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Next steps - Looking to the future: greater member security and rebalancing risk

Volume 2023

Issue 28

29 November 2023

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On 22 November 2023, following the Chancellor of the Exchequer's Autumn Statement 2023, the DWP published a new call for evidence (Looking to the future: greater member security and rebalancing risk). The document is in two parts: the first is a response to the proposal to resolve the small pots issue that was published following the Mansion House speech in July, and the second is the new call for evidence on the long-term direction of workplace pension saving (including the development of a so-called 'pot for life').

This document is part of a number of documents published by the DWP designed to "continue to ensure that trustees and those who advise them continue to work to produce the best possible outcome for pension savers".

Background

This document was published on the same day as other calls for evidence and responses to those that followed the Mansion House speech.

Our FYI dated 14 July 2023 (Ending the proliferation of deferred small pots) explains the framework put forward by the DWP for the multiple default consolidator approach to resolve the small pots issue.

In the Ministerial Foreword to the document, new Minister for Pensions, Paul Maynard (who replaced outgoing Minister, Laura Trott, days before the Autumn Statement), confirms his "intention to proceed definitively with [the multiple default consolidator approach] which [the DWP] estimate[s] will benefit the average saver by £700 at retirement".

55 responses were received to the consultation which looked at the creation of a central clearing house or central registry with a default consolidator which eligible pots would be automatically transferred to.

The Pensions Minister wants "to understand how we can go further to set out a long-term vision for workplace pension saving". "Australia have successfully implemented a 'stapling' model, based on the idea of a pot for life. I want to understand what the benefits and considerations of this approach are".

Next steps for the multiple default consolidator framework

The consultation response covers the questions and feedback that was received from respondents on the framework itself.

The conclusion of the DWP is that the multiple default consolidator framework will be introduced when Parliamentary time allows.

An industry delivery group will be established in early 2024 "to work through the complex and challenges design and delivery questions that need to be addressed to ensure the successful implementation of this approach". It is expected to provide an interim update to DWP Ministers by Spring/Summer 2024 with proposals in late 2024.

Clearing house or central registry

The DWP has decided to proceed with a clearing house approach. The role, remit, and design will be considered by the industry delivery group as a priority area.

Default consolidator where members do not make an active choice

Where members have a deferred pot already with an authorised consolidator scheme, this would be the recipient scheme. Where they have multiple pots with different consolidators, they will be allocated to the scheme that holds their largest pot.

Where members do not have a pot with any of the authorised consolidators, the DWP has concluded that a carousel approach will apply where members will be allocated to authorised consolidator schemes in rotation.

An authorisation regime for the consolidator

The DWP will develop an authorisation and supervisory regime for trust-based scheme to act as consolidators and investigate options, with the FCA, for a similar framework for contract-based schemes.

Schemes will have to demonstrate that they meet certain conditions, including: an auto-enrolment scheme; already undertake same scheme consolidation; good levels of VFM; offer decumulation services.

Eligible pot criteria

The DWP intends that the criteria for eligibility will be: pots created since the introduction of auto-enrolment (i.e. presumably post 2013); pots within charge-capped default funds (except those with guarantees); no active contributions for at least 12 months; pots valued at £1,000 or less (with this threshold to be kept under review).

Looking to the future: Greater member security and rebalancing risk

In the new call for evidence, the DWP is looking at a "long-term vision for pension saving in the UK". The plan is to "ensure there is a greater balance of risk across the system and that savers do not individually bear unreasonable levels of risk for managing a retirement pot they may not fully understand".

The suggestion is that the approach for automatic consolidation of deferred small pots is a starting point for looking at a "lifetime provider model" and this could work together with the ambition to grow the CDC market.

A lifetime provider model

The DWP starts by looking at some statistics on the low engagement that savers have with their pensions. The automatic enrolment framework may be successful due to the use of defaults, however, as a result of job mobility, multiple small pension pots have now been created.

Savers find it difficult to keep track of their pensions and having multiple pots creates barriers to engagement and makes decision making more complex at the point they want to access their pension.

The DWP believes that a lifetime provider model would reduce the number of DC pension pots. It would also support member engagement, result in less administration, reduce the likelihood that members will lose track of their pension and ease decision making.

It also believes that having one pot invested for life would create opportunities for long-term savings horizons that could result in more diverse asset allocation (such as productive finance). Potentially, this could deliver higher returns.

Steps to achievement

The DWP suggests using the central clearing house that is being developed for small pots as a way for employers to identify which scheme their employees are using as their lifetime provider. New employees would not then need to inform their employer of the pension that they would contribute to.

In the period before this is developed, the DWP wants to implement a voluntary "member-led lifetime provider which could act as a stepping stone to a default model for both individuals, employers, payroll providers and schemes".

As this would require a change in the automatic enrolment legislation, this needs further work, not least because employers would be required to act on an employee's request to contribute to the scheme of their choice.

The proposal involves using the data standardisation driven by pensions dashboards, the value for money framework, the multiple default consolidator model for small pots and ensuring that schemes provide a range of decumulation options.

Implications for employers, the industry and individuals

The DC market has already concentrated with 95% of savers in trust-based schemes belonging to around 30 Master Trusts.

The DWP asks employers their views on the implications a lifetime provider model would have for their approach to supporting employees with their pensions.

Exemptions would be needed where the employer provides a better offering, such as DB schemes, some DC or CDC single-employer trusts, Master Trusts or GPPs that have more generous features.

The DWP is also looking to understand how payroll would work and believe a system similar to BACS in banking would be needed. There are cost and funding considerations.

There are many other considerations, including for the pensions industry, such as the viability of different providers, how it would work across both the contract and trust-based market, as well as changes in the competitive balance.

Managing risk while improving outcomes – whole life CDC schemes
Members with DC pensions have more options since 2015, but it is widely recognised that engagement is low, understanding risk and making complex financial decisions at retirement is difficult.

The DWP wants to explore whole life CDC schemes and sites research that suggests income from a CDC scheme can "provide an income-for-life pension which can be much higher than that from a DC scheme, potentially improving member outcomes". It also confirms that being able to invest more in higher growth assets supports the government's "productive finance agenda to use pensions investments to generate growth in the UK".

Combining the lifetime provider model and CDC schemes
The DWP wants to explore how these could work together. This a long-term vision but the DWP is looking to understand the merits of this.

The new call for evidence – five questions

The new call for evidence closes on 24 January 2024.

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?*
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?*
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?*
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?*
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?*

Comment

The changes explored in the outcome to the first consultation and the new call for evidence will, if they come to fruition, result in a significant transformation of the workplace DC pensions market. However, a lot needs to happen before these could become reality. In particular, the multiple default consolidator framework and the infrastructure needed for pot for life are still a long way off being available.

The Default Consolidator Implementation Delivery Group is being launched in early 2024 and they will have a lot to consider by the end of that year, including the not insignificant matter of a clearing house, authorisation of consolidators and how this all interacts with the pensions dashboard programme.

The ‘pot for life’ is an interesting initiative to help individuals keep track of every penny they save for retirement over their working lives. An important aspect of the call for evidence will be considering how not to undermine the care and attention that some employers put into providing well run pension schemes for their workers nor introduce a risk of worse outcomes for employees whose ‘pot for life’ does not provide the same value for money.

The proposal is full of challenges and potentially higher risks for individuals who, it is widely acknowledged, find pensions complex and difficult to engage with. Until all the other initiatives, most of which are still in the early stages of development, are progressed this long-term vision is likely to remain as such.

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