Small schemes stand up to general levy hike

Niamh Smith explores why the leading proposal to change the general levy has sparked a backlash from small schemes, and what could be done to limit the negative impacts

Summary

- The DWP's favoured proposal is unlikely to increase the consolidation of smaller schemes and does not factor in schemes' governance levels.
- An additional premium of £10,000 for smaller schemes is likely to be passed on to members, which would make them disproportionately expensive.
- The industry has urged the DWP to use the levy only to fund regulation, not as a tool to promote the consolidation or standardisation of pension schemes.

The Department for Work and Pensions' (DWP) latest change to the ever-evolving pension regulation landscape is a proposal to restructure the general levy on occupational and personal schemes.

The general levy is collected to fund The Pensions Regulator (TPR) and The Pensions Ombudsman, as well as contribute to the Money and Pensions Service.

The DWP has presented three potential plans to address the accumulated deficit in levy funding, which was £80 million in 2021 and continues to grow. However, the proposals to increase the general levy have been met with a backlash.

Option one is to continue the current levy and structure, allowing the accumulated deficit to grow. Option two would maintain the current levy structure and increase rates by 6.5 per cent per year.

However, option three would increase rates by 4 per cent per year and entail an additional premium rate for schemes with up to 10,000 members from 2026. The government has stated this is its preferred plan – and this has sparked concerns across the industry and from small schemes in particular.

During a consultation that ended on 13 November 2023, many small schemes warned of the potential adverse impacts that the levy increase would have on their operations.

To consolidate or not to consolidate?

The DWP's plan to introduce a premium rate of £10,000 for schemes with under 10,000 members from April 2026 is

aligned with the government's efforts to encourage the consolidation of smaller schemes.

However, Society of Pension Professionals (SPP) Legislation Committee chair, Faye Jarvis, says the premium is unlikely to increase consolidation.

She says many small schemes are unable to consolidate, for various reasons, and therefore the premium would only serve as a punishment to schemes and their members instead of a tool to drive consolidation.

"For example, orphan schemes that no longer have a sponsor that can exercise the necessary powers to enable consolidation, or schemes that provide members with valuable guarantees that would be lost on consolidation," she says.

She adds the push to consolidate is particularly difficult for small DB schemes because many are seen as unattractive to commercial consolidators. This limits their options, which is an issue that the government noted in its options for defined benefit schemes call for evidence. The Association of Member-Directed Pension Schemes (AMPS) chair, Andrew Phipps, also believes that the DWP would not achieve the level of consolidation that it expects from option three. This is because many small self-administered schemes (SSAS) hold commercial property that is let to the sponsoring business, the principal employer of the scheme, to allow it to invest in illiquid assets.

"The prospect of incurring the costs to transfer a property to a larger scheme would be deeply unpalatable as they would exceed the additional, one-off levy being proposed," he says.

The DWP's drive to increase consolidation is rooted in the government's concerns that small schemes tend to have lower levels of governance, knowledge and compliance.

However, many in the industry have voiced frustration that the £10,000 premium unfairly assumes all small schemes are not well governed and does not account for individual scheme circumstances.

BESTrustees trustee executive, Bob Hymas, says a distinction must be made between small schemes that have big sponsors and those with smaller sponsors in potentially distressed situations.

"Those with the bigger sponsors are likely to be better governed and also have greater access to resources or funding to meet costs, so you can't just use this as the single measure," he says.

The DWP has also failed to consider the impact of a professional trustee on a scheme's governance level, adds Association of Professional Pension Trustees (APPT) member, Vassos Vassou.

He notes the regulator has said schemes with a professional trustee on their boards already achieve higher governance standards, so the push to consolidate and impose an additional premium seems unnecessary.

"Smaller schemes with a professional trustee are achieving the highest standards and are still being asked to pay. There's a sense of unfairness basing the premium on size – because we're small, we have to pay – rather than on not being well governed," he says.

"The levy needs to be proportionate to avoid unintended consequences for small schemes"

Impact on members

Since many small schemes are unable to consolidate into larger schemes, they will be forced to pay the additional cost of £10,000. This is likely to lead to a negative impact on member outcomes.

Firms that provide services to smaller schemes are concerned they will have no choice but to pass on the cost of the premium to the scheme itself, which will have to fund the costs directly from the scheme's assets, says Phipps.

"The outcome of this is that the £10,000 additional charge will be spread across just a handful of members in these schemes, which is both disproportionate and unfair," he adds.

Jarvis agrees there is a risk that members of the schemes impacted by the premium will be unfairly burdened with excessive charges.

"A premium of £10,000 could mean each member in a scheme with, say, a total of 50 members has a reduction to their pension savings of £200. That seems very unfair to those members," she says.

Dalriada Trustees managing director, Chris Roberts, adds the additional cost exacerbates the overall challenge that smaller schemes are becoming more expensive to run because of regulatory guidance.

Professional trustees are already

working to achieve appropriate governance with finite budgets, so the increased running costs could reduce the funds available to improve governance standards, he says.

"The concern we have is that increased levies are simply going to move available funds away from strategic advice, member benefits and/or governance-enhancing activities," he says.

Consultation response

A large number of firms and industry bodies have responded to the consultation on the potential plans, with many urging the DWP to reconsider its favoured proposal of option three.

The DWP has also been encouraged to engage with the industry to find a more appropriate solution to fund the general levy, with many organisations having put forward suggestions to limit the negative impact on small schemes and their members.

Vassou recommends the DWP should focus more on encouraging smaller schemes to improve their governance rather than penalise or force them to consolidate into a larger scheme.

"Why should you just give the money to the DWP when you could spend it on effectively raising your own scheme governance directly? And you would not need to spend quite that much either," he says. He adds that a scheme with a professional trustee on its board should not be charged the £10,000 additional fee because it is clear that its governance standards would already be higher.

This would also support TPR's and DWP's objective to enlist more professional trustees on scheme boards, he says.

Phipps agrees that schemes with professional trustees should be exempt from the premium rate.

"If there is concern about how SSASs are run, a reasonable response to this would be the return to requiring a mandatory professional trustee to be part of schemes that have between two and 11 members," he says.

He adds this is a realistic measure because the levy change is anticipated to come into effect in 2026; therefore, trustee boards have an achievable timeframe of 2.5 years to appoint a professional trustee.

Even if the DWP makes amendments to the premium, the industry has been clear in its view that the government should not use the levy as a mechanism to promote consolidation.

"Ultimately, the purpose of the levy is to fund regulation," Robert says, "The levy is not a tool to drive consolidation and it should be set at an appropriate level to achieve its primary function."

He notes the levy needs to be proportionate to avoid unintended consequences for small schemes and ensure it does not discriminate against schemes that provide valuable benefits to their members.

Jarvis adds the regulator should focus on enforcing compliance with existing regulation designed to drive consolidation, instead of using the levy for this purpose.

"There are already legislative measures in place to achieve this aim. For example, the value for money assessments that require DC schemes with less than £100 million in assets to assess whether they provide value to members and, if they don't, wind-up," she says.

The DWP is currently analysing industry feedback from the consultation and aims to provide a final outcome in the near future.

Written by Niamh Smith, a freelance journalist