Broadstone

The Mansion House Speech

The Great Pensions Project

July 2023

Introduction

Pensions and politics don't always make the best bedfellows. While we hope for insightful long-term policy, the use of pensions to achieve political objectives rarely results in the best outcomes for scheme members, trustees and sponsors.

The Mansion House speech on 10 July 2023 covered several diverse pension projects and proposals, some more clearly defined than others. It has brought a number of pre-existing projects forward and also emphasised the desire to make 'better' economic use of some of the trillions of pounds of assets in UK pension schemes.

This note summarises the various announcements and status of the projects.

The announcements

The Mansion House compact

This was probably the marquee announcement but the one on which there is the least known. The rhetoric from across a number of think-tanks was that the Government should establish various superfunds or even mandate pension schemes to invest in private equity and high growth potential start-up companies in order to help boost the economy. While the quality of some of their arguments (or consideration of the detail, legislative restrictions or potential downside) may have been lacking, clearly the idea had caught the Chancellor's eye.

Nine of the biggest defined contribution pension providers have agreed to aim to allocate 5% of their default DC fund (the fund in which members who don't make a choice are automatically placed) to unlisted equities by 2030.

Other announcements

There was then a string of additional announcements (and a flood of accompanying pensions papers the morning after the speech), which we cover individually below. Within his speech, the Chancellor advised these would all be underpinned by three 'golden' rules:

- to aim to secure the best possible outcomes for pension savers;
- to prioritise a strong and diversified gilt market; and
- to strengthen the UK's competitive position as a leading financial centre.

Value for Members

What has been announced? - The response to a consultation that ran between January and April 2023.

What is the policy aim? - To standardise a framework for assessment of Value for Members across Contract based and Trust based schemes (this is a joint consultation between FCA, TPR and DWP).

Summary – The key discussion for this consultation is how to demonstrate value in a defined contribution scheme that isn't purely cost. For example, looking at investment performance (both past and forward looking) as well as customer service. It will also allow TPR to wind-up or consolidate schemes if they are seen to be underperforming in those areas.

What next? – The response confirms that the framework will be implemented in phases which will require primary legislation, but further requirements for defined contribution schemes, including larger schemes, will be coming soon. This includes further consideration of the role of the Chair's Statement.

Defined contribution small pots

What has been announced? – The response to a consultation that ran between January and April 2023 together with a further consultation closing 5 September 2023.

What is the policy aim? – To address the estimated 12 million small pots dotted across thousands of pension schemes.

Summary – The Government has announced an "authorised and multiple default consolidator model" and so rejecting the "pot follows member" solution.

The multiple default consolidator model will mean that pots of less than £1,000 that have not received a contribution in 12 months will be consolidated. Members will get the options to transfer to a scheme of their choice or, if not, a clearing house will make the choice for them. There will be an authorisation system.

What next? – We will need further discussions on how this will work and then primary legislation to enable this to happen.

Decumulation in occupational defined contribution schemes

What has been announced? – The response including a further consultation on an earlier call for evidence which ran between June and July 2022.

What is the policy aim? – To provide support for members as they make informed choices when taking benefits from a defined contribution scheme, and to identify what decumulation products could be offered to members.

Summary – The consultation covers a framework which would require ALL defined contribution schemes to provide "decumulation" options to members. This would be provided directly through the existing scheme or via third-party providers. This means allowing members to enter drawdown or purchase an annuity through the scheme. There should be a default option but the opportunity for members to do their own thing. Notably Nest will also have the same requirement. It is also hoped, by the Government, that Collective Defined Contribution (CDC) schemes have a role to play.

What next? – We anticipate that primary legislation will be required.

Collective Defined Contribution (CDC) expansion

What has been announced? – The response to the consultation that ended in January 2023.

What is the policy aim? – To allow the establishment of multiple employer CDC schemes and decumulation only CDC schemes.

Summary – This supports the plans for DC decumulation and the possibility that master-trust style arrangements could be set up to provide CDC schemes. With the scale to operate a cost-effective CDC scheme beyond most individual employers, the move to allow this would potentially assist those employers considering CDC as an option to have access to a viable vehicle. The consultation also covers the authorisation regime that would need to exist.

What next? - This would require primary legislation and remains a long way from implementation.

Defined Benefit (DB) schemes and "productive assets"

What has been announced? – A new call for evidence on how the assets invested in defined benefit schemes could be invested differently. It also looks at consolidation and the potential of an expanded remit for the PPF. This closes on 5 September.

What is the policy aim? – To incentivise schemes to invest in "productive assets" (i.e. assets with a longer-time horizon and greater growth potential) and to review where regulations stop those decisions being made. Consolidation of schemes should allow them to access alternative asset strategies through economies of scale.

Summary – One of the key focusses is looking at how surpluses (a recent problem for defined benefit schemes) could be invested in more growth assets and how longer-term planning could even keep schemes running on and not transferring the risk to an insurer. There are also considerations about how the superfunds could operate and even use the PPF as a public-sector consolidator.

What next? – a call for evidence is often an initial step on a long journey to law but political will is behind this move to use pension assets differently and the fact it runs contrary to the draft new DB funding regulations would appear to bring this to a head more quickly. While in principle this could be a way from fruition, expect the Government to push this as fast as possible so they can make further announcements.

Defined benefit superfund regime

What has been announced? – The Government originally consulted on this in 2018 and they've finally responded to the feedback received.

What is the policy aim? – Provide a legislative framework for the establishment of DB consolidators aka superfunds.

Summary – The response defines a superfund and provides the framework to authorise and supervise the schemes. This is very similar to the interim one already being used by the Pensions Regulator and so would not appear to fundamentally shift the pensions landscape in this area.

What next? – Primary legislation will be required to bring this to the statute.

Pension trustee skills, capability and culture: a call for evidence

What has been announced? - A call for evidence which closes on 5 September 2023.

What is the policy aim? – Improve the skills and capability of pension trustees and remove barriers to making effective investment decisions. There is a concern that some trustees are not up to the job with a focus on defined contribution schemes and understanding investments.

Summary – The document considers whether there should be a central register of all trustees and that each board should have an accredited trustee (or even whether this should be 50% or 100% representation). The document also discusses the role of advice and board effectiveness. This seems to be a small step to professionalism and the subtext is that via better understanding trustees may be less risk averse, making them more willing to utilise unlisted assets.

What next? – As noted above this is the start of a journey and the slight vagueness of the direction may leave this one at the back of the queue for the time being.

Impact on members

The Government's own modelling on the impact of the package of changes noted above suggest that a member's fund could be 12% (or £16,000) higher. However, the allocation to private equity accounts for less than a third of this, with most of the improvement coming from the Value for Member initiatives.

Larger figures released by the Government relating to the impact of their pension reform are driven by the 2017 Auto Enrolment review measures currently going through parliament which will reduce the starting age to 18 and mean employees receive contributions from the first pound they earn (rather than from the Lower Earnings Limit).

The analysis on the changes is not the deepest with some of the impacts not overtly accounted for, and some sweeping assumptions around the expected returns of private equity and an assumed reduction in associated management fees. Some of the language around this upside experience has been questioned, as there are scenarios within the paper where members would be worse off. Indeed, the use of "will" when discussing member outcomes has left many uncomfortable with the expectations that people may have relative to the risks associated with these investments.

Broadstone comment

The Mansion House speech has had a mixed reception. While there is no denying the political appetite to make pension scheme assets work harder to support the wider economy, there is significant scepticism that the utilisation of unlisted investments can provide the upside for members being suggested.

In terms of the Mansion House compact itself, there needs to be more detail on the impact on charges for these funds as they will primarily be auto-enrolment schemes and so the charge cap will come into play. Whether the Government will further adjust the charge cap or squeeze manager charges (potentially then impacting on performance) remains to be fully understood.

Aspirations to then get more of the £2.5 trillion tied up in UK pensions invested in this manner have not been fully worked through. In many cases this would appear to require individual members or Trustees to actively seek exposure in this area, making some of the Chancellor's extrapolations to the wider marketplace appear somewhat optimistic.

In the DB landscape there are serious contradictions between the ideas being floated and the draft legislation related to the funding code. The draft regulations emphasise de-risking, end game planning and forced investment in gilts and low risk assets as schemes head to the ultimate security of an insurer, whilst the consultation focuses on the continuation of schemes and higher growth asset exposures. It is unclear which side might win this battle but extended debate on this topic will raise serious questions about the (already delayed) April 2024 start date for the new regulations.

Suggestions that DB consolidators (as yet untested) and/or an expanded role for the PPF (which has a very different core model, with standardised benefits for members) provide the answer to 'free up' these DB assets would also appear optimistic, at least in the short term, barring a radical change in stance around the need for employers to honour member's DB benefits in full. Whilst we welcome more options and flexibility for the schemes we advise, fleshing out a new role for the PPF raises a huge number of queries and so would appear some way off - perhaps missing the mood of employers hoping to finally draw a line under their DB exposure in the foreseeable future.

The defined contribution changes around Value for Members are well trailed and part of a wider issue to help individual savers understand whether they are in the right schemes for them – although the consultation response itself states that the initial expectation is that the framework will be for the 'professional' audience in phase 1 and communications to members will be a later addition. Indeed within the Small Pots paper there is a hint to allowing members to choose their own scheme. This is a tough challenge at the current time with no clear way of comparing and rating pension schemes.

Ultimately, the direction of travel is clearly to have fewer, larger pension schemes to choose from (outside self-invested personal pensions) which would make governance, comparison and regulation easier. This should also make it easier to ensure more of these assets are allocated as the Government would like. It will be interesting to see how the Chancellor's three golden rules can be made to tie in with this vision for the future.

Next steps

Much of what is discussed above will need primary legislation and/or further secondary legislation. This will take time and so the next key point (aside from the consultation responses) will be the King's Speech at the State Opening of Parliament in September and whether a Pensions Bill is included. We expect further news on these Mansion House consultations in the Chancellor's Autumn Statement.

We will continue to engage with the consultations and update you on progress.

Find out more

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