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Looking to the future: Greater member security and rebalancing risk

Hymans Robertson LLP call for evidence response

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What category best describes you or your organisation?
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Introduction and Summary

Introduction

Hymans Robertson provides independent pensions, investments, benefits, insurance & risk consulting services, as well as data and technology solutions, to employers, trustees and financial services institutions.

We are passionate about delivering better member outcomes and more sustainable futures for everyone. What drives our advice and services is supporting the empowerment of members to make better decisions and improve members outcomes at retirement. Therefore, we welcome the government's call for evidence and would be happy to provide further information and support as required.

Our view

While we remain open minded on the potential attractions of a lifetime provider model, we do have a number of concerns and believe that there are currently bigger priorities facing the pensions industry and members that should be tackled first. We believe that cross party cohesion is critical for effective medium to long term policy implementation.

We do see the merits of a lifetime provider model which could help to resolve the small pots issue caused by the current system and could help to drive up members' engagement with their pension and give a clearer picture for retirement planning. However, we must recognise that the majority of pension scheme members are disengaged with their pension and lack the financial education to choose from too open a range of pension provider candidates. We also have concerns on how resulting provider pricing behaviours could disadvantage lower income groups vs. today's collective pricing.

For a lifetime provider model to be a success, a robust administration system will need to be developed and there would need to be further consolidation in the pension provider market to ensure that members can choose an appropriate, high quality pension arrangement. Implementing a successful lifetime provider model will require a significant investment of time and resource within the pension industry which would perhaps act as a distraction from more critical problems facing the industry and members that we believe should be tackled first. We believe that the primary focus should be on addressing the savings adequacy challenge that exists in the UK today with DC savers, and completing the major projects which are already underway, for example, the Value for Money framework, the development of a small pot solution and the implementation of the Pensions Dashboard, where such projects may bring solutions which could limit the need for a lifetime provider model or enable a route to its simplification.

The most notable feature of provider models such as Australia's system is in relation to the amount their members save and their adequacy outcomes. In Australia, the minimum employer contribution is 11% (increasing to 12% in 2025), compared with 3% in the UK. The lifetime provider model does not tackle the savings adequacy challenge and will perhaps act as a distraction to addressing this and risk exacerbating the issue with a shift to more responsibility placed on savers.

We strongly welcome policy engagement on longevity pooling and we see credible alternative approaches for introducing this more swiftly to members.

Overall, we therefore believe that the decision of a lifetime provider model is a possible later step to be considered in the longer term.

Responses

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?

Government support and vision

We believe that there needs to be cross party support for effective medium to long term policy implementation and this support will be imperative for the lifetime provider measures to succeed.

Linked to this, there must be a clear plan to tackle the savings adequacy challenge that exists in the UK today with DC savers. The lifetime provider model does not tackle this issue, and risks exacerbating it with a move to more responsibility placed on the saver away from employers.

The provider market

Can a lifetime provider model operate effectively in the current dense provider market? At present, we do not believe it can. Having too many players in the provider market would make regulation and member choice complicated and would risk members choosing poor quality providers that are not obligated to meet new appropriately higher standards or pricing rules.

We believe that a lifetime provider model will work better in a more consolidated market with fewer, larger, well-run schemes that provide value for members and have the operational and financial resources needed to support the requirements of a lifetime provider model.

In the short term, the number of providers operating in the market will remain stable and so the introduction of a lifetime provider model in the current market would require significant updated due diligence and/or rules to ensure providers offer a suitable product for members. For example, to protect member outcomes, will providers need to apply to be 'verified' and demonstrate that they have the necessary operational and financial resources, and the appropriate scale to deliver value for members? If providers do need to apply to be 'verified', this may naturally force consolidation in the market.

Under the above scenario where providers need to apply for verification, can other providers remain in the market and hold deferred pension pots (that would not be consolidated as part of the proposed small pot consolidation as they are above the value of the maximum limit for automatic consolidation)? Regulation would need to be in place to ensure 'verified' providers continue to meet the required standards.

Is the government only considering Master Trusts in this framework?

Impact on Employers

Employers would likely need to update their payroll systems and communications to their employees which would require time and investment. Payroll systems and software which were developed to meet automatic enrolment requirements may not be fit for the purpose of a lifetime provider model. Consideration of the time and support to allow employers to prepare for these changes needs to be given. However, in the context of the historical pension costs employers had to meet in order to provide pension schemes, the costs required to develop and run administration are arguably comparatively modest

There is a question as to whether employers will change their approach to providing workplace pensions and if they will still see workplace pensions as an integral employee benefit. Or if the lifetime provider concept would undermine the link between employers and workplace pensions and perhaps lead to lower employer contributions (where they currently pay above the automatic enrolment minimum requirements). The lifetime provider model

may weaken employers' duty of care and employer led governance oversight of their pension arrangement leading to less challenge on the quality of the offerings from pension providers.

We expect that employers will still need to offer a default pension arrangement for new employees who need to be enrolled into a pension scheme for the first time. Consideration should be given to whether employers can use their existing default pension arrangement for these employees or if employers will be encouraged to offer a default solution via a 'verified' Master Trust arrangement.

Who would be ultimately responsible for acting in the best interest of members and ensuring that members have access to an appropriate scheme and investment fund? Currently, employers must adhere to strict criteria and governance rules to select a suitable pension provider and default investment fund for members. Would employers be required to provide an equivalent level of governance and investment oversight under a lifetime provider model? If not, there would need to be regulation around this, and the appropriate governance and investment criteria included in any 'verified' provider framework.

In your consultation (133) you note that you "anticipate the need for exemptions to the lifetime provider model in circumstances where an employer provides a better offering than the lifetime provider." Consideration needs to be given as to how a "better" scheme is measured, for example, will a framework be developed for employers to measure existing schemes against?

Impact on members

We believe that a system where members can build up their pension savings in one place could help to drive up members' engagement with their pension and give members a clearer picture of their total retirement savings to aid decision making at retirement. Allowing members to choose a retirement fund which best suits their values and needs, for example in relation to risk appetite, features and additional services, may encourage members to engage with and take more ownership of their pension. Having a better picture of members total retirement savings could lead to more meaningful and personalised communications. It would also reduce the risk of members cashing out perceived small pension pots at retirement.

A lifetime provider model could bring the pension provider market closer to the retail banking market, perhaps leading to an increased focus on customer experience, value add features and nurturing loyalty. Under a retail market setting, pensions may become better integrated with more 'everyday finances' as providers in this space will typically offer other products or services which may help to improve member engagement.

However, a key concern is the impact on members outcomes and the protection of the less engaged members. We believe that any solution to the problem of multiple pension pots should help engaged members whilst also protecting less engaged members.

Under the current automatic enrolment framework, employers act on behalf of their entire workforce to negotiate competitive charges for their members due to their scale. Under a lifetime provider model, the universal case of collective pricing for the entire workforce would be removed and it would become the legal right for employees to choose their pension provider, meaning that the employee essentially becomes the buyer. This has the potential to create 'two lanes' for employees – those who are high earners (or have large pension pots) who may be more 'attractive' to pension providers and be able to access the most attractive pension schemes and benefit from more competitive charges, and in the other lane you would have lower earners (or those with smaller pension pots) where their choice of provider and scheme could be more limited and carry higher charges. This could lead to members having significantly different and inequitable financial outcomes as pension providers will have a commercial incentive to behave in this way. We believe that measures need to be developed to adapt to this market behaviour, for example, are those who classify as lower earners able to pool together to receive better terms? We believe that it is imperative for careful pricing protection to be explored for members. There should be regulation around charges, for example, a cap on charges or requirement for providers to carry out a regular

review of charges vs service. We also appreciate pricing protection can drive poor market behaviours, so we see this as a challenging area for the industry to deliver good outcomes across all wealth groups.

Currently, member engagement with their pensions is low (from your consultation note 106, only 25% of people contributing to a DC pension were highly engaged with their pension), and our concern is that the low levels of engagement and understanding of pensions could result in savers making sub-optimal decisions based on the cheapest solutions or those that are the most well marketed, rather than those that offer the best value for money. Many members lack the financial education and confidence to make an informed decision on the best investment fund for them, as evidenced by the significant proportion of members who remain in their scheme's default investment solution, which is generally upward of 90% (The Pensions Regulator scheme return data for 2022 to 2023 notes that 97% of memberships in non-micro schemes are invested in the scheme's default investment strategy).

We believe that the inertia of members was key to the success of automatic enrolment, however, under a lifetime provider model there is a risk of members staying in the same scheme for life and not reviewing this at any point to consider if the scheme still meets their needs and provides value. There is evidence from Australia's model that inertia rules with the large majority of employees remaining 'stapled' to their first default fund. There should be regulation around a requirement to review the suitability of the scheme on a regular basis so that this does not happen.

For members carrying these new responsibilities who cannot afford financial advice, what free guidance and support will be available? We believe that a framework would need to be put in place which gives members the information and tools to be able to make an informed decision around which provider, scheme and investments is right for them. Regulation around the level of required information and controls around marketing should be put in place. Will FCA's DP23/5 plans include the greater guidance needs of members under a lifetime provider model?

If members make the wrong choice, can they change scheme? Can a change of provider only be made when members move to a new employer, or can movement be made at all?

Decumulation

We welcome the new proposals for all DC trustees to offer a range of decumulation services and products and a default decumulation solution available for members who do not make an active choice. We believe that more information on how decumulation challenges will be addressed under the lifetime provider model is needed.

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

Create a simpler longevity pool product within Master Trusts (and other Trusts and retail SIPP structures) based on the trust deed legal structure. This pool could be operated within a drawdown based arrangement which we believe would preserve the flexibility and choice of Pension Freedoms, whilst addressing the longevity risk. We consider that in contrast to CDC, this product has a materially lower complexity, cost, and an absence of intergenerational judgment for the providers. It is likely to be both easier to implement and operate for providers than CDC and can be done without major scale or transition requirements.

Simpler longevity pooling better achieves the maximising income goal for the member, which is the critical objective for the majority of future retirees. Our analysis on risk sharing found that the retirement income for DC members could increase by nearly 20% if longevity pooling was made available to them at the point of retirement.

Research we carried out with savers indicated a clear understanding of the benefits and trade offs, for giving up passing on your remaining pot on death in favour of generating a higher income while alive. Roughly a third of savers were in favour with a third against.

Such a model would further preserve other familiar retirement planning choices as assets can be pooled in full or in combination with various options including an annuity or drawdown. This income withdrawal can be tailored to suit members lifestyle needs (to a maximum limit), whilst being anchored to sustainable levels though guidance features. These guidance features could consider annually setting “green” income withdrawal rates to ensure pot resilience over time. The FCA DP23/5 plans are likely helpful in this regard.

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?

Timeframe and priority order

We believe that there are currently bigger priorities facing the pensions industry and members that should be tackled first. For the lifetime pension model to be done properly, it will require development of infrastructure and a significant investment of time and resource within the pension industry which would perhaps act as a distraction from the more critical problems facing the industry. Including the development of small pot solutions, the government’s Value for Money framework and the implementation of the Pensions Dashboard, where such projects may bring solutions which could limit the need for a lifetime provider model or provide an avenue for its simplification.

Relatedly, the current emphasis on complex CDC solutions is unhelpful for pragmatic near term delivery. There are onerous governance, implementation and scale challenges that could be avoided. Aside from the solution benefits of a simpler longevity pooling solution, noted above, we see no transitional barriers to getting those increased income benefits to members quickly to a timeframe unhindered by these other policy measures.

Required infrastructure

A robust and centralised clearing house will need to be developed. The role and responsibilities of the clearing house need to be set out. The exercise of member choice should not create a significant additional burden for employer’s payroll operations. Employers will need to update administration and payroll systems to link with the clearing house, consideration of the time and cost to do this needs to be considered. Who will meet these costs? Will they fall to the employer? Consideration on who is responsible for contribution monitoring obligations is needed, would this lie with the providers?

Development of frameworks

As noted in question 1, we believe the following clear frameworks on the following need to be developed:

- How providers and schemes are reviewed and measured to ensure value for money (before being permitted to participate as selectable providers), who can be exempt from the lifetime provider model and how a “better” scheme is measured.
- Member charges and how these are regulated.
- Required disclosures to members to support decision making at retirement and rules around marketing.

Non-standard schemes

Thought needs to be given to schemes which have additional, non- standard features, including hybrid, AVCs and underpins and how the lifetime provider model will deal with these.

Taxation and regulation of schemes
DC pension arrangements operate under a net pay or relief at source taxation model. Further differences apply and provider regulation is governed by either tPR or the FCA. A single taxation model and uniform governance framework would make the design and operation of a lifetime provider model significantly easier.

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

Implementing a voluntary form of the model in the first instance will allow engaged members to opt out of their employer's pension scheme and choose a scheme of their choice without losing their employer's pension contribution.

However, if a voluntary, member-led lifetime provider model is implemented ahead of the significant structural and technological changes, the following needs to be considered:

- The administrative impact on employers. Under this transitional model, we assume that without the development of a clearing house, the employer would be responsible for directing contributions to the members selected provider. Whilst, based on the current low level of engagement in pensions, the number of members who engage with this model is likely to be low, contributing to multiple pension providers could be a burden for some employers, requiring a change to payroll systems and processes and increase the risk of administrative errors. Will employers be required to partner with any voluntary, transitional arrangements? Or could they choose not to let members pay contributions to an alternative scheme if they do not have the administrative capabilities to do this?
- The risk of poorer quality providers being selected by employees.
- Required member disclosures and guidance. There would still need to be a framework on the information and tools a member would need to be able to make an informed decision around which provider, scheme and investment fund is right for them.
- Who would be responsible for communicating information about the member-led lifetime provider model to members? There is a risk that members direct questions to employers who are not able to give advice.

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?

As noted in question 3, we believe that there are currently bigger priorities facing the pensions industry and members that should be tackled first.

We also believe that further reforms are needed to the automatic enrolment framework to increase the minimum contribution requirements. Research from the PLSA has found that without reform more than 50% of savers will fail to meet the retirement income targets set by the 2005 Pensions Commission. We are supportive of the PLSAs findings and the call for a reform of the auto-enrolment framework to gradually increase total minimum contribution requirements from 8% to 12%, with the employer contributing at least 6%.

We believe that the government's Value for Money framework will drive greater consolidation of pension providers in the market. As noted in question 1, we believe that a lifetime provider model will work better in a more consolidated market with fewer, larger, well-run schemes that provide value for members. The Value for Money framework needs to evolve further under a lifetime provider model with clear requirements that 'verified' providers

need to meet in order to participate in the market such as the infrastructure to support small pot consolidation, 'stapling' and default retirement solutions.

Tackling the problem of small, deferred pension pots in the first instance and creating the proposed default consolidator model will mean that the model and processes developed as part of this project can be reviewed and considered with learnings used to develop a lifetime provider model.

The questions posed within this consultation may be better answered again once experience of a working Pensions Dashboard is gained and to learn from the elements included within this.

We therefore believe that the decision of a lifetime provider model is a next step to be considered in the longer term (post 5 years):

Phase I	Pension Dashboard; VFM Framework (evolved version); Simple longevity pooling
Phase II	Small Pots automatic consolidation
Phase III	Lifetime provider model