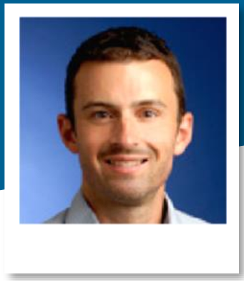
Regulatory Update



James Carter
Head of Pension Product and Policy

Back in July, the Department for Work and Pensions (DWP) published a package of policy proposals in conjunction with the Chancellor's Mansion House speech. That package included a response on managing **small pension pots,** evolution of the **value for money framework** and proposals for how trust-based schemes can support members to **transition into retirement**.

It is pleasing to see a more coherent and connected policymaking approach from DWP under the current Minister. Pensions policy is clearly being applied to support broader Government objectives, for example investment in domestic private markets. Whilst there is a political desire for impact, with a general election looming, the majority of these policies will take time to implement and take effect.

We participated in the **Small Pots** Industry Coordination Group and have consistently advocated for **a 'default consolidator' approach** rather than a 'pot follows member' solution, so I was pleased to see DWP pursue a version of that option.

I was also pleased to see a **small pot size of £1,000** proposed rather than any of the higher amounts under discussion.

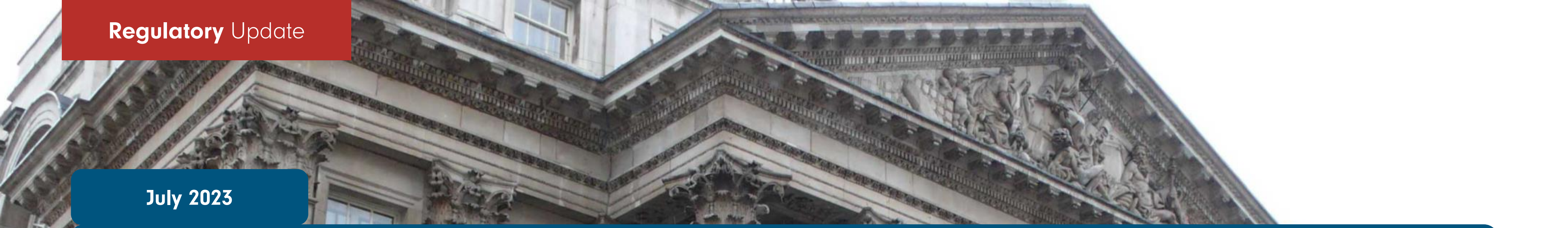
The immediate focus needs to be on consolidating genuinely small pots as we await the impact of pensions dashboards. More work needs to be done though to ensure the solution isn't over-complicated.

In September, the Automatic Enrolment (AE) extension Bill received royal assent which was a huge landmark for pensions. As a reminder, that Bill gives the Government the ability to **reduce the qualifying age** for automatic enrolment and **lower the starting level of earnings on which contributions are paid**. The Government has committed to consult quickly on regulations that will enact those changes and we expect that consultation to be published soon with perhaps a proposed implementation date of early 2025.

We remain close to the Pensions Dashboards Programme (PDP) as it continues its 'reset' which we understand is well progressed, but certainly not complete. The next critical milestone will be for DWP and the Financial Conduct Authority (FCA) to communicate the new data connection dates to pension schemes. With the guidance containing those dates still awaited, it starts to raise the question whether any schemes will connect in 2024. Political pressure may become a factor and whilst continued delay is a frustration to all, it remains imperative that the launch is well planned and controlled.

In this issue...

Watch James Carter talk through the key regulatory themes from Q3



July 2023

Mansion House Reforms

At the beginning of the quarter, the Chancellor, Jeremy Hunt, outlined his 'Mansion House Reforms', which, although not strictly in Q2, we included as 'breaking news' in our Q2 Regulatory Update. The following day, Pensions Minister, Laura Trott gave a supporting speech with a more specific pensions focus. Here the Minister noted key areas for improvement:

- AE savers pension adequacy is 'not where it should be'
- Returns on Defined Contribution (DC) pensions are not always high enough
- Significant difference between what people would have previously received under a Defined Benefits (DB) pension and what they can achieve with a DC pension
- Some people have too many pots which makes planning difficult

The Minister also outlined key reforms to help to achieve this, including, the Value for Money (VfM) framework, (which the DWP is developing with The Pensions Regulator (TPR) and the FCA), resolving the challenges of 'small pots', and introducing requirements for occupational schemes to offer decumulation options. The goal for these reforms is to achieve better outcomes for pension savers and for the system to deliver better, fairer, and more predictable pensions.

At the same time, the DWP released two consultations; Ending the proliferation of deferred small pots and Helping savers understand their pension choices, as well as the response to January's VfM consultation.

Mansion House Compact

Fidelity is highly supportive of emerging efforts to unlock so-called 'productive capital' from defined contribution schemes. For our defined contribution clients whose investment horizon is measured in decades not years, we believe there is strong alignment in objectives of private market investments and member objectives. We see an opportunity to deliver improved outcomes to investors, whether that be for return, income, sustainability or diversification purposes.

Whilst we welcome the City of London's focus on defined contribution default schemes capital to unlisted securities, we do not see there is value in signing the Compact at this point in time. We feel that the restriction to unlisted securities is still too narrow in scope, and scheme members would be better served through a more diverse productive asset mix, such as private credit, infrastructure, and real estate. We also feel that given the shift in stance away from 5% to "up to 5%" this became a commitment to thinking about investing in global unlisted equities, but with no requirement.

We will continue to work with our clients and industry stakeholders to deliver improved solutions and outcomes for scheme members.

July 2023

Ending the proliferation of deferred small pots

The small pots call for evidence earlier in the year focused on two possible solutions for solving the deferred small pots issue; 'default consolidator' and 'pot follows member'.

Default consolidator: Where eligible pots would transfer automatically to a ‘consolidator’, with the member being given the chance to opt out of the transfer if they wanted to remain with their current provider.

Pot follows member: Where, if a member changes jobs, their deferred pot would automatically move with them to their new employer’s scheme, if it meets the chosen eligibility criteria for automatic consolidation. ‘Pot follows member’ was previously proposed as a solution when Sir Steve Webb was Pensions Minister, the policy was then abandoned in favour of Pensions Dashboards which has yet to be implemented.

In its response to the call for evidence (CfE), the Government noted that there was no clear industry preference for either of these models. In this following consultation, the proposal is to progress with a ‘default consolidator’ model, but to allow multiple consolidators to operate.

Since the consultation was released and responses were submitted in September, it has become apparent that although industry are united in wanting to solve this problem, there is still little consensus on the best solution and a desire from some parts of the industry to revisit solutions that were not taken forward by the Government, including those who remain advocates for the 'pot follows member' idea. The Government also suggested that a 'simpler system' could be developed with a member being provided a 'pot for life'.

Our view...

We remain supportive of the ambition to address this issue and Fidelity have been deeply involved in considering possible solutions as we were members of the Small Pots Cross-Industry Co-ordination Group. We have consistently advocated for a ‘default consolidator’ approach, as we believe this is favourable to ‘pot follows member’. It is pleasing that the Government is progressing with the ‘default consolidator’ model, however, we would have preferred a single, Government appointed consolidator rather than multiple consolidators so that it was easier for members to understand and provides a simpler operational framework.

As part of our response to the consultation, we highlighted that the operational framework put forward by DWP is significantly more complex than it needs to be to resolve the problem of small pots, especially as the suggested approaches all rely on active engagement from members and a costly infrastructure to be in place. Instead, we put forward that it would be better to look to the success of AE which is based on member inertia and offer members the option to ‘opt out’ rather than ask them to opt in. Reversing this expectation and placing an undue administrative burden on members will not support the policy aim of reducing the number of deferred small pots or reducing costs for schemes and is more likely to increase costs.

A 'pot for life' model would radically change the UK pensions market and risk removing the benefits of workplace pensions and the regulatory and governance framework which protects members of workplace schemes. We are not convinced this would improve member outcomes, also because it would dis-intermediate employers from their role in supporting the financial wellness of employees through the workplace. It is important that the industry focuses on delivering pensions dashboards and that it is allowed to support consumers with multiple pots by providing them with a single, consolidated view of their pension wealth. We have to let existing policy take effect before considering any need for wider changes.

July 2023

Helping savers understand their pension choices

From February 2021, FCA regulated schemes have been required to offer 'Investment Pathways' to savers as they move into drawdown. However, no equivalent requirement has been placed on trustees to do the same for their members. The initiative by the FCA was introduced in response to 'pension freedom and choice' and is designed to ensure that anyone with a pension drawdown account has access to simple, good-value investments that broadly match their retirement income goals. Currently there are no equivalent requirements for members of trust-based pensions.

Last summer the DWP issued a CfE on 'helping savers understand their pension choices', seeking views on how options like investment pathways could be offered to members of trust-based schemes. DWP has published its response to the products and services element of this CfE and is now consulting on proposals to require trustees to offer in-scheme decumulation to their members and if they are unwilling or unable to do so, to partner with another provider who can. As the Pensions Minister also mentioned in her speech, the Government remains committed to Collective Defined Contribution (CDC) and wants schemes to consider how CDC could feature in their offering. However, it does not propose to mandate specific products being offered.

Our view...

We strongly support the policy ambition to help members better understand and engage with their options at retirement. We are also pleased that the Government is considering some level of alignment with the FCA rules. We were supportive of the intentions behind Investment Pathways and when we implemented this for our contract-based products, we extended this to members of the Fidelity Master Trust.

It is widely understood that since the introduction of AE consumers at retirement will have multiple pension pots. DWP research has shown, on average, an individual will work for eleven employers during their working life, which may result in as many pension pots. It is likely that these pots will be a mix of contract-based and trust-based schemes. As time goes on the number who will mainly rely on defined contribution pensions will increase. These members need the necessary tools to make informed choices holistically and access their savings flexibly in a manner which suits their needs.

The key consideration when making these changes should be delivering the best member outcomes and any framework and requirements should support trustees to achieve this.

The publications also mention the potential opportunities for members through the provision of CDC. In this consultation, DWP asks how it can stimulate a CDC market in decumulation, in our response we noted that the needs of savers must be prioritised first and foremost and this means that stimulating a CDC in decumulation market should not be a policy objective in itself.

It is important to note that at present, there are no commercial CDC schemes in operation and the regulations to allow multiple employers within a CDC scheme are expected to be consulted on 'this autumn'.

July 2023

Value for Money (VfM)

DWP published their response to the consultation released in January, which was developed with TPR and the FCA. They plan to keep the proposed framework broadly the same, with some notable exceptions, such as a simpler set of data requirements including a move from net to gross investment performance to reduce data complexity in the initial phases.

The initial focus will still be on workplace default schemes, bringing in other types of schemes in the future. It is also noted that the Chair's Statement may be phased out as the VfM framework becomes established and this framework will replace the 'Value for Members' framework which is in place for schemes with less than £100 million of assets.

In addition, regulators will be given the power to intervene and force schemes to wind up if they do not offer VfM. Contract based schemes will be given the power to move money without member consent and this will be progressed in conjunction with DWP's small pots work.

The framework will require primary legislation, so we await a Pensions Bill being announced in order to bring this forward.

July 2023

Draft Finance Bill published

Since the Chancellor announced the abolition of the Lifetime Allowance (LTA) in his Spring Budget, work has been ongoing by the Government to implement this. The published 'L-Day' legislation' gave some detail on how the regime and the legislation will need to be adjusted to allow for the changes, but exactly how this will work in practice is not yet clear. Especially for beneficiary drawdown pots which are currently paid tax free, as by removing the LTA, HMRC are now bringing these pots into scope for taxation.

Our view...

The removal of the LTA charge for this current tax year presented numerous challenges and certainly isn't simplifying pensions for anyone in the short term - and there is much work to be done to analyse and plan for the removal of the LTA from 6 April 2024. If HM Treasury progress with taxing beneficiary drawdown at the beneficiaries' highest marginal rate, consideration will need to be given to unintended consequences, as it creates an incentive to take the pension as cash, and is inherently unfair to beneficiaries who are higher rate tax payers and are inheriting pots from those who were basic rate tax payers.

We hope to quickly see a building of activity and momentum through the industry group working with HMRC to consider the issues. Moving from the current state of a zeroed LTA charge to the LTA's removal will hopefully relieve much complexity and burden from both pension scheme members and administrators.

September 2023

Bill to extend automatic enrolment receives Royal Assent

Earlier this year, Jonathan Gullis MP introduced a Private Member's Bill on AE reform, which has now received Royal Assent. The Act contains powers to make regulations that expand AE by:

- reducing the lower age limit from 22. The Government has announced it intends to reduce this to age 18; and
- reducing or removing the lower limit of qualifying earnings on which minimum contributions are calculated, from the current £6,240 per year. This means that pension contributions can be calculated on a larger portion of earnings.

The DWP will need draft regulations and to consult before the changes can be enacted. The Pensions Minister has previously expressed her support for these measures and suggested that the upcoming consultation may be published this autumn.

Our view...

Since the 2017 review the Government has reiterated its commitment to the recommended changes, but before this legislation, it had not set out a timetable to do so beyond an ambition of mid-2020s. Although this legislation does not directly make changes to the qualifying age or the earnings lower limit, it is an important step towards creating the power to make these amendments.

In addition to these changes, the Government has also identified the need to consider the rates of contributions required and how to improve pension participation for the self-employed. However, we are mindful that in the current cost-of-living crisis it is necessary to balance the need to increase pension contributions with employer and consumer affordability.

In other news...

Pensions Dashboards Programme 'reset' update, August 2023

We have reported previously on the PDP reset after its announcement in March 2023. We followed that last quarter with the Pensions Minister's subsequent statement announcing that staging deadlines will be put into guidance and only the 'single and final' Pensions Dashboards connections deadline of 31 October 2026 will be in legislation.

Since these announcements, the DWP have set the Pensions Dashboards (Amendment) Regulations 2023, which came into force on 9 August, to enact this change. Then, in line with these regulations, the FCA published corresponding amendments to their rules reflecting the new statutory connection deadline for firms they regulate.

Our view

We remain close to the policy surrounding PDP as it completes its 'reset' and are pleased that PDP have been conducting roundtables with senior industry stakeholders to seek views. We understand that the PDP reset is well progressed and are hopeful that they will soon be able to provide essential detail to schemes on the connection methodology and data requirements which are critical for the technology programme to continue.

The dates which will now be in guidance will be set by the DWP and FCA, however, there is not currently any clarity on when these dates will be provided.

HMRC publishes draft legislation and policy paper on pensions tax relief, July 2023

Alongside the Government's draft Finance Bill (2023/24), HMRC have published a policy paper on pensions tax relief. Pension contributions attract tax relief which can be applied through two types of arrangement, 'net pay' or 'relief at source' (RAS). Under net pay arrangements people contribute to their pension from their salary before tax is deducted. However, under RAS, they contribute to their pension after the deduction of tax and the basic rate of tax then needs to be reclaimed from HMRC.

At the Autumn Budget and Spending Review in 2021 the Government announced that it would digitise the RAS pension tax system and this legislation is a step towards that aim. It makes the necessary updates to support digitisation and will allow HMRC to provide the correct legislative framework for new RAS regulations that will be published for consultation in due course. It is intended that the new regulations will apply for contributions made after 6th April 2025.

TPR updates guidance to help defined contribution schemes comply with the new requirements on illiquid asset disclosures, August 2023

These updates reflect and support the Government's 'disclose and explain' policies on illiquid investments, which require most occupational DC schemes to 'disclose and explain' their illiquid investment policies and the percentage of assets in the default fund that are allocated to certain asset classes.

These requirements come into force for schemes' first Statement of Investment Principles and Chair's Statements after 1 October 2023. The guidance also reflects that since 6 April this year, regulations exempt certain performance-based fees from the charge cap. The change is intended to give schemes the option to incur 'well-designed' performance-based fees.

DWP publishes independent review of TPR, September 2023

The report found that 'TPR is overall well-run, has a strong relationship with the DWP, and is generally well-regarded by its main stakeholders.' It notes that 'TPR's main challenge is pursuing its digital agenda in a way that meets its strategic ambitions yet provides enduring value for money.'

The Lead Reviewer makes a total of 17 recommendations that are grouped under three themes: risk and growth, compliance and enforcement, and digital transformation and value for money. Although there is no explicit timeframe for the implementation of the recommendations, she believes that the majority could be put in place within the coming year. It is noted in the report that it was finalised before the Chancellor's Mansion House speech in July.

Important information