ASSOCIATION OF CONSULTING ACTUARIES

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DWP
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Dear All

Looking to the future: greater member security and rebalancing risk

I am writing on behalf of the Association of Consulting Actuaries in response to the above call for evidence.

Our comments on your questions are set out in the Appendix.

The key points we would like to make relate to the "pot for life" initiative. While we remain open minded on the potential attractions of such a model, we do have a number of concerns:

- The new infrastructure required across multiple areas (administration, technology, regulation, protections, and safeguards for members, etc) will be significant. We worry this is a distraction. Given the range other important initiatives in flight (dashboards, new VFM framework, further development of CDC, small pot consolidation, etc) we believe it would make more sense to focus current attention on making good progress in these areas.
- We agree that engagement levels increase when savings pots are larger but have concerns that people may select based on familiarity or using a purely price or short term performance lens, without thinking more holistically about future outcomes.
- A move away from employer sponsored arrangements will reduce employers' engagement with retirement saving.
- How will the regulators ensure that lack of competition and potentially heavy marketing to individuals does not result in poorer outcomes for members.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In this event, please contact me at Tessa.Page@mercer.com.

Yours sincerely

Tess Page
Chair, DC Schemes Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

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?

- **Administration and infrastructure.** To work efficiently across the full market of providers we believe the clearing house model would be necessary, as it would not be practical for an employer's payroll to interface directly with multiple providers. While this could leverage the systems and developments associated with Dashboards and small pot consolidators, there will still be a significant amount of work necessary to build, test, and launch this. Costs will fall on providers, administrators, and employers, and may ultimately be passed on to members. We would like to see evidence of a clear cost benefit analysis for such a framework.

- **Creating a definition of 'authorised'.** There are many workplace and retail products available in the market and it is important that any lifetime arrangement should meet (and continue to meet over time) certain quality requirements and provide value for members. There is a significant risk with any lifetime provider model that members end up with worse outcomes because their lifetime pot offers poor value with weaker governance / suitability oversight than is now in place for workplace schemes.

- **Engagement and education.** Many savers find pensions complex and difficult to engage with. To move to an approach whereby individuals with limited financial knowledge need to make judgements about the merits of different pension products (or perhaps "default" to an existing scheme and fail to consider a new employer's scheme, through lack of engagement) is a significant ask. Additionally, the involvement of the employer, often a guiding hand in the education process, could well become diluted. The pension product that a person picks when they begin their career will matter more in a lifetime provider model, so learning for the broader population will need to occur sooner – ideally as part of school education.

- **Information to savers.** There will need to be a framework for disclosures to allow savers to make informed decisions around which provider is right for them. Consistency in how information is shown, controls around aggressive marketing and clarity on where the advice boundary sits, will be necessary. Some individuals may seek financial advice and it will be important that regulators ensure that such advice is suitable, and conflicts of interest are managed appropriately (eg the financial advisers may be incentivised to recommend an alternate arrangement to the employer's). Consideration should be given to prevent scams.

- **The role of the employer.** As noted, there is a risk that "pot for life" prompts employers to view workplace pensions as less important, with payments to a clearing house being very transactional. Many employers have in place strong support for their scheme members and provide a package of communications and support based around their workplace scheme. This may include employee workshops, webinars and pre-retirement courses run jointly with the scheme provider. If the "provider" is in future a large number of different entities, the employer could reasonably consider existing support as no longer appropriate and cease to offer this. We do not wish to see the care and valuable support that many employers put into providing well run workplaces schemes diminish.

- **Employer oversight in supporting good member outcomes.** A less employer centric model would be expected to reduce the "scheme level" information employers have in relation to the savings levels, retirement outcomes, and choices across their employees. This may therefore hinder progress in addressing pension savings gaps across the workforce.

- **Decumulation.** Whilst consolidation is conducive to engagement, the matter of where, when, and how to draw an income is still an unsolved aspect of the process. The availability of good value decumulation products remains mixed. We are very encouraged by the new proposals for all schemes to offer a set of decumulation options by default that members will be opted into. With a lifetime provider model, it is less clear how decumulation challenges will be addressed.

- **International experience.** Research should be undertaken to thoroughly understand experience from overseas, including areas where the UK may be different.

- **Costs to member** Retail investors in pensions usually incur much higher costs than institutional investors. This will partly be because marketing costs to members (across a wide range of platforms) will be higher, and the costs passed onto members.

- **A long-term CDC lifetime provider model**
    1. The lifetime provider model could attract more providers to the CDC market, as savers are expected to accumulate larger pots which would improve the cost-efficiency of running a CDC scheme.
    2. A lifetime provider model should allow for exceptions when an employer already provides CDC.
    3. Moving from one CDC scheme to another would be more expensive than moving from one DC scheme to another. If the goal is to make CDC more widely available and limit the number of small CDC pots, then a lifetime provider model would be preferable to a default consolidator model.
    4. However, master trust CDC has not yet launched in the UK. It would not be appropriate for it to be part of a lifetime provider model until sufficiently tried and tested.
    5. One of the main difficulties with the lifetime provider model is how a member can pick a good CDC scheme. Members are likely to be less motivated to switch schemes if they are not satisfied with their performance because they are not as well equipped to assess different schemes. Individual members also have less bargaining power than employers, which lowers market competition.

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?

- **CDC.** We have long been supporters of expanding CDC opportunities, so that more savers can take advantage of the attractions it has to offer. We consider there may be mutual benefits between the lifetime provider model and CDC if the former could help to grow the whole life CDC market. However, this will necessarily take time to develop. New requirements on decumulation options, as outlined above, could help with the development of CDC decumulation, with or without a lifetime provider model.

It is important to consider whole-of-life CDC separately to decumulation-only CDC as they are very distinct. Both have their advantages and are in different stages of development:

1. Under **whole-of-life CDC** members accumulate a pension (instead of a pot), which turns into a pension income. Using CDCs for auto-enrolment could be another way of increasing the size of CDC schemes more quickly. However, without a lifetime provider model, you are likely to end up with many small pots, which lower the benefits of CDC schemes because of the expenses of running them. Raising employer awareness of CDC schemes would also help increase their scale. CDC schemes are not straightforward to assess, and we think employers are more likely to make informed choices around CDC schemes, compared to individuals.

2. There are many and increasing DC pots that are building up. **Decumulation-only CDC** can play a role here. It will be some time before whole-of-life CDCs grow and become used in retirement. Decumulation-only CDC is important as it gives people an alternative income option to annuities, but less uncertainty than a traditional drawdown product. Requiring Trustees to offer a pathway to CDC for decumulation would be a useful step for encouraging take-up of CDC post-retirement without the need for CDC in accumulation.

- **Lifetime mortgage.** Not a solution in of itself, but an investment type to consider. What changes could be made to equity release products that could make them more trusted, safe and attractive? For many, accessing their property equity may be the only way they will achieve enough income to retire with sufficient security and comfort.

- **Review the level of freedom given to people at the point of access**. In particular, consideration should be given to the level of cash being taken from pension accounts under the pension freedoms – exacerbated by the current cost of living crisis. Consideration could be given to members needing to have a minimum guaranteed level of secure income before being permitted to access cash as a proportion of total pot.

- **Simpler consolidation processes.** The lifetime provider model appears to make it easier for a saver to keep track of their pensions, and there is a generally held belief that the larger the pot the more engaged the saver is. In that case, the other option is retaining the status quo but making it much easier for savers to consolidate their pots. Initiatives that would support this include simplification of transfer processes, ability to easily compare VFM of existing and new scheme (with little involvement by the member), passing legislation such that all schemes must allow transfers-in, introducing functionality to allow consolidation of pots on/via Dashboards, and legislation to automatically consolidate pots within the same scheme. Dashboards being extended to facilitate consolidation would help. We raise this as the current processes around transfers are unnecessarily complex for members, meaning that many give up.

- **Guidance and advice.** Whilst not a product in itself, we would like there to be consideration of a requirement for guidance and advice beyond Pension Wise, particularly for larger pot sizes. Products do not take account of individual circumstances, whereas guidance and advice models that can handle a broad range of inputs and variables, can. There is however currently limited capacity in the guidance/advice market – more innovative products might result in better outcomes for members, but they are often complex and are better accessed through the advice/guidance gateway. Advice/guidance at a reasonable cost, including digital models, would be an important development to allow individuals to access these more complex products.

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?

- **Timeframes and priority levels.** There are many live initiatives still to come to completion. Adding to this an immediate plan to roll out a lifetime provider model will put unnecessary pressure on trustees, employers, administrators, and providers. We worry this distracts the industry.

- **Clear framework for disclosures and for assessing value for money** for individuals when selecting their scheme, including industry standard metrics that allow ease of comparison. This may also need to take into account advertising and marketing standards. It is important to ensure that providers aren't incentivised to just compete on cost – also quality.

- **Appropriate regulatory oversight of lifetime providers** as member choice is likely to be a less powerful driver of quality schemes.

- **Consideration of what will happen in the event of a failure.** This could be a provider or clearing house.

- **The role of the clearing houses and central processing functions.** What will become the broader role of the central processing functions? Could they ultimately take on more of the communication and notification functions? If this is the case, where will the regulation apply and to whom?

- **Definition of 'better arrangements.'** Regarding the exemptions for employers offering 'better arrangements' – how would these be defined and assessed? How often?

- **Growth of guidance/advice market or alternatives** – as members have more responsibility to select their pension provider, it would be helpful for them to have access to advice / guidance that is more affordable. There will also need to be more emphasis on teaching individuals about pensions earlier in their working lives. If the employer link is weakened, consideration should be given to whether other entities should be involved in assessing and / or supervising pension providers (beyond existing regulatory supervision).

- **Ensuring individuals can get appropriate and affordable advice/support and are protected from scams.**

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?

Advantages

- ✓ Potential for greater level of individual engagement and sense of ownership. However, we question if the majority of members are ready for this level of engagement.

- ✓ There is little doubt that management of multiple pots is complex, confusing, and likely to make for siloed decision-making. Having pots physically in the one place reduces administrative friction and creates different perceptions.

- ✓ This model could enable people to retain access to CDC if their new employer doesn't offer CDC.

Disadvantages

- X The potential for mis-selling of expensive retail products and SIPPs coupled with lack of member understanding to make informed decisions.

- X Inertia after making initial product choice (or being defaulted into a scheme with first employer and staying with it through inertia). Choosing a pension product at the start of a working life without any requirement to give further consideration of whether it remains 'fit fur purpose' is unlikely to deliver best value for a member in the long term.

- X Employers begin to see sponsoring workplace pensions as a transactional tax and dis-engage with workplace education and support. Employers play an important role in negotiating favourable scheme costs and services for their workforces. Also, will there be any incentive for an employer to provide anything other than the minimum contributions, where a product is provided through a disparate system? Pot for life could also result in higher earners / those with larger pots receiving more favourable terms and those at the other end less favourable, even if they are in the same workforce. This highlights the loss of the employer involvement and ability to seek preferable terms for their whole employee population.

- X Drivers for a "pot for life" approach are to ensure there are fewer pension pots in the DC marketplace, as well as aiding investment in productive finance. Consideration should be given to whether this will actually be borne out in practice. Is there sufficient evidence that the new model will increase investment in productive finance (which is already underway through other initiatives) to warrant a major overhaul of the current system?

- X If employers are not involved in selecting a pension product, it may reduce the appeal of more sophisticated products like CDC, because they are harder for individuals to understand, and so may not be selected.

- X If the lifetime provider model does lead to increased engagement there will likely be more attention paid to how much is being deducted from pay packets each month. Auto-enrolment has been successful partly through member apathy - if member apathy is tackled then paradoxically, we could see the number of opt outs (or contribution reductions) increase. In Australia, where a pot for life regime exists, it is not possible to opt out so this issue may not have been identified elsewhere.

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

We believe the focus should be on delivery of current “in flight” policies before progressing this further. In addition, there should be a clear roadmap for how more complex arrangements such as hybrids and underpins will be dealt with. It is important that future changes are well-thought through and have cross-party support. Uncertainty around pensions is a key reason people do not save into pensions.

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