ASSOCIATION OF CONSULTING ACTUARIES

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Dear All

Helping savers understand their pension choices

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

Summary and key points

- We support the proposal to require schemes to offer decumulation solutions and for an appropriate solution to serve as a default approach for members who are unable to make their own choices.
- While CDC may make a valuable contribution to decumulation, it will likely take a while for CDC to develop. We therefore propose that the government proceeds with enacting its proposals rather than deferring them until CDC becomes a widely available option.
- Legislation rather than simply guidance is needed to make these proposals an operational reality, not least because many schemes do not grant trustees a unilateral power to establish decumulation arrangements. Also, only new legislation can adequately define the extent of trustees' duties, responsibilities and potential liability.
- We would like regulations to be drafted with a wider suite of products in mind, rather than simply current CDC designs. For example, longevity pooling products. To that end, regulations should be drafted with desirable principles rather than narrow product requirements.
- Consideration should be given to how the decumulation requirements (and VFM framework) will apply to DC/DB underpin schemes, rather than leaving it to each scheme to resolve this. It should be borne in mind that these hybrid schemes don't always have the option to consolidate with a bigger scheme if they find the DC requirements too exacting.

Our responses to your specific questions are set out overleaf. We would be happy to discuss them further if that is helpful. In that event, please contact Tess Page at tessa.page@mercer.com

Yours faithfully

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

APPENDIX

Helping savers understand their pension choices

1. Should it be up to trustees to determine the other suitable suites of products?

We understand that the intention is to place a duty on trustees to offer decumulation services, either in-house, or through another provider.

The exact definition of "other suitable suites of products" is not clear, but as a principle we believe that trustees should be the party responsible for selecting and overseeing decumulation services for members, particularly in the context of offering a default decumulation offering. This should include establishing suitable guidance for members, in order to ensure there is an appropriate framework around member decision-making.

The offering should then form part of trustees' ongoing assessment of value for members.

Our rationale for placing the duty with trustees is to align the arrangements with fiduciary duty and acting in members' interests.

In a number of instances, employers have fulfilled this responsibility, and we would expect that in practice trustees and employers will work together to establish suitable options.

All this being said, we do have some concerns that trustees of many schemes will be insufficiently resourced (in terms of both time and budget) to perform these duties, particularly if/when the proposed new VFM framework is extended to cover decumulation arrangements. Any requirement to offer decumulation services will therefore extend and accelerate moves by smaller schemes to consolidate. While we support this, there will be some schemes that find consolidation difficult, for example owing to complex benefit structures (underpins in particular).

2. What can government do to help a CDC-in-decumulation market emerge?

We strongly encourage the DWP to move forward with the legislation required to facilitate decumulation-only CDC products. The following would be helpful in encouraging a market to develop:

- Applying the **DC charge cap** to CDC decumulation arrangements would be inconsistent with the treatment of other decumulation options. Not mandating a charge cap is our preference, and we note that this would also align with the renewed focus on value over pure cost in the VFM framework. This position could then be reviewed in the future, for example if concern emerges that the market is seen to be charging excessively.
- We also suggest that the legislation makes it clear that the pricing of a CDC decumulation pension **should not differentiate by gender**, consistent with the requirements for annuities (and for contributions to whole-life CDC schemes).
- If the new regime for whole-life CDC schemes is not implemented at the same time as for decumulation-only options, this could enable whole-life schemes to act as a decumulation-only arrangement by offering transfers in. This **may make it difficult for new decumulation providers** (notably DC Master Trust providers, who may be very well-placed longer term to offer decumulation CDC) to enter the market as other schemes will have had a 'head start'. One possibility would be to prohibit transfers in close to normal minimum retirement age, except for members actively accruing benefits in the whole-life scheme (at least until the framework for decumulation-only arrangements is put in place).

- Many of the issues around **communication** of risks to members are similar to those that have had to be addressed for other CDC schemes. These requirements should therefore be mirrored for decumulation CDC solutions. However, there are additional considerations. For example, individuals may be choosing between multiple decumulation options, including more than one CDC scheme. A concern raised in our response to the Consultation on Extending Opportunities for CDC Pension Schemes is that a CDC scheme with a higher proportion of growth assets (and hence a higher expected return / risk) is likely to be able to offer / "market" higher benefits, and may therefore appear more attractive to prospective members, than a CDC scheme adopting a lower risk investment approach.
- It will therefore be important to **communicate risk in a way that will enable comparisons**, and we think this means it is likely to be necessary to legislate for how risk should be communicated for decumulation arrangements, at the point at which a prospective member is considering a transfer in (in particular, if there is more than one CDC product to select from). Such legislation may need to consider both the form of disclosure of risk and the underlying calculation, to ensure consistency.
- **Size requirements should be avoided** at this stage; provisions could be included in the VFM framework such that if the arrangement is not projected to mature to viability, then it would be a VFM fail.
- In general, we encourage the **legislation to be made as flexible as possible**, to avoid potential decumulation CDC providers being put off by legal complexity.

3. We would welcome views to understand what are the minimum requirements that trustees should put in place for members facing decumulation?

We believe that the key requirements should include:

a) Establishing a specific decumulation offering that enables members to withdraw benefits in the various permitted ways, including via annuities.
b) We would advocate for requiring that guidance should be made available directly through the scheme or with a "preferred / selected" partner that has been vetted by the trustees.
c) Signposting how to access advice (beyond guidance) and ensuring that this is appropriate.
d) Requirements for trustees to exercise governance/supervision over these services, for example, by assessing their VFM.
e) Establishing investment pathways that resemble those in the contract-based environment to reflect the different ways in which members might withdraw benefits.

We would like to see "open market option" thinking at the point of retirement (and potentially transfers within decumulation products, to keep the market efficient), alongside default decumulation options. "Whole of life" products require more diligence at the decision stage and this should be reflected in the requirements (potentially advice on top of guidance). This also applies to other questions, notably Q4 and Q13.

4. What factors should a trustee / scheme take into account when developing their decumulation offer?

- Membership characteristics, namely:
    - Typical current and projected pot sizes,
    - The ages at which members retire,
    - Levels of financial awareness.

- Schemes should also have an awareness of what Master Trusts offer – the question many trustee boards and employers are increasingly asking themselves is "if we aren't doing something better than the best Master Trust, why are we doing it?".

5. We would welcome views to understand if these are the right questions to capture the majority of ways an individual will want to use their pension wealth?

Yes, we are comfortable with these in broad terms. However, it may be helpful to have consistency with the FCA's investment pathways framework, not least because many individuals will likely have both trust based and contract based DC memberships, and may be taking benefits from both at the same time. To have different questions and frameworks would be confusing.

Further, the FCA investment pathways include time periods which are helpful in decision-making. The FCA investment pathways questions/statements are:

1. I have no plan to touch my money in the next five years.
2. I plan to use my money to set up a guaranteed income (annuity) within the next five years.
3. I plan to start taking my money as long-term income in the next five years.
4. I plan to take out all my money in the next five years.

6. Are there any other questions we should include in the framework?

We suggest asking whether the individual intends to use the money to pass on to beneficiaries. Inheritance planning is often an important part of benefit decisions and should form part of the framework.

7. We welcome views on whether you see any issues with this approach and whether there are potentially any implications due to the advice/guidance boundary.

The boundary between guidance and advice has always been challenging for trustees and employers to navigate.

In our view, nervousness in this area has hindered both trust based and contract based schemes from communicating and helping individuals in a way that meets their needs. Trustees still express reluctance to assist members with decision-making on the grounds that they do not wish to stray into providing regulated advice. Contract based providers are so anxious about ensuring that disclosure requirements are met, and boundaries are not overstepped that their communications end up as either lengthy small print, or as generic and oversimplified.

We therefore believe that the advice/guidance boundary should be further clarified, with members in mind, in order to help each type of scheme assist with members' decumulation decisions.

Similarly, further clarification on the ambiguities attending the Privacy & Electronic Communication Regulations and the distinction between 'servicing' and 'marketing' in a pension context would be helpful.

We, and trustees, remain wary of trustees being drawn into FCA regulated advice requirements, so our preference is for guidance to be trustees' area of "ownership", with hand off to regulated advisors where appropriate.

8. Do you have any suggestions for key metrics or areas that would need to be included if the proposed value for money framework was extended to decumulation or suggestions for where proposed metrics may no longer be required?

We believe that the new metrics in the VFM framework covering investment returns, costs/charges and member services will remain helpful and applicable for decumulation options. The aim should however be a holistic assessment of the contributors to good outcomes rather than a purely check-box "inputs" approach.

We do have reservations regarding a number of metrics in the new VFM framework:

- Stochastic modelling of future returns
- Quantitative metrics for qualitative services such as member communication.

Our concern that these metrics will provide little insight into comparative value of different accumulation arrangements applies also to decumulation arrangements.

In a decumulation context, we would suggest adding guidance and requirements for how to assess and compare guidance and advice providers (e.g. using fee benchmarking and quality).

9. Do you have safeguards in place for members in the decumulation stage? If so, what are these safeguards and what information do you provide to members?

N/a – we are not a provider.

10. Do you use the same charge structure as you do in the accumulation stage?

N/a – we are not a provider.

11. We would welcome views to understand what are the practical considerations of partnering arrangements

Partnering can be a sensible approach for schemes that do not offer drawdown solutions, or even UFPLS. For example, partnering with a high-quality Master Trust can be an attractive solution in that there are economies of scale and ongoing member oversight and governance.

In our experience, the vast majority of member assets move off the accumulation platform at the point of exercising retirement options. Much of it is being encashed and the larger pots are moving to advised platforms, often with substantially higher costs and charges than the pre-retirement vehicle, as assets move to the "retail" world.

We suggest that the requirement to offer a safe pathway to income drawdown, which may well be through partnering, is a higher priority than simply retaining assets within the scheme.

Other practical considerations include:

- Being able to easily compare costs for decumulation partners. Solution providers often have very different models for how costs are levied and disclosed.

- Often, trustees and employers have concerns around being seen to "recommend" a partner. Tied arrangements are not popular for this reason.
- Many trustees will be nervous regarding the legal/contractual risks of partnering, albeit they already contract with a number of parties.
- Not all schemes' governing documents will permit trustees to unilaterally enter into decumulation partnering arrangements. Legislation will be required to address that.
- Trust based scheme administrators should not be forgotten about – they would be the main party involved in the "hand off" to a new partner and will need time to establish new processes and checks.

12. Should government set out a minimum standard partnering arrangement?

Guidance on what the key features of a partnering arrangement should comprise would be helpful.

13. a) Should all schemes be allowed to establish partnership arrangements or only schemes of a certain size? b) If only a certain size what should that be??

All schemes should be allowed to partner with providers of decumulation services.

Many smaller ones will likely not wish to do so when it is realised that the government might extend the VFM framework to cover decumulation services. Instead, they are likely to consolidate into larger entities. Again, provisions could be included in the VFM such that if the arrangement is not projected to mature to viability then it would be a VFM fail.

14. Is there a role for a centralised scheme to deliver decumulation options, where trustees are unwilling or unable to offer these directly?

We believe that it would be more helpful to encourage a thriving market, with a number of providers operating in a competitive space.

The existence of a centralised scheme would present the possibility that it might at some stage be deemed via the VFM framework to offer poor value, thereby earning disrepute and casting doubt on the efficacy of the industry's decumulation framework.

We would though suggest that this be reviewed by Government periodically, to test whether a market is developing and operating effectively.

15. We would welcome views on if there is an alternative to our approach for legislation that would achieve the same results?

We believe that 'regulatory nudge' could go far in prompting many schemes to establish or strengthen their decumulation offerings (or indeed to see an inability to be able to do so as a prompt to consider consolidation options). This would be particularly true if accompanied by a suggestion that legislation will follow if no actions are taken.

Alternatively, extending the proposed VFM framework to cover decumulation offerings (perhaps via a 'key features' rather than 'metrics' approach, initially) would also trigger some schemes to take action.

Overall, though, we believe that legislation is necessary, not least because that will send a more effective signal to providers that the government is 'serious' about supporting members in decumulation and provide them with greater reassurance that they can invest in new offerings.

Also, trustees' duties, responsibilities and potential liability are best defined via legislation.

As a broader point however, we would like any regulations to be drafted with a wider suite of potential products in mind, rather than singling in on current designs of CDC. For example, longevity pooling products. To that end, regulations should be drafted with desirable principles rather than narrow product requirements.

16. We want to work with industry during the implementation of these proposals; what timeline should we work to implement these changes?

It is difficult to see how proposals as extensive as these could be enacted with less than two to three years of preparation time (particularly given the busy agenda of regulatory change that trustees, providers, and administrators are already grappling with).

The emphasis on CDC as a decumulation option would likely push that timescale out further. We believe that the plans should not wait for CDC aspects of the proposals.

17. When we introduce legislation should this only apply to Master Trusts in the first instance?

Whilst this has practical appeal, on balance we do not believe so. It would be unfair to members who are not in Master Trusts, and we believe that most Master Trusts already operate well-developed decumulation offerings.

The savers with the greatest need for these offerings are typically members of single employer schemes.

18. Do you have views and evidence on how this can be delivered in ways that achieve our policy aims of stimulating CDC in decumulation, enabling Nest to provide the services outlined in this consultation, while ensuring a healthy competitive marketplace?

Requiring trustees to provide a CDC decumulation option to members might help stimulate the market for this type of pension provision.

19. Are you able to quantify any of the one-off or on-going costs at this stage?

N/a – we are not a provider.

20. Are you able to provide a breakeven point in pot size for providing certain decumulation products or services? Would this be different for decumulation only CDC's?

N/a – we are not a provider.

21. What benefits do you expect there to be from the proposals members/schemes/wider)? Do you think they are quantifiable?

We support the broad direction of the proposed changes and consider that supporting members both at retirement and through decumulation should be a policy priority.

One benefit will be to encourage more providers to establish decumulation arrangements and stimulate competition and innovation.

Another might be to encourage members to save more during the accumulation years if schemes are generally viewed as less of a 'minefield' when savers retire.

While we do not believe the benefits can be quantified now, it is possible that extending the proposed VFM framework to decumulation offerings might help benefits to be quantified in future.

Ultimately, the desired benefit should be higher retirement incomes and improved income certainty / stability for members, when compared with existing arrangements.

22. Do you think the benefits from the proposed changes outweigh the costs?

Yes.

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