Broadstone

Autumn Statement

Productive Finance drives pension innovation

November 2023

Introduction

The main pension related headlines in this year's Autumn Statement were:

- Triple lock has been maintained with an increase of 8.5% from April 2024.
- Employee rate of National Insurance cut from 6 January 2024, from 12% to 10%.
- Lifetime Allowance abolition to continue with effect from April 2024 despite practical concerns raised by industry.

However, the key points of interest from a pensions perspective were arguably in the longer-term policy initiatives trailed in the speech.

The Government is pushing ahead with a great swathe of ideas designed to, ultimately, create a pensions industry with a much smaller number of far larger pension schemes. It is through this scale that the primary benefit (for the Government) of schemes investing more heavily in productive finance might be unlocked.

So, what are the big ideas?

We can summarise the main policies as follows:

- Create a system where Defined Contribution (DC) schemes have to assess how they provide Value for Money. Those that cannot, must consolidate.
- Accelerate the consolidation of Defined Benefit (DB) schemes into insurers, superfunds or potentially a new vehicle run by the Pension Protection Fund (PPF).
- Create an Australian style "pot for life" or "lifetime provider model" to reinvigorate the DC sector, better engage members with their pensions and stop the prolific creation of new small pots as individuals change job.

- Provide more investment opportunities for pension schemes including a new growth fund run by the British Business Bank.
- Increase the professionalism on trustee boards to ensure the skills are present to better understand and make decisions around the use of productive finance.
- Conduct a review of the Master Trusts schemes, including work to explore their ability to allocate funds to productive finance.

Initiative overload?

If you are starting to feel overwhelmed by this wide-ranging wave of initiatives (in amongst Jeremy Hunt's easily remembered 110 measures for growth), the following summary might help.

Defined Contribution (DC) schemes

Existing small pots – over the summer we had a consultation on the proliferation of small pots. The industry and government agree that the escalating number of small pots makes it hard for members to keep track of their pension savings and ensure they're not being eroded by fees. They are also inefficient for providers to maintain and manage. The big question was how to address this.

The Government has now promised to introduce the 'multiple default consolidator model', which will allow a handful of authorised defined contribution schemes to receive these pots. There are a number of different methods, around how this might work in practice, and we'll understand more in due course.

'Pot for life' or the 'lifetime provider model' – This extension of the policy objective will genuinely represent a huge shake up of the pensions system if it comes to fruition. The jury is still out on this right now as there are some fundamental design questions to be addressed but, in principle, it would mean individuals choosing, or being assigned by default, a pension pot they then retain for the rest of their working life.

Unlike the 'pot follows member' proposal, where the pension pot transfers to the employee's new pension provider, employers would no longer be determining the pension fund for their staff – rather it will be the employee's responsibility. This system has worked well in Australia with advocates pointing to greater interaction between savers and their pension. However, there will be practical technological hurdles to overcome in creating the necessary infrastructure, as well as the ideological shift. A call for evidence on this has been launched.

Default "decumulation" – there will be an update on the proposal to force occupational defined contribution schemes to provide savers with a default pathway into retirement (the decumulation phase) similar to that offered while the member is actively saving (accumulation phase). This will require trustees of DC schemes to understand or determine what their typical members may like and then find a way to provide this in a quality and cost-effective way. The Pensions Regulator (TPR) has already announced its plans to issue guidance on this next year, which is now keenly awaited.

Value for Money – The Financial Conduct Authority (FCA) will consult, in the Spring, on a framework requiring schemes to compare themselves against other larger schemes. This is to ensure they provide good value for their members, with clear implications that this will push more arrangements towards consolidation. The Value for Money framework proposes to give regulators (FCA/TPR) the power to intervene and 'remove persistently poor performing schemes from the DC pensions market'.

There is also to be greater emphasis on 'value' (net outcomes) within these assessments rather than undue focus purely on the level of fees – effectively acknowledging that investment in aspects such as productive finance will come at a higher cost. The Pensions Regulator will need to provide more information on what will be required, but this could lead to a change of mindset when choosing providers and default investment strategies.

Master Trusts review – In an announcement that may put fear in anyone who worked on getting a Master Trust authorised in 2018, there will be a review of the market.

Defined Benefit (DB) schemes

A public consolidator coming soon? – Reducing the number of small schemes is also a hot topic for the DB landscape. The announcement that, despite protests from the insurance industry, a new public consolidator (run by the PPF) will be introduced by 2026 (political follow-through permitting, of course) appears set to disrupt the existing market. Currently the options are to secure benefits with an insurer or Clara (the only authorised commercial consolidator to date), or in the case where the employer is insolvent, to fall into the PPF.

What is being proposed is utilising the skill set of the PPF to create a separate solution that protects members and also allows smaller schemes, who are unattractive to the existing commercial providers, to consolidate. This will create a larger pool of investments to potentially then access productive finance opportunities. A consultation on the details is promised over the winter.

Surplus repayments to employers – The headline initial step is a reduction in the rate of tax a surplus payment would attract from 35% to 25%, effective from 6 April 2024. There will also be a review of the rules around payment of surpluses to employers.

Whether this could incentivise employers to keep a scheme running for longer and encourage trustees to invest in higher risk assets (productive finance again!) to increase their surplus is an open question. We do note however that concerns raised around protecting member security, which were not a key feature in the initial Mansion House consultation, are getting more recognition this time around.

Trustees

Trustee register - TPR will build a register of all trustees, with no distinction between professional/lay trustees. TPR's new General Code, once laid, will set accreditation for professional trustees as an expectation and there are moves for all professional trustees and all Chairs of Trustee Boards to be accredited. This could force TPR's hand in barring professional trustees that fail to gain accreditation and/or fall below TPR's required standard.

Trustee training - The register could also be used to track and monitor TKU (trustee knowledge and understanding) requirements and there is a suggestion that the Trustee Toolkit (which is due an update to pick up training on additional investment classes, minimum standards of ESG factors and climate risk) should be taken and passed on an annual basis.

Trustees in general are expected to have a better understanding of the full range of potential investment options, with a directive for those providing trustee training to cover alternative asset classes (yes, there it is again!).

In summary, we are told that the Department for Work and Pensions (DWP) "...must ensure that there is a mindset shift for trustees, advisers, and employers that achieving the best outcomes for pension savers should be at the forefront of their decision-making, including a holistic consideration of value."

Investment opportunities (in productive finance, of course)

Pension friendly infrastructure funds are to be set up to allow pension schemes to invest 'productively'. These are being kickstarted with £250m seed money from the Government. We shall be examining these funds closely to see if they offer attractive opportunities for (particular types of) schemes.

Salary sacrifice (NI changes)

The National Insurance rate cut is clearly the major announcement from a personal finance perspective. However, its rushed introduction (from 6 January 2024) is notable from the point of view of employers who use salary sacrifice arrangements as they will see the value of their saving reduced.

Broadstone comment

The short summary of the Autumn Statement shows that almost everything that was announced in the Mansion House speech is continuing in some form or another and for this the Government should be applauded. However, there is clearly a lot of detail still to be added to the bones of some of these ideas and how this evolves (and how much will survive) may well depend on the outcome of the next general election.

If Labour form the next government we anticipate a high proportion of these measures will continue in some way. Aspects such as dealing with small pots and decumulation solutions in the DC market will still need to be addressed, whilst elements such as improved trustee regulation and understanding are hard to argue against in principle. Ideas such as the public DB consolidator are probably on much shakier ground. In all cases though, it must be said that the priorities, timescales and the political focus on specific aspects may well shift, making it hard to plan with any certainty.

Overall, there is much to debate, and it would appear plenty of evolution of the pensions industry in the years ahead. It is hard from a practical perspective to fully buy in to this vision of everyone in the UK having a pension pot, just like they have a (main) bank account, and the industry being limited to hundreds rather than thousands of schemes. But it will be interesting to see how close we get, and how quickly some of these steps might be implemented to take us in this direction.

Some of the ideas give us cause for optimism, with more member connection with their pension and a greater focus on valued outcomes rather than fees. Others raise alarm bells, such as the potential for investment consultants to be directed as to the range of asset classes they should explore with trustees (pressure to include productive finance, regardless), and employers rushing to extract (potentially temporary) DB scheme surpluses. Ultimately though, at this stage, most just leave us with questions – how does pot for life work in practice? what would the PPF's public consolidator look like? how attractive an investment will these UK productive finance funds be?

Actions needed:

Many of these ideas may appear too far off to have immediate impacts but there are a few elements from the Autumn Statement meriting some short term, practical action:

- Administrators and Trustees will need to move quickly to implement the changes required to processes in relation to the abolition of the Lifetime Allowance. This is going to put significant pressure on your administrators, particularly when faced with member questions, as there are a number of technicalities still being addressed.

- Employers linked to a scheme in surplus that are hoping to get a refund should consider whether it is in their interest to hold off on that payment until after April 2024 when the tax rate will reduce significantly.
- Schemes interested in allocating funds to productive finance will want to ensure that they are keeping a close eye on developments and understand these new options. Timing of entry into these funds could potentially be significant, but understanding any restrictions and limitations will be crucial.

In terms of slightly longer-term plans, we will keep you informed regarding new (or follow up) consultations that are announced. Please speak to your Broadstone consultant if you have particular questions or views, in relation to:

- Upcoming updates to the Trustee Toolkit and whether your Trustee board should consider becoming accredited or otherwise improving their skills.
- Changes to the VFM framework that many sub £100m schemes are already looking at, which will be extended and made more complex. We will know more about this in the Spring.
- The proposals for a public consolidator for DB schemes that are unattractive to the commercial market.
- The development of a DC industry built around a ‘pot for life’.

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Find out more:

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