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UK PENSIONS UPDATE – CHANCELLOR UNVEILS PACKAGE OF PENSION REFORMS AT MANSION HOUSE SPEECH

On 10 July, the Chancellor announced a number of pension reforms during his speech at Mansion House. A swathe of responses to old consultations and fresh consultations was published the following morning. These form part of a wider government agenda to improve opportunities for investment in alternative assets, boost UK businesses and improve saver outcomes. The proposals come hot off the heels of the announcement that a number of large pension funds have signed up to the "Mansion House Compact", committing to an objective of allocating at least 5% of their default funds to unlisted equities by 2030.

The Pensions Regulator ("**tPR**") has welcomed the proposals, commenting that value is best achieved by having fewer, larger, well-run schemes. In this special edition of the UK: Pensions Update, we take a look at the key announcements and what these could mean for the pensions industry. It is clear that the overall theme is focused on scrutinising investment strategies and value for members and where schemes are not delivering, there will be a push to consolidate and move members into a scheme which can deliver.

Timing wise, the Chancellor has commented that all final decisions will be made ahead of the Autumn Statement later this year. However, we note that many of the proposals would require new legislation, indicating that implementation of the reforms is likely to be a way off yet.

1. REVIEWING TRUSTEE DUTIES

The government wants to better understand the culture of investment decisions and the interaction with pension trustees' fiduciary duties across both defined benefit ("**DB**") and defined contribution ("**DC**") schemes. The Department for Work and Pensions ("**DWP**") has published a joint call for evidence with HM Treasury to consider whether trustees have the right knowledge and skills to consider the full breadth of investment opportunities. In this context, the consultation is looking at:

- **Trustee skills and capability** – whether some types of trustee are better than others and whether it would be beneficial to require all trustees to register with tPR, as well as whether it would be beneficial to require a wider range of trustees to obtain accreditation, or imposing a requirement for every trustee board to have a certain proportion of accredited trustees.

- **The role of advice** – what changes could be made to improve trustee support in relation to investment in unlisted equities.

- **Barriers to trustee effectiveness** – whether trustees' fiduciary duties (specifically, the duty to invest in the best interests of scheme members) is well understood and whether changes could be made to current regulation and guidance to support trustees to make investment decisions which seek higher returns.

It will be interesting to see whether the consultation is the first step in looking at how the government can actually interfere with trustees' fiduciary duties and require schemes to invest in a particular way, or whether, as expected, this is more of a fact gathering exercise.

Timing: the consultation closes in September.

2. ENCOURAGING DB SCHEMES TO INVEST IN UK BUSINESSES

As part of the government's policy to promote economic growth, the DWP wants to build an evidence base around how DB schemes could increase the amount they invest in 'productive finance' (the government's generic term for investment that provides equity capital and finance for UK businesses, as well as longer-term investments, typically in illiquid assets) and has launched a call for evidence to support the development of investment in wider economic initiatives, while maintaining appropriate protection for DB members.

The consultation notes that the direction of future policy has not yet been decided, but any development in this area will be guided by three principles: (i) to ensure fairness for DB members; (ii) to prioritise a strong and well diversified gilt market; and (iii) to strengthen the UK's competitive position as a leading financial centre able to fund public services. In particular, the consultation is looking at how employers might be incentivised to invest for surplus (including potential tax changes to make repaying surplus to the employer more attractive). It is also considering whether a public consolidator (and potentially a consolidated fund managed by the Board of the Pension Protection Fund) would result in wider investment in productive finance.

Timing: the consultation closes in September and given that the direction of future policy in this area has not yet been decided, changes here are unlikely to be imminent.

3. NEW REGULATORY REGIME FOR DB SUPERFUNDS

The DWP has published its long-awaited response to the 2018 consultation on the consolidation of DB schemes. The response notes that while one superfund, Clara Pensions, has met tPR's expectations under the interim regime that was introduced in June 2020, the government is keen to see the market for DB consolidation develop further, and soon. (This is in the context that it is felt superfunds are more likely to invest in a more productive way than many closed DB schemes.)

In the response, the government confirms its intention to introduce a permanent regulatory regime and proposes that tPR will be required to produce a Code (and have the power to vary that Code as the market evolves).

The consultation sets out at a very high level some of the key principles of the new regime, noting that there is more value in on-boarding larger schemes initially and that tPR sees superfunds really helping those schemes which are 70-90% funded on the insurance/buy-out basis (or schemes which are better funded, but with an uncertain/weak employer covenant). The consultation notes that there will be rigorous controls on profit taking and superfunds will need to have a long-term objective – while this will not be a *requirement* to ultimately target buy-out with an insurer, this is something a superfund may wish to consider.

Timing: the new regime would require new legislation and will be introduced as soon as parliamentary time allows. After a transition period, existing superfunds will be required to comply with the new legislative framework in order to continue to accept new transfers in. It remains to be seen how the new permanent regulatory regime would overcome the issues that have prevented the superfund market taking off under the interim regime. In any event, given the lead in time, it seems likely that it will be some time before any changes are implemented.

4. FACILITATING DC CONSOLIDATION

The DWP has published a response to the January 2023 call for evidence on "addressing the challenge of deferred small pots", together with a consultation on proposals to resolve the small pots issue. This is ultimately aimed at facilitating DC consolidation to ensure that funds are able to maintain a diverse portfolio of investments and deliver the best possible returns for savers.

The January consultation sought views on the development of two large-scale automated consolidation solutions – a default consolidator model and a pot follows member model – with the aim of mitigating the growth in the number of small pots that can arise where an individual moves jobs.

The DWP has concluded that the multiple default consolidator model (whereby a small number of authorised schemes would act as consolidators for deferred small pots) is the optimum approach. The proposed process would involve a scheme identifying an eligible deferred pot and contacting the member to help them decide whether or not to opt out of consolidation. The scheme would then contact a central entity to identify the member's chosen consolidator scheme and ultimately the deferred pot would be transferred to that consolidator scheme. Members would be given the option to choose their designated consolidator, alongside the option to opt-out of consolidation if they believe that is not in their best interest. The consultation asks for input on key questions, including exactly which deferred pots should be in scope (it is proposed that this would catch deferred pots of £1,000 and below which have not received contributions for 12 months). The proposals would require a fair bit of work for schemes to put in place new processes and systems.

Timing: the consultation closes in September. The DWP has said it will form an industry group in late 2023, working with interested parties to explore the design and implementation of the default consolidator framework. However, the new regime will require new legislation, which will be taken forward when parliamentary time allows.

5. ENCOURAGING THE ESTABLISHMENT OF CDC SCHEMES

The DWP has published its response to the January 2023 consultation on a policy framework for broadening collective defined contribution ("**CDC**") provision beyond single or connected employer CDC schemes – the intention being that the framework should accommodate schemes providing benefits to unconnected multi-employer schemes and master trusts.

While there is a clear drive to encourage the establishment of CDC schemes, the consultation response itself does not say very much on some of the more substantive issues. For example, it comments that concerns have been raised regarding the risks of CDC e.g., overpromising CDC benefits to gain a competitive advantage and the importance of communication so members do not think they are being promised a guaranteed level of benefits. However, it does not set out how these risks should be addressed and it remains to be seen whether there will be any appetite from employers to set up CDC schemes while these risks are present.

Timing: the DWP intends to consult on draft regulations to extend CDC provision to whole-life multi-employer schemes (including master trusts) in the Autumn.

6. NEW DC VALUE FOR MONEY FRAMEWORK

The consultation response to the January 2023 "*Value for Money: A framework on metrics, standards and disclosures*" policy consultation has been published. The consultation related to proposals requiring trustees of relevant DC occupational pension schemes and Independent Governance Committees of workplace personal pensions schemes to disclose data and assess and compare the value for money their workplace pension schemes provide. It included a proposal for tPR to have new powers to enforce consolidation and wind up where a scheme is consistently not offering value for its members.

The consultation response confirms that a new value for money framework shall replace the value for members assessment currently required of trust-based DC schemes with under £100m in assets under management and that it will also apply to providers of contract-based workplace pension schemes. The intention is that the framework will provide greater transparency and standardisation of reporting across the DC pension market so that employers and members can more easily compare value and performance across different DC schemes.

Timing: the new framework will be implemented in phasing. Further details on phasing, the types of pension scheme funds in scope during each phase, and other elements of the framework will be set out in legislation and future consultations. In the meantime, the value for members assessment will continue to apply.

7. IMPROVING UNDERSTANDING OF DC PENSION CHOICES

The DWP has published a response to the June 2022 consultation on helping savers understand their pension choices, together with a fresh consultation on a policy framework for supporting individuals on how to use their private pension savings at the point of access.

In the response, the DWP comments that a wide variety of decumulation products and services are being offered across the market. For example, several master trusts reported offering a full range of options including flexi-access drawdown, uncrystallised funds pension lump sums and an annuity brokering service. However, smaller schemes offered fewer options and the popularity of annuities remains low.

The new consultation asks whether it should be up to trustees to determine decumulation solutions to deliver what a member wants to achieve from their income in later life, what questions should be asked to understand how an individual wants to use their pension wealth, how the requirements should be implemented and how these would apply to CDC schemes, master trusts and NEST.

Timing: the consultation closes in September. The intention is to legislate, when parliamentary time allows, to require trustees to consider the needs of their members when they want to access their pension pot and develop ways to deliver those needs. In the meantime, the DWP will work with tPR to issue guidance to show how the objectives of these policies can be met without legislation being in place. Specifically, the DWP wants schemes to consider how CDCs could feature in their offer to members. If implemented, the proposals could amount to a significant additional burden on trustees, particularly when taken together with the DC consolidation and value for money proposals discussed above.

8. LGPS ASSET POOLING

The Department for Levelling Up, Housing and Communities has published a consultation seeking views on proposals relating to the investments of the Local Government Pension Scheme ("**LGPS**").

The consultation seeks views on accelerating the consolidation of LGPS assets, with a deadline of March 2025 for all LGPS funds to transfer their assets into local government pension pools and ensure greater transparency on investments. Proposals also include amending regulations to require LGPS funds to set a plan to invest up to 5% of assets in "levelling up" in the UK (i.e. in investments designed to spread success equally across the UK) and to report annually on progress; and amending guidance to require funds to consider private equity investments to meet the government's ambition of a 10% allocation to private equity in the LGPS.

Timing: the consultation closes in October.

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