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Briefing note

Chancellor Jeremy Hunt's Mansion House Speech: Implications for DB schemes and DC savers

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On 10 July, the Chancellor delivered his annual **Mansion House speech**, providing a comprehensive review of the current economic landscape and outlining a number of reforms and initiatives intended to support pension savings. Initiatives range from the Mansion House Compact, enabling access to private markets; further work to consolidate small pots; the introduction of a new value for members framework; and the idea of a DB Superfund. In this briefing note, we cover the reforms for DC and DB pension schemes set out in the Chancellor's speech.

The three "golden rules"

Underpinning his speech, the Chancellor indicated that his decisions have been made with reference to three golden rules:

1. Always striving to achieve the best outcome for pension savers – putting their needs first.
2. Prioritising a strong and diversified gilt market.
3. All decisions made must improve the UK's competitive position as a leading financial market.

Key initiatives from a DC perspective

The Chancellor reiterated a series of reforms for DC pension schemes, following on from the commitments made in the Budget. Further supporting this, various consultations and calls for evidence were released subsequent to the speech.

The Mansion House Compact This commitment was most notable announcement. Endorsed by nine major pension providers, it aims to allocate a minimum of 5% of default funds to unlisted equities by 2030. The Chancellor believes that, if others follow suit, it could unlock up to £50bn worth of investments into high-growth companies. This demonstrates the government's objective to seek UK economic growth through riskier investment opportunities within the DC sector.

CDC The government set out a "roadmap" to expand upon the use of CDC. In addition, it provided a response to its call for evidence on addressing the issue of deferred small DC pots; announced a new consultation taking forward the idea of multiple default consolidators for small pots, which would be subject to an authorisation regime; and announced a consultation on supporting DC savers in decumulation.

VFM The Chancellor announced that a new value for money framework would be introduced in response to the consultation issued earlier in the year. This will require all schemes to report at the same Q1 year-end point, based on 31 December data, and is largely unchanged from the original consultation. Forward-looking analysis will be included alongside a method of ensuring all users are producing analysis based on consistent methodology.

Calls for evidence and consultations Several calls for evidence, responses to consultations and new consultations were issued the day after the speech, links to which are provided at the end of this document. These mainly build on work already undertaken in the areas of VFM, CDC development and trustee skills and knowledge, with the aim of raising the bar in these areas.

Paul Waters, Head of DC Markets, stated yesterday: “It’s great to see the Chancellor recognise both the value DC pensions can have for the UK economy and the need for innovation like CDC to drive better member outcomes. Despite his support for CDC, it’s not the only answer to this issue. There are alternative forms of risk-sharing that could have materially better outcomes for savers in different situations. These have the potential to deliver more value to savers, at arguably lower long-term risk, and can be implemented today.

“The government’s ambition for a 5% allocation in unlisted companies is to be applauded. We’ve been suggesting greater allocation to private markets for some time with our 10-10-10 statement: a 10 basis points increase in charges could support a 10% allocation to illiquid investments and at least a 10% improvement in retirement outcomes for younger savers.

“It’s encouraging to see the Mansion House Compact providers stepping forward in this regard. We need greater innovation from providers in many areas as well as investment, such as decumulation proposition design and delivery for better outcomes for members.”

Key initiatives from a DB perspective

DB Superfund The Chancellor announced plans to introduce a permanent “superfund” (a scheme established to consolidate a collection of individual DB schemes’ liabilities) regulatory regime, which will allow sponsoring employers and trustees to manage DB liabilities in a new scaled-up manner. Permanent superfunds will be overseen by The Pensions Regulator, and the government aims to encourage superfunds to invest more productively than traditional closed DB schemes and provide pension savers with more security.

PPF and DB schemes A call for evidence was launched, investigating the role of the PPF and DB schemes in productive investment by considering the provision of more equity capital for UK firms, including start-ups and infrastructure, and long-term investments in illiquid assets, while protecting the effective functioning of the gilt market. Ultimately, the Chancellor seeks to achieve a more flexible investment approach without compromising on the security of members’ benefits or trustees’ fiduciary duties.

Culture of Decision Making The Chancellor promised to study the culture of investment decisions to improve the understanding of pension trustees’ fiduciary duty, for both DB and DC schemes. A call for evidence launched by both DWP and HMT will examine three main areas: investment consultants’ role in assisting trustees, the skills and capabilities of current trustees, and barriers to trustee effectiveness. The Chancellor hopes that investments in illiquid assets will increase as a result of increasing trustee expertise; over time, this is expected to enhance investment returns enjoyed by pension schemes and support the Chancellor’s objectives.

The main thrust of the speech explores the ways in which DB schemes (and the PPF) can enhance their contribution to “productive investment” – this will centre around consolidation, incentivising more investment in growth assets and the aforementioned superfund regime.

Commenting on these proposals, Elaine Torry, co-Head of Trustee DB Investment, observes, “It’s great to see that the statement is addressing head on the elephant that’s been lurking in the room, which is ‘How do we as an industry make it possible for pension schemes to invest in a way that generates the best value for money for its members?’ The statement goes some way to tackling this; however, there are a number of practical hurdles to overcome in order to make this a reality, not least ensuring the regulations surrounding DB pensions are supportive and facilitate schemes investing in some of these opportunities. There’s also a question mark around the ability to get the desired scale and consistent, risk-adjusted returns, net of fees, that will make a tangible difference to UK pension savers over a variety of time horizons.”

Concluding remarks

At Hymans Robertson, we’re supportive of the direction of travel for DC and DB pension schemes announced by the Chancellor. We believe that the series of reforms will continue to improve the outcomes of pension savers in DC and for DB schemes in the UK. As confirmed by the Chancellor, there will be multiple consultations over the summer (particularly on DB consolidation, DC value for money and extending CDC opportunities), to which Hymans will provide responses. We welcome the introduction of a common framework for assessing value for money and the shift to allow diversification within asset classes, allowing access to a wider pool of investments.

We exercise caution, however, over the focus on UK-specific investments, noting that pension schemes will typically look to diversify using a global approach, of which the UK forms a small part. Overcoming the challenges associated with small pots is good news for these savers, who can often be left in poorly performing arrangements. The intentions expressed by the Chancellor impacting DB schemes are laudable, with “productive investment” likely to benefit schemes’ funding positions over the longer term, while directing capital towards innovative, growth-generating companies. Of particular interest and importance will be the outcomes, and follow-on action, that arise from the DWP consultation on Options for Defined Benefit schemes: a call for evidence.

This could be the ideal opportunity for the government to foster enhanced innovation in the provision of capital to a wide variety of growth-producing institutions that currently attract only modest, if any, investment from DB schemes. Similarly, the idea of consolidation through superfunds is likely to be beneficial for DB schemes that are relatively well funded but are not in a position to buy out in the near to medium term, as well as potentially attractive to employers looking to manage legacy liabilities. Consolidating substantial capital via a superfund should also foster enhanced opportunities from an investment perspective, providing further momentum to the Chancellor’s idea of productive investment.

If you would like to discuss further, please get in touch with Paul Waters or Elaine Torry.

Links to Consultations and Calls for Evidence

Automatic enrolment review 2017: Maintaining the momentum - GOV.UK (www.gov.uk)

Value for Money: A framework on metrics, standards, and disclosures - GOV.UK (www.gov.uk)

https://www.gov.uk/government/consultations/defined-benefit-pension-scheme-consolidation

https://www.gov.uk/government/consultations/helping-savers-understand-their-pension-choices

Helping savers understand their pension choices: supporting individuals at the point of access - GOV.UK (www.gov.uk)

https://www.gov.uk/government/consultations/pension-trustee-skills-capability-and-culture-a-call-for-evidence

Options for Defined Benefit schemes: a call for evidence - GOV.UK (www.gov.uk)

Extending opportunities for collective defined contribution pension schemes - GOV.UK (www.gov.uk)

Addressing the challenge of deferred small pots - GOV.UK (www.gov.uk)

Ending the proliferation of deferred small pension pots - GOV.UK (www.gov.uk)