure requirements and the charge cap. Trustees are required to:

- disclose and explain their policies on illiquid investments in the default SIP (or the main SIP for CDC schemes) the first time that it is revised after 1 October 2023 (or by 1 October 2024 at the latest), and
- publicly disclose and explain the percentage of assets in the default fund(s) (or the scheme as a whole for CDC schemes) that are allocated to certain asset classes in their annual chair's statement, from the first scheme year which ends after 1 October 2023.

"Well-designed" performance-based fees are excluded from the DC default charge cap from 6 April 2023 onwards. Trustees should make sure their schemes are addressing these changes.

Small pots consolidation

Work goes on in the search for solutions to the issue of deferred small pots. The DWP issued a call for evidence to "deepen the evidence base around the scale and characteristics of the growth in the number of deferred small pots". This built on work by the Small Pots Cross-Industry Co-Ordination Group, and ran from 30 January to 27 March 2023.

This project has potential to significantly impact the DC pensions landscape, and the industry's view will be key to its success.

Extending opportunities for collective defined contribution ("CDC")

The DWP has consulted on:

- proposals for broadening CDC beyond single or connected employer schemes to accommodate unconnected multi-employer schemes, and
- the role of CDC in decumulation, and particularly the potential for CDC decumulation-only products.

The consultation focussed on how the existing CDC authorisation and supervision regime might be harnessed to accommodate these new designs, the challenges involved, and legislative changes that might be required. With TPR now having authorised the UK's first CDC scheme, the developments in decumulation options are particularly relevant for DC scheme trustees, as TPR and the FCA continue to carry out work on the consumer journey.

Climate and ESG compliance

TPR is putting "extra emphasis" on trustees' ESG and climate reporting duties, and has launched a compliance campaign. It issued a statement on TCFD reports on 23 March 2023, highlighting emerging good practice and asking trustees to consider some areas for improvement, including making the published reports fully accessible to savers with different needs. A review of SIPs and implementation statements will follow in the summer. Trustees should take the feedback and guidance into account in complying with their ESG duties.

This is an evolving area and more developments may be on the horizon. The DWP is expected to review the Climate Change Governance Regulations during 2023 to assess whether the regulations and statutory guidance need to be updated.

Review of TPR

The results of a review of TPR are due to be published in May 2023. The review is in line with the expectation that public bodies are reviewed each Parliament. Aiming to identify efficiency savings, this could potentially lead to future changes to the way TPR works, so is an area to watch.

TPR's guidance on equality, diversity and inclusion ("EDI")

On 28 March 2023, TPR published, for its first time, best practice guidance on EDI for pension scheme governing bodies and pension scheme employers.

TPR believes that improving EDI in governing bodies will lead to wider discussion, new thinking and approaches, and more effective decision-making that reflects members' needs.

What does this mean for trustees?

TPR recognises that there is not a one-size fits all approach, and each scheme will have different challenges to consider. However, the guidance indicates that TPR expects schemes to consider EDI, and suggests some initial steps that can and should be taken by trustees to make improvements. TPR may question schemes about the steps they have taken as part of its one-to-one supervision.

Key actions for trustee boards to consider include:

- ✓ **Training on EDI** – to understand the role it plays in board effectiveness, and any next steps involving trustee appointment and member communications
- ✓ **Setting EDI objectives** – agree scheme-specific objectives and goals at the start of each scheme year
- ✓ **Developing and maintaining an EDI policy** – put in place an EDI policy that sets out an agreed definition of EDI, the EDI aims of the board and a training plan. Schemes at the earlier stages of considering EDI may wish to set their EDI principles first, then develop these into a policy
- ✓ **Role of the chair** – TPR recognises the important role of the chair in leading progress towards meeting EDI objectives and actions, engaging with the employer, and creating an inclusive board culture, for example by making progress on EDI objectives a regular agenda item
- ✓ **Making reasonable adjustments** – some individuals may need adjustments to board processes to act as a trustee, such as holding meetings virtually or providing meeting papers in a particular format
- ✓ **Inclusive communications** – TPR has also updated its guidance on communicating and reporting for DC schemes to include a section on inclusive communications. The guidance highlights the use of accurate pronouns, checking for unconscious bias, and avoiding stereotypes and words with negative connotations. Communications should be accessible and reflect the diversity of the scheme's membership.

Action

Trustees should review the guidance at their earliest opportunity, and identify the most appropriate next steps for their scheme. Initial actions could include an assessment of the board's diversity, experiences, expertise and skills, and engaging with the employer on the appointment process for employer-nominated trustees.

Sackers

Contact

Sackers is the leading specialist law firm for pension scheme trustees, employers and providers. Over 60 lawyers focus on pensions and retirement savings, including our DC experts who provide practical and specialist help on all aspects of DC arrangements. For more information on any of the articles in this briefing, please get in touch with Helen Ball, Claire van Rees or your usual Sackers contact.

Helen Ball
Partner and head of DC
D +44 20 7615 9509
E helen.ball@sackers.com

Claire van Rees
Partner
D +44 20 7615 9573
E claire.vanrees@sackers.com

Jacqui Reid
Partner
D +44 20 7615 9550
E jacqui.reid@sackers.com

Olly Topping
Associate Director
D +44 20 7615 9037
E oliver.topping@sackers.com

Upcoming events

We offer an extensive programme of workshops, seminars and trustee training. If you would like to attend any of our events, please contact events@sackers.com or visit www.sackers.com/events.

Quarterly legal update	13/07/2023	Online webinar This session will provide an essential overview of significant developments affecting occupational pension provision in the UK for employers and trustees.
Key issues for DC pensions	18/09/2023	Online webinar This session is aimed at those running DC arrangements. It will look ahead to 2024 and focus on the issues likely to be of most interest, including value for money, dashboards and the General Code.
Getting dashboard ready	03/10/2023	Online webinar In this webinar, our dashboard experts will be joined by Angela Bell from TPR to discuss the latest developments, including the impact of the latest “reset” and any new regulations. They will also share highlights of clients’ experience to date.

You can sign up to receive any of our free publications and updates here.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 20 7329 6699
E enquiries@sackers.com
www.sackers.com