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Pensions Committee

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Dear Sir/Madam

Response to DWP's call for evidence on Looking to the future: greater member security and rebalancing risk

We are writing on behalf of the Pensions Committee of the 100 Group of Finance Directors with regard to the Consultation.

About the 100 Group

The 100 Group represents the finance directors of the FTSE 100, several large UK private companies and some UK operations of multinational groups. Our member companies represent the vast majority of the market capitalisation of the FTSE 100, collectively employing 6% of the UK workforce, and pay (or generate) taxes equivalent to around 12% of total UK government receipts.

Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

The 100 Group represents companies sponsoring Defined Benefit (DB) pension schemes with assets of approximately £600 billion and membership of 3.5 million (around a third of the overall DB universe) and represents many companies running their own trust-based Defined Contribution (DC) pension schemes, with several individual employer-run DC schemes holding total assets far in excess of several authorised master trusts.

The 100 Group also represents companies using group personal pension plans and master trusts operated by third parties, to comply with their auto-enrolment obligations.

Summary

While we support the DWP's proposal to develop a long-term vision for workplace pension saving in the UK, we have material reservations and concerns about the proposals contained in this call for evidence.

In the Annex to this letter, we have set out our detailed responses to the questions in the call for evidence. I summarise our primary reservations and concerns as follows:

(a) Undermining trust in pensions by breaking the link to employers

The proposed lifetime provider model risks undermining the vital relationship between employer and employee which lies at the heart of the UK's workplace pension regime.

For many people, their employer (and the education, well-being and financial benefits provided by their employer) is a significant source of trust, confidence and assurance (particularly for those people employed by the 100 Group's representative companies). In our view, the proposals risk undermining this relationship. They also risk undermining the provision of high quality employer-run DC pension schemes, which still make up a significant proportion of total DC assets under management and provide commercial master trusts with an important benchmark of value through employers' willingness to subsidise the costs for members and support their employees through their retirement savings journey.

If assets under management of (even the largest) employer-run DC schemes are eroded by member choice, it risks reducing the buying power of such schemes which could, in turn, lead to increased charges for those members who remain. It also risks shifting the existing trusting and supportive relationship between employer and employee, which is important in bolstering engagement, to one of a purely transactional nature in the context of pensions savings. This would be to the detriment of both employers and employees.

(b) Unsustainable burden on employer payroll, pension and HR systems

It is critical the proposed lifetime provider model (including any interim steps such as introducing greater member choice initially) does not place additional governance, administration and operational burden on employers and, in particular, their payroll, pension and HR systems and teams. If employers were required to pay contributions to multiple pension arrangements at the same time this would be incredibly difficult and impractical for payroll teams to administer, particularly for large employers.

While we note that the government's proposal for a clearing house would potentially mitigate this issue, there is still the question of who would pay for the clearing house which would cost £multi-billions as a significant structural project. We consider it is likely that industry participants (i.e. those companies/schemes paying the general levy) would be impacted directly or indirectly, even if the government is willing to establish and host the clearing house itself (see the first clearing house in Australia).

(c) Overloaded pensions industry and risk of poor implementation

Given the level of change already taking place in the pensions industry, we consider the government should exercise caution in seeking to implement a lifetime provider model at this time. Instead, the government should focus on other initiatives that are already well progressed and would help to achieve the overall policy intention of reducing the number of small pots, raising awareness and engagement in pensions and helping savers to amalgamate and grow their pension pots to improve retirement income.

These initiatives include:

- expanding auto-enrolment (to provide access to pension savings for a wider section of society and, over time promote greater levels of saving, so that more individuals have the opportunity to achieve an adequate income in retirement);

- implementing the multiple default small pots consolidators proposal to reduce the existing stock of small pots; and

- most importantly, establishing pension dashboards (to give individuals far greater visibility of their fragmented pension savings and hopefully, trigger saver-led pot consolidation).

Once these initiatives have been implemented (and their impact properly understood), the government and pensions industry will be better placed to judge if there is a real need for greater member choice and a lifetime provider model.

(d) Risks if moving to "retail/member-choice" model too fast

If the government is minded to proceed with the proposal, we urge caution against shifting the UK pensions system from a "wholesale/employer-choice" model to a "retail/member-choice" model too quickly – this would be risky and fraught with issues. For example, it would risk:

- undermining the incentive for employers to operate their own high quality pension schemes;

- increased charges for members who choose their own provider and for those that remain; and

- undermining confidence in pension savings, particularly if the infrastructure needed to operate member choice/a lifetime provider model is not ready or is not proven to be capable of dealing with large volumes of transactions.

Instead, we would urge incremental change, to give the industry time to carry out proper due diligence and analysis, to ensure the necessary infrastructure is in place and proven to be effective and to ensure that any changes will build on the success of auto-enrolment, rather than risk undermining it.

In any event, we strongly oppose the government introducing a system of 'stapling' based on the Australian model, as we are concerned this would:

- undermine the link between an individual and their current employer, which lies at the heart of the UK pension system and is the foundation for the success of automatic enrolment in the UK;

- distort the UK pensions market by skewing default pension scheme membership towards providers who are more likely to pick up individuals early on in their working lives (e.g. those in the retail market, as seen in Australia where we would note stapling is not a universally popular policy); and

- risk further negative unforeseen and unintended consequences.

It is also important any moves towards a lifetime provider model do not lead to the loss of existing high-quality company run DC trust-based schemes and that any schemes recognised as lifetime providers meet the same high governance standards demonstrated by such schemes.

(e) Building a consensus

Finally, it is vital that the proposal has broad cross-party and industry support to design and implement it successfully. Much work needs to be done before any proposals along the lines of those outlined in the call for evidence can be advanced. This includes building a clear evidence base for any changes and their likely consequences.

Should you wish to discuss any aspect of our response further, we would welcome the opportunity to do so.

Yours faithfully,

Phil Aspin
Chair
The 100 Group Pensions Committee

Annex - Response to specific questions

Call for evidence

Question 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?

a) Clarity on the lifetime provider model

It is obviously important to be clear on what a "lifetime provider model" means. We note the proposal could potentially be phased by:

- introducing member choice initially (i.e. giving individuals' the ability to choose where their pension contributions are directed without automatic transition on changing jobs); then
- moving to automatic transition (i.e. where an individual's chosen pension arrangement becomes their default destination on moving jobs); before
- moving to a stapling model where an individual's first (or current) workplace pension scheme becomes their scheme for life, unless they positively choose otherwise.

The lifetime provider model in the call for evidence could involve all or any of these elements, which is leading to industry confusion.

We note the call for evidence refers to the stapling model seen in Australia. We would strongly oppose the government introducing a system of 'stapling' based on the Australian model. In our view, this would:

- undermine the link between an individual and their current employer, which lies at the heart of the UK pension system and is the foundation for the success of automatic enrolment in the UK;
- distort the UK pensions market by skewing default pension scheme membership towards providers who are more likely to pick up individuals early on in their working lives (e.g. those in the retail market, as seen in Australia where we would note stapling is not a universally popular policy); and
- risk further negative unforeseen and unintended consequences.

Although there are lessons the UK can learn from Australia, it is important to recognise that there are fundamental differences between the UK and the Australian systems, which mean the government should not just cut and paste a stapling model into the UK.

Having said this, we recognise that a "lifetime provider model" could be implemented without the need for stapling (i.e. by simply giving individuals the ability to choose a lifetime provider without this being automatic). While we recognise there may be some potential benefits in giving individuals a choice as to where their workplace pension contributions are paid, we would urge caution in taking this proposal forward at the current time for the following reasons:

- allowing employees to direct where their workplace pension contributions are paid risks undermining the relationship between employer and employee. It is likely employers would start to view automatic enrolment as far more transactional and adopt a less paternalistic approach to pension contributions, which could lead to lower contribution rates market-wide and encourage

employees to divert HR resources to other employee benefits. This in turn could exacerbate the retirement adequacy crisis, rather than seek to mitigate it;

- further, employees may be encouraged (via providers' marketing campaigns) to leave their employer's pension scheme which may not be in their interests and risks "levelling down" the employer's workplace pension provision if a significant proportion of assets and members drift out of their scheme;

- the proposals could result in increased charges for members who choose to leave their employer's scheme (which may benefit from an employer subsidy and competitive pricing) and also lead to increased charges for those who remain. If the assets under management of (even the largest) own-trust DC scheme is eroded by member choice, it risks reducing the scheme's buying power, which could lead to increased charges for members; and

- we consider there is a potential issue with the current charging rules. Although they prohibit active member discounts where an active member cannot receive a preferential rate than their deferred member comparator, this is on an employer-by-employer basis. So, it would be feasible (and in line with the existing laws) for an individual to be on a different, less favourable charging structure when they change jobs and employer, even if they stay with the same provider.

b) Avoiding additional burden on employers

We are very concerned about the potentially significant additional governance, administration and operational burden that the introduction of a lifetime provider model could place on employers of all sizes and, in particular, their payroll, pension and HR systems and teams.

We foresee real issues if a single employer (or employer group) is required to direct contributions to multiple pension arrangements (which, if left unchecked, could span trust- and contract-based workplace and non-workplace arrangements). This would cause serious operational and administrative strain.

To minimise this additional burden, we consider it essential that a fully functioning pension clearing house is in place from the outset (even with phased implementation of a lifetime provider model), so that employers are only required to pay contributions to a single destination. (We note in this regard the government's intention to establish a clearing house for the multiple default small pots consolidators proposal.)

Once this is fully functioning and proven to be successful in handling large volumes of transactions and data flows, the government could contemplate extending its remit to include the operation of a member choice/lifetime provider regime.

Finally, it is also important that:

- before any lifetime provider model is implemented, a suitable and effective authorisation and supervision regime for lifetime providers is introduced – this is essential to give employers assurance that any arrangement to which workplace pension contributions might be paid is appropriate and a qualifying arrangement for automatic enrolment purposes; and
- employer-run DC occupational pension schemes are not eligible to act as a lifetime provider, to prevent an employer being required to pay contributions into a competitor's pension scheme.

c) Exemptions from the lifetime provider model

The proposed lifetime provider model risks undermining the vital relationship between employer and employee which lies at the heart of the UK's workplace pension regime. It also risks undermining the incentive for employers to run their own high-quality workplace pension schemes. To reduce the negative impact of any lifetime provider model on the employer-employee relationship and on the quality of UK workplace pension provision, we consider it is vital that any lifetime provider regime contains suitable exemptions from automatic application where an employer provides high quality pension provision.

This should include a full carve-out where an employer provides employees with access to:

- a DB scheme (or DB section of a hybrid scheme);
- a collective DC scheme; or
- a large employer-run DC scheme (i.e., a scheme with £500 million or more in assets under management (**AUM**) or one that has 5,000 or more active members).

As we have set out above, it is essential any moves towards a lifetime provider model do not lead to the loss of high quality employer-run pension schemes. The need for a lifetime provider model for employees of large employers is also reduced by the fact that, on average, they are likely to have longer service tenures that employees of smaller employers. This is why we are calling for a carve out where an employer operates its own high-quality pension scheme, including one for large employer-run DC schemes. To ensure any such carve out captures recently established DC schemes operated by large employers, as well as those that have been in existence for some time, we request that it applies where a scheme's AUM exceeds £500m or where a scheme has more than 5,000 active members even if it has not yet hit this AUM threshold. Minimum governance standards (such as a "green" rating under the new value for money framework) could also form part of any carve out, where relevant.

A carve-out for high quality employer-run pension schemes would ensure employers continue to be incentivised to offer and operate well-run pension schemes for their workforce and support (rather than hinder) the employer-run DC market. It would also help maintain the trust and support between employer and employee in the context of pension savings and retirement. We also consider large employer-run DC schemes to be an important component of a competitive DC market, as they act as an important value comparator to the large master trusts which are operating commercially and for profit.

Without large employers running their own DC pension schemes, there is concentration risk and the potential for the DC market to become anti-competitive. We consider these types of exemptions would ensure that the UK system does not shift from a "wholesale/employer-choice" model to a "retail/member-choice" model too quickly and in a way that would be detrimental to members' interests.

A further reason for including a carve-out for large employer-run schemes, is that where an employer operates its own scheme it has more control over the scheme's approach to addressing environmental, social and governance (ESG) risks and concerns and it is able to ensure that its own values and approach to managing these issues is reflected in the way the scheme operates. Without suitable carve-outs the introduction of a lifetime provider regime, risks undermining the scope for employers to influence the management of ESG risks in this way or to ensure that the pension scheme into which their contributions are paid reflect its values on ESG matters.

d) Sequencing of proposals and initiatives

We urge the government to adopt a strategic and systematic approach to any reforms. There are a significant number of initiatives already underway within the UK pensions system, including the creation of pension dashboards, proposed implementation of a small pots solution to reduce the number of small pots, and the planned extension of auto-enrolment to 18-year-olds and so that qualifying earnings apply from the first pound earned.

These are all major policy developments in their own right. They are likely to have a significant impact on the shape of the UK workplace pensions landscape and on the case for introducing greater member choice. Therefore, we urge the government to focus on delivering these initiatives before it takes the proposals set out in this call for evidence further. Once these existing policy initiatives are fully embedded, the government and industry will be in a much better place to judge the need for further reform.

This is particularly so, given that we expect pension dashboards and the small pots solution to promote greater consolidation of employees' pensions and significantly reduce the number of stranded workplace pension pots (whether by automatic consolidation via small pots consolidators or voluntary consolidation via individuals' use of dashboards).

Question 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?

There are potential ways of pooling longevity risk and maximising scale for investment, which could help to provide higher levels of retirement income, and which do not require new legislation or wholesale change to existing benefit structures and do not place additional costs on members or employers. These include:

- longevity pooling through a flexi-access drawdown fund with flexibility about withdrawal rates, but with maximum limits. Upon the death of a member, the remaining pot would be spread fairly amongst surviving members of the pool, rather than going to the member's estate; and

- later life longevity protection. This could take the form of income withdrawal with protection against longevity risk at a pre-determined age through switching to an annuity. This could be designed to combine flexibility in the early years of retirement with the security of a protected income in later life.

These alternative mass market vehicles could work in tandem with whole of life collective DC (CDC) schemes, which offer an alternative to traditional DC schemes and decumulation-only CDC schemes, which offer an alternative to annuities and income drawdown in retirement.

Question 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?

Before moving to a single lifetime provider, we consider the following building blocks would be required:

- the small pots solution and pension dashboards should be fully embedded so that government and industry can properly assess how they impact member behaviour, which would serve as an evidence base for a lifetime provider model;

- a fully operational clearing house is essential so that, from inception, employers are only required to pay contributions to a single destination (in order to drive efficiency in the system and prevent additional burden on employers);

- a suitable and effective authorisation and supervision regime, under which there are a limited number of authorised lifetime providers to ensure members' savings are adequately protected;

- carve-outs for employers that offer access to a high-quality pension scheme (as set out in our response to question 1);

- consideration of safeguards to prevent providers "cherry-picking" employees with the highest value pots - which otherwise runs the risk of leaving lower earners in schemes that offer less value for money – hopefully, this risk would be mitigated by existing auto-enrolment providers catering for the lower paid/smaller employers, the proposed new value for money framework and the FCA's Consumer Duty and other consumer protections, but it is important that a lifetime provider model does not benefit (or is not perceived to benefit) higher earners (and those with higher pots) at the expense of lower earners (and those with smaller pots); and

- consideration of safeguards to prevent exacerbation of pension inequalities and the gender pension gap – for example, if providers can cherry pick employees with the largest pension pots, how might this disadvantage the under-pensioned, including many women and ethnic minorities. Again, we expect there are mitigants to this risk – for example, stopping the creation of new small pots every time an individual changes jobs would help those in lower paid and transient jobs/industries by combining rather than fragmenting their pension savings, but this is a point to consider in the impact assessment and design stage.

If the government decides to press ahead with these reforms in the future, we would urge it to adopt a well-publicised staged timetable.

We favour giving employees a simple choice initially of where their workplace pension contributions are paid, before moving to a position where an employee's existing or chosen arrangement becomes their default provider every time they move jobs (subject to exemptions, as set out above). We consider phased implementation would need cross-party support and backing, so that these steps are not undermined by short-termism and potential changes of government, and to enable the industry to properly plan and allocate sufficient budget and resources to the project.

Question 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?

For the reasons set out in our response to question 1, we are not supportive of a default lifetime provider model based on the stapling system in Australia.

However, if the government decides to move to a member-led lifetime provider model under which individuals can direct where their workplace pension contributions are paid

(subject to certain carve-outs), we think there would be real advantages to adopting a staged approach. This could see employees initially simply given a choice of where their workplace pension contributions are paid, before moving to a position where an employee's existing or chosen arrangement becomes their default provider whenever they move jobs.

The benefits of this staged approach are that it would:

- give employers and the industry time to adjust to the new world of member choice;
- maintain the link between an individual and their employer's scheme (at least initially) when an individual changes jobs;
- give the government and industry a chance to assess the appetite among employees to choose their own provider and to assess any detrimental consequences arising from the employee making the choice on the individual concerned, remaining members, employers and the wider pensions industry; and
- provide an opportunity to assess whether the central clearing house can successfully operate and administer member choice.

Question 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 do not think the government should consider implementing member choice or a lifetime provider model until: (a) the small pots solution has been implemented (and a pensions clearing house established); and (b) pension dashboards are up and running and the impact of dashboards on member behaviour and the UK pension market are known.

Furthermore, we believe the government should prioritise expanding auto-enrolment so that more individuals have the opportunity to achieve an adequate income in retirement, in particular by expanding access to pension savings to a wider section of society and, over time, promoting an increase in savings rates.

Having said that, it is important to consider the implications of any potential future move to a lifetime provider model in the design of these policies (and the related infrastructure) to prevent duplication and unnecessary cost retrospectively fitting for this initiative. In particular, the clearing house being designed for small pots consolidators needs to be fit for purpose and able to implement member choice/a lifetime provider model from the outset (should the need arise).

In terms of sequencing, as set out above, if the government decides to press ahead with these proposals, it should start by introducing a member-led model and allow sufficient time to see how this works in practice before it considers going any further.