Broadstone

Consultation Response

The Occupational and Personal Pension Schemes (General Levy) Regulations review 2023

November 2023

Contents

Executive Summary

We oppose your preferred option (option 3), seeing it as disproportionate and attempting to force a consolidation agenda that would be impractical for defined benefit schemes in the timescales, even if this were the correct way to encourage it. Our sense is that our concerns are shared by many others in the industry and fervently hope you will re-think your approach.

We wonder whether the premise for the proposals have been based on a mis assessment of the current state of the market for both DB and DC schemes.

- 10,000 members is not 'small' in the DB world, and many schemes (at least those who can afford to do so) are already looking to endgame and buy-out discussions. An additional fine/levy will not tilt the balance in these discussions and to go through a proper buyout process takes time.
- Related to this, insurers are already facing huge demand in this area and the level of proposed consolidation is not consistent with a realistic expectation for transactions over the next few years. The potential expansion of commercial and/or public consolidation vehicles could help in this area and they appear to present some exciting solutions, but these are in their infancy and will take time to develop into a mass market option.
- The apparent belief is that the small scheme premium will act as an encouragement to trustees to take their responsibilities more seriously (focusing the mind for those acting slowly or a punishment for those not acting) is a misjudgement. If government and regulators believe trustees are not acting appropriately then they should be targeted to do so. A rather arbitrary penalty based on the scheme's existence (whether well run or not) is not a fair method to encourage 'better' behaviour.
- In the DC space, schemes are already going through the Value for Members (VfM) work and judging their position. There may be legitimate reasons to maintain their status outside the greater Master Trust framework and in our view they should not be punished for taking that decision. If there is a belief that small schemes are not taking their VfM responsibility seriously then it is under those regulations that action should be taken.

Our recommendation is that a more balanced and even increase in Levy is introduced. This will give greater consistency and stability for the future. In that regard, option 2 is clearly the 'least bad' option.

We have further detailed our objections with your preferred solution below and welcome the opportunity to discuss them with you should you wish to.

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Responses

Question 1 Which option do you prefer?

Option 2.

Question 2 In respect of your answer to Question 1, why do you support your preferred option?

The reasons why are summarised below but can be boiled down to strong objections with options 1 and 3.

Option 1 is clearly unsustainable and does not address the need to appropriately fund the activities of the relevant organisations. Running a deficit is not appropriate over the longer term.

Option 3 has some severe shortcomings. The £10,000 premium for small schemes with under 10,000 members in year 3 is an outrageous suggestion in the DB space for the following reasons:

1. It is a complete mis-definition of small. 10,000 does not represent a small scheme and represents almost the entire DB sector. This makes it sound preposterous.
2. It is predicated on a belief that many schemes will have consolidated by year 3. In the DB world while the funding and willingness among employers and trustees has significantly increased in the past few years, the market is currently unable to cope with consolidating that many schemes and to do so accurately and cost effectively takes a longer time horizon than you are working to. In particular we would note that:
    a. Insurers are currently at full tilt assessing and onboarding schemes. As a result, their current focus for new business, understandably, is on the larger more profitable schemes. Arguably this is not where the regulatory focus on consolidation lies. Small schemes can already find themselves faced with uncompetitive pricing or no immediate interest from insurers and additional arbitrary time pressure with a financial penalty will do nothing to address this.
    b. Third party administrators are required to undertake data cleanse activities, which are time consuming and can involve resolving complex issues such as GMP equalisation.
    c. Clara, the sole approved commercial consolidator, has only just completed its first transaction so will take time to reach large numbers of schemes.
    d. Other options such as master trusts will have already been considered and dismissed by most remaining arrangements.
    e. A mooted public sector consolidator could be established. However, this is very much still in the early, theoretical stage, with no detailed proposals let alone a functioning solution. In practice we must surmise that its existence and ability to do business is years away, even with an optimistic timeline and no regulatory bumps on the way.
3. There is little evidence of greater regulatory engagement with truly small DB schemes and so asking them to fund this with an eye-watering scheme existence penalty cannot be fair.
4. A penalty premium like this is unlikely to be a driver for consolidation in many cases (running costs are already significant and a disincentive for DB schemes). Instead, they would represent another expense and irritation for employers and trustees to bear. This may not seem significant but good will of the regulated community is important. People

need to feel that part of a system that treats them fairly. Small schemes often feel that they have a disproportionate regulatory burden, and this will neither help their attitude nor achieve the policy aim of a smaller regulatory universe.

5. The suggestion that 50% of schemes will consolidate seems highly unlikely, and if true would potentially lead to less regulatory manpower being needed. As such, the parameters used within your modelling appear flawed.

More generally, if this is to be a one-off premium then there would presumably once again be a shortfall in later years. If used every year (perhaps more suitable to encourage continued consideration of consolidation) then the size is disproportionate.

Overall, Option 2 appears to be a fairer way of spreading the costs amongst schemes according to size and regulatory risk/intervention with a controlled level of increase.

More sensible alternative solutions (including perhaps rebalancing the burden between DC and DB schemes) may have led to more constructive debate. As an example, we could consider “truly” small DB schemes as those:

a. With less than 100 members – already identified in pension legislation to be exempt from some of the regulatory requirements and facing disproportionately higher running costs; OR
b. With less than £10m in liability value - we assume TPR might consider this to offer a low (financial) risk and so regulate proportionately.

A more moderate increase to the ‘minimum payment’ level would seem a more appropriate way to target these cases if you believed there was a strong reason to do so.

Question 3 What is the impact on your scheme/business of raising the levy under Option 2?

Minimal – it remains below the current level of inflation and is mitigated slightly as many if not most DB schemes are reducing in size. A predictable level of increase consistent with historic levy levels can be absorbed relatively easily.

Question 4 What is the impact on your scheme/business of raising the levy under Option 3?

This would have a disproportionate impact on smaller schemes many of which would be unable to consolidate in that timescale. For other well-run small schemes, consolidation may well not be in the interests of their members. To penalise either group does not seem fair or appropriate.

Option 3 could also result in a windfall for DWP if, as we would predict, many schemes will still exist in year 3. Without an evidence base that consolidation is going to speed up dramatically to reach the 50% modelled, this seems a cynical way to raise funds.

If you are committed to an option of this nature then a more suitably set (i.e. much lower), annual surcharge for (genuinely) small schemes, focused solely on the DC space where consolidation might be more viable and desirable should be the starting point for finding a way forward.

Question 5 How will your scheme respond to a levy increase and/or premium? (For example: would it be absorbed by the scheme, passed on to members, or employers?)

Many of our clients are defined benefit schemes and we expect that any increased levy would be funded by the employer (either directly, or indirectly if first absorbed by the scheme). However, large increases (or penalties as in option 3) will likely come out of other funding and so could ultimately delay rather than encourage consolidation.

We would be concerned that some DC schemes will simply pass this on to members, potentially with little notice, hurting their pension outcomes and damaging their trust in the industry. This may be disproportionate to the size of the member's DC pot (if shared evenly across the membership).

Question 6 If you were to consider passing on costs to employers to absorb the levy increase, what is the size composition of employers using your scheme? (For example: are they mainly small, with less than 50 employees or larger employers?)

No comment.

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