HYMANS # ROBERTSON

60-second summary

Mansion House Speech: The Chancellor's vision for DC pension reform and consolidation

On the evening of 14 November, the Chancellor of the Exchequer gave a speech to the Lord Mayor of London, business leaders and City notables, at the Mayor's official residence, Mansion House. She used the occasion to launch an interim report from the ongoing Pensions Investment Review, and a consultation exercise on proposed reforms to workplace defined contribution (DC) schemes.[1]

The issue

With a projected £800bn of assets in workplace DC schemes by the end of the decade, the Chancellor (like her predecessor) is pursuing an agenda of getting pension scheme assets put to work in the UK. She pointed in her speech to the Australian Super schemes that invest three times as much in infrastructure and ten times as much in private equity than their UK counterparts. Her diagnosis of the problem is fragmentation in the UK's DC pensions market, and her prescribed treatment is to encourage the establishment of 'megafunds' via legislation in the forthcoming Pension Schemes Bill.

Proposals

The focus of the current proposals on which the consultation is seeking views is on the authorised master trust and group personal pension (GPP) schemes used for automatic enrolment. Single-employer schemes are for now out of scope. The hope being that the imminent new value-for-money (VFM) framework (also to feature in the Bill) will do some of the work necessary in that sector.

Defaults

To achieve its 'megafunds' aspiration in the workplace DC arena, the Government plans to limit the number of investment default arrangements in the system, whilst imposing a minimum size, by assets under management (AUM) on those that remain. The Government is leaning toward limiting each provider to a maximum number of default funds, and requiring each fund to have a minimum level of assets under management (AUM). There's no solid indication of what those limits might be, but AUM of £25bn – £50bn were mentioned.

Providers would not have to comply before 2030. It's suggested that, in the meantime, they might have to report on progress towards meeting the requirements, and consolidate if they cannot achieve the necessary scale. There's the possibility of some flexibility over the timing for those that are on track to achieve the targets, but need more time; and a suggestion that schemes with specific characteristics might be exempt. Where investment fluctuations reduce the size of a fund, there would be a window within which it must meet the minimum AUM requirement again. The consultation document seeks views on how this policy could be applied

[1] A separate consultation document covers proposals for changes to governance and investment in the Local Government Pension Scheme. Please see our other Mansion House summary for details.

without stifling competition, innovation, and increasing systemic risks.

Contractual override

To facilitate the desired consolidation, the Government plans to allow contract-based scheme providers to make transfers between schemes without obtaining the members' consent. The Government notes that the contractual override could help with the plan for a multiple-default-consolidator model for the automatic transfer of small DC pots to be included in the Pension Schemes Bill, and whenever schemes receive a 'red' (ie the worst) VFM rating. Safeguarding of member interests would be achieved through changes to the Financial Conduct Authority's (FCA) rules for regulated firms, and potentially also requirements on receiving-scheme trustees. The FCA might need powers to prevent or mandate transfers, and to gather information. Additional protection would be provided by a requirement for independent third-party scrutiny of proposed transfers, perhaps undertaken by providers' independent governance committees.

Employers & advisers

The consultation document discusses ideas for improving employer decision-making on pensions. The Government is considering imposing upon employers a new duty to review their auto-enrolment choices, periodically (perhaps every five years). The assessment would require them to review returns, charges and service quality, and could use information gathered by scheme trustees and providers under the new VFM framework. With this additional burden on employers, it's perhaps unsurprising that the Government is considering whether to apply it only to large employers. It also moots the possibility of requiring employers to nominate someone at board level who would be responsible for staff retirement outcomes.

The subject of the (non-)regulation of employee-benefit advisers and investment consultants is raised (again). The consultation document seeks comments about whether regulation of advisers could help employers focus on value for money considerations beyond costs and charges, and could increase schemes' allocations to productive assets.

We support the drive for scale and consolidation of lower-value default pensions particularly the removal of the member consent rule for GPP arrangements. Moving too fast towards consolidation, however, could cause more harm than good. 2030 is ambitious given especially the number of GPPs which exist. It's also worth recognising the number of extremely well-governed and high-performing own trust DC schemes, which are out of scope but will want clarity about the future implications for them.

Alison Leslie
Head of DC Investment
alison.leslie@hymans.co.uk

Paul Waters
Head of DC Markets
paul.waters@hymans.co.uk