XPS DC

XPS
DC Briefing
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The future of DC: What is next and where are we heading?

In recent months we have seen the Government's response to several consultations, and the launch of several others. During July the Chancellor of the Exchequer delivered his Mansion House speech, setting out key aspects of the Government's future plans for pensions.

This briefing considers both the short-term and long-term consequences to defined contribution (DC) scheme members, sponsors, providers and trustees of these developments.

Key Insights

We are undoubtedly about to enter a period of change for DC pensions. Consolidation of DC schemes and providers has been happening for some time now, but, it is clear that the Government wants, and expects, this to accelerate over the next few years. Exactly where this takes us is still not totally clear. However, the following trends are already evident, and gathering pace:

- **single-employer occupational trusts** are consolidating at pace, and with the burden of governance to increase through a new Value for Money regime and other matters as noted in this briefing, we expect this to continue;
- the **master trust market** itself is consolidating, with several providers entering partnerships or being absorbed into others;
- **collective defined contribution (CDC) schemes** are gaining some momentum, and the wider use of these (e.g. as a provider of retirement income for the mass market) is being considered;
- **employers are reviewing remuneration strategies** due to cost of living pressures and the potential broadening of the automatic enrolment age and salary bands which will increase costs for many employers;
- many **defined benefit (DB) schemes** are either reaching the 'end-game' and buying out, or, have reached a point of surplus and considering how this could be utilised (perhaps to the benefit of people in DC schemes); and
- the Government continues to encourage pension schemes and trustees to invest in private market investments.

> The future is fewer, well-run DC arrangements. How we get from here, to there, is becoming a little clearer. Everyone involved in DC arrangements will see change, and soon. For some, this could be seismic, for others an evolution, but for all of us, the goal is the best retirement outcome possible for members, delivered in the best way for all stakeholders.
>
> **Christopher Barnes** – XPS DC Senior Consultant

What are the changes and their implications?

1. Value for Money (VFM): A consultation on metrics, standards, and disclosures

Summary of what this covers:

- Currently, DC occupational pension schemes must undertake a prescribed VFM assessment if their scheme has less than £100m in assets. For schemes of over £100m, the requirements differ. For personal pension and other arrangements, the assessment requirements differ again. All rather confusing, and not at all helpful for individuals, employers or anyone else trying to compare schemes and providers!
- New VFM assessment requirements would apply across most DC pension arrangements both pre- and post-retirement. It is to be phased in, and the timeline is yet to be confirmed. It is also planned to cover CDC arrangements eventually.
- Pension schemes and providers would be required to publish data including past investment returns, future expected returns, and administration performance each year.
- Each scheme would need to compare itself against other schemes and publish a report confirming how it has performed.
- The Government expects this to lead to consolidation across the market, into schemes which can leverage economies of scale.
- New powers are expected for The Pensions Regulator, to enforce consolidation and wind-up of schemes that are not offering good member value.

What you need to do and when:

- The most direct effect will be for occupational trust-based DC arrangements, whose trustees will need to comply and publish the necessary information.
- It is not clear when the requirements will be introduced, but it could be as early as 2024 or 2025.
- It is clear the new framework will require much more disclosure, and this will be a material level of work, to tight timescales (e.g. a significant amount of investment return data will need to be published online each year by each scheme, within very tight timescales).
- Do not wait until then. Trust-based schemes should be undertaking annual VFM assessments already, so we recommend this is used to consider whether you intend to run on your scheme for the long-term (which may require changes and improvements) or start the process of consolidation.
- We recommend that you start discussion with your investment adviser and administrator to start to understand how they would provide the necessary data.
- Consolidation of the DC market has already started. Providers are busy and so slots to move into master trusts are starting to be restricted, plus pricing is competitive at present as providers fight for market share.
- The timeline to select a provider, introduce a new scheme and wind up an old scheme is typically 9-12 months, so you need to start soon, should you want to be sure of beating the new regulations.

Ensuring members receive good value from a pension scheme is every trustee and sponsors duty. Proving value is going to become increasingly essential and challenging. Considering whether to meet this challenge, or to consolidate is something best done sooner, rather than later.

Sophia Singleton – Head of XPS DC

2. Helping savers understand their pension choices: supporting individuals at the point of access

Summary of what this covers:

- This is a consultation, that is focused on occupational DC trust schemes. This will place a duty on trustees to offer decumulation services which are suitable for their members and consistent with pension freedoms. This is important, as at present many schemes only provide a restricted range of retirement options.
- Trustees will not be required to use specific products or providers but will be encouraged to consider using a CDC arrangement.
- There could possibly be a set of minimum requirements too – this is tbc following further consultation.
- The consultation suggests that The Pensions Regulator may issue guidance on this ahead of the legal introduction, thereby encouraging trustees to introduce retirement services sooner than otherwise may be the case.

What you need to do and when:

- Again, timelines are not yet clear, but expect it to be sometime in 2025 or thereafter. However, a 'comply or explain' approach could be introduced earlier by The Pensions Regulator.
- This would need all trustees of occupational schemes to review, and likely design and implement, a broad (or broader) at-retirement offering to members.
- This is likely to include linkups with new providers (e.g. master trusts to provide drawdown), providers of at-retirement guidance services and a redesign of communication journeys.
- Again, this is something that may be a few years away in law, but, in anticipation trustees and sponsors should consider how their scheme currently delivers at-retirement support.

3. Ending the proliferation of deferred small pension pots

Summary of what this covers:

- This is a consultation, that proposes a 'multiple default consolidator framework'.
- For 'small pots' of £1,000 or less where there have been no contributions for 12 months, these would be consolidated into one of multiple consolidators. Each person would have a consolidator into which their pots would be placed, although they could opt-out, or choose their own should they wish. These consolidators are expected to be master trusts that have volunteered and been approved as a consolidation vehicle.

What you need to do and when:

- Implementation of this still appears several years off. However, trustees should have a clear view of their member profile, and be helping members consolidate (whether in the trustees scheme or elsewhere) by effective communication, guidance and transfer operations.

4. Extending opportunities for collective defined contribution pension schemes

Summary of what this covers:

- This is a consultation response that looks at how CDC can be introduced to permit access for a broader range of individuals and providers. Examples of this could be in retirement, where trustees may be encouraged to point members to a CDC scheme.
- The consultation also suggests that employers could make greater use of CDC in accumulation too.

What you need to do and when:

- Legislation has been promised for later this year to begin the implementation of the legal framework required. However, no providers have yet publicly confirmed their intentions in this space.
- For employers this may be an interesting alternative to DB or DC pension provision for pension accrual.
- Also, trustees of occupational schemes will need to be knowledgeable about CDC post retirement options should other areas of the Government's proposed retirement framework happen.

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

Summary of what this covers:

- This call for evidence has three main focuses, and appears to be seeking insight as to whether trustees have the skills to implement the Government's agenda of investing in private market investments and UK growth, amongst other things:
  - **Trustee skills and capability** – this considers whether trustees currently meet the knowledge and understanding requirements expected of them and whether more formal minimum requirements should be imposed, perhaps by way of an accreditation for some or all trustees;
  - **The role of advice** – focuses particularly on how the advice trustees receive impacts their decisions on whether to invest in private market/unlisted equities; and
  - **Barriers to trustee effectiveness** – considers whether there could be a 'risk averse culture' holding back investment in private markets/unlisted equities.

What you need to do and when:

- Trustees should assess their training needs and effectiveness, and ensure they are recording training undertaken.
- Trustees should undertake training to ensure they are conversant with illiquid investments and the Government's intentions.

6. Increased coverage for automatic enrolment

Summary of what this covers:

- A new law has been passed, to provide for two potential changes to the automatic enrolment provisions:
  - lowering the current age for auto-enrolment from 22 to 18;
  - removing the lower earnings limit (LEL) on contributions, so that people can start saving from the first pound of earnings, rather than contributions being based on a band of earnings above £6,240 as is currently the case.
- The Government is now intending to consult on the implementation of these changes, so timelines are yet to be confirmed.

What you need to do and when:

- We recommend that all employers and sponsors of DC schemes assess the financial impact on pension spend. This could prompt a wider review of a sponsors pensions offering, including what it provides and how. We note, that there are also many employers not leveraging the full saving that can be made from salary exchange – and recommend this is considered.

7. DC investment and illiquid assets

Summary of what this covers:

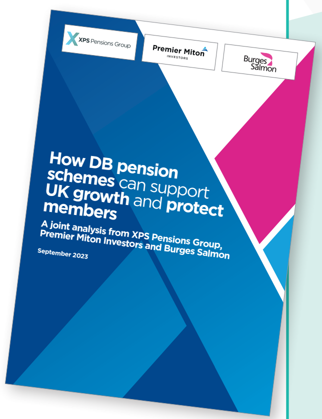
- In a drive to use more of the DC invested monies in private market investments, the Chancellor and the Lord Mayor have supported an agreement between nine of the UK's largest DC pension providers, committing them to the objective of allocating 5% of assets in their default funds to unlisted UK equities by 2030. These providers represent over £400 billion in assets and the majority of the UK's DC workplace pensions market.
- Unlisted equities can be classified under a broader set of investments known as illiquid assets, which have an appeal in a DC context by offering:
  - diversification from traditional equities;
  - potential to earn an 'illiquidity premium';
  - potential for inflation linkage; and
  - potential alignment with environmental, social and governance (ESG) policies.
- The Government believes that encouraging schemes to invest in a wider range of asset classes has the potential to deliver higher returns for savers as well as supporting the UK economy.

What you need to do and when:

- Investment in private markets and unlisted equities is now a 'live topic' and master trusts are already making changes to incorporate these (or have already done so). All trustees will be expected to have a good knowledge of these and consider how these could be incorporated into their strategies.
- To further encourage DC investments in illiquid assets, the Government has issued statutory guidance on the amendments to disclosure and reporting requirements for schemes.

Where?	What?	When?
Default SIP	Disclose and explain policies on illiquid investments.	First SIP review after 1 October 2023 and in any case by 1 October 2024.
Chair's Statement	Report (and publish) the amount of any performance-based fees which have been excluded from the charge cap.	First scheme year ending after 6 April 2023.
	Report on (and publish) underlying asset allocations of default arrangement(s).	First scheme year ending after 1 October 2023.
Value for Member assessment	Schemes with more than £100m assets must assess the value of any performance-based fees.	First scheme year ending after 6 April 2023.

DB surplus and potential DC opportunities



Recent events have seen many more DB arrangements find themselves in positions of surplus funding. This raises the unfamiliar question, of what to do with this? The answer will depend on several factors relevant to the scheme itself, but for some this could include using this surplus to fund or improve DC provision.

For example, Company A has a surplus in its pension scheme's DB section, but also has a DC section in the scheme. It therefore uses the surplus to fund or improve its DC section contributions.

Or, Company B is looking to buy out its DB pension scheme, but expects to have a surplus left over. It therefore sets up a DC section in the scheme and moves employees into this to utilise this surplus over several years.

XPS has set out several considerations in our report here

Key actions for trustees and employers

- **Consider the future of your current DC arrangements now** – tomorrow could be too late as you get swallowed up by new regulations, and a fast-moving provider market.
- **If you want to keep your current scheme, make sure its operating effectively,** and delivering member value. Otherwise if not, the decision could be taken out of your hands as the regulators tell you what to do!

  We also recommend you consider:
  - whether your at-retirement options are delivering to members;
  - whether you have the scale to participate in the expected introduction of ESG/climate change and private market investment and if so how you plan to do this;
  - if your framework for considering value for members is effective, and does it consider the full range of matters needed to deliver value to members? How do you expect to deliver the anticipated new VFM reporting requirements?
  - if your trustee board is effective? Could it be improved and be more representative of your members?
- **And if you run a DB scheme, has this got a surplus now, or do you expect it to have one in the future?** Are you in a position to make best use of this surplus? Could this involve using some of this to fund the current, or an improved DC pensions offering?
- **For sponsoring employers** – now could be the best time to review the benefit offering provided, with the potential for an increase in the automatic enrolment minimum requirements on the horizon. This could be offset by using salary exchange if you do not do so already.

About us

XPS Pensions Group is a leading independent pension consulting and administration business focused on UK pension schemes. XPS combines expertise, insight and technology to address the needs of over 1,500 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over one million members and provide advisory services to schemes and corporate sponsors in respect of schemes of all sizes, including 81 with assets over £1bn.

We also provide pension advisory and administration services to over 200 defined contribution schemes, with over one million members and combined assets in excess of £15bn.

If you'd like to find out more about the requirements for your DC scheme, please get in touch with Mark Searle or Christopher Barnes or speak to your usual XPS Pensions contact.

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