DC Governance Watch

PASA

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CONTENTS

Decumulation

This issue of DC Governance Watch focuses on:

- the July 2023 DWP Consultation 'helping savers understand their pension choices' and PASA's response
- trustees' current responsibilities and what they could be doing

Pension freedoms gave savers more flexibility in how they could use their pension savings, but there was uneasiness savers weren't sufficiently equipped to be able to make well informed decisions about their retirement options. New requirements to signpost the Pension Wise service from MoneyHelper were introduced alongside pension freedoms, but there were concerns about the effectiveness and take up rates of the initiative.

1. The Consultation & PASA's Response

The consultation proposed a new trustee duty to offer decumulation services "which are suitable for their members and consistent with pension freedoms." This service offering would need to meet the "generality" of savers within the scheme.

At decumulation members would have the option to either choose this 'default' service or access the products and services available under the pension freedoms. Trustees would either be required to offer these services in-house, or partner with another provider which could offer them. DWP is keen to ensure Collective Defined Contribution (CDC) arrangements are included within the types of products trustees consider offering/partnering to their scheme members at retirement.

PASA's response to the consultation noted the Government sees helping savers by adding options for them (including CDC). The majority of questions therefore seem to be focused on the products which could be offered to savers and not how to help them choose the right one for their circumstances.

More offerings invariably add complexity both operationally and confuses savers. This isn't to say CDC shouldn't be introduced as a decumulation option, but it should be understood 'helping' savers means more than offering just further options and flexibility.

The proposed changes should consider trustees' role in deciding on decumulation options, the market in developing those options and Government in enabling product development.

2. Trustee Responsibility

Trustees should determine the suite of products available to their scheme members. They're responsible for overseeing and administering their scheme in the best interests of their members using their existing knowledge of their scheme's demographics.

Trustees should assess the needs of their membership based on evidence and implement the best suited options. The factors to consider are relatively straightforward: age, wealth, pot size, engagement level, financial literacy, life expectancy of scheme members, employee base of scheme, age people take benefits etc. Trustees should report on the reasoning behind the options offered.

Schemes should offer a full range of options, or have good reasons for not doing so. As a minimum, schemes should have an arrangement in place to signpost to a suitable provider and they should undertake regular due diligence to ensure the selected provider remains a suitable vehicle for their scheme members.

A clear framework is required to provide both trustees and their members with reassurance and achieve consistent standards across the industry. To achieve this, the DWP could encourage trustees to provide certain services, but ultimately it should be up to trustees to decide what should be provided.

3. CDC Decumulation

When coupled with the other papers issued as part of the Mansion House proposals, particularly the Consultation: Extending opportunities for collective defined contribution pension schemes, it's clear government is interested in creating a market for savers to choose CDC at retirement options.

While this would be a positive step, it's trustees' responsibility to decide what to make available to their own members and the market who is best placed to provide and develop solutions.

4. Consider & meet the challenges

The biggest challenge when offering help to savers is the fine line to be considered between advice and guidance.

However trustees choose to approach the new duty, they (and their administrators) will be conscious to ensure any assistance given about retirement options doesn't constitute Regulated Advice.

Trustees will also need to ensure they don't breach the requirements in relation to financial promotions. This is likely to be a particular issue in the context of partnering arrangements which are implemented as part of complying with the new duty.

It would help trustees, administrators and schemes if any guidance in how to help savers confirms what would and wouldn't constitute Regulated Advice and make clear what trustees can communicate to their members about the new options.

5. Timing

Trustees and administrators should consider when to provide information and guidance to savers:

- in the lead up to taking their pension
- at the point when they want to access their savings
- after they have started to use their pension savings

6. Savers' Understanding

One tenth of the UK's workforce doesn't know if they'll be able to have a comfortable level of income in retirement

To be able to provide savers with the right guidance and help them understand what's the best retirement option for them, schemes should ask clear, concise questions to understand what they would like to receive at retirement. Questions such as 'do you want to do something else?' are too vague and unhelpful to provide suitable guidance. An individual could wonder what else there is and think they're missing out on a better offer, rendering their answers to any other question irrelevant.

As always, the use of plain English and the avoidance of industry jargon should be applied to help savers understand and be approachable.

7. Partnering/Partnerships

An option for trustees and schemes who don't want, or are unable to develop and provide products, is to partner with a third party to offer decumulation.

While some trustees have already done this, there are some who are nervous about partnering with other providers and appearing to endorse a particular provider. They're also concerned about breaching FCA regulatory requirements by breaching the financial promotion restriction (Section 21 Financial Services and Markets Act 2000) and the risk of undertaking Regulated Activities as an unauthorised person (in particular arranging transactions in investments and, potentially, providing regulated advice).

Certain aspects of the current guidance could make trustees particularly nervous about implementing partnering arrangements and it might be helpful to revisit these in the context of the new duty. For example, the joint FCA/TPR guide for employers and trustees on providing support with financial matters references several times trustees shouldn't steer their members towards a specific provider.

As mentioned in the consultation, single trust schemes are already using master trusts as an option for the provision of drawdown for savers, as both legally and practically it's difficult to offer this option via the existing construct. The principle of partnering arrangements seems most logical and clearly having the savers' interest forefront is the most important aspect.

A consideration when partnering would be what happens if/when a partnering arrangement breaks down. What impact does this have on the member and would there need to be remedial/recourse activity?

The consultation questioned whether all schemes be allowed to establish partnership arrangements or only schemes of a certain size. But, if only a certain size what should that be? Partnering arrangements should be open to all schemes and would certainly benefit the smaller ones, opening up greater choice and flexibility for savers.

The next obvious question to lead from this, is whether there is a role for a centralised scheme to deliver decumulation options, where trustees are unwilling or unable to offer these directly?

On the surface a centralised scheme delivering simplified offerings such as annuity, CDC and drawdown appears to be a good option for smaller schemes with limited resources. However, all trustees have a responsibility to be willing to offer the best retirement options for their membership and any not doing so should question whether they should be in the market at all. Another consideration would be whether having a centralised scheme offering drawdown would reduce competition in the market already looking to address this area which could lead to innovation and improved service.

8. Implementation & Legislation

The market is naturally developing flexible solutions revolving around partnership. However, it does require assistance with making partnerships easier for single trust schemes to enter.

The Government's response to the consultation promises to legislate "at the earliest opportunity" to implement the new duty. Whether the next government will have the same policy intention is an unknown so for now it's watch this space.

In November 2023, TPR confirmed it'll be engaging with the industry to produce interim decumulation guidance. DWP has stated the guidance will show how the objectives of its decumulation policies can be met without legislation and to encourage innovation.

The sooner government can share its thinking on timeline the better. In reality, it'll be driven by how this aspect of the Mansion House proposals is prioritised against other aspects of government policy. It'll be extremely challenging (and perhaps unrealistic) to meet all the Government's objects at once and in short order. It's worth noting CDC schemes are still in their infancy and not well established within the industry, and CDC decumulation options aren't yet available and hence it'd be difficult to consider a timeline for proposals involving CDC.

Master trusts may be a suitable candidate to deal with these new requirements first (as they have done with other aspects of policy such as TCFD disclosure requirements) due to their larger scale and existing support structures. If this approach was taken, it could lead to a risk of creating a two tier retirement sector, with those in a well-run master trust receiving better retirement support than those in other kinds of pension arrangements.

It will be interesting to see what emerges from the joint FCA Treasury Advice Guidance Boundary Review on advice and guidance issues. The FCA has recently consulted on a number of proposals in relation to the advice/guidance boundary. While the three main proposals are not directly relevant to trustees of occupational pension schemes, the FCA and Treasury have acknowledged trustees have raised the issue of the advice boundary as potentially constraining the support they can provide. This is relevant in the context of putting in place partnering arrangements as part of any new duty. The FCA and Treasury are keen to receive feedback on this in light of the DWP's own decumulation proposals and the specific considerations for trustees, including trustees of master trusts.

9. Conclusion

The benefits to introducing this proposal would be wide ranging. The proposed reforms focus on member outcomes by giving savers more support both in preparation for and at retirement.

'Freedom and choice' often come with complexity and so it's key for savers to have clear communications giving sufficient guidance on the options and products available to them. The benefits outweigh the costs, but care needs to be taken when implementing the proposal, and trustees remain best placed to decide which retirement options should be offered via the scheme.

CDC should be an option, but one of a range. Very soon we will have a General Election and possibly a change in Government - will it be all change again for pensions policy? Possibly not, while focus has been on Labour's stance regarding the Lifetime Allowance, there seems to be a consensus on CDC but it could delay any progress in this area plus many others. However, this doesn't mean we shouldn't continue looking at ways of helping members as they approach retirement.