PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

PENSIONS INVESTMENT REVIEW: UNLOCKING THE UK PENSIONS MARKET FOR GROWTH

JANUARY 2025

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ABOUT US

We are the Pensions and Lifetime Savings Association, the voice of workplace pensions and savings, and uniquely placed to collaborate with the new government on its goals for the pensions industry. We are a not-for-profit membership organisation, representing pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures.

EXECUTIVE SUMMARY

The PLSA welcomes this consultation and we are pleased with the degree to which government has committed to engaging with us and our members on what amounts to potentially radical changes to how DC pensions are run in the UK. The complexity of the UK DC system, combined with the nature of the proposed reforms, has highlighted – more than in most consultations – the need for a comprehensive and detailed understanding of the economics and practicalities of how pensions are provided, prior to taking any decisions.

Assumptions

Before discussing the reforms, we below set out the assumptions on which we have based our response:

- The level at which the proposed scale tests are applied is critical, but is not articulated clearly, with many of our members having different interpretations of the text in the consultation. In Annex 2 we set out a typical provider structure, and introduce the concept of 'default strategy level', which somewhat aligns with 'default fund level' in the consultation – this is the level at which the tests, if implemented, should apply.
- The proposed scale reforms apply to master trusts and GPPs used for AE – and not single employer (own) trusts. This exclusion also applies to own trusts which cover a number of connected employers e.g. employers working in one sector, or companies in the same group. In practice, most own trusts service more than one employer, so this is a critical point of clarification, as their inclusion would essentially close almost all own trust schemes, which we do not believe to be the objective of this work and therefore we have not interpreted this as the intent.

Objectives

The stated aim of this consultation is to build scale in DC pensions, which Government considers will lead to increased investment in productive finance, helping grow the UK economy, and better returns for savers.

We agree there are important benefits to greater scale, which include better efficiency, including through more in-house management, improved governance, wider investment diversification, and improved bargaining power, all of which should be beneficial for members. As we have said in previous publications, greater scale does also naturally facilitate more investment in private markets – assets with the potential for more growth, albeit DWP's own paper suggests that the impact on average returns may be minimal.

However – we do not believe scale targets are the way to achieve this.

Consolidation is already happening in the DC market, leading to fewer, bigger schemes, and policies already in train, such as the Value for Money framework (VFM), multiple default consolidators to address the issue of small pots, sub £100m value for members assessment, as well as reforms such as Guided Retirement pushing own trusts toward master trust, will significantly accelerate this consolidation over the coming years. Indeed, DWP's analysis suggests that even without those reforms we are likely to see 86% of trust-based members in the largest 10 master trusts by 2030. We support this trend.

Our significant concern – which we bring out throughout this consultation – is that a scale test *on top of* the reforms already announced will:

- Create a distraction that will make those existing reforms more difficult or impossible to deliver, at least within envisaged timeframes
- Risk market disruption
- Not achieve the core aim of increasing UK investment in productive assets.

It is our impression that scale for the sake of efficiency, diversification and good governance is a subordinate objective in the Government's thinking to this core aim of UK investment. As above, scale does facilitate greater private markets exposure, but in order to increase UK investment, trustee boards would also need to increase their home bias, a conclusion that does not follow. Trustees' fiduciary duty dictates that they invest wherever the returns will be greatest for their members, and scale in and of itself will not change this.

- The investment paper published alongside the consultation states that currently, UK DC has a '2x' home bias for listed equities, and Figure 9 starkly highlights the inverse correlation between home bias and 5-year returns for different schemes. This suggests that greater UK listed investment would likely be bad for member outcomes, so trustees are very unlikely to do this given their fiduciary duty to act in members' best interests, unless the fundamentals of the UK market change with a greater focus on future expected outcomes.
- On the unlisted side, the argument is clearer, with 45% of DC unlisted investments in the UK, however, this still suggests that over half of any increase to private market allocations would go to other markets.

As an illustration, if we reached £800bn in workplace DC by 2030, as the consultation suggests, and all DC schemes invested 5% in unlisted equities (as per the Mansion House Compact), with 45% of that in the UK, this would mean £18bn invested in UK 'productive finance' – a very small figure compared with overall government spending (£1200bn in 2022-23). In reality, this figure could be considerably lower given the widely reported low supply of quality assets suitable for DC pension schemes, and the fact that not all schemes are Mansion House signatories, so it remains unclear whether this would be considered a success from the productive finance perspective.

Therefore, there is a very significant risk that radical change is introduced in the pursuit of scale, that does not in turn deliver the benefits the Government is looking for in relation to investment in UK growth assets - but rather disrupts reforms already in train, and creates market disfunction. Further: a scale test may in the shorter-term lead to a reduction in illiquid investment levels in some schemes where those unlikely to reach the scale test pull out of this type of investment.

Our solution

Rather than a sole focus on scale, we would like to work closely with government to establish what contribution DC schemes could and should be making to UK productive finance investment, being rational but ambitious about what is achievable and keeping fiduciary duty and member interest firmly in mind. We consider this a faster route to increased productive investment.

A key next step we recommend is for schemes and Government to consider what level of investment schemes might be able to commit to on a voluntary basis that goes further than the Mansion House Compact **and is UK-specific**, to better enable the Government to plan. This is something we will be urgently exploring with our membership in early 2025.

Of course, if we are asking schemes to invest more in the UK, there also needs to be adequate supply of quality assets to invest in. The PLSA has written extensively about the UK growth agenda and made several proposals for increasing both the supply of investable assets and the incentives for schemes to invest in them. We stand by the conclusions of these reports in terms of measures to support with this agenda.

If we accept on the basis of the arguments set out here that scale, in and of itself, will not deliver the level of UK investment the Government is seeking, the next question to consider is whether action to increase scale for reasons of efficiency, diversification and good governance is merited – and if so how that should be brought about.

Scale, consolidation & the UK market

If government does want to pursue a scale objective, it is critical they do so in a way that does not undermine existing areas of excellent value. That means seeking scale at an 'effective' level, and not setting targets that seek to drive change in a shorter period of time than is reasonable in such a long-term market, and if tests are applied, they would need to allow schemes to have additional defaults where these clearly add value for members.

We would argue that any AUM targets should be at default strategy level – that is the level at which asset allocation is decided across funds from different products and employer arrangements. We agree that there is fragmentation where many individual employer defaults do not have a sufficiently sophisticated investment strategy to warrant separation from firm-designed defaults, and that these should be consolidated. However, forcing this with a 'blanket' approach would also negate the value and input some engaged employers with a good knowledge of their employees add to their investment strategies, which members benefit from. The same can be said for employer pricing power, which means members benefit from far lower charges (without suffering proportionately lower returns) than in a highly individualised system, such as Australia.

Whilst there are many attractive elements to the Australian market, the two systems are of course not directly comparable and trying to apply those elements in 'blanket' forms risks compromising in certain areas where our market is preferable. A one-default-one-price model is simpler, but will lead to more investment homogeneity, and is not possible without also removing the valuable role of the employer in striking good deals in bulk for their employees, and in places, bespoking investment strategies which in some cases actually include higher illiquid allocations than more basic mass market defaults. We would happily facilitate discussions for government with such employers to help explore this detail.

If all DC schemes had to price at individual level, rather than employer level, average member charges could see large increases, as new cross subsidies are introduced, and as the employer role in pension provision is sidelined, the path would likely lead back to a lifetime-provider-type model, which as per our engagement with the previous Government, is not good for outcomes. We believe this consequence may have been missed given Government's clear interest in the employer's role in Chapter 4. The discussion on pricing also gets to the very core of the UK system, in which many schemes are run on a commercial basis - fundamentally different from in Australia where superfunds were borne out of non-profit and industry schemes. There are benefits of both models; the key is a fuller understanding of the wider impacts to the system as a whole when considering specific changes like this one.

There are multiple risks, then, associated with the proposed scale test which we cover in detail in our response. In summary, these include:

- Losing good value schemes that have higher than average private markets exposure. This includes smaller 'innovators' and large hybrid schemes already leveraging significant scale
- Uncertainty for both individuals and employers, as well as more generally in investment markets
- Disruption to reforms already proposed around small pots, VFM and decumulation, as well as wasted resources in schemes implementing other policy initiatives before having to wind up in any case
- Disincentivising illiquid allocations for schemes that might struggle to reach scale targets in the near-term, potentially leading to a 'dip' in these type of investments in the years to 2030
- Lack of capacity at tPR to process the required amount of consolidation activity
- Poor service in providers where all resources are dedicated to integrations
- Small master trusts getting stranded, where they're not seen as economic to acquire
- Lack of means to bespoke investments according to specific investment beliefs

If the Government is determined to push ahead with a scale test, we would suggest this policy is implemented in a phased and more nuanced manner, which would need to include exemptions for certain types of scheme, and that it is implemented in a way that actively considers interactions with reforms already underway.

Chapters 3 and 4

We are very supportive of the proposals in this section of the consultation. We understand from providers that fragmentation in the GPP market is a challenge, with thousands of defaults across the industry whose members – especially those in legacy products - would benefit from consolidation into better value products, something not currently possible in the way that it is in trust. This would also likely result in better investment opportunities, with greater diversification, over time. The proposals for a contractual override to enable providers to move members into better products without consent would be a positive move, providing the governance around the process is rigorous.

We have also long supported the regulation of investment consultants, and believe the suggestion of Employee Benefit Consultancy (EBC) advice requiring authorisation is a good one, in that where employers are advised purely based on cost, this will continue to be the deciding factor in the advice consultants give to trustee boards. We would gladly work further with HMT and FCA to shape proportionate and effective regulation for these advisors.

CHAPTER 2 – ACHIEVING SCALE IN THE DEFINED CONTRIBUTION MARKET

Question 1: Do you think that providers should be restricted to a limited number of default funds, and if not why? Please consider any equality considerations, conditions and to what extent saver choice could be impacted.

We understand the intention behind this proposal, and agree that the structure of many UK workplace DC schemes is overly complex, with many different default funds and arrangements within individual providers. Therefore, we would support a reduction in the number of defaults, however, as we explore, we would not recommend a hard cap on numbers, due to the negative impacts this would bring.

We also agree that building scale does have benefits for savers, however, these are primarily to do with more efficiency of management, administration, and bargaining power – benefits which are achieved by scale at asset allocator level – not by scale at the level of individual employer arrangements. Therefore, the implication at paragraph 39 that the *average value of assets in a default fund being significantly lower than the total AUM held by the provider* prevents the benefits of scale from being realised, is incorrect.

We would also caution against any assumption that building greater scale through the consolidation of different default funds would result in any additional productive investment in the UK. As per DWP's research, published alongside this consultation, increased scale does result in higher allocations to unlisted assets, however, trustees still allocate to wherever the best returns are to be had, so that might simply mean allocations to US private equity, for instance, increase.

Given the efficiency gains, most providers would, overall, be supportive of reducing the number of defaults they run, and as per our answers to the statutory override section, some of the proposals in this chapter are very positive. Limiting the number of defaults could be positive, though it would depend on at what precise level it was applied, and it would be very difficult to apply a consistent maximum number, given there are important reasons why certain 'sub-scale' defaults will have to remain.

Employer choice

Many providers have a few different defaults to cater for different price points, risk tolerances, investment strategies, and eventual access options, all according to employer choice. The mention of saver choice in this question is a red herring; unlike in Australia, in UK workplace pensions, savers benefit from far more competitive prices as a result of collective employer bargaining; this also means that different employers have different objectives, so some providers offer 'premium' default funds, which typically invest more in private markets, and are therefore more expensive. Therefore, providers would need to be allowed a small number of 'firm-designed' defaults to cater for **employer choice**.

Certain employers also require specific investment strategies which are unavailable in a firm-designed default:

- Shariah funds – funds created because a particular membership may have specific investment beliefs, for example needing to invest in accordance with Islamic law, preventing them using a provider's main default fund. Therefore, some providers will offer a Shariah default, which would always have to sit alongside other defaults.
- Some employers will require a bespoke default to screen out certain stocks which are included in a firm-designed default. Examples of these could be social exclusions, e.g. employers or trustees who do not wish for funds to be invested in sectors such as tobacco or controversial weapons.
- Certain other employers, because of the nature of their businesses, must avoid conflicts of interest in their investment strategy, or firms which are themselves screened out as per the previous point. For instance, audit firms will often screen out investments in their clients, and this would also require a bespoke default for that particular organisation.

Accidental defaults

Many schemes run a significant number of 'accidental' defaults. For more information on this, please see Annex one, which includes a letter from our previous correspondence with DWP on this issue.

Due to uncertainties between The Occupational Pension Schemes (Charges and Governance) Regulations 2015 and DWP and tPR guidance, there is a lack of clarity over the creation of default funds, which has resulted in the creation of new defaults, largely as a result of transfers of members out of self-select funds, into another fund. This can arise where members are moved into and out of cash funds after property funds gate, where trustees wish to move members to a new/preferred ESG fund, where changes are made to a self-select investment option without member consent, or where scheme mergers or changes of fund manager result in self-select fund moves – again without consent. Unless DWP can simplify the regulations to prevent the future creation of such funds, they will continue to proliferate. The existence of such defaults is clearly sub-optimal currently, but in a world with a cap on default numbers, would place schemes in an impossible position, where the creation of such defaults could push them over the maximum number. This issue would therefore either need to be resolved to prevent their proliferation, or accidental defaults would need to be exempted.

Question 2: The proposed approach at default fund level could mean that the number of default arrangements would remain unchanged. Will imposing the requirement at this level have any impacts on the diversity of investments or the pricing offered to employers?

As the consultation notes, the industry is inconsistent with its terminology regarding schemes' structures, and this has meant that our members have noted some confusion in relation to the proposals and the different levels at which any new rules could be applied.

In annex 2, we include a diagram which demonstrates the structure of a typical (Lifeco) provider, including where funds from different employers, through different types of pension, are invested. This diagram does not represent any provider in particular, and is not drawn to scale. It is important to bear in mind that most of the UK DC system is structured in this manner, as the majority of the system has grown on a commercial basis. Superfunds in Australia are typically structured more like Nest; they have a simpler structure, and many were borne out of industry and non-profit schemes. As a result, it is not just internal scheme structure which is different: the whole dynamic of the Australian DC market is fundamentally different. Below are some definitions based on our diagram, and we base the rest of our discussion on this structure, to avoid any confusion over interpretations over terms used in the consultation.

- Default arrangement – this is the level at which contributions are collected and fees are agreed for each employer. Distinctions between arrangements are therefore distinctions between either products (GPP or master trust), or between different employer agreements, where bespoke arrangements mean one employer has its own, separate investment strategy.
- Default strategy – this is overall default investment approach used by either one or a group of employers, and one strategy can be used across products. Many providers will operate one 'firm-designed' default strategy which most employers within the master trust and GPP will all be invested in.
  They will also have a number of separate employer arrangements, whose strategies range from entirely bespoke, to a mix of the firm-designed default strategy with some additional features. Therefore, given the varying composition of these bespokes, we can consider that some are 'truly' bespoke (employer 1 in the diagram) – these theoretically do not contribute to overall scale, while some are 'nominally' bespoke (employer 2) – these, in reality, are largely made up of the same building blocks as the firm-designed default – so these theoretically do contribute to overall scale.
  The main firm-designed default strategy will either function with a lifestyle glidepath, or with target-date funds (TDFs) in order to ensure asset allocation is suitable for members as they age. Either way, we must consider the default strategy to encompass this whole range – rather than, for example, splitting out individual derisked defaults, or individual TDFs (Nest's default, for example, has 46 TDF vintages).
- Default fund level – we consider this to include the different building blocks that make up the overall strategy. This is the underlying component level, so will include a mix of different types of asset, e.g. equities, bonds, property, private equity, infrastructure.

We agree there is fragmentation, especially where some providers run hundreds of different defaults across their master trust and GPP. However, the key here, is increasing **effective** scale, so any minimum bar should be assessed at default strategy level. This allows scale efficiencies within investments, i.e. pools assets from different products, and would also allow for those bespoke arrangements which invest predominantly in the firm-designed strategy (contributing to its scale), but with some additional bespoke elements ('employer 2' in our diagram).

We concede that (as per paragraph 37), some providers already have considerable scale at default strategy level, and so a minimum default size at this level might not engender much change. We would highlight that where Government might consider these providers are not currently investing 'enough' in productive finance, this is not down to fragmentation between defaults and a lack of scale. These schemes are already able to leverage scale for better governance, better pricing power and in-house expertise; any perceived underweighting to illiquids is down to other constraints, such as commercial price dynamics, performance fees, and other technical and regulatory barriers, such as daily pricing constraints and permitted links rules. This last factor is a key consideration given most DC providers invest via life platforms, a fundamentally different structure from a custodian model used by Nest and the Australian supers; it is unclear from the consultation whether any of these proposals are intended to materially change that. These barriers are covered in detail in the BVCA Pensions & Private Capital Expert Panel Interim Report, but overall, it's worth bearing in mind that structures such as Long Term Asset Funds (LTAFs) are still very new but fast gaining popularity, so we'd expect that addressing these challenges would lead to increased productive finance investment in the coming years.

Investment diversity - schemes already invested in productive finance

A minimum AUM level applied at any level would be counterproductive for certain bespoke employer arrangements (and smaller innovative master trusts) which are already investing in productive assets – often more so than the firm-designed default – but will never reach the level of scale discussed in the consultation. Some large employers enter a master trust for the improved governance offered, but retain investment autonomy via a bespoke sleeve, allowing them a more sophisticated investment strategy than the standard default would offer. The scale proposal would therefore greatly restrict these employers' investment choice, and we have heard that some of these would likely move 'back' to an own trust environment in preference to having to move into the firm-designed default. This would run counter to Government's objectives, both by forcing sales of illiquid assets, and by causing more scheme level fragmentation. Bespoke arrangements with significant productive finance allocations, and which are demonstrably delivering value for members should therefore be exempted from these rules, though we do concede these are a minority.

Similar to those schemes are hybrid structures, where scale exists at provider level (combining DB and DC assets), but where DC alone may not meet the minimum, e.g. in USS, the £3bn DC scheme benefits from the investment capability of £78bn of combined DB and DC scale, while Railpen's DC section benefits from the combined scale of £35bn across DC and DB. These providers leverage all the benefits of scale from across the portfolio to the benefit of the DC scheme, allowing it to invest, in some cases, considerable allocations in private assets. Requiring such a DC scheme to separate and enter a master trust would inevitably result in less money invested in productive assets overall. This is another example of where an exemption would be needed, and the basis of this could already exist via exemptions for mixed benefit schemes from mast trust scheme funder requirements as per Regulation 28 of the Occupational Pension Schemes (Master Trusts) Regulations 2018.

Certain smaller master trusts are already ahead of larger competitors on productive finance investment, and on investment performance, there is no correlation at all with provider size. In order to avoid the risk of losing good performers, and with member outcomes in mind, there would logically need to be an exemption from the AUM test for those schemes that are both performing well and investing in productive assets.

Other exemptions

If implemented, we agree that AUM thresholds could only apply at ‘entry level’ (paragraph 37). Large defaults are typically made up of a number or building block funds, each with different asset classes within them. In order to reflect the investment objectives for different ages of members, schemes will operate either lifestyling or TDFs within that default, meaning different proportions of those building blocks. While lifestyling means gradually moving a member from a growth default fund to a more cautious default as they age (smaller, lower risk defaults for later on), TDFs are separate funds within the default, each of which changes asset allocation as members get closer to retirement (between a third and half of master trusts use a TDF). As in the question on numbers of defaults, any AUM test would need to apply across the TDF strategy, and not apply to individual derisked funds within a lifestyling strategy. In any case, these smaller derisked funds have less capacity to invest in productive finance assets, so little opportunity for scale would be lost by excluding them.

Similarly, where a GPP implements investment pathway funds, or master trusts develop in-scheme retirement solutions, these default pathways will need to either be exempted, or ideally included in the main strategy. We would point out that in Australia there is far less prevalence of de-risking and lifestyling; this is partly because their default funds are more diversified, and therefore less risky, but also because in-scheme retirement products are far less developed there, and typically it is up to members to transfer fund choices themselves and transfer elsewhere for different solutions. As Australian superfunds develop further their decumulation offerings, we would expect lifestyling and TDFs to become more prominent there, and that they might seek more risk earlier on, similar to in the UK market.

Finally, similar to the maximum number of defaults test, exemptions would also be needed for accidental defaults, or belief-led and other necessary employer defaults if we are not to overly limit employers’ investment flexibility, something largely seen as a positive feature of the UK system.

Solutions

As above, there are so many challenges with the AUM test, and necessary exemptions, that an alternative approach would be both easier to implement, and more impactful. Ultimately, what is important, is that providers can realise the benefits of scale and invest productively. This will mean different things for different providers, so if we are to avoid a homogenous market akin to Australia, where investment ‘herding’ is prevalent, it is preferable to enable providers latitude in how they drive value for their members.

As we have said, scale is already building in DC schemes and the proposed reforms in the draft Bill will accelerate this further. To address the productive finance question directly, we would like to work closely with Government to establish what contribution DC schemes could and should be making to UK productive finance investment, being rational but ambitious about what is achievable and keeping fiduciary duty and member interest firmly in mind.

Question 3: What do you think is the appropriate minimum size of AUM at default fund level within MTs/GPPs for these schemes to achieve better outcomes for members and maximise investment opportunities in productive assets?

There are important potential benefits to increased scale, including efficiency, diversification and governance improvements, and consolidation is already moving the industry in this direction. Setting targets for schemes could be helpful, but these should not be compulsory minimums, as we disagree that setting a minimum AUM size would necessarily improve member outcomes and maximise productive finance allocations, and many schemes below the size discussed here are already innovating with investments and delivering value for members. DWP's own paper, published alongside this consultation, evidences that there is no correlation between gross returns and AUM (paragraph 70), whilst the modelling detailed in paragraphs 58-64 suggests that the investment case for allocating substantially more to private markets is inconclusive.

Based on these points, it is concerning that Government is considering intervening and closing schemes which may, according to government and regulators' own VFM framework, be providing objectively good value, and have emerged through a true competitive market.

The reference to 'productive assets' in this question could be read as referring to UK-based assets, which would help grow the UK economy. Of course, it is not true to suggest that more investment in UK domestic assets is complementary with improving returns for savers. As we covered in our Pensions Review response, all returns data in recent decades spells out that any scheme with a larger than average home bias would have performed materially worse than better diversified peers over any period.

The suitability of different AUM targets largely depends on timeframes. Any figure would create a cliff edge which would be challenging to operationalise and implement, but to avoid the most perverse consequences of rushed consolidation, we would favour a less aggressive scale target to drive towards other efficiencies (we would advise against any minimum bar of above £10bn by 2030, to align with VFM scale comparators), combined with an investment-focussed initiative which drives to the core of government's objectives. Equally, if deadlines are imposed, this will need to be done conscious of potential difficulties moving potentially resistant employers into a different default. This process could take time with each employer, and this, alongside additional analysis they might decide to conduct, could negate any potential efficiencies to be gained.

Any higher targets, subject to the need for various exemptions discussed above, could result in a number of unintended consequences, including, but not limited to:

- Widespread sale of existing productive finance allocations given liquidity challenges in scheme integrations. Similarly, schemes wary of not meeting the target will be disincentivised from allocating to illiquids, as this would make M&A more challenging.
- Market distortion, which is already happening, where certain schemes lose business (and advisers cease recommending them) if they're seen as unlikely to hit the target. This is dangerous, especially where those are the schemes providing more innovative investment solutions.
- Further downward price pressure in the workplace market, where the rush for scale means providers offer even lower prices to attract more business and asset scale.
- Consolidation and integration is a resource-intensive process. Service within providers can suffer as a result, meaning worse value for members where providers feel forced into acquisitive behaviour. This can also mean those integrating another scheme receive less external new business than they otherwise would.
- The risk of shutting down schemes with green VFM ratings for failing to hit arbitrary targets.
- Poor member experience where pots could be rolled over multiple times between different providers, both through small pot consolidation and scheme consolidation.
- Members in the smallest master trusts could end up stranded. Given the complex, lengthy and costly process of consolidating any scheme, if the rush to an arbitrary scale target is too fast, consolidating the smallest schemes may not be seen as worthwhile for larger providers, so it is unclear what would happen to those members were their scheme terminated.
- There is a risk that due to the necessary focus on M&A and reaching sufficient scale, providers deprioritise and cease investment in other important areas, such as new products and decumulation solutions.

Question 4: Are any other flexibilities or conditions needed regarding the minimum size of AUM (e.g. should it be disapplied in circumstances at regulators discretion for example to enable an innovator to provide competitive challenge in the market or be disapplied in case of a market shock or another specified circumstances)?

It is imperative that Government's approach does not stifle innovation, especially due to the risk of investment herding in a world with a small number of large schemes. The VFM framework already provides a disincentive from risk-taking and innovation to 'get ahead of the pack', and as we discuss above, an AUM test would exacerbate that, meaning it could in future be almost impossible for new schemes to enter the market. Furthermore, it is important to note that even the suggestion of imposing hard AUM targets has already had an impact, specifically on some of those small-mid size master trusts currently innovating the most.

In the UK's price driven workplace market, it is often the smaller providers who have to innovate more on investment, in order to differentiate themselves, since they cannot compete with the big players on price alone. Alongside this consultation, government announced Cushon's partnership with the British Business Bank on the launch of the British Growth Partnership; this is a £3bn master trust, currently well below the mooted £25bn minimum requirement, yet one of the most forward-thinking on productive finance. Therefore, rather than a single aggressive AUM test, we would prefer a less disruptive path to increased scale, and a more focussed asset allocation target regime, enabling schemes to evidence how they're progressing towards government's productive finance objective, while maintaining focus on member outcomes.

If the AUM test is imposed, there would need to be allowance made for the types of scheme we discuss above, with considerable regulatory discretion. If Government wanted to maintain a focus on scale, a growth rate linked metric, evidencing significant progress towards 'adequate' scale could be used in conjunction with evidence on plans for the investment strategy's allocations to productive assets.

Question 5: Do you think there should be targets for (i) achieving a reduction in default fund numbers down to a single fund and, (ii) setting incremental minimum AUM?

As discussed above, a hard AUM test with aggressive timeline, such as 2030, would lead to poor outcomes for scheme members, and likely not meaningfully increase allocations to UK productive finance (indeed it may decrease smaller schemes' investments in productive finance in the years to 2030). While we appreciate political imperatives mean short timelines, in order that we don't lose good value schemes, providing good member outcomes, there needs to be a longer lead in time for any reforms. It is worth noting that £25bn by 2030 would be considerably faster than the consolidation in Australia, where, adjusting for inflation, only five schemes met that benchmark in 2017, 25 years after their superfund regime began.

Should the Government decide to go ahead then progress reporting on scale - alongside stepping stones – would be useful, especially for the regulators, which as per the previous question, will need to exercise discretion. This would work, were reforms to be introduced on a 'disclose and explain' basis, whereby schemes would be afforded some latitude where extenuating circumstances might apply, for instance if they're providing demonstrably good value and allocating to productive assets – rather than imposing a single maximum number of defaults.

Question 6: Are there any potential barriers/challenges that should be considered in reaching a minimum size of AUM at default fund level before a future date, such as 2030?

We predict that approximately 10 existing providers are on track to reach £25bn by 2030, based on organic growth and the considerable positive cashflows in DC. However, as the consultation notes, some schemes would struggle on the current trajectory, unless they processed a large amount of consolidation activity.

We cover the damaging consequences of rushed consolidation above; here we discuss capacity barriers to processing the required level of consolidation.

The integration process is, according to many of our members, very time-consuming, largely due to capacity and process challenges within tPR. These transactions also require considerable work within providers. Therefore we would question whether there is sufficient capacity within regulators or industry to meet government's targets.

Regarding tPR, we understand the process takes considerable time, both in relation to triggering events (which need to be streamlined), and the time taken for approval of the implementation strategy (which, anecdotally, can take close to a year). As a result, receiving schemes have to wait a protracted period before they can begin redirecting contributions and communicating with employers, resulting in poor member experience at best, and increased member scam risk at worst. If AUM targets are imposed, streamlining tPR's processing of these transactions would be beneficial as well as regulatory service level agreements; it would be perverse were a provider not to hit the target because of delays outside of their own control.

Government should also consider the pace of existing scheme consolidations. Integrations require a lot of internal resource, and they often take years to complete – after the transaction is approved. This is down to both technical and administrative challenges, e.g. the infrastructure and operations changes are complex. Therefore, in the five years before 2030, any given provider could reasonably only be expected to complete one or two – and that is assuming commercial agreements can be reached. As above, the resources to process a consolidation are not materially reduced for a smaller scheme, so there is the risk that the smallest master trusts are left stranded if they do not appear commercial for other providers to acquire.

Finally, it is worth noting the difficulty of certain consolidations. While these are less the case for transfers of modern workplace products, consolidation of certain own trusts or legacy products that include guarantees, are considerably more complex. We support the contractual override proposals in chapter 3 – these will greatly ease that process of moving legacy members to better value modern products, but the process will not always be quick, especially where extensive actuarial modelling may be required.

Question 7: Given the above examples, what exclusions, if any, from a required minimum size of AUM at default fund level and/or the maximum number of default funds requirement should government consider?

We agree with the two scenarios described. In the case of the market downturn, the agreed catch-up period can't be prescribed, as what is realistic will be dependent on the nature of the market movement. Therefore, tPR/FCA will need to have discretion to work with the scheme on a suitable timeframe.

We also agree that paragraph 52 is sensible, i.e. accounting for schemes with consolidations in progress, and as per our previous answer, full integration takes time, so this will need to be factored into the additional time given. It wouldn't be in members' interests to wind up a scheme halfway through a consolidation just because an arbitrary threshold hadn't been reached by an arbitrary date.

There are many other examples we discuss above of where exemptions would be needed if government chose to impose both an AUM and default count test (as below), and these numerous necessary exemptions are the reason we believe it would be easier and faster to concentrate directly on productive investment.

- Above we discuss 'sub-scale' master trusts or bespoke employer arrangements which already invest more in productive finance than a typical firm-designed default, and which provide demonstrably good value to members.
- Belief-led defaults, including Shariah defaults would need exemptions, as would whole schemes whose investment beliefs preclude them from joining a larger scheme. The BCF master trust membership's beliefs exclude many investments in other master trusts' defaults, including any equities or corporate fixed interest securities, and they are also prevented from pooling investment funds. This results in an asset allocation completely at odds with most other defaults: a 27 year-old's asset allocation would include 75% cash for instance. There is no clear route to consolidating this scheme, however, at £64m of AUM, arguably it would not make a meaningful difference to the growth agenda overall.
- Above, we cover hybrids/accidental master trusts, such as USS, Railpen and SAUL (the Superannuation Arrangements of the University of London) where there is scale at provider level (between both DB and DC), and this demonstrably contributes to member outcomes and effective investment scale for the DC side. Therefore, where such schemes pool investments, members of the DC scheme have access to an advanced level of in-house investment expertise and capability, as well as the price, efficiency and governance benefits discussed in DWP's analytical paper (paragraph 84). Such schemes often run a highly employer-specific investment strategy, often including higher than average allocations to illiquids and are run on a non-commercial not-for-profit basis and are clearly not set up as a business to be marketed as a DC scheme. As a result, any forced consolidation of the DC section would result in highly detrimental outcomes for members.
- Accidental defaults, which are created beyond the control of providers.

Question 8: With regards to the proposals in this chapter, we anticipate the need for mechanisms to encourage innovation and competition, and for safeguards to protect against systemic risk. Are there other key risks that we need to consider? How do we mitigate against them?

We mention the risk of herding in investments elsewhere, which is a likely outcome of the past performance focus of the VFM framework. This, along with the fact that many of the 'survivors' of the AUM test are likely to be the most cost driven providers (and least innovative in investment terms), will likely lead to a homogenous market where a small number of 'megafunds' all carry very similar investment strategies. This could be - in part - mitigated via forward looking metrics in the

VFM framework, as well as by focussing on investment objectives instead of scale targets. This would favour those schemes genuinely providing good value and those seeking to continuously improve their offering.

In any market dominated by very few very large players, there is a clear systemic risk in the scenario that one runs into trouble. We would argue that moving to such a market is an unnecessary risk to take, especially with our current DC workplace market, which provides members highly competitive fees combined, largely, with strong globally diversified investment returns, while continuously building value and slowly consolidating. As discussed above, through a new investment target initiative, allocations in certain productive areas for the UK economy in certain areas without introducing systemic risk.

Finally, there is a real danger of winding up well-performing schemes – given these proposals are not based on performance – which would also mean members bearing the associated transaction costs. As per figure 11 of DWP's analytical paper, some of the consistently best performers on investment returns are in the £5-10bn bracket. These reforms would, theoretically, ignore this, and force them out of the market, pushing members into a likely worse performing scheme. We would advise against such an uncompetitive intervention.

Question 9: Under a minimum AUM model, competition in the market could be more restricted. Would additional exceptions be required to ensure innovation can continue to flourish?

CDC schemes are a good example of a need for exemptions. New multi-employer CDCs will be setting up from scratch, so while they may grow fast, it would take considerable time for them to reach the scale tests discussed. Nonetheless, we would not expect this to prevent them moving to productive assets quickly; given their cashflows will be overwhelmingly positive in early years, they will face very few liquidity challenges, therefore reducing other barriers to illiquid allocations.

Question 10: We would welcome views on what further interventions or regulatory changes might be necessary or beneficial to accelerate this process?

There are several other initiatives in train that would interact with the initiatives described in this consultation, with several of them cutting across one another, making it imperative to consider sequencing. Several of the initiatives described in the list below are likely (indeed intended) to drive efficiencies gained through scale. Were these proposals, combined with a minimum default strategy AUM, sequenced in a suboptimal way they would likely cause duplicated reconsolidation where pots or schemes that have already been consolidated would then be consolidated again under another measure shortly afterwards. The inefficiency of this, including poor member experience, would need to be carefully assessed when measuring the overall net benefit and proportionality of these measures in relation to member outcomes.

Value assessments for under £100m schemes – TPR has had this initiative in progress for some time, but it has yet to make the most of the opportunity. Compliance has been low, and TPR should have time to fully supervise this existing policy, especially since it is intended to identify poor value schemes and remove them from the market, with the natural consequence that they will be consolidated into larger schemes. This is the only measure focused on the very smallest schemes.

Dashboards [2027] – The Dashboards programme needs to be implemented in its entirety. All other measures are undertaking automatic consolidation on behalf of members, whereas this measure theoretically helps members consolidate their own pots on the basis of their own needs once they have understood their total pension position.

Value for Money framework – The forthcoming framework will enable schemes to assess and compare good value they are offering. It would be illogical for schemes to undertake the extensive work required to assess themselves against the new value for money framework, only to be forced to consolidate based on a strict, binary scale test regardless.

Expansion of AE – Given improving member outcomes should be a key purpose of any intervention it would be logical that the AE 2017 recommendations are put in place by the Government. Any expansion of AE also has the consequence of increasing AUM in the DC market and this would be the case without any forced consolidation based on a scale test. Consideration should be given to assess whether increasing the scope of eligible workers and/or contributions should be pursued with the intention of increasing assets under management, and enabling scale efficiencies to be achieved. All other measures change the sizes of the slices of the pie, whereas this measure is the only one that increases the size of the pie in total.

Guided Retirement – Placing a new obligation on schemes to provide for members in decumulation risks forcing schemes to partner with larger schemes or, in extremis, consolidate where they are unable to deliver these solutions. Both of these options will have the potential effect of consolidating AUM into fewer, larger, better value (for decumulation, at least) providers. Some of the most innovative schemes may well not meet an arbitrary scale test, however, this market is very new and so care would need to be taken to not drive homogeneity in decumulation solutions, especially where 'mass market, one size fits all' products may not well suit members' needs.

Small pots default consolidator - Building and making operational any small pots consolidators should be considered in light of any 'survivors' of this initiative, since transferring, especially very small pots, en masse, to providers that end up not meeting the scale test would require these pots to be moved again at a later date.

Focusing initially on those initiatives listed above, Government has several different routes to dealing with the potential for suboptimal implementation.

We would argue that should Government wish to pursue a scale test at default strategy level, that work on value for money and small pots are paused until the resulting consolidation has taken place. Consideration would also need to be given to how new requirements around decumulation are enacted by schemes when many may be justifiably disinclined to invest in new product builds when their future is uncertain. The expansion of AE, whilst primarily required to improve member adequacy, would also have the effect of supporting schemes to reach scale requirements over a shorter period.

One of the benefits of an alternative, target-based approach is that a pause of other initiatives would not be necessary as it could be designed to be complementary and implementation could be undertaken in parallel. Instead, were a scale test implemented in parallel with these initiatives already in train, there are greater risks of introducing inefficiency, waste and uncertainty into the market; rating schemes as good value after a lengthy and involved assessment process, obligating schemes to design and build good decumulation solutions and consolidating small pots towards them, only for schemes to be eventually subject to forced consolidation as they don't meet a scale test would, clearly, not be in in members' best interests. For this reason, a series of exemptions would also need to be considered in this case, to protect good schemes from the threat of eventual closure, and these exemptions would need to be made very clear so that all employers and their advisers understood that they were not at risk.

Finally, we would argue that different core objectives would lead to different sequencing decisions: i.e., starting with member outcomes as an overall objective would lead you to sequence policies in a different way compared to if you started with UK productive finance investment, or indeed with scale for its own sake.

Question 11: How would moving to a single price for the same default impact positively or negatively on employers, members and providers?

When discussing differential pricing it is important to be clear on the distinction between admin costs and investment charges. The implication in paragraph 62, that differential pricing is simply due to "a focus between providers and employers on price" misses the key point that the cost to the provider of servicing each member (i.e. admin cost) in theory reduces, the more members they serve and the 'book value' increases. As a result, members in most commercial providers benefit from an admin charge which is reduced thanks to their employer's purchasing power - as an individual they would not be offered as low a price. Therefore, differential pricing, based on the admin element of a bundled charge, simply removes cross-subsidies between employer cohorts on what is a fixed cost, meaning many members get a better price.

A problem can, however, arise, when a provider wishes to win new business, but cannot further reduce the admin element (as the cost is fixed). As a result, to reduce their overall quote any further, they must reduce cost in the investment budget by allocating to cheaper assets though tracker funds. As such, differential pricing can cause compression in investment budgets, as providers compete for business. We would argue that this can happen – but does not *need* to be a consequence of differential pricing. Meanwhile, it can be the case that providers extend differential pricing to the investment component, where different employers get the same default. The same efficiencies in admin pricing do not apply here, so we would not support this practice.

The simplest way to implement one-default-one-price is to charge either a flat cash price (or a % of contributions) for the admin, with an AUM % charge for the investment and require unbundling of charges, as proposed under VFM. This model removes the cross-subsidy between employees within a workforce, but introduces a cross-subsidy between different employer workforces, whereby those in a larger employer would help support those from a smaller one. Clearly, there are winners and losers in either model, but in any case, changing the pricing structures would be very difficult, not just operationally, because it would mean substantially increasing costs for many workforces within a scheme – before you even consider increasing the investment budget. This is because those in a large employer would no longer benefit from the bargaining power that employer commands; outcomes for low earners in employers such as supermarkets, would thus be particularly harmed.

While there can be a connection between differential pricing and investment budgets, removing this pricing model would therefore remove the benefits the employer drives in the UK workplace system. Furthermore, by dislocating the employer in this way – removing their ability to tailor their pension provision to their membership (including on investment if bespoking was removed), the incentive for them to contribute above the AE minimum decreases, so we could see overall flows into DC schemes decrease.

Employers or individuals?

Our understanding is that this Government has discarded the previous 'lifetime provider' proposal in recognition of the value and importance employers bring to pensions in the UK. We support that decision, but must stress that a removal of differential pricing risks setting a path to an individual-focused pensions system, where employers have no influence over price or investment strategy (meaning higher individual member charges and more homogenous default funds), and which would lead back to that lifetime provider model.

This system works in Australia, in a largely nonprofit industry without a charge cap, where minimum **mandatory** contribution levels are higher, but it would be arguably impossible to retro-fit to an industry dominated by corporates with a charge cap, unless government plans to shift the UK system to that of a non-commercial quasi-utility service. Finally, one other potential impact in the UK might be the introduction of 'differential servicing'; if providers can't vary the price for different employers, they'll simply offer them different levels of service.

CHAPTER 3 – CONTRACTUAL OVERRIDE WITHOUT CONSENT FOR CONTRACT-BASED ARRANGEMENTS

Question 12: Under what circumstances should providers be able to transfer savers to a new arrangement without their consent?

Paragraphs 69-75 provide a clear and accurate description of why the introduction of transfers without consent would be highly beneficial for contract-based schemes. Such a mechanism would enable providers to comply with new rules, according to VFM and small pots frameworks, while it would also enable providers to move members out of legacy products into better value 'modern' ones. They key principle for such transfers must be that they are always in members' best interests and improve value they receive.

Our members have widely stated that the lack of this mechanism to date has prevented them from moving legacy customers to, often far lower-charging, better value arrangements (as Consumer Duty would require), given only very small proportions of members provide active consent when contacted about such a transfer. Our assumption is that for most of the transfer activity this proposal is facilitating, the intention is to transfer members into a better value product *within the same provider*.

Our members have also stated that these transfers would give providers more leverage with modern bespoke adviser-led arrangements, where they think better value could be offered by moving those members into the firm-designed default.

Another scenario where this would be useful is where a single-employer trust is consolidating into a master trust, and alongside the main trust, there may be a small number of older GPP policies. Under the status quo, these will often get left behind wherever member consent can't be obtained, but with a contractual override, it would allow these fragmented legacy policies to move with the rest of the workplace book.

Question 13: Do you think that an independent expert, such as an IGC, should be responsible for undertaking the assessment of whether a transfer is appropriate?

We agree there needs to be rigorous oversight and governance to ensure members are only moved without consent if it is in their best interests. Some of our members have suggested that firms' Consumer Duty should be sufficient to ensure this, but given this applies at a principles level, it is unclear that at individual level it could be counted on to ensure transfers would always be good value.

We agree the IGC (or Governance Advisory Arrangement) is the logical oversight body, given their role is to provide an independent view on value provided within contract-based products. However, we are conscious this may represent an extension of the IGC role into a more operational, trustee-like role, with attached liability, and anecdotally, we understand some IGCs would not support this extension of their responsibility. Some of our members have also suggested that IGC oversight of these transfers would be very costly, given the cost of additional IGC time required. However, some of this time may be offset by the IGC time saved by no longer needing to oversee older legacy products.

One alternative suggestion is that schemes seek independent assessment of the transfer from an independent investment consultant, who themselves, subject to other proposals in this consultation, be regulated by the FCA. In any case, we would suggest that, given the technical analysis involved, IGCs would inevitably need to employ investment consultants and/or actuaries to properly assess value, especially where the legacy product might be more complex and involve guarantees.

As a result, we consider that IGCs are the right body to provide oversight of these transfers. The key question is what level of approval they are required to provide, i.e. whether active approval is required, or whether a more general opinion which the provider would consult, would be sufficient.

Question 14: What, if any, changes may be needed to the way an IGC's role, or their responsibilities/powers for them to assess and approve contractual overrides and bulk transfers?

Assuming IGCs do oversee such transfers, it would make most sense that they are required to consult on transfers proposed by the provider, and pass a judgement on whether it is in members' best interests and represents improved value, and they would take independent actuarial advice to do so. The provider would then ultimately be responsible for the decision-making on the transfer, and be required to take into account the IGC judgement.

Given the added importance on the IGC judgement, and potential for conflicts, some of our members have also suggested that all IGC members should be required to be independent from the provider.

Finally, as this proposal is clearly moving IGCs to a more operational, trustee-like function, consideration needs to be given of another key difference, in that often an IGC will oversee many small products, unlike a trustee, which will often involve much closer work with one large scheme. The framework IGCs carry out this duty under therefore needs to be clear and proportionate in how they assess value. An obvious route to take would be that they can only approve transfers into green-rated VFM schemes (which would also necessarily mean open, workplace defaults).

Question 15: What, if any, role should the employer have in the transfer process?

and

Question 16: For active schemes, would a transfer require a new contract between the employer and provider?

The consultation notes that often with these legacy products, the employer relationship may have ceased. However, where that relationship is still active, e.g. if an own trust is consolidating, or if an AE scheme receives a red VFM rating and **has to** move members, then the employer would need to be consulted, not least because any change would affect where future contributions are paid to. In such a scenario, while the simplest option may be to move into the same provider's firm-designed main default, it is unclear whether a provider would have to offer this both via the master trust and GPP route, where both products are available.

As above, where an active scheme is moved, a new employer contract would be required, given the various administrative changes, while this process might in some cases prompt an employer to conduct their own wider provider review (possibly with the assistance of an adviser).

Question 17: What procedural safeguards would be needed to ensure that a new pension arrangement is suitable and in the best interests of members? What other parties should be involved and/or responsible for deciding the new arrangement?

and

Question 18: Do you foresee any issues with regards to transferring savers from contract-based arrangements to either other contract-based arrangements or trust-based arrangements? If so, what issues?

A scheme would need to carry out statistical modelling to analyse the outcomes for the members, and decide whether the transfer would represent good or bad value for each member. Where the legacy product contains guaranteed annuity rates, guaranteed investment returns or With Profits, these calculations could be very complex, and some of our members have suggested that such policies may not be in members' interests to transfer, and that doing so could create significant liability issues, as seen with DB to DC transfers. However, our understanding is that within most providers, these benefits are a minority – most legacy business is legacy GPP, stakeholder, or unit-linked policies which should be more straightforward to transfer.

We understand most cases of these transfers would be moving members of a legacy product into a modern AE workplace scheme. However, there is a risk that they could be moved into another legacy product only offering a marginal value improvement. As above, we suggest that this process is aligned with the VFM framework, so that transfers without consent can only be effected into a green-rated scheme. There does remain a risk, when combined with potential scale tests, that an IGC might have to approve a transfer out of a green-rated scheme, simply because it didn't meet a scale threshold; if otherwise performing well, this would be hard to justify in terms of members' interests.

The proposed process involves the provider first suggesting a suitable better value option, before seeking a third party's assessment. Again, we assume that there would be no obligation on the provider to include external product options; if it did, the scope of due diligence and analysis would be considerably wider. Further, while it could take multiple years to conduct an internal transfer, this could be far longer if external, as the two providers would need to liaise, there may be large employers involved, where benefits are linked to broader employee benefits platforms, so there would be more complexity to work through.

One final challenge that could arise in future is that as more defaults are invested in illiquids, the transferring of assets can take more time, and this could mean providers need to tranche transfers as in the DB buyout market. This is more likely to be a challenge in future as more workplace defaults might invest in illiquids, though the issue could arise too in legacy products which may hold sizeable commercial property allocations.

Question 19: What safeguards and measures should be put in place to ensure that consumers are protected?

As above, we think that requiring transfers only move to green rated defaults, that IGCs would provide independent value assessment, and that firms will also only be able to process these transfers in accordance with Consumer Duty, should provide adequate protection and ensure that transfers only happen where in members' interests. Where products with guarantees are involved, there should be a requirement of actuarial advice to establish how much compensation – if appropriate – might be paid.

Question 20: Are there any specific circumstances in which a transfer should not be allowed to take place, or savers should be able to opt out?

If the transfer is occurring because it has been independently verified as offering members better value, or where the transfer is the result of the provider abiding by legal obligations (VFM wind-up), there should only be the ability to opt-out in-so-far-as a member can transfer out. Opting out to remain in the legacy product should not be an option as this would prevent a theoretically poor value product from closing and would also prevent further consolidation and simplification.

Question 21: What complications could arise if savers have the choice to opt out of a transfer and remain in their current arrangement?

Clearly, there would be more fragmentation of investments as these members' money would continue to be invested in an increasingly minority fund, which the provider had assessed as poorer value than alternatives.

Question 22: In what circumstances do you think that consumers/savers should have the right to compensation or an individual right of recourse enforceable in court?

Where a transfer out of a legacy product means a member relinquishing valuable guarantees, this could entail compensation payments from the provider, where an independent actuary confirms this is appropriate.

Question 23: What safeguards from trust-based bulk transfers may be appropriate for contractual overrides, so that similar consumer protections apply?

Question 24: Where the transfer is into a trust should the duties of the receiving scheme trustees be extended to ensure terms and conditions balance both the interests of incoming and current members?

In reality, risks here are unlikely to materialise because were a transfer likely to cause worse outcomes for existing members of a scheme, the fiduciary duty of that scheme's trustees would prevent them from going ahead with the transfer.

Question 25: How should the cost of the transfer be borne?

The cost of the transfer, including all the provider's analysis, should be covered by the provider. As the consultation notes, where any of this cost is passed onto members, this would need to be factored into the value assessment.

We have also heard from providers that it would be in both members' and providers' interests to move people out of a lot of legacy products. In this case, given providers would only be proposing a transfer where it was likely to be commercially viable (as well as better for the member), it is only reasonable the provider pays for this.

Any standalone member costs to fund a transfer should not be allowed. Costs like this are likely to be highly unattractive to members, and would likely push them towards the retail market – where the opposite – in the form of incentives – can be offered for transfers, often masking a product offering overall worse value.

Question 26: What costs do you expect to be involved in a contractual override/bulk transfer and what factors may influence the level of costs?

The largest cost is likely to be the oversight body, which could include both IGC hours and an independent adviser. The provider's own analysis would also come at a cost, albeit covered internally. There would also be transaction costs wherever investments could not be transferred in-specie or simply reregistered.

Question 27: What benefits may a member lose out on because of a bulk transfer? What benefits could they gain?

These are largely covered in the consultation and above in our answers. Legacy products include Guaranteed Annuity Rates, Guaranteed Investment Returns, With Profits, early retirement provision, as well as certain tax protections, all of which are very valuable to members. However, such features tend to be a minority of providers' legacy books.

Those benefits aren't typically available in modern workplace products. However, administration systems can cost millions to run, for relatively few members with these benefits, there can be a considerable saving for the provider if they close the product, and we would expect this might often fund compensatory payments, as has happened in the past in some providers when certain products have closed.

Question 28: What role should the FCA, and where appropriate TPR, have in contractual overrides and the bulk transfer process?

Paragraph 87 suggests "the FCA would set out rules to ensure a suitable and standardised approach to assessing the value of benefits"; we would be interested to discuss this in more detail. Clearly, FCA needs to supervise this transfer activity, and it will be important that they do so in alignment of how tPR supervises equivalent transfers out of trust-based schemes in order to avoid regulatory arbitrage.

CHAPTER 4 – COSTS VERSUS VALUE: THE ROLE OF EMPLOYERS AND ADVISERS

Question 29: Do you think establishing a named executive with responsibility for retirement outcomes of staff could shift from the focus on cost and improve the quality of employer decision-making on pensions?

and

Question 30: What evidence is there that placing a duty on employers to consider value would result in better member outcomes? If such a duty was introduced, what form should it take? Should it apply to a certain size of employer only? How can we ensure it is easier for employers to make value for money comparisons?

Earlier in our response we discuss the current importance of the employer in pension provision. Some of the proposals in this consultation would result in a significantly reduced role for employers; we answer this question based on their *current* role, rather than a potential future where other reforms might have resulted in a more individualised pensions system, and therefore a compromised role for the employer, which we do not support.

Our members' views are split on these requirements, but overall they are unconvinced they would lead to substantial change. Either option could only apply to the largest employers, which have the resources to support the requirement, including either internal expertise or the cost of consultants, while the increased burden on employers more generally, in the form of increased National Insurance, should also be borne in mind. The key issue is that most large employers will already be conducting reviews on a semi-regular basis, and where these are not leading to more 'value' improvements, the consensus is that this is down to the advice they receive. Indeed, according to research carried out by Cushon, almost half of employers with over 500 people prioritise cost in provider selection, even though they rate costs as less important to value than other factors, such as investment performance, provision of a good income, and easy member servicing. Therefore, it is not clear what added value this duty would bring.

There is also a concern that this would simply lead to a 'cottage industry' for EBCs, which as the consultation acknowledges, are not always focussed on the most important factors in scheme selection. Conversely, where an employer is already receiving specialist advice, it will often have considered 'value' more comprehensively, and have concluded that a more expensive investment strategy, including 'productive finance', wouldn't necessarily be an improvement. This may especially be the case where an employer is not the only actor that needs to recognise the benefits, but where it would be necessary to explain any increased charges – and the value of them - to the membership.

Of the two options though, members prefer the regular review, and from our member survey, this was seen as the most effective of all the options in this section of the consultation by 48% of respondents, which reflects that our members largely support the role of the employer in good retirement outcomes. The utility of the review would come down to exactly how employers should evaluate pensions provision; we agree making use of VFM metrics makes sense for consistency, however, we would not expect many employers to have the expertise or resources to fully evaluate the entire complex dataset, so clear guidance would be needed. Some of our members did, however, suggest that in a VFM world, where choice of scheme may only be limited to a small number of good value arrangements, such a review may not be necessary, and so an employer duty would be unnecessary also.

If a review duty was imposed, it would make sense to link it to the regular AE reporting that employers already have to do, and that only large employers were in scope to begin with. Once the review process was refined, and proved worthwhile, it could then be extended in a proportionate manner to smaller employers. Again, though, this duty may only be worthwhile once some EBCs' focus could be more aligned to 'value' factors.

Finally, there may need to be certain exemptions, such as where employers are part of collective agreements and therefore cannot exercise choice over their provider, e.g. USS and Railpen.

Question 31: What evidence is there that regulating the advice that some employers receive on pension selection will better enable them to consider overall value when selecting a scheme?

We would support the regulation of those advising employers on provider selection and, anecdotally, we've heard broadly that price tends to be the biggest factor in the recommendations of – especially – smaller advisers.

It is important to be clear who we are discussing and what role they have. Advice employers receive varies, from basic one-off assessment of a small number of options, to a full provider analysis, including detailed evaluation of investment options, with ongoing review. This in-depth service is typically provided for the larger employer market by EBCs, and for providers this smaller number of EBC-advised employers will account for a large proportion of assets. Smaller employers might typically be advised by Corporate IFAs, providing a more basic service, and for the very smallest, an accountant might appoint a provider.

Given both have an influence on price in the market, we believe both should be regulated for specific services – and Corporate IFAs will often already be, given they also advise individuals. Advising EBCs would have a greater impact though, given the larger funds they advise on. Bigger EBCs are often dual FCA-IFOA regulated, and their existing FCA authorisation means they must apply Consumer Duty across their whole business and report on it. Smaller advisories without this authorisation are clearly subject to less scrutiny, and we understand some of them may only have a relationship with a single provider. For these smaller advisers/accountants, one measure to increase focus on value could be to require the accountant to attest in the annual report they've picked a good value scheme for employees.

Like with investment consultants, regulation would need to be proportionate, given it would increase the cost of advice overall, but one key element would be a thorough understanding of the employer business model and its needs (both EBC and Corporate IFA advice often do not take account of this in any detailed manner), and mandatory requirements to provide certain details – including non-cost elements such as in the VFM framework - to clients when providing that advice. Where EBCs are advising larger employers, modelling and analysis of different default strategies – as done by investment consultants – would be helpful too.

Regulation of EBCs would logically be a prerequisite for regulation of investment consultants. Investment consultancy provided to master trusts necessarily accounts for price: if the investment strategy is too expensive, the master trust will inevitably lose clients. Therefore, the provider selection cost bias needs to be removed for investment strategy advice to change meaningfully.

Furthermore, many EBCs only recommend a shortlisted panel of providers. Robust, objective provider reviews should be regulated for to also ensure their decision-making isn't conflicted by either existing advisory relationships that they may have with certain providers, or even where a firm has an in-house master trust.

Question 32: What evidence is there that regulating the advice that pension schemes receive on investment strategies would enable more productive asset allocation? What type of regulation would be effective?

PLSA has long supported the regulation of those providing investment advice to pension schemes (see our response to the FCA's Asset Management Market Study and the resulting referral to the Competition and Markets Authority[1]). This should improve the quality of advice, although it's important to note that this, in and of itself, won't necessarily increase allocations to productive finance assets, as these may already have been considered. Trustees still have their fiduciary duty to consider, and especially where the supply of quality productive assets is lacking, they still may not consider a change in investment strategy to be good value.

At present, financial advice provided to individuals is heavily regulated by the FCA, but the advice trustees take on investment strategy, which can have huge impacts on the savings of thousands of people, is unregulated. Such regulation has also been part of the FCA's business plan for some years, following the CMA's initial recommendation to HM Treasury for this regulation over five years ago.

Many of our members support this regulation and it is unclear why HMT have not yet implemented it; in any case it will be key to identify exactly how investment consultants' conduct would be supervised. IFAs need to follow a set qualification route, and firms are regulated via the FCA's Senior Managers and Certification Regime. Therefore, one route to hardwire focus on specific elements, such as expertise in longer-term alternative assets to maximise holistic value for members, would be to include a short qualification on this topic, while including the advisory firm as a whole to achieve FCA authorisation.

[1] See, for example, the PLSA's response to the CMA's Provisional Decision Report, and the PLSA's response to the CMA's Working Paper on Information on Fees and Quality.

CHAPTER 5 – IMPACTS AND EVIDENCE

We have encouraged our members to respond directly to these questions, and would refer you to their answers.

ANNEX 1 – LETTER TO DWP ON ACCIDENTAL DEFAULTS (22 SEPTEMBER 2022)

RE: UNINTENDED DC DEFAULTS LEADING TO MEMBER DETRIMENT

During our meeting in August we agreed that the PLSA, with help from our members, would draft a letter to you outlining the problems arising from the 2015 Charges and Governance regulations and how they classify what amounts to a DC "default arrangement". The legislation creates inadvertent default arrangements which can result in members' funds being invested against their wishes, can increase costs, and can impede sensible trustee activity to upgrade and consolidate DC schemes. The result of all these factors is member detriment.

Why is this an issue now?

Because there is increased transfer activity in the market, as DC own trusts move members and assets to master trusts, as master trusts consolidate (transferring members and assets), and as trustees (of all trusts) refresh their investment offering to DC members, with a particular focus on ESG factors. Each of these situations heightens the risk of creating inadvertent default funds which cause member detriment and impair the member's experience.

Why is this something about which DWP should be concerned?

Because it causes member detriment. The legislation works against the value for members' principles by increasing transition costs (including adviser fees to navigate the legislation), and by causing members' funds to be invested in ways contrary to their instructions – there is a risk this could lead to a further breakdown of trust and confidence in pensions if members perceive schemes to be acting against their instructions. In addition, the legislation may increase discrimination risk by diverting assets away from specialist Shariah funds against their instructions and it may impact the successful implementation of trustees' ESG policies and management of climate change risks, which are an integral component of the government's roadmap towards greening the financial system.

What's the cause of the issue?

Most issues arise from the definition of 'default arrangement' in regulation 3 of the 2015 regulations[2]. Those regulations were amended in 2018[3] which saw (amongst other things) the introduction of a limited easement regulation 4(4) for self-select members not protected by the default arrangement charge cap. Both sets of regulations were consulted on in their original form[4], and relevant DWP guidance[5] was published in 2018 (see paras 50-58 in particular). TPR's guidance is contained in its DC investment guidance[6].

The wording of the regulations, particularly when read alongside DWP and TPR guidance, creates the member detriment issues flagged in this letter. They create considerable uncertainty and a

[2] The Occupational Pension Schemes (Charges and Governance) Regulations 2015

[3] By the Occupational Pension Schemes (Preservation of Benefit and Charges and Governance) (Amendment) Regulations 2018

[4] https://www.gov.uk/government/consultations/better-workplace-pensions-putting-savers-interests-first; https://www.gov.uk/government/consultations/bulk-transfers-of-defined-contribution-pensions-without-member-consent-draft-regulations

[5] Bulk transfers without consent: money purchase benefits without guarantees - Guidance for trustees April 2018

[6] Appendix 1, TPR's DC Investment Governance Guidance: https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/investment-guide-for-dc-pension-schemes-

range of legitimate legal views about when a default arrangement is created. The outcome does not always align with trustees' overriding fiduciary duties, nor support the government's policy to facilitate consolidation of smaller schemes into larger, better governed schemes.

We can provide more detail if helpful.

How can DWP help?

By engaging with us in a constructive discussion to amend the legislation and accompanying guidance so it works as intended and doesn't cause member detriment. We have ideas about how to simplify the regulations to make them work better which we would be very pleased to discuss with you.

Specific examples

We have set out below a little more detail on the specific problems and real-life examples we are encountering in practice.

- **Members' contributions eroded in real terms** as they were left invested in cash when the member had chosen to be invested in property. These members have now seen low returns from cash and an erosion of their savings versus inflation. This occurred following the re-opening of property funds which were gated in March 2020, and legal advice said that members couldn't be automatically moved back to their original choice without consent due to the operation of the legislation and parameters around a "default arrangement".

- **Self-select members are exposed to ESG risks**. If trustees wish to transfer money from a current non-default ESG fund into a preferable non-default ESG fund (e.g. to increase climate change focus) within the same scheme, unless member consent is acquired, the new fund will often become a default, despite the preferable fund having similar objectives, characteristics and risk profile to the current fund. This means that the preferable fund would need to comply with the charge cap (amongst other things), which may not fit with the asset allocation and strategy of the non-default ESG fund – for example, it may be a property fund or fund invested in other illiquid assets (e.g. infrastructure) with a charging structure which exceeds the charge cap.

- **Members transferred out of religious options into standard (non-religious) options –** we've seen situations where a master trust receiving a bulk transfer (without consent) doesn't offer members to be transferred into anything but default options because of the regulation. Members therefore get mapped into a standard default without religious (often Sharia, or otherwise ethical) considerations which we consider could be discriminatory. For members to reinstate their choice (i.e. for religious or other grounds) they would incur transaction costs and also need to provide positive consent to re-instate their fund choice (despite having elected the Shariah fund previously).

- **Members with small pots may be adversely impacted –** whilst legislation is ongoing in this space, the current legislation would mean new defaults would be created with small pot transfers and this could lead to members not being able to be consolidated, to their detriment, because of the administrative and governance burden of taking on these small pots.

- **All member holdings moved to a default after a change to a non-default investment option, and members incurring transaction costs both for this and**

to reinstate any choices. In certain circumstances, when a fund manager makes changes to a non-default fund (for example, to incorporate ESG components), the scheme legal advisers may deem it to become a default unless explicit member consent is obtained. However if, as can be the case with some active funds, the fees exceed the charge cap, absent member consent, the holdings cannot remain without consent and the impacted members would be transferred to a default, typically a lifestyle strategy. Some providers' systems do not allow for members to be invested in both a lifestyle strategy and other self-select funds, so all of the non-consenting members' holdings, including other previously self-selected funds where no changes are being made, get transferred to the default lifestyle arrangement. This would result in transaction costs being incurred across the whole of the member's savings for no reason. We have seen this occur for some members where the fund being changed was only a small percentage of holdings, but their entire pot was transferred to the default lifestyle arrangement, incurring costs.

As above there are a range of scenarios where scheme members are suffering detriment as a result of what we believe to be an unintended intricacy of the legislation. We have some ideas as to some minor amendments to the legislation and accompanying guidance which might prevent this from happening. I hope this letter is helpful in outlining the issue, and will help in directing it suitably within the department, and we would value the opportunity to discuss these further with you and colleagues.

Yours sincerely

Ruari Grant
Policy lead: DC

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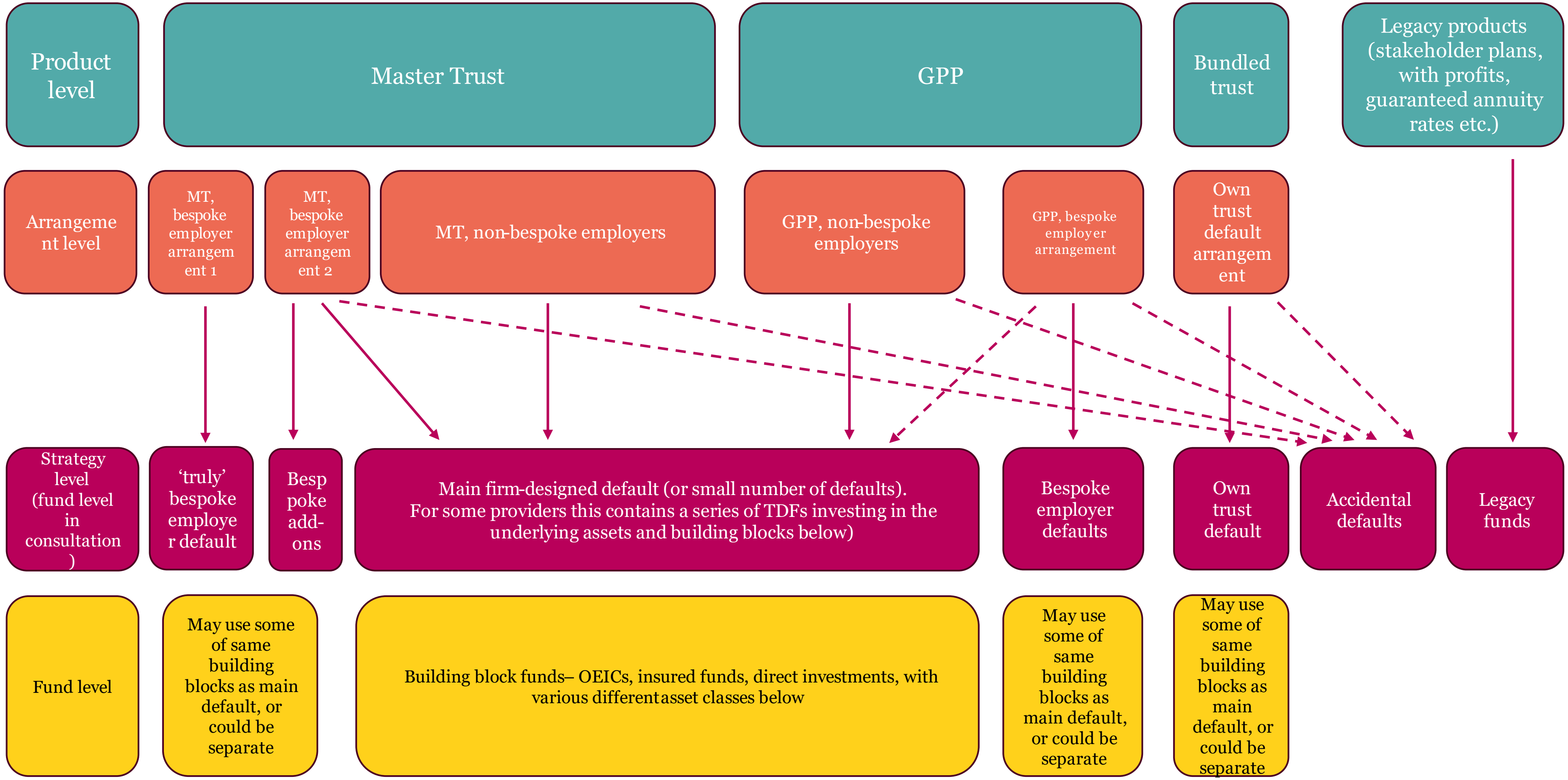
PENSIONS AND LIFETIME SAVINGS ASSOCIATION

ANNEX 2 – PROVIDER STRUCTURE



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