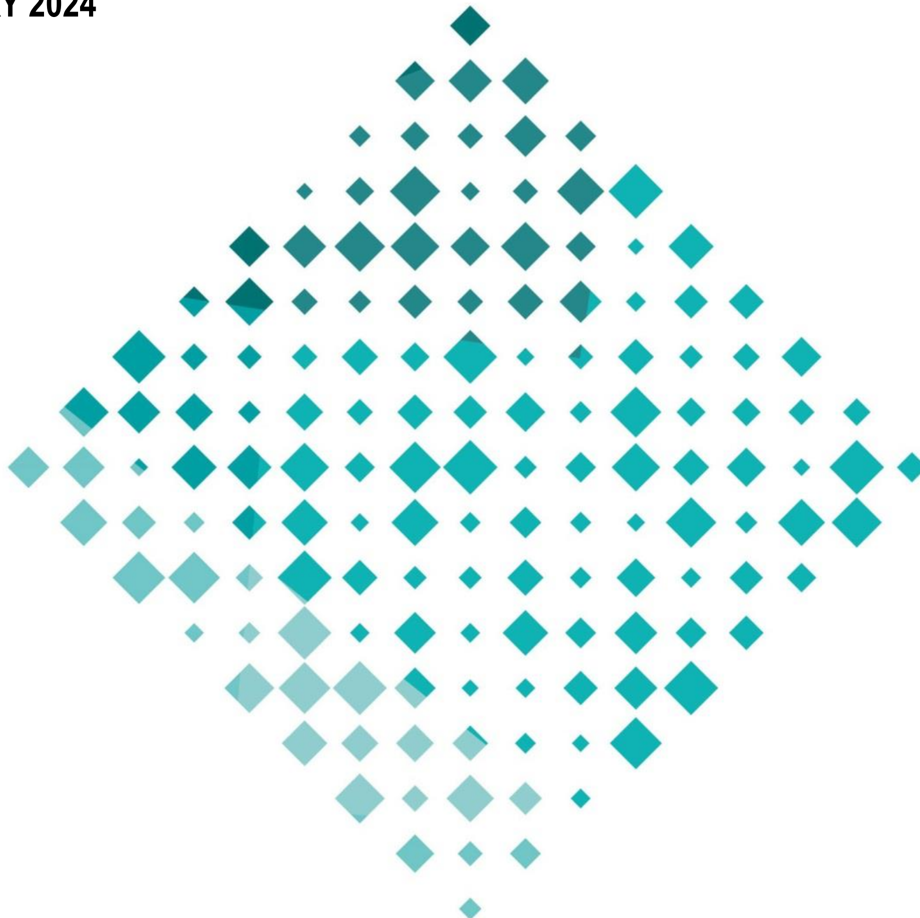
PENSIONS AND LIFETIME SAVINGS ASSOCIATION

LOOKING TO THE FUTURE: GREATER MEMBER SECURITY AND REBALANCING RISK

PLSA SUBMISSION

24 JANUARY 2024



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EXECUTIVE SUMMARY

- The PLSA welcomes the Government engagement with industry at this very early stage of evidence gathering to examine the viability of a Lifetime Provider model.
- The ideas included in this Call for Evidence are at a very conceptual stage, and the system wide outcomes that are intended by the implementation of the model are not always clear. We believe greater clarity is needed on the purpose of the reforms as well as a great deal more analysis and research to assess the likely impact. The model would be a radical change in the nature of Automatic Enrolment (AE), with the potential to significantly undermines its success.
- We are aware that some elements of a Lifetime Provider model may appear to be attractive to savers, especially given it seems to give them access to more choice and control. However, independent research finds that, when given the choice, more than two-thirds of employees want their employer to choose their workplace pension provider. Moreover, 55% of employed workplace pension savers expressed minimal confidence in making this choice, stating they would be either not at all or only slightly confident in selecting a pension provider[1].
- Most importantly, it is very unclear whether the model would actually result in any beneficial outcomes for savers. International evidence suggests that there would be very significant technological, operational and cost implications, all of which would ultimately be borne by members.
- International examples also suggests that – so far – there is quite limited switching amongst many savers, with switching mainly taking place among savers that are already well equipped to make the most of their pension and wider wealth. For example, in Australia the best estimates are that only between 2 and 10% of savers switch. This disinclination to change provider mirrors other interventions where attempts have been made to encourage switching, such as in current accounts and annuities. We would not expect to see superior results here given the complex nature of the comparison required.
- Financial literacy is low in the UK. It has been found that only 5% of British people have a high degree of financial literacy, with 73% falling below the financially literate benchmark[2]. We are concerned that this may lead to savers making poor choices, for example choosing a higher cost scheme, which result in harm to their long-term finances. Prior DWP analysis[3] has shown that an individual who saves for their entire working life could – everything else being equal – see a private pension income that is over £1,800 a year (25%) higher if they saved in a scheme with a 0.5% charge on funds under management compared to one with a 1.5% charge (retail fee) on funds under management.
- It is also possible that predatory marketing, encouraging switching to 'poor value' pensions, will prompt unwelcome consequences for pension saving, such as increasing opt outs and

[1] https://www.plsa.co.uk/Press-Centre/Press-Releases/Article/TWO-THIRDS-OF-EMPLOYEES-DO-NOT-WANT-TO-CHOOSE-THEIR-OWN-WORKPLACE-PENSION-PROVIDER

[2] https://www.wealthify.com/blog/what-is-the-uk-s-level-of-financial-knowledge

[3] https://assets.publishing.service.gov.uk/media/5a7e0b7ced915d74e33efb1c/pensions-act-ia-annex-g-charges-in-qualifying-pension-schemes.pdf

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cessations. It could also lead to an increase in scams occurring. The risks of fraud are likely very high where insufficient protection is provided to the saver to ensure they are choosing a safe scheme. Finally, costs of marketing would be expected to increase substantially.

- Notably, and in some very specific ways, the introduction of a Lifetime Provider model risks undermining the key successes of the UK's current regime, which are to harness the principle of inertia for savers while also maintaining the vital role of employers to negotiate on behalf of their employees, which itself supports continued innovation in the commercial AE market.
- Whilst we are not aware of any evidence that moving to a Lifetime Provider model would deliver better outcomes for members, it might undermine the essential link between employers and workplace pensions and is likely to introduce higher costs and worse outcomes for some savers. For example, employers we have spoken to say that the Lifetime Provider model may discourage employers from engaging fully with pension saving, and may disincentivise them from increasing contributions beyond the minimum AE contributions, thereby further compounding the risk of savers' future pensions' adequacy.
- Additionally, moving from a whole workplace approach to a more individualised system will disproportionately affect less wealthy and less informed savers that are currently benefiting from the bargaining power and good governance of their employer. A Lifetime Provider model is – for example - likely to disadvantage the low paid, who are disproportionately women, as compared with the current model of Automatic Enrolment. This effect could be exacerbated by the loss of the benefits of collectivisation and cross subsidy for small pots, and the comparative weighting of retail-like charging structures which currently tend to be more expensive, and notably even more so for smaller pots.
- Any intervention should not compromise the quality of workplace pension provision and should be designed to address the most critical problems given a cumulative impact assessment of all the other policies 'in flight'. There are many other policies in train, in particular Dashboards, Value for Money and Default Consolidators, which will help to support the outcomes that the Government notes as desirable on lost pots, consolidation and small pots. Beyond these policy building blocks, there are also infrastructure and technological elements that will need to be designed, implemented and then tested for efficacy. Distractions from these policy initiatives should be avoided. The necessity of the Lifetime Provider model can only be fully understood once these have been implemented.
- This may also run counter to or have unpredictable effects on other Government policy goals in respect of the productive finance and growth agenda, by diverting expenditure towards marketing, back towards competition on costs and away from the desired shift to greater risk bearing asset allocation.
- We do not have any CDC schemes up and running in the UK, and so it would be highly premature to make decisions of this nature until we have concrete evidence of improved outcomes. A lot more investigatory work, and time to observe the evolving market, is needed. Moreover, a system where choices were expected of consumers between CDC and other models, especially early in their careers, is likely to be risky for savers and undermine the feasibility of any CDC model.

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- Any variation of a Lifetime Provider model would likely place a very significant increased administration burden on employers and payroll as they would need to deal with paying contributions into multiple schemes. The payroll community feedback highlighted that this would need considerable new investment costs and a multi-year implementation. Any costs will be borne by members either directly or indirectly. There could also be issues for schemes in ensuring contributions are paid regularly, monitoring AE compliance and following up late payments, where they do not retain a strong link with the employer.
- Finally, the suggestion of a Lifetime Provider model, even over a very long-time horizon, risks acting as a distraction from bigger, evidenced issues with known solutions such as the inadequacy of pension saving, where the pension sector agrees contributions should increase to help everyone achieve a better income in retirement.

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<table>
<tr><th>Summary of likely benefits of the Lifetime Provider model</th><th>Summary of likely proven risks of the Lifetime Provider model</th></tr>
<tr><td>

Potential economies of scale (though the level of the value chain at which this is felt is unproven)
More agency and flexibility for engaged savers
Prevents future proliferation of small pots

</td><td>

Loss of employer link:

Potential loss of contributions above the AE minimum
Loss of provider support delivered through employers

Complex choices for savers, and increased need for support
Increased cost for savers:

marketing costs
loss of employer level bargaining power
loss of saver cross subsidy within schemes

Vast implementation costs
Risk of stapling to first pot, which may not be the best value
Added complexity of decision-making, were CDC added to the system

</td></tr>
<tr><th colspan="2">Summary of further evidence required</th></tr>
<tr><td colspan="2">

Market structure impact
Impact it might have on the level and engagement of savers, and the eventual magnitude of saver switching
Cumulative impact assessment of 'in flight' policy proposals
Interactions with productive finance agenda
Advice, support and information needs for savers to effectively compare value of different schemes
Assessment of a new regulatory and supervisory regime, the structure and burden of this (including on Government and Regulators) and whether it is proportionate to the likely impact
Evidence from employers on the impact of the proposals, included the expected impacts on savers

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INTRODUCTION

About the Pensions and Lifetime Savings Association

1. The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, FinTechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

Our use of terminology in this submission

2. It will be important to use consistent language in assessing and considering any future alternative visions for Automatic Enrolment. For this reason, in our response to the Call for Evidence we have used the following phrases and definitions to provide consistency and clarity:
   - Default (for example, investments) – By this we mean a 'true' default, whereby something (for example, selection of an investment solution, selection of a provider) will happen in all cases, including where savers do not take an active choice. A variety of mechanisms might be deployed to facilitate this (for example, new legislative requirements on schemes or employers, or a new carousel process introduced).
   - Automated (for example, process, transfer or nominated provider) – We use this word to mean without a manual or human selection process, and is assumed to be digital or electronic.
   - Chosen provider – A provider that has been selected by a saver through an active choice. This is distinct from providers that might have been selected from other means (for example, 'employer chooses' or 'carousel' selection).
   - Default consolidators – The proposed small pots solution which will address a large proportion of 'stock' pots and, over time, many 'flow' pots by automatically consolidating small pots meeting certain criteria on behalf of savers.
   - Lifetime Provider(s) – Assumed to be a new category of provider that are able to participate fully in the new model. In most uses of this term throughout our document we assume that this is also a new authorisation category, with associated regulatory requirements, supervision and other restrictions; not any and all providers could become 'approved' Lifetime Providers, though existing providers may choose to apply to be authorised as such (for example an authorised Master Trust may wish to also become a Lifetime Provider in the future).
   - Single pot for life – Savers select a single provider, and remain with that same provider throughout their working life. Employers are required to send pension contributions to each of their employees' chosen pension schemes, potentially using what was referred to at the time as a 'third party bureau' to do this. Variations on this model were required where savers did not take an active choice (for example, 'employer chooses' or 'carousel' versions). In the Call for Evidence we believe the model in question is sometimes referred to as a

'single lifetime provider', and so we have chosen instead to use this new term to retain the distinction between other, previously considered and discounted 'single pot for life' models, despite there being many similarities between them.

- Member-led or 'stage one' model – A variation of the model whereby only savers that choose to continue to contribute to a previous or chosen Lifetime Provider will do so, and otherwise all other elements of Automatic Enrolment for 'non-volunteers' will remain unchanged.
- Automatic, default or 'stage two' model – A non-voluntary variation of the model (for example, a Lifetime Provider model outside of a voluntary, 'Stage 1' version), requiring primary legislation to radically change Automatic Enrolment to disassociate savers from their employers when it comes to their pension provision.

3. If you have any questions on our use of terminology throughout this submission, please do not hesitate to contact us.

Our proprietary evidence

4. The primary sources of evidence for our submission are provided by our members. We would therefore encourage the Department to consider their individual submissions alongside ours.
5. We have also discussed the proposals with other industry representatives and participants wider than our members, where this has been informative for our submission.
6. As part of our preparation to respond to this Call for Evidence we undertook research to gain the views of employees actively saving for a DC workplace pension on the choice of workplace pension provider. The independent research was carried out online by Yonder consulting with a nationally representative sample of 581 employees actively saving for a DC workplace pension. The research was carried out on the 13th and 14th December 2023. Please refer to our press release for further information[4].
7. During this period we have also participated in a consortium of sponsors for a piece of work ongoing undertaken by the Pensions Policy Institute which will culminate in the publication of a report titled *'How could a Lifetime Provider Model impact members, employers and industry?'*. This will report in due course, and we would encourage the Department to consider its findings alongside this and other submissions.
8. All publicly available information is referenced throughout the submission.

[4] https://www.plsa.co.uk/Press-Centre/Press-Releases/Article/TWO-THIRDS-OF-EMPLOYEES-DO-NOT-WANT-TO-CHOOSE-THEIR-OWN-WORKPLACE-PENSION-PROVIDER

ALTERNATIVE VISIONS FOR THE FUTURE OF AUTOMATIC ENROLMENT

9. Our priorities for the future of AE are that we achieve a framework that is good for savers, operationally workable and that does not undermine workplace pensions.
10. This Call for Evidence seeks to set out a vision for the future of AE, and in doing so raises a number of significant strategic questions which remain unanswered by Government, including:
    - The preferred future structure of all money purchase and workplace pension saving in the UK. The document implies that the current, highly successful, AE system could be radically altered, and that other options might be considered as the new default solution.
    - The expectation on savers regarding engagement, and the degree to which a choice or inertia-based model is understood to provide the best outcomes for savers.
    - Whether solving the pensions inadequacy problem can depend on delivering better efficiency for savers rather than increasing contributions.
    - The degree to which risk should be pooled across and between individual savers and shared between employers and employees.
    - The wider approach to pensions policy, particularly with a focus on the future of AE, and whether all of the interventions in train and planned interventions work together as a cohesive strategy.
11. It will be necessary for DWP to do more to define its 'long-term vision' before considering whether alternative policy solutions might be beneficial to meet the aims of Government.
12. Defined narrowly, the proposals seek to explore the following:
    - Explore whether a Lifetime Provider model would improve outcomes for savers,
    - How the CDC market could be fostered, and;
    - Whether there are synergies between Lifetime Provider and CDC.
13. Elsewhere in the package of documents DWP make clear they wish to support:
    - The consolidation of Master Trusts,
    - The growth of CDC,
    - Improved decision making at decumulation, and;
    - Increasing allocations to illiquids in mass market AE investment solutions.
14. Additionally, DWP makes it clear that any Lifetime Provider model would need to be designed to avoid negatively impacting the wider market.
15. If correctly implemented the Small Pots Default Consolidators solution should address a large proportion of the 'stock' of deferred small pots, supporting the Government's wider consolidation agenda. We agree that this approach to address the small pots problem is preferential to others, at least in part because it better accords with the Government's illiquids agenda than alternatives. PLSA members have been positive about the direction of travel to address the small pots problem and will be supporting all the next steps on this work as is appropriate. This solution should also dramatically reduce the total number of non-consolidated small pots in any given period.
16. The Lifetime Provider model is noted as having 'significant attractions' and 'some challenges'. This position understates the significant challenges we foresee with the Lifetime Provider

model and overstates the potential attractions, which could be achieved through other mechanisms. It will be worth DWP considering what intent they have more generally to support more meaningful and detailed engagement with the ideas and proposals in this Call for Evidence. Historic reforms include:

- The introduction of Automatic Enrolment itself.
- Charge capping default arrangements of qualifying DC workplace pension schemes to 0.75%.
- Asset management market study remedies – costs and charges disclosure and assessments of value introduction.
- Value for members assessments for schemes under £100m – All pension schemes regardless of size and structure should provide savers with good value, and though completely consistent comparison between schemes is difficult, we have supported the intent to build a framework through which schemes can demonstrate their value to members. We have previously expressed disappointment that there has been a lack of engagement with these assessments, particularly among micro and very small schemes with less than 100 members.
- Wider value for money and Governance reforms, including for FCA regulated firms, including but not limited to the introduction of Independent Governance Committees, benchmarking and reporting/transparency requirements.

17. The net effect so far of these reforms have led to an evolution of the DC (and particularly AE) market, including trends towards greater and more widely distributed money purchase pension saving across the population, fewer schemes that are growing in average size, increasing Governance standards, decreasing costs and increasing net returns. We would argue that many of these proposals are therefore beginning to work as intended. Wider reforms – all of which are, to some extent, still being implemented or are forthcoming – are intended to address areas of refinement, or specific concerns that have emerged during this period of rapid evolution. These include, but are by no means limited to:
    - Launch of CDC – pooling of mortality and investment has the potential to boost retirement incomes, so for this reason we are supportive of further exploration of how the challenges and risks of this model might be overcome and mitigated for the benefit of savers.
    - Dashboards – which will reduce the likelihood that pension savers lose their pots and helps encourage engagement with pension saving. Their introduction will also introduce data standardisation, which could increase the efficiency of some administrative activities in pensions more generally.
    - Commitment to the AE 2017 Review (forthcoming) – the Jonathan Gullis Private Members enabling legislation passed in 2023 has given Ministers the power to expand Automatic Enrolment coverage. This was a strong demonstration that the Government remain committed to implementing the recommendations made in the AE 2017 review.
    - Multiple Default Consolidators (forthcoming) – the PLSA is supportive of the decision of DWP to select a multiple Default Consolidators model, enabled by a 'Clearing House'.

Some of the real policy challenges relating to this model will need to be worked through. If this occurs, then the proposal has the potential to address the stock of small pots.

- Value for money assessment (forthcoming) – the introduction of the new pensions value for money framework.
- New decumulation requirements (forthcoming) – we are highly supportive of DWP's planned reforms requiring schemes to support their savers through retirement with suitable income options.

18. These interventions are designed to support engagement and choice in accumulation and decumulation, reduce the number of lost and small pots, increase pension saving further for those currently excluded, improve value for money, support allocations to illiquids and other return seeking assets, and facilitate consolidation.
19. We believe that any further interventions to support an alternative vision for AE should be informed by the principles of success so far, and much of this success has been to:
    - harness and leverage the collective bargaining power of institutional investment,
    - strengthen the duties to act in the best interests of members, and
    - design inertia-based solutions to deliver the best outcomes, alongside options for choice where protections from poor outcomes are high.
20. For this reason, we have concerns regarding the Lifetime Provider model which – to be a success on a system-wide basis – would potentially undermine the institutional level bargaining power, require a high degree of engagement and risk the requirement for additional member protections. Any change to AE or alternatives considered should also be intended to improve adequacy in member outcomes or targeted to address specific issues of inadequacy. For example, DWP's own previous assessment of impacts of the Mansion House reforms found that the most valuable reform on median earners were those identified in the 2017 Review, adding more than £34,400 (female) to pension pots, as compared with only £700 after addressing the small pots problem (female) on average[5].

General comments on the Lifetime Provider model as envisaged by the Call for Evidence

21. Despite the broad and radical nature of the proposals included in this Call for Evidence there has been limited time to engage with the issues in the detailed and thorough way which we would have wished. We have also found that the purpose and outcomes for savers envisaged by introducing the proposed Lifetime Provider model is not fully clear in the Call for Evidence, and this makes it difficult to both address any theoretical detailed policy development questions, gather related evidence or suggest alternative solutions, as the Call for Evidence invites.
22. Notwithstanding these limitations, we have set out – based on our interpretation of the Government's proposals – how the introduction of a Lifetime Provider model may or may not tackle certain issues. We hope that this acts as a background to our specific responses to the

[5] https://assets.publishing.service.gov.uk/media/64abe19c404eac0013763bbf/analysing-the-impact-of-private-pension-measures-on-member-outcomes.pdf

questions posed, as well as inform any future evidence gathering work the Government chooses to pursue.

Problem statement

23. We observe that the problem statement does not include any aim to address the fundamental problem of projected pensions inadequacy. We would expect that this should be a high priority for any proposed pensions reform, especially for reforms focused on AE, where median earning savers’ largest pension assets – and therefore their likely pensions adequacy or inadequacy – will be determined. Risks to pensions adequacy come predominantly not from inefficiency in the market, or from inappropriate allocation to less risky assets, or from high costs, but from insufficient contributions, and this is not acknowledged at all in the context of this mooted Lifetime Provider model. Unduly emphasising these other elements to savers risks increasing saver complacency that they do not need consider contribution levels or saving more, which at current contribution levels should be their primary concern.
24. We have understood from the Call for Evidence that the Lifetime Provider model is predominantly intended to be an additional solution to the small pots problem, with some second order potential benefits alongside this. We’d note that given the Government has just committed to a small pots solution in the Default Consolidators model, it is unlikely that a true assessment of the need for an additional small pots solution could be made until that is functional and we have evidence of the impact on the overall quantity of small pots, and the true number of savers with multiple deferred small pots over time. The Government has separately assessed the efficacy of the Default Consolidator solution and found that there are sufficient grounds to find this a viable and helpful solution; Government did not suggest that both framework changes were required to achieve an impact.
25. We would also expect to see further consolidation in the market during the period of establishing and operating Default Consolidators. This should further improve the efficiency of small pot consolidation and aggregation naturally as and when people switch jobs but not schemes as much.
26. Notwithstanding this, we do understand that there may be a wider desire to increase engagement in pensions and increase individuals’ agency with one of their largest assets. Many of those that already engage with their pension saving – and therefore are likely to be interested in this policy – are likely to already make choices with their assets, take advice, save alongside any Automatic Enrolment saving (for example, in a personal pension) and have access to other assets. This means that many of these people will have already consolidated deferred pots and will continue to do so without further intervention needed. This is why the PLSA and the Association of British Insurers (ABI) established the Pay Your Pension Some Attention (PYPSA) campaign. Now in its third year with an aim to make pensions a talking point and encourage people to understand and appreciate the value of their pension saving.
27. Finally, assumptions appear to have been made about the Lifetime Provider model meeting some of the objectives that are set on the basis that increasing retail competition in the workplace pensions market would lead to cost reduction, quality improvements or increased utility for individuals as they consider choice to be very valuable in and of itself, or some

combination of these. At least one of these must be found to be true for Lifetime Provider to be a suitable solution to the problems as set out, especially once forthcoming 'in flight' policy initiatives are taken into account. Generally, we have not identified a great deal of confidence that these assumptions would hold true in reality in the pensions market as it currently stands, and would likely require other interventions ahead of Lifetime Provider (including, but not limited to, supporting consolidation, very much greater average financial literacy and pensions engagement, and less 'total wealth' based charging structures in the retail market) before this would be the case.

Timing, dependencies and sequencing

28. We expect that you will receive many submissions that refer to the timing, dependency and sequencing of the different policy solutions already in train to address some or all of the issues that this Call for Evidence refers to alongside the potential for a Lifetime Provider model. At a minimum, we expect that following a timeline of dependent proposals is a reasonable starting point to implement ahead of any Lifetime Provider or other more radical changes to AE; any alternative visions for Automatic Enrolment should be sequenced in the context of existing reforms in train.
29. The proposed small pots solution – the Default Consolidators model – should be implemented in full and assessed for success before any additional solution is implemented for the 'flow' of small pots. Given the proposed Default Consolidators model that is currently proposed any new 'flow' of pots would only be deferred for 12 months before they would be swept up into a consolidated pot; this means that though the 'flow' problem may exist it is as yet unclear how much of an issue this would continue to be once the Default Consolidators were implemented.
30. Many appear to envisage that a great deal of natural market consolidation should happen before a Lifetime Provider model is introduced. This is in part because savers would need to be selecting from a smaller universe of options to make comparison reasonable, and because only good value Lifetime Provider schemes should be available to savers. It was also the case in Australia before this kind of policy was attempted there[6].

Evidence

31. Further evidence needs to be gathered to ensure that some of the assumptions made as a prerequisite to the success of the model are borne out in practice. These include:
    - Evidence that there will be a measurable (net return) cost benefit to savers. This will require demonstration that retail pricing is cheaper and more competitive than current workplace arrangements. This will be especially important to evidence for smaller pots, where retail pricing models often include flat fees or proportionately higher fees than for larger pots. It will not be sufficient to demonstrate that potentially higher returning assets could be held unless there was evidence that savers would independently allocate to these assets and that they would be sufficiently high returning and low charging to make a measurable difference

[6] It should also be noted that a proliferation of an alternative kind of pension pot has expanded alongside consolidation amongst Supers. Please refer to our answer to Question 3 for further information.

to outcomes without too much risk being placed on the individual. Similarly, under a Compulsory model, this would assume that whoever is designing the default on behalf of savers would do so with different guiding principles to that which influence how current defaults are designed so as to increase risk allocation.

- Evidence that savers will switch and/or combine pots in such a way, manner and volume as to merit the cost and impact of implementing such a wholesale change to the model for automatic enrolment. This would likely include an assessment of the second stage Value for Money framework (which is intended for a 'consumer' audience) and whether this could enable savers to make complex comparisons between schemes.
- Transfers could be sufficiently cheap and quick, whilst also remaining error free.
- The equalities assessment was found not to impact individuals sharing protected characteristics, especially given the observed differences in cohort behaviour in relation to pension saving, pension engagement, financial education, financial vulnerability and confidence in taking financial decisions.
- Cost of implementation, specifically for employers and schemes as if costs are borne by either of these it is likely the burden would be passed on to or at least shared with employees (e.g. through lower wages or reduced pension contributions) or savers (e.g. through less R&D spending and innovation).
- Measurement of the system benefits of employer paternalism and engagement. More generally we would also question the validity of the argument that competitive pressure exerted by individuals would somehow be stronger than the collective bargaining power of employers. We suspect that the contrary or the significantly stronger power of employer pressure could be proven to be the case. This is so even where only a relatively small proportion of the overall number of employers (albeit representing a relatively large proportion of overall UK employments) are highly active in pension negotiations with providers, who then do not differentiate between their offerings for other employers. In this way savers are likely to benefit significantly from the current market structure in a way that is likely measurable as compared with alternatives such as the Lifetime Provider.
- An assessment of the degree to which the loss of cross subsidy for smaller pots (in both lower comparative charges, but also access to good quality investment and support solutions) is justifiable given that those with smaller pots are likely to be disadvantaged in other ways (such as being lower earning, lower engagement levels, gender and having projected inadequacy of saving in retirement).
- Cost benefit analysis taking account of the vast potential costs for change and implementation required to deliver this solution.

32. Further work would need to be undertaken before assessing whether the additional intervention would even be required given the scale of the problem after other interventions, as noted above. For example, these may have impacted the scale of the multiple small pots problem (for example, as a result of the Default Consolidators, and if the decumulation policy can help people take better decisions at retirement), the amount of consolidation that has taken place by that time (for example, as a result of the VFM framework) and any other market

evolutions that are difficult to guess (for example, automation of administration or payroll as a result of digitisation and data standards).

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RESPONSES TO CALL FOR EVIDENCE QUESTIONS

1. What are the key considerations to take into account before deciding the process to implement a lifetime provider model and what elements would need to be in place?

33. The success of any Lifetime Provider model in the UK would be dependent on numerous other policy elements being fully implemented first. Most of these policy strands are still under consideration by Government, and at different stages of development; some of these include:

- Dashboards,
- The Small Pots Default Consolidators,
- Value for Money (VFM) framework, and;
- A default decumulation offering.

34. Before proceeding, it is necessary to highlight that DWP need to go further than they have done in paragraph 127 in the document in explaining their rationale behind suggesting a member-led Lifetime Provider considering it would require significant and unprecedented changes being made to Automatic Enrolment, employers and payroll. This is goes beyond being just a pension-only change. The ramifications will be felt by most private sector employers.
35. Any Lifetime Provider model would alter the role of employers in the process and remove a key demand side driver for better outcomes on behalf of employees. Given the enormity of this change, it is worrying to see a distinct lack of evidence testing whether there are issues with current Automatic Enrolment provision. In addition, it is important that DWP assess whether the Lifetime Provider model takes into account the needs of the modern workforce and whether disempowering employers to ‘do right by’ their employees is appropriate.

Evidence of harm in Automatic Enrolment

Small pots

36. Automatic enrolment has successfully enabled millions of workers to financially prepare for later life. However, frequent job changes and disengagement have led to the proliferation of small deferred pension pots. This growth presents significant challenges for savers and pension providers. It is predicted that in 2030, without action, the cost of this will reach over £300 million per year[7]. The Default Consolidators model, proposed alongside this Call for Evidence, is intended to resolve this issue.

[7] https://www.gov.uk/government/consultations/addressing-the-challenge-of-deferred-small-pots/addressing-the-challenge-of-deferred-small-pots-a-call-for-evidence

Access to choice in savings and investment

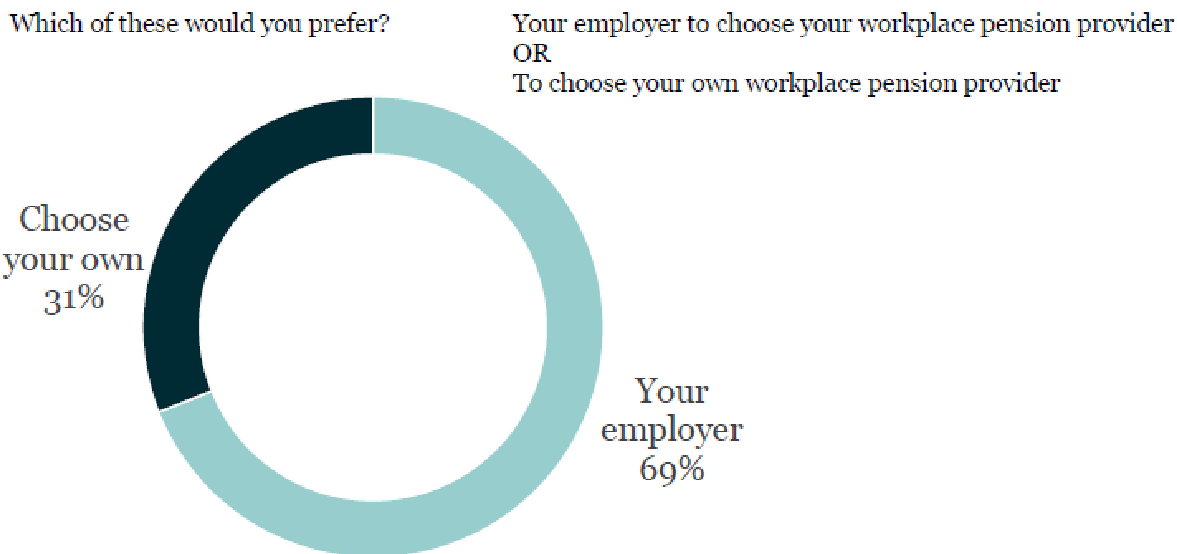
37. Savers are unlikely to suffer from a shortage of choice as there are at least ten different types of open tax-advantaged savings & investment wrappers available to the everyday person, including Self Invested Personal Pensions, Stocks & Shares ISAs, the Innovative Finance ISA, Help to Save, Premium Bonds all alongside their workplace pension.

Lack of evidence of positive impact for savers

38. Without evidence being provided by Government of the positive impact a Lifetime Provider model would have on savers, it is difficult for schemes to assess how such a model would work and how it would impact the members that save with them and their business.

Saver preferences on choosing their workplace pension

39. Over two thirds of a representative sample of the UK population said they would prefer their employer to choose their workplace pension provider, leaving under a third who said they would prefer to choose their own.



40. It is likely that this effect would reinforce existing differences in confidence between men and women, with women more likely than men to say they would prefer their employer to choose (75% of women, as compared with 63% of men).

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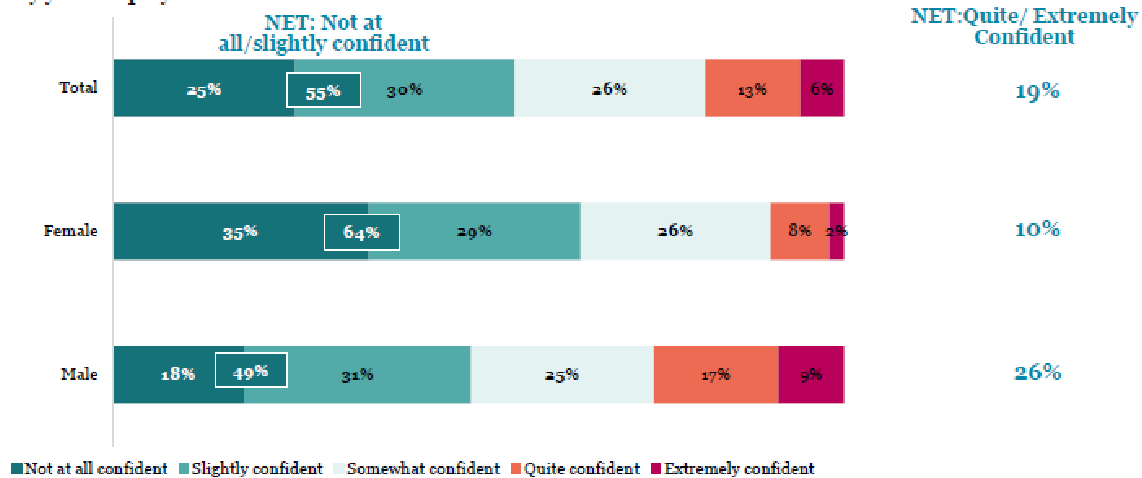
CONFIDENCE TO CHOOSE A PENSION PROVIDER

Currently employers are given the legal responsibility to choose or set up a workplace pension scheme to provide a pension for eligible employees. How confident would you be choosing a pension provider for yourself rather than going into the one chosen by your employer?



41. We also found that a lower proportion of younger savers aged 18-54 (though still a majority at 66) said they would prefer their employer to choose, compared to 84% of those aged 55 and over.
42. We did not explore other demographic factors, but we might expect any preferences to reflect wider differences in financial confidence, which disproportionately advantages the wealthy. It is likely to disadvantage financially vulnerable, ethnic minority women, though further evidence would need to be gathered given these effects are under researched and not well understood. This lack of financial confidence is shown by our research. More than two thirds (69 per cent) of savers would prefer their employer pick their workplace pension. This figure rises to 85 per cent amongst those aged over 55[8].
43. Disengagement with pensions is widely evidenced; even looking at just one study that was carried out on pension interactions following the 2015 Pensions Freedoms found that, despite government efforts to improve pension understanding, just 23% of people were even considering taking independent financial advice about their pensions[9]. This low figure was not because the majority of people feel so confident with their pension they do not believe they need to take advice, rather it exposes a systemic lack of confidence, awareness and understanding of pensions.

Precedent on switching behaviours

44. The degree to which precedents represent realistic comparisons and evidential cases for the likely increase in 'switching' behaviour amongst savers in the UK pensions market under new models is unclear. Potential examples include the bank account switching service, open market

[8] https://www.plsa.co.uk/Press-Centre/Press-Releases/Article/TWO-THIRDS-OF-EMPLOYEES-DO-NOT-WANT-TO-CHOOSE-THEIR-OWN-WORKPLACE-PENSION-PROVIDER

[9] For example, see the following.

annuities, the Stapling amongst Supers model in Australia, and existing pension consolidation data.

- *Cash savings as a potential precedent* – 75% of UK adults have their savings account with their main current account provider, and 33% of UK adults did not compare savings accounts from two or more different providers before opening their account (FCA, Financial Lives Survey, 2022). This suggests that, despite cash savings being a simpler and short-term product, only a minority of savers make a researched decision when choosing where to keep their money.
- *Bank account switching in the UK* – Research has shown that bank account switching is not a common phenomenon in the UK. According to HSBC data, over half of British people (54%) have had the same current account for over a decade, with more than 2 in 5 sticking with the same one for over 15 years (41%)[10] .
- *Investment fund switching in Australia as a potential precedent* – Estimates of annual fund switching vary between 2% and 10%. The vast majority of Australians also stick with their employer's chosen default fund[11].
- *Pension transfers* – FCA[12] found that rationale for DC pension consolidation was to 'have all my pension savings in one place' (72%) and 42% stating 'easier access'. Factors that are more likely to be correlated to potential better outcomes were less popular, such as a 'recommendation from a financial adviser' (12%) and 'being dissatisfied with costs/charges' (10%). Four times as many savers had moved to a non-workplace pension after seeing an advertisement about pension consolidation than to a workplace pension, and twice as many had moved to a non-workplace pension for a special offer than to a workplace pension.

Allocation to productive finance and illiquid assets

45. Government has been encouraging allocation to risk seeking illiquid assets in DC, which all things being equal is likely to result in higher investment fees, within the current charge cap legislation. This capacity is likely to be curtailed by the introducing a Lifetime Provider model, which is anticipated, based on the international evidence, to lead to a significant increase in marketing costs, due to competition pressure to secure savers. We anticipate that this will divert limited provider expenditure 'headroom' away from focusing on diversifying asset allocation towards productive finance, and instead on towards meeting these costs. Increased levels of switching may also require high levels of liquid assets within scheme investment strategies to meet demands from savers. It may also inhibit the intention to establish a smaller number of authorised Master Trusts managing substantial assets under management due to proliferation of providers some of whom will market to and 'cherry pick' commercial savers and attract them away from defaults.

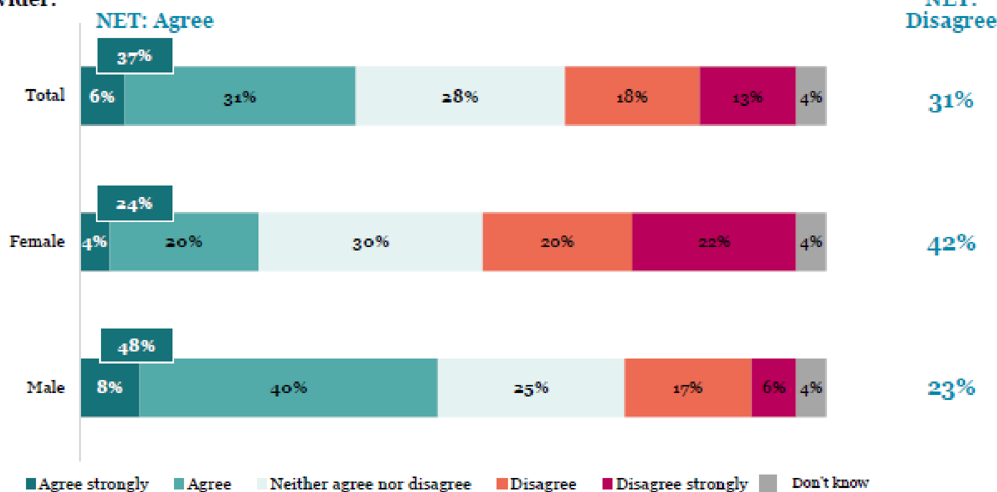
[10] https://www.hsbc.co.uk/current-accounts/benefits-of-switching-current-accounts/
[11] Draft report - Superannuation: Assessing Efficiency and Competition (pc.gov.au)
[12] https://www.fca.org.uk/publication/financial-lives/fls-2022-pensions.pdf

Forcing engagement with pensions

46. It is possible that the introduction of a Lifetime Provider could reduce people's willingness to pay into a pension if they suddenly understand that there are fees associated with their pensions, and do not fully comprehend the benefits achieved by saving. 56% of people are not aware that fees are charged on DC pensions (FCA, Financial Lives Survey, 2022) and 29% are not aware their DC pension is invested (FCA, Financial Lives Survey, 2022). Where marketing focuses on 'chasing value' or switching away from 'bad pensions' people may extrapolate or misunderstand what will benefit them over the long term.
47. Alternatively, being faced with even more choices, savers may be dissuaded from taking any decisions at all. For example, 23% of non-retired UK adults agreed with the statement 'I keep putting off retirement planning because I am afraid I will make the wrong decision'[13]. It has been found that only 5% of British people have a high degree of financial literacy, with 73% falling below the financially literate benchmark[14].

Overall cost/benefit analysis

48. It will be crucial to ascertain the relative cost/benefit for savers.
49. Currently just under a third (31%) said they would not have the requisite skills and knowledge to compare workplace pension schemes and choose the right provider.



50. Interestingly we have found that younger savers (18-24 year olds) are more likely to say they felt they had the skills than older respondents, though this in itself could suggest that people will need to better understand the factors to take into account before they could even make this assessment.

[13] FCA, Financial Lives Survey, 2022
[14] For example, https://www.wealthify.com/blog/what-is-the-uk-s-level-of-financial-knowledge

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Impact on the pensions system

51. It will also be critical to consider the viability of the providers, and the industry as a whole. Such radical changes to the AE model need to be considered in the round. They would impact the structural integrity of savings provision in the UK and could undermine a thriving sector that provides a much needed and successful support to much of the population. We are disappointed to note that some evidence of cost/benefit provided in the context of the previous small pots consultation may have been used in ways in which it was not intended and inferences made that it provides support for a wider idea which has some, but not all, of the same implications. For example, a Lifetime Provider model would, in effect, replace (and therefore place in run off) all workplace pension schemes used for AE, and this would not be the case in a Default Consolidators model.
52. It is worrying that DWP does not take into account that the Lifetime Provider model may call into question the economic viability of some providers. The business models of many providers are likely to be threatened by even small 'numbers' of switches if these switches represent a large proportion of total assets; given the likely demographic of switchers it is quite likely that they will represent larger pots, and therefore have a greater effect on the viability of some providers than the simple 'count' of members might suggest. There is also a worry that the Public Service Obligation, as it currently stands, could have a detrimental effect where the most commercial pots are attracted away from defaults. A similar requirement applying to all potential Lifetime Providers, such an obligation to accept saver pots even if they are uneconomic, could be considered in the case this model was introduced to minimise discriminatory behaviours negatively impacting the market.
53. This cost/benefit consideration from both the perspective of savers and providers will underline the importance of the very significant structural changes and regulatory regime changes to accommodate such a proposal without very large risks to the integrity and success of the existing UK pensions market.

Beginning the assessment of impact for savers

54. Examples of benefits that savers would definitely lose immediately in the case of the introduction of a Lifetime Provider would include:
    - Benefits attached to contributions made inside specifically designed schemes (such as linked memberships between final salary and money purchase schemes).
    - In many cases, increased and matching contributions beyond the AE minimum.
    - Wider financial benefits and support provided by employers. Good employers often offer packages such as a life assurance, as well as financial wellbeing tools. Were the relationship to become purely transactional the incentive to provide these will be reduced.
    - Benefits of the cross subsidy in a more 'retail' market. This should be assessed particularly for those savers that are going to be perceived as less commercially attractive, and for whom the most competitive pricing will not be available. A comparison should be made to their current projected outcomes, where they are benefitting from pricing being applied across

different employees after their employer has negotiated on their behalf, and where competitive pricings is for the benefit of the many not just the few.

- Reduction in demand side pressure from engaged employers, which also benefits wider members directly in some Master Trust schemes, and more broadly drives competition in the wider market.

<u>*Beginning the assessment of impact for the pensions system*</u>

55. Examples of further work required to assess the likely impact on the pensions system as a whole include, but are not limited to:
    - The mechanisms to minimise the negative impacts on employers, who might otherwise suffer significant increased administrative burdens, and costs, to implement such a model,
    - A structural review of Levies will be needed to establish a settled and long-term and transparent approach.
    - A detailed understanding of the role of Government or public bodies in providing 'Clearing House' services and the cost to taxpayers and industry of establishing and maintaining services.
    - Costs of implementation and the degree to which this could threaten the viability of some or all parts of the value chain.
    - The impact on Guidance and Support services, such as MaPS, as well as on Regulators and Government, of a new supervisory regime.

2. What are the alternative viable mass market vehicles, including CDC, that can provide security for members while spreading risk, and address the transition into a pension income?

56. There are a number of other theoretical pooling products which could achieve some of the same benefits as CDC. These include mortality pools for DC, which could operate as individual drawdown funds, but by pooling remaining assets after members pass away, regular incomes could be enhanced, or alternatively, incomes could be guaranteed for life for those members that outlive their pots. However, legislation is not currently designed for these products as they tend to fall between the definitions of money purchase and CDC, and for this reason providers will remain reluctant to invest too much in them until regulatory clarity is provided.
57. While we always remain supportive of new innovation which could improve member outcomes, we are very mindful of the need to avoid complexity. We currently have a system with both DB and DC, and where the complexity of accessing DC pots is likely to lead to bad outcomes without market intervention. Adding even more models to this system – and we include CDC in this – without a clear route to a 'norm' or 'default', risks further complicating the whole retirement system, which inevitably leads to increased cost for savers.
58. As covered in paragraphs a 151 and 152 in the document, there are a number of potential saver benefits to be derived from CDC, including pooling of investment and longevity risk, and negating the need for complex retirement decision-making – which so many are ill-equipped to

manage. The longer investment horizon and reduced need to de-risk assets also provides the opportunity to stay invested for longer in higher growth assets. We therefore welcome Government's steps thus far to extend the current single employer regime to multi-employer schemes, and this should lay the groundwork for more savers to access whole-life CDC schemes. We also welcome Government's efforts on decumulation products where innovation could mitigate the needs for de-risking.

59. It could be argued that those with most to gain from saving into – and eventually receiving an income from – a CDC scheme are the mass market non-advised workers, who would otherwise retire with modest DC savings and need to make complex decisions over how to make best use of them over the course of their retirement, without running out of money. While wealthier demographics are consistently more likely to access financial advice, and secure the most optimised and tax-efficient solutions, the majority of retirees with more modest DC pots cannot rely on a seamless transition into a suitable retirement product blend, and on this basis, we strongly support Government's plans to require trustees to provide default solutions to their members. This issue is particularly acute where saving is not sufficient to deliver adequate pots over time, which could disappoint savers.
60. CDC therefore has the most to offer to these members, in that the scheme automatically pays an income for life, with no engagement required from the member. However, in the wider context of auto-enrolment, with existing employer obligations, it is unclear how the model might be extended far enough that all workers have access to it. It is hard to predict how the market might react in different scenarios, but we assess certain different strategies below.

CDC access in the status quo

61. Were Government to continue with the DC regime as-is, while putting in place regulations for multi-employer CDC schemes, it is likely a small number more single-employer and/or sectoral schemes might emerge, and possibly some commercial CDC schemes. After the rollout of AE, and now that most employers are using a master trust to fulfil their AE obligations (DWP's own figures show they account for 90% of all DC memberships[15]). DWP's own research indicates that 77% of employers have not considered switching workplace provider, and that a large reason for this is that they see it as 'too difficult a process'[16]. It is hard to conclude that including CDC options within this mix would make the process any less complicated. Actively taking such action would require additional consultancy and advice, and it would take considerable time before employer awareness and understanding of CDC was such that it was adopted on a large scale.
62. Furthermore, we presume the VFM framework is intended to assist employers (as well as trustees and IGCs) with shopping around between pension schemes to ensure their provider is one of good value. This is a challenging initiative to get right – and we are working closely with Government and regulators on it – and that is just to put in place a framework to compare DC schemes. Extending this framework so that employers could then meaningfully compare the

[15] Evolving the regulatory approach to master trusts - GOV.UK (www.gov.uk)
[16] Evolving the regulatory approach to master trusts - GOV.UK (www.gov.uk)

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value of a DC with a CDC scheme would be an additional task and one that is likely to be highly challenging given the two models work in different ways and provide distinct benefits, which cannot be compared on a like-for-like basis.

63. Therefore, under the status quo, CDC is unlikely to be adopted on a sufficiently widespread basis that all savers have access to it in accumulation.

CDC based on a member-led Lifetime Provider

64. CDC is a model which works based on inertia – it removes decision-making and the need for engagement, and 'does it for you', much as is the case with a DB pension, so it would be an odd fit with a member-led model requiring engagement. We know how few savers engage with their pensions in accumulation, and asking savers to choose for themselves between a DC and a CDC scheme, would require a level of understanding even fewer possess. As a result, it is likely that only very few would actively opt for a CDC Lifetime Provider, reducing the ability of any scheme relying on this as a source of members to operate at effective scale. Meanwhile, we know more generally the potential for harm which exists for those making these types of decisions on a non-advised basis, so a high proportion may make decisions that would lead to sub-optimal outcomes, due to the complexity involved.

CDC based on a default Lifetime Provider

65. CDC is most consistent with a regime that fully exploits the basis of inertia, on which auto-enrolment has so far been so successful. Therefore, a scenario where savers were automatically stapled to one of a small number of large CDC schemes, which all – in relation to each other – offered good value, would appear most workable, as no complex decisions would be required from employers or individuals. In such a scenario, CDC would, however, presumably become the default regime, and this in itself raises some key challenges.
66. As above, avoiding a system *à deux vitesses* is necessary, however this would necessitate existing Master Trusts/Lifetime Providers/Default Consolidators to develop CDC structures to replace their current DC arrangements. This is clearly the most radical intervention, and presents many other risks and challenges far wider than the scope of this Call for Evidence.
67. As with elsewhere in the discussion on Lifetime Provider, the question of which schemes should be involved, arises here too. As per paragraph 165, there is a suggestion that Default Consolidators could be a stepping stone to CDC and Lifetime Provider. Given the scale required for CDC and the benefits of pooling to be effective, there can inevitably only ever be a small number of large schemes. Therefore, default consolidators/Lifetime Providers would necessarily have to be limited to a very select number of existing master trusts, authorised to undertake these new activities. This would also mean more people have fewer, larger pots.

Adequate contributions

68. A key benefit of a Lifetime Provider CDC model is that in the future, savers will not need to take any active choices with regard to either consolidating pots, or how to convert their pot to a

pension. However, in order to this to work without harm, and for people to retire with adequate income, enough money needs to be contributed in the first place, otherwise we risk people sleepwalking into inadequate retirement saving. Therefore, it is absolutely paramount that minimum contributions are increased to at least 12% before any such system is adopted.

69. We would point out, more generally, that none of the Government's proposed reforms, from CDC, to Default Consolidators, to illiquid investments, moves the needle on adequacy. When compared to increasing contributions, these changes have marginal impacts. Indeed, one of the main reasons DB pensions are seen as the gold standard, and that they are able to provide guaranteed incomes at reasonable levels is the amount of money contributed which equates to more than 20% employer contributions.

Legacy DC

70. Were Government to take the drastic step of requiring master trusts to transition to CDC, the question of how to handle existing, legacy DC pots arises. While it might be possible to calculate a buy-in price for these pots into a CDC, the legal ramifications of doing so automatically, i.e. changing the terms on which an individual has contributed over the course of their career, would require using legislation to overwrite people's existing legal rights require a significantly high bar of justification and appropriate impact assessment. It would be preferable to allow people to gradually run off legacy savings through existing DC decumulation products.

Other considerations

Compatibility with the freedoms

71. CDC schemes which provide an income for life are not inherently incompatible with flexible access to a pension, as long as members retain the right to transfer out before drawing an income. The same principle applies to DB schemes, in that people can transfer either partially or in full to secure a pot rather than an income. Similar options should be possible with CDC, with appropriate safeguards in place to avoid undesirable outcomes.

Existing product market

72. In the near and medium term, while legacy DC pots are run off, there would continue to be demand for existing retirement products. However, were CDC to become embedded as the norm for accumulation and decumulation, there would inevitably be a decline in demand, as more people draw an income through their scheme. Assuming people retain the right to transfer, there would continue to be a need for drawdown and UFPLS to enable flexible access.

Gilt market implications

73. The Call for Evidence raises the question of what the impact of a move to CDC would have on the gilt market. Our view is that there is unlikely to be a substantial impact compared with the

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status quo. As Nikhil Rathi told the Work & Pensions Select Committee in 2023, "90% of the index-linked sterling bonds are held by defined benefit" schemes[17], however, DWP's own data indicates that at present DB pensions are worth £1.7tn of assets, compared with £200bn in DC trust assets. Therefore, compared with DB, DC schemes hold a very small proportion of the overall gilt supply, and an even smaller proportion when you consider this initiative would primarily be focussed on accumulation – during which phase gilts only receive marginal allocations in DC schemes in any case, especially when higher proportions of younger members are considered. CDC schemes are theoretically able to take more risk with their asset allocations than DC, and the Royal Mail scheme will open with 75(equities):25(private markets), but this is not vastly different to a comparable DC master trust.

74. Therefore, the shift from DB to DC is likely to see a very gradual reduction in demand for gilts, and this trend would not be largely changed with the introduction of CDC.

3. What are the other considerations and building blocks that need to be in place before moving to a single lifetime provider, including any transitional arrangements?

75. Given the Government is only calling for evidence at this time only a small amount of detail is provided about how the Lifetime Provider model is envisaged to work in practice. Further information would be needed to assess the true requirements for industry, and to fully assess the merits and drawbacks of such models. We can, however, infer from the limited information provided that the following has already to some extent been considered:
    - Some models would require a automated decision making mechanism to select and allocate between different Lifetime Providers where savers have not made a choice themselves (even where they are given the opportunity to do so).
    - Any model requires a central architecture, and it is suggested that this be built on an as yet undesigned small pots 'Clearing House', which in turn is supposed to be informed by Dashboards implementation (which has yet to set out fully settled standards, and are not currently applicable to any alternative application such as this).
        - Furthermore, we have heard suggestions that the Dashboards data standards may also not be appropriate for this, and instead Pay As You Earn Real Time Information data might be more appropriate. It is therefore possible that neither data standard is appropriate, and a new data standard will need to be designed and built.
    - Any model would have defaults 'built into it' to 'continue to build on the power of inertia'. As no further detail is provided, we propose some considerations on potential options and building blocks on this further below.
    - Any model needs a new BACS-style solution to help payroll (and others) to implement the necessary changes. The potential costs of technological developments for payroll,

[17] https://committees.parliament.uk/publications/40563/documents/197799/default/

administrators and employers are noted, though they are likely to be significant and should feature as a key consideration in any future assessment of this model.

76. We would add the following elements that will need to be in place before moving to either a member-led or automatic default Lifetime Provider model.
    - Authorisation and supervisory regime would need to be in place for the new Lifetime Providers.
    - Decisions will need to be taken about transfers, as these will need to be as efficient as possible to enable any kind of model to be implemented and whether they will require disinvestment or *in specie* within any new process.
    - The role of the employer, including how and if their current AE compliance responsibilities would change.
    - Advice, guidance and support for savers across all spectrums of ability to pay for this. For example, the impact on the Money and Pensions Service could be significant in variations of the model that assume that everyone should be taking a choice.
    - Clarity about marketing, financial promotions, support and information provision that is permissible by different types of schemes. Currently these rules differ between the various regulatory regimes, and it is therefore possible that different providers would be limited from communicating with their own and future potential savers without changes to the FCA regulatory perimeter.

    We estimate that these elements alone could take several years to resolve and take significant Government and industry resources to do so.

Policy design considerations

77. Other considerations are noted elsewhere in our response, though we would also emphasise the following in the context of potential building blocks:
    - The number, scale and type of potential Lifetime Providers (and potentially of all other types of DC schemes) that are optimal to delivering a successful model,
    - The responsibilities of different parties and, particularly where these differ to current responsibilities (such as employer responsibilities under AE),
    - The degree to which data standards should be fully or partially harmonising,
    - Mechanisms to protect savers from scams,
    - Employer and employee rights to accessing default or chosen providers (for example, would some or all providers have to offer universal access), and providers' rights to 'reject' potential savers (for example, whether uncommercial pots could be turned away),
    - Liability for and compensation opportunities when things go wrong for savers in cases through from fraud to poorly performing or ill-suited investments,
    - Permissible forms of marketing and communications to savers by schemes and Government, to increase awareness and understanding of any choice model, and
    - Cross Governmental and Regulatory support given the likely overlap in responsibilities on some relevant elements (such as HMT, HMRC, FCA, TPR, ICO and so on).

Learning lessons from previous successes internationally

78. In the following section we provide highlights of international evidence which we suggest are informative of policy design considerations were a UK model reviewed in the future. In all areas the different socio-economic context in the UK should be considered before assuming that the following findings, or indeed other international evidence, could apply.
79. *Increased marketing costs:*
    - In Mexico, higher mobility between managers has resulted in an increase in advertising expenses, from a previous decreasing trend before the introduction of the new framework.
80. *Fee structures:*
    - In Chile, fee structures within a similar model include:
      - A fee for opening a new account,
      - A proportional fee on contributions,
      - A fee for managing programmed pension withdrawals,
      - A fee for managing voluntary contributions, and
      - A flat fee per period when contributions are made.

      It is currently prohibited to charge exit fees, which is purported to encourage competition.
    - In Mexico, fees have been capped. This is alongside wider reforms, including an increase employers' contributions to 15% of salary (from what was previously 6.5%) and an increased minimum sum workers are guaranteed to receive.
81. *Centralised database:*
    - In Mexico, a central national database for all information related to the pension fund system contains information on each individual and the fund manager they are affiliated with. The primary function of this database is the identification of accounts (unique IDs are Social Security Numbers), facilitation of transfers and distribution of money flow to each account. This separates the employer entirely from the choice of asset manager, and no intervention from the employer is required.
82. *Regulatory requirements for providers:*
    - In Chile, pension funds in a similar system are required to be a certain kind of company, and are subject to specific supervision. They have minimum capital requirements, which increases with the number of 'affiliates' (similar to members).
83. *Deregulation of the transfer process:*
    - In Mexico, deregulation was required to facilitate an unrestricted transfer and mobility framework as transfers had previously taken 13 months to complete. Deregulation of the switching process and changes on legal restrictions, including requirements and documentation production reduced[18].
84. *Switching behaviour:*

[18] Villaseñor-Zertuche, Jaime A.,October 1999, An Overview of the New Pension System in Mexico,
CONSAR Comisión Nacional del Sistema de Ahorro para el Retiro, Mexican Pension Fund Regulatory Agency

- In Chile, despite improvements from the auction mechanism, many people do not move to providers with lower charges and so administrative charges continue to be a concern[19].
- In Australia, estimates of annual switching rates range widely between 2 and 10 per cent, with up to a total of a third of members ever estimated to have switched.
- In Australia, males were slightly more likely to have switched funds than females.
- In Australia, the majority of fund switching is concentrated around age 30, then tails off before peaking again just prior to retirement age.

85. *Consumer understanding:*
    - In Australia, despite choosing their own Super, only 11% say they understand how their funds are invested very well and 7% know very well how fees and charges apply to their main fund.
    - In Mexico, new 'e-services' and comparative information by way of official indicators was required to avoid 'informational arbitrage' and facilitate comparison of fees and returns.
86. *Characteristics of switchers:*
    - In Australia, evidence suggests that the individuals that take the most active choices may in fact increase the disaggregation across the market where the model is not designed to protect against this risk. Self-Managed Super Funds represent about only one million individual accounts, and at times in have represented almost a fifth of the total AUM in the Australian pensions market despite representing less than 10% of the population of savers.
87. *Government involvement and state guarantees:*
    - In Chile, the Government plays a role in providing guarantees, which can be summarised as:
      - A guaranteed minimum pension for those that exhaust their accumulated funds,
      - A guaranteed minimum return where a provider underperforms that expected by the Supervisory body, after first exhausting the profits of the company, forcing insolvency and transferring the funds to other providers, and
      - Guaranteed pension payments of any insurance company that becomes bankrupt.
    - In Mexico, pension collection is undertaken through the same process that the Social Security Institute collects its contributions.

The need for defaults and associated regulation

88. In any potential model savers will need to achieve a good outcome even when they do not engage as is currently the case with Automatic Enrolment; the inertia principles that have made AE such a success should not be undermined. This means that decisions about what happens to those that *do not make* choices are as important as the decisions around those that *make* choices. Defaults are a powerful policy tool and for this reason they are especially important to test and assess for impact, and monitor the success of over time.

[19] *Reforming Pensions in Chile,* N Barr and Peter Diamond (2016)

89. Regulation and supervision of defaults needs to be sufficiently stringent to protect savers from bad outcomes including poorly designed products, misleading communications, risks of loss and compensation in the case of no-fault errors. We can conceive of Lifetime Provider models where new parties in the value chain are given roles and responsibilities they do not currently have and, for example, may therefore require new authorisation and supervision to undertake such activities. In our view this is not solely limited to the new Lifetime Providers and a new 'Clearing House', but includes others such as payroll and third-party administrators who, depending on the model, may be involved in the defaulting process sufficiently that they merit new regulatory responsibilities.

Technological, administrative and infrastructure building blocks

90. There is a logical implementation order, in line with previous comments, that would need to underpin any new model. These would include full implementation of the Pensions Dashboards and small pots Default Consolidators models first, as well as any 'BACS-for-pensions'.
91. We would also need clarity on peripheral rules and laws such as data protection. This may be complicated as some of these are built upon EU law. Considerations will need to be given to the Data Protection and Digital Information Bill, which is in the final stages of passing through Parliament. It appears that a reasonable expectation is that the process to resolve this could take several years.
92. Other questions remain about how a Lifetime Provider model would be possible, including:
    - Unique identifiers, or how such a model would be possible without a unique identifier (given other proxies require multiple matching criteria owing to the limitation of, for example, National Insurance numbers).
    - DC and CDC interactions.
    - Funding sourced for the building and maintenance of a 'Clearing House', and any other required central architecture.

Authorisation and supervision

93. While the member-led model appears to rely on the existing workplace pensions market as potential destination pots, it is very unclear whether the compulsory Lifetime Provider model assumes that there is a restriction to current workplace pensions within the intended scope. To maintain sufficiently high member protections some kind of restriction on eligibility to become a Lifetime Provider would be vital. The risk of poor value and bad outcomes for members is otherwise intolerably high, especially given the insufficient evidence that members would benefit from this proposal more than they risk losses.
94. This could be the case even where the restriction were to be the existing trust and retail regulated markets, where for a variety of reasons the structures, protections, prudential requirements, governance requirements, reporting requirements and so on vary between the two regimes. Given the information available about the intended activities of Lifetime Providers it would seem reasonable to expect that the kinds and combination of regulatory risks represented would differ from any that are faced by current pension schemes today, and therefore a new regulatory regime (including reporting and supervision) would likely need to be

designed. The risks of fraud and scams are likely very high where insufficient protection is provided to the saver to ensure they are choosing a safe scheme. There are several different ways in which this could be done, but the most consistent with the current pensions landscape would be to limit the number and quality of Lifetime Providers. This can be done through requiring them to be authorised as such, and then facilitating saver choice amongst these schemes alone. This would also enable employers, who would otherwise be burdened with significant scam and fraud due diligence checks, to be confident that their portion of the total contribution are not being directed to nefarious actors.

95. Changes would also need to be made to who and how contribution accuracy and efficiency is monitored and controlled, including new responsibilities for different parties and supervision of these parties.
96. Thought would also need to be given to rules around financial promotions and unsolicited marketing.

Governance

97. Breaking the employer link – by dislocating the decision about workplace pension contribution allocation from the employer and instead placing the responsibility for this choice on the saver – will irreparably threaten the value of the protections afforded to savers through the workplace pensions model. It would also threaten the 'on the ground' support that savers can receive through their employer.

Additional elements that could be considered ahead of proposing any form of Lifetime Provider model

98. Were this policy to be progressed it suggests that very radical changes to the pensions market would be pursuable under the current Government. If very large, ambitious changes are the intention of this Government, the workplace pensions industry might suggest others that could be considered as part of a more wholesale 'ground up' reform of a similar scale. These include, for example:
    - *Adequacy* -
        - Increasing contributions to more than 12%, with the balance paid for by employers. The net cost and administrative burden on employers may be lower than this proposal, the net benefit to savers is almost definitely greater and could be done without a significant infrastructure spend taking many years to deliver benefits.
        - Increasing contributions to 12%, with an equal share between employers and employees. This policy has a demonstrated positive impact on savers outcomes for median earners.
    - *Small pots* - A Government consolidation vehicle for small pots where no 'home' can be found for them through other more simple means, for example where savers have left the country or where data matching has not been possible. This could be through an HMRC-led solution, for example.
    - *Self-employed savers* - A Lifetime Provider-like mechanism for delivering better or AE-like outcomes for the self-employed, potentially by facilitating or mandating a similar model

designed for them to enable them to choose a previous provider and continue to contribute to them.

- *Value for money and consolidation* - TPR should re-double and prioritise their efforts and regulatory focus with the cohort of micro and very small schemes who have not engaged with the required assessments of Value for Money. Value for money assessments will aid supervision of small schemes and also provide the tools for schemes to help themselves improve governance and performance. All savers deserve to belong to a scheme that has high standards of governance. TPR's Regulatory Initiative on Compliance with the obligation to assess value for money may be informative in this.
- *Tax relief* – The Net Pay/RAS anomaly would be brought into sharp focus by the prospect of a Lifetime Provider. It would be inconceivable to consider how current administrative processes would be able to accommodate the simultaneous Net Pay and RAS approaches to tax relief.

4. What are the advantages and disadvantages of moving to a member-led lifetime provider model prior to considering introducing a default lifetime provider model?

99. Both the member-led Lifetime Provider regime and the default regime proposals represent substantial shifts to the way the current AE system operates, and so it is vital we do not lose sight of the key principles behind what has, to date, been a policy success. AE and workplace pensions in accumulation harness people's natural disengagement with pensions and work through inertia; altering this could pose very real risks to the fairness of the entire system.
100. Below we assess the advantages and disadvantages of beginning with a member-led model, and we base these on the assumption that default consolidators and Dashboards have both been implemented *before* a move to this regime, as this is our reading of Government's intentions. As such, we can make the assumption that we will already be dealing with a system with both fewer small pots and fewer lost pots.
101. In summary we believe that implementing a member-led option first would present considerable risks which outweigh any advantages it might offer.

Advantages of moving to a member-led Lifetime Provider model first

Evidence and testing of systems and processes

102. As the Call for Evidence notes, there are considerable technological innovations necessary to implement ***any*** Lifetime Provider model. These include the elements mentioned in paragraph 130 in the Call for Evidence, such as data standardisation and the building of a 'Clearing House' for Default Consolidators, but also may demand innovation within payroll providers to enable payment of contributions to multiple different schemes and providers.
103. Based on data in our response to Question 1, we can assume that only a minority of savers would make an active choice of a Lifetime Provider, so a member-led model would provide a smaller-scale testing ground for these systems. The volumes of transfers, transactions and data processing required for the default model would be enormous, so the opportunity to develop,

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improve and gather evidence on the effectiveness of these systems at a smaller scale would be beneficial.

104. This stage would similarly provide evidence of successes and failures ahead of the default stage on saver behaviour and reactions to their options. This could include evidence of misleading communications that prompt savers to do unhelpful things with their money.

105. Fundamentally, if the default Lifetime Provider was brought in directly, without the member-led model, we would be implementing a radical change to the structure of AE, breaking the crucial employer link, without any testing or evidence of the benefits of the model.

More time for parallel policy initiatives to be implemented

106. This is especially helpful where some are intended to address some of the same issues (e.g. Dashboards help with lost pots which would not be 'found' through a Lifetime Provider, default consolidators help with small pot consolidation, etc.) and so the case for implementing something like this – which would take years, money and resources – could be made in the 'net of change' context.

Disadvantages of moving to a member-led Lifetime Provider model first

Inequality and fairness risk

107. The member-led model relies heavily on member awareness and taking a choice, and as we know, those with the most are those most likely to take choices and engage, whilst among the large majority, financial literacy is very low, in both a self-reported and relative sense. The FCA's financial lives survey (2022) found that:
- 24% - equating to nearly 13 million people when extrapolated across the whole population - reported 'low confidence' in their ability to manage money. Moreover, nearly 35% - equating to more than 18 million people – had poor or low levels of numeracy involving financial concepts.
- OECD data finds that the UK is ranked 15th out of 29 in terms of adult financial literacy competencies, with the 'knowledge' scores particularly low in the UK as compared with peers such as France and New Zealand.

108. Therefore, a member-led model risks facilitating 'landgrabs' by the least likely to need to benefit (e.g. the financially educated, the rich, the professionally advised, etc.), and a very large financial literacy campaign would be required to assist everyone else.

109. A two-tiered system within workplace pensions, with 'haves' and 'have nots' in the advised/non advised market may inevitably also emerge. Much of the internet-based support for consideration of pension charges are currently marketing; they are either there to sell (usually higher cost) products or advice services to help with decision making. Advice is expensive, and will only be available to the most wealthy.
- The advice gap is worsening. In 2023, as compared to 2015 (The Lang Cat, 2023):
  - 19.1 million people, or an additional 9 million people, lacked awareness of the money advice that is on offer.
  - 6.5 million people, or an additional 1.1 million people, were willing to pay for advice but think it is too expensive.

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- 11% of GB adults have received paid for advice in the last two years, more than half of which were over the age of 55 (The Lang Cat, 2023).
- Of the 89% who haven't paid for advice 70% reported being unlikely to do so in the future when asked (The Lang Cat, 2023).
- Of adults with investible assets of more than £10k (FCA, Financial Lives Survey, 2022):
  - 4/5 would not be willing to make a sizeable investment without support.
  - 83% would not be willing to set up a pension without support.

110. This unfairness would be exacerbated by a redistribution of – and increase in – the costs and charges which fund workplace pensions. Master trusts operate at incredibly low cost and margin, and currently the primary beneficiaries of this are those with smaller pots. Such pots would be uneconomic for providers to service, however they do so at low cost to those members thanks to a cross-subsidy from the larger pots. Once members are able to choose where contributions are paid, certain providers will engage in marketing campaigns to attract those wealthier members, leaving those (predominantly AE) Master Trusts unable to recoup costs from them. This would result in a considerable increase in charges for those already at risk of inadequate pension savings.

111. Overall and on average, it is likely charges would also increase across the industry. The increased marketing that schemes would engage in, particularly those targeting wealthier savers, would come at a significant cost. This cost would ultimately fall on members, as we have seen in Australia, where average superfund fees are considerably higher than in the UK. While a true average in Australia is impossible to establish, as charges vary depending on pot size and investment options, a median fee for a $10,000 balance across all funds is 1.52%[20], double the UK's charge cap. Indeed, the Australian Prudential Regulation Authority announced late last year that it is looking at requiring Australian funds to disclose their spending in various categories – including on marketing. In the UK we are aware of some publicly available information that suggests some retail consolidators' marketing costs are already many multiples above the budgets spent by Master Trusts.

112. Perhaps of even greater concern is the increase in costs members will face as they lose the collective bargaining power their employers are able to achieve. Thanks to the benefits of scale and bargaining power employers are able to secure far lower charges than individuals – this is already apparent when you compare Master Trusts to existing consolidators and SIPPs. Therefore, in a world where individuals are choosing their own provider, they are highly unlikely to be able to secure such rates.

<u>*Potential bad outcomes*</u>

113. Member choice introduces the chance that savers take decisions on 'suboptimal' decision factors, such as the best marketing campaign or the best free gift. Currently this is not the case as members are entirely protected by the structures surrounding workplace pensions which means that others – with duties and responsibilities, as well as interests that are to do with

[20] https://www.superguide.com.au/comparing-super-funds/feeding-frenzy-super-fund-fees#Average_MySuper_super_fees_for_various_balances_and_investment_options

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quality (e.g. in an employment context) – take the decisions. In this way this change would introduce a new risk that workplace pensions savers are currently not vulnerable to.

114. It is also far from clear whether savers would have the sufficient skills and knowledge to take such complicated choices and, where they were to invest the time and effort to do so, whether they would conclude that switching away from their previous or current scheme would be the best course of action.

Scam risk

115. Under a member-led model there would be a clear increased need for scam protection. As soon as savers have more have more agency over the movement of their money – and especially with those with the largest pots most likely to do so – the risk emerges where bad actors seek to take advantage. Therefore, without 'safe lists' of approved recipient schemes (see transfer regs debate for complexity over this point), it is unclear how employers could ensure contributions are being paid into legitimate pensions. As such, it would be vital to limit lifetime providers to a small number of schemes authorised with the highest standards.

Incompatibility with illiquids agenda

116. this approach is unlikely to make a material difference to illiquid allocations, and may actually reduce it given schemes would need to be ready for even more 'switching' behaviour than they currently are, further disincentivising allocation to illiquids (at least in the short term, while evidence is gathered about how much switching behaviour is likely for any given scheme). It would likely prompt a desire for high correlation/homogeneity in asset allocation as switching behaviour would be unpredictable, and liquidity would need to be maintained. The opportunity for increased returns would likely suffer as a result.

Decumulation

117. Finally, while we have heard a theory that there is a potential advantage of a member-led model that for some individuals as it might allow their selected provider to see 'all' of their workplace pension saving more easily. This could help with retirement planning, though we would argue this is, in fact, unchanged from the current circumstances. Information can be provided on total pension saving by members already, and this will be facilitated further with the introduction of Dashboards and it would be unlikely to be their pension provider that would be advising on this total view in this case. Forthcoming decumulation policy changes should also take account of some of this use for the average saver.

Alternative member-led models that could be considered ahead of any Lifetime Provider model

118. Other ways of addressing the 'flow' of multiple small pots might include reassessing the situation after the introduction of the Default Consolidators. Depending on the distribution, reason for creation and proportionality of addressing them, options could be considered such as:

- Potential design choices could be taken regarding the Default Consolidators model which might better reduce the flow of small pots.
- Giving savers choice to refund very small ('micro') pots in cash or into another type of investment vehicle, for example where the values are so small that they would likely be less than the cost of transferring and consolidating the pot. This would need to be carefully designed so as not to undermine the spirit of AE, but could encourage saver engagement with pension saving, as well as giving them agency over decisions that could be taken with that saving without risking their future pensions adequacy. This has previously been discounted by the Government.
- Increasing the opt out window, in limited and controlled circumstances. This could be designed to target types of work or industries where job turnover is more common (for example, seasonal work) and enable people to take different choices with potential contributions. There are risks that this undermines the spirit of AE and/or facilitates avoidance of AE duties by unscrupulous employers. This has previously been discounted by the Government.

5. What is the right timing and sequencing of these potential changes? Which part would be best implemented first and why, or should any be implemented concurrently?

119. Questions surrounding timings are challenging to answer as there remains great uncertainty around the implementation of policy elements that will need to come before the launch of a Lifetime Provider model. For example, the industry remains in the dark about when the small pots Default Consolidators model will actually start to allocate small pots.

120. On the point of sequencing, our responses to the previous questions make clear that any Lifetime Provider model proposal must not be viewed in isolation. We do welcome the recognition of this in the Call for Evidence as it lays out the main building blocks, and we have suggested others as part of our answer to other Question 3.

- It must be the case that the Dashboards programme is first implemented in its entirety.
- Following this, a logical next step would be to build and make operational the small pots Default Consolidators model – and any 'Clearing House' structures that are needed for that policy. Whilst it remains to be seen to what extent, we are aware that the Clearing House will use technology that is based on Dashboards infrastructure. There will be lessons to be learnt from this process that could inform and influence any debate on the feasibility of a Lifetime Provider model in the UK.
- In addition, any Lifetime Provider model is inherently reliant on savers being able to make informed and considered decisions about their pension provision. The proposed Value for Money (VFM) framework, which is a joint project of the FCA, DWP and TPR, will need to be in place first in order to ensure all schemes that act as Lifetime Providers are delivering good value to their members.

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- Given that improving member outcomes should be a key purpose of any intervention it would be logical that prior to the launch of a Lifetime Provider model, the recommendations made in the AE 2017 review are put into action by the Government.

121. It is crucial that the capabilities, and limitations, of technology is at the forefront of deliberations around any Lifetime Provider models. Rapidly evolving advancements in technology will make the implementation of any variation of a Lifetime Provider model easier, but, first, improvements are needed to support member choice. They are also needed to derive the efficiencies that are envisaged. See Australia as an example, which has been able to achieve efficiencies at least in part due to straight through processing. Continuing to deploy research and development on digitising and streamlining existing pensions administration and scheme operations, particularly where these efforts are still in train, would realise benefits for members before any further structural changes to the pensions landscape; reducing manual activities would increase the speed and reduce the error rate.

122. Allocating to illiquid assets – one of the Government’s other priorities as part of this package – is expensive. To do this, schemes would need to increase investment costs which will require them to have saved costs elsewhere if they are to remain competitive. Implementing expensive pensions technology and infrastructure – such as that which is needed to support the delivery of any Lifetime Provider model – would necessarily route money that could otherwise be spent on investment.

123. Whilst there would be advantages to enacting some of the elements concurrently, implementation must be done in a way that acknowledges schemes, and indeed Government departments, have finite resources.

124. Finally, more people should be saving into a workplace pension and at higher contribution levels. Over the next decade contributions should rise gradually from 8% to 12%. While employees should only be required to put in 1% extra, we believe employers should put in 3% extra, with the result that by the early 2030s each will be paying 6%, totalling 12%. The Government should set the groundwork for reforming AE over the next decade, so that it gets a greater range of people saving and balances contributions between savers and employees. We ask the Government to set a timetable for increasing contributions as soon as possible.

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