Sackers

Mansion House Reforms – the pensions avalanche

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Introduction

As widely trailed in the press, the Chancellor, Jeremy Hunt, delivered his Mansion House speech last night. Being guided by three golden rules, including seeking to secure the best possible outcomes for pensions savers, he announced a package of measures to enable the financial services sector to "increase returns for pensioners, improve outcomes for investors and unlock capital for our growth businesses".

Key points

- In what could be described as an avalanche of pensions developments, no less than eight pensions-related documents have been published following the Chancellor's speech. DC related developments dominate many of the documents, with a consultation response on the new value for money framework ("VFM"), largely confirming the January consultation proposals.
- The Government also sets out "a roadmap" to expand upon the use of CDC, provides a response to its call for evidence on addressing the challenge of deferred small DC pots, alongside a new consultation taking forward the idea of multiple default consolidators. In addition, there is a new consultation on supporting DC savers in decumulation.
- Announcing that some of the UK's largest pension providers have agreed to a voluntary "compact" to commit 5% of their DC scheme investments to private equity and early-stage business, the Chancellor estimates that this could potentially unlock up to £50 billion by 2030 if other DC schemes follow suit.
- The Government has also set out plans for "introducing a permanent superfund regulatory regime" to provide employers and trustees with a new "scaled-up way" of managing DB liabilities. Quite separately, it has published options for exploring how DB schemes could use their assets more flexibly.
- Trustees' skills, capability and culture are also the subject of a call for evidence.
- **All consultations mentioned above will run for eight weeks, closing on 5 September 2023.**
- Finally, although not covered in this Alert, an LGPS consultation has been launched, with a suggested deadline of March 2025 for all LGPS funds to transfer their assets into LGPS pools. This consultation will last 12 weeks, closing on 2 October 2023.

The Golden Rules

The Mansion House reforms are guided by the Chancellor's three golden rules:

- seeking to secure the "best possible outcomes for pension savers, with any changes to investment structures putting their needs first and foremost"
- prioritising a "strong and diversified gilt market", and
- Government decisions "must always strengthen the UK's competitive position as a leading financial centre able to fund, through the wealth it creates" the country's "precious public services".

Value for Money

Background

Over the last couple of years, the DWP, TPR and the FCA have been working closely to establish a common assessment framework for VFM across the DC market, culminating in a joint consultation earlier this year. The consultation sought views on policy proposals to require trustees and managers of DC occupational pension schemes, as well as the providers and IGCs of workplace personal pension schemes, to disclose, assess and compare the VFM of their schemes. They have now published a joint response to the consultation ("the Response").

The VFM Framework ("the Framework") has been developed "to support a consistent and more objective process for assessing VFM across DC schemes". It is intended to provide a transparent, standardised process for schemes to "holistically assess and evidence VFM outcomes and the actions they are taking to improve the value they provide to savers", with the ultimate aim of ensuring better retirement outcomes.

The three components of the Framework will cover: investment performance, costs and charges, and quality of services. The requirement for "consideration of factors critical to longer term saver outcomes" is aimed at shifting the focus from costs to value. In turn, a long-term focus on VFM across the pensions industry "could encourage schemes to invest in more productive assets, with the potential for higher returns for savers and boosting economic growth", a key Government priority.

Underperforming schemes will be required to take immediate action to improve or to wind up and consolidate, if this is in savers' best interests. The Response acknowledges that the VFM proposals "have been designed to support and accelerate the consolidation of underperforming and poorly run schemes" with better run schemes. While there are no details yet, it confirms that regulators "will be given the necessary powers to intervene – removing persistently poor performing schemes from the DC pensions market".

In relation to contract-based schemes, legislative changes will be explored "to enable providers to transfer pension savers without consent, internally or to another provider, with appropriate protections built into the process". IGCs are regarded as being best placed to determine whether a transfer would be in savers' best interests, but legislative changes will also be considered with a view to the FCA supporting or enforcing such a transfer.

In summary

For the most part, the intention is to go ahead with the original proposals. Although the Response is relatively short on detail, it confirms that:

- the Framework will be implemented in phases, starting with default arrangements
- schemes will be required to publish their framework data in Q1 to allow for timely comparison
- VFM assessment reports will have to be published by the end of October each year
- comparisons will be required against schemes of sufficient scale to deliver good outcomes, and there will be tightly defined criteria to prevent gaming or comparison against poorly performing schemes
- there will be a prescribed process, with supporting guidance, “to ensure a consistent and comparative approach”
- the current value for members assessment will be phased out as the Framework is introduced.

Chair’s statement

For now, the chair’s statement will remain and there is no decision on whether to separate out the member focused aspects into a separate document. However, as the Framework is implemented, it will increasingly duplicate the statement’s requirements. To address this, the DWP, TPR and FCA will consider how the statement requirements could be managed down and ultimately phased out.

Next steps

Many of the Framework proposals, including the definition of default arrangements, will require primary legislation and the intention is to legislate “when parliamentary time allows”. There will, therefore, be further consultations on draft regulations and FCA rules addressing the detailed requirements, including the types of pension scheme funds in scope during each phase.

Expanding CDC

Responding to its January consultation on expanding opportunities for CDC schemes, the DWP confirms its view that CDC will have an “integral role in the future of pensions”. The DWP believes that feedback received on the consultation demonstrates “increasing interest and appetite” for CDC schemes. It therefore intends to move forward with proposals to extend the legislative framework to allow unconnected multi-employer CDC schemes, including master trusts, and CDC decumulation-only products.

A consultation on draft regulations to enable unconnected multi-employer CDC schemes is planned for autumn this year, after further consideration by the DWP on some key areas such as regulation of marketing materials and whether to mandate MNTs in these schemes. The draft regulations will also clarify existing CDC legislation in relation to the smoothing of benefit reductions over multiple years and securing survivors’ benefits on winding up.

Legislating for CDC decumulation-only products remains some way off, although the DWP is “committed to moving forward” with this policy by exploring how it could operate in the best interests of members and “without unwarranted impacts on other aspects of the pensions framework”. This work will run alongside developing the legislation for multi-employer CDC schemes. There are no firm plans yet

to extend CDC to the contract-based space, but the DWP is "working closely" with the FCA to understand if there is potential for this.

Deferred small DC pots

The Government's January call for evidence focused on two possible large-scale solutions for dealing with deferred small pots: "default consolidator" and "pot follows member" models, alongside member exchange and greater member engagement. The DWP has now published its response, finding that there was no clear preference for either model, with both solutions having their merits and supporting the aim of reducing the number of deferred small pots.

Highlighting particular challenges with the "pot follows member" model, including frequency of transfers necessitating schemes to invest in more liquid assets, as well as the impact of members having frequent job changes or multiple jobs, the DWP has set this option aside. Instead, it is moving forward with proposals for a framework to enable multiple default consolidators in a new consultation.

Under the proposals, a small number of schemes would be authorised to act as automated consolidators for deferred small DC pots, with a "clearing house" acting as a central point to store and manage data and inform schemes where to transfer. Pots of up to £1,000 would become eligible for automatic consolidation 12 months after the last contribution is made, with the Secretary of State required to review the pot size limit at regular intervals.

The DWP believes that using multiple schemes will have a less distortive effect on the market than a single consolidator, while achieving greater value for members through economies of scale and "opening opportunities to invest in productive finance". To reduce the risk of detriment to members whose pots are automatically transferred, consolidator schemes would need to meet certain authorisation criteria and members would be able to choose their designated consolidator or opt out if they wished.

The DWP recognises that to stem the flow of new deferred small pots, "a more fundamental change to the automatic enrolment framework may be needed" in the future.

Supporting individuals in DC decumulation

The Government has published a consultation on a policy framework to support individuals using their pensions savings in decumulation, which includes its response to the product and services element of its 2022 call for evidence on helping savers understand their pension choices.

A key theme in the call for evidence feedback included a need to act to:

- encourage members of most occupational pension schemes to become more engaged with their workplace pensions
- support members to make informed choices about how to optimise their later life income
- ensure that decisions made at the point of access remain ones which individuals wish to continue
- closer align the FCA and TPR requirements.

In response to this feedback, the Government is consulting on a proposal to place a duty on trustees to offer decumulation services which are suitable for their members. Trustees would need to offer these services either in-house or by partnering with another supplier who could provide them.

The consultation asks for input on a variety of issues, including:

- what questions trustees should consider when developing their decumulation offering
- the potential role of CDC in decumulation
- practical considerations of any partnering arrangements, and
- what the timeframe should be for implementing the proposals.

The Government intends to legislate "when parliamentary time allows". In the meantime, the DWP will work with TPR to issue guidance for trustees on offering decumulation products.

Trustees' skills, capability and culture

Today's call for evidence forms part of an increasing focus on trustee boards, with TPR's guidance on helping to improve pension schemes' equality, diversity and inclusion having been published relatively recently.

Against the backdrop of an "evolving and more complex regulatory environment", the call for evidence focuses on three key areas:

- trustee skills and capability
- the role of advice, and
- other barriers to trustee effectiveness.

The call for evidence looks at trustees' skills and capability in the context of different scheme types, namely DC, DB, CDC and hybrid, as well as different types of trustees. In addition to posing some general questions around TKU standards, the call for evidence explores whether there are barriers to improving trustee capability, including whether trustee liability puts potential trustees off coming forward in the first place.

Naturally there is also a focus on training, with the call for evidence asking where the bar should be set if schemes are required to have a certain proportion of accredited trustees. Master trust trustees are acknowledged as having to meet "more rigorous competence requirements", although the call for evidence raises the possibility that they may be required to have a greater proportion of accredited trustees than, say, single employer schemes. Similarly, "more rigorous requirements" for those acting as professional trustees are discussed.

Many trustees are volunteers, carrying out their role alongside employment or retirement. If requirements around accreditation were introduced, the Government wants to ensure that all types of trustees are able to comply. Noting that pensions legislation already requires employers to allow employees who are trustees reasonable time off from work to carry out their duties or training, the call for evidence asks whether both lay and professional trustees have sufficient time and support to perform their duties effectively.

Given the investment focus of much of the Chancellor's speech, unsurprisingly, the Government is "particularly interested in whether trustees have the right knowledge and skills to consider investment in the full breadth of investment opportunities" and, if not, what can be done to improve this. There is concern that there may be a risk averse culture or "even a perception that fiduciary duty means capital preservation at all costs". Views are therefore sought on whether the way in which fiduciary duties are interpreted or exercised could be holding schemes back from exploring a broader range of investments, including in less liquid assets.

Consolidating DB and the rise of the superfund?

DB superfunds

The Government has published its response to the 2018/19 consultation on a new legislative framework for authorising and regulating DB "superfund" consolidation schemes. Since the original consultation was published, TPR has set up an interim regulatory regime for DB superfunds, along with regulatory guidance, with one superfund currently authorised under that regime. The Government's aim is for superfunds to be a viable option for schemes that cannot yet afford or access a buy-out with an insurer but are "suitably funded" to avoid introducing too much risk to the superfund itself.

A superfund is an occupational pension scheme set up for the purposes of consolidating DB schemes' liabilities. The link to the sponsoring employer is severed or "substantially altered" following the transfer of a scheme to the superfund, with the "covenant" replaced by a capital buffer provided through external investment.

Some of the finer detail is still to be worked out, and the Government is "keen to learn any lessons" from TPR's interim regime, but the key principles for the proposed legal framework include:

- superfunds will be authorised and supervised by TPR
- superfunds will need to have systems and processes in place to ensure effective governance
- there will be a trigger system for interventions (ie when TPR can intervene), profit taking and winding up
- superfunds must have a long-term objective, although that would not have to be tied to targeting buy-out with an insurer
- there will be requirements around financial sustainability and capital adequacy.

The proposed regime will require primary legislation. As with other changes announced in the Chancellor's speech, the Government is looking to bring forward legislation "as soon as parliamentary time allows". The intention is for the primary legislation to provide for a new compulsory framework for superfunds as well as "other relevant models of consolidation".

Options for DB schemes: a call for evidence

As part of the Government's "drive to promote economic growth", the DWP has launched a call for evidence on options for DB schemes, to support the development of "innovative policy options". This looks at how DB schemes could use their assets more flexibly, while maintaining appropriate security of members' benefits and not undermining trustees' fiduciary duties.

Questions in the call for evidence explore:

- access to and the use of surpluses
- the potential benefits and drawbacks of a public sector consolidator, and
- the role of the PPF as the public sector consolidator.

What's next?

With eight documents, including analysis, consultations and consultation responses published today, there will be plenty of reading material to keep the pensions industry busy over the summer. But not all of the documents will be relevant to all schemes, so it will be important to prioritise over the coming days and weeks.

Whilst pensions are clearly now high on the Government's agenda, with so many changes seemingly happening all at once, today's publications may cause some concern for already busy trustees, employers and pension providers. But whilst the Chancellor is looking to make decisions "ahead of the Autumn Statement later this year", some of the changes will inevitably take time to come to fruition.

If you would like to discuss any of the above proposals, or would like any assistance with producing a response to any of the consultations, **please speak to your usual Sackers contact**.

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