Pensions Investment Review: Unlocking the UK pensions market for growth

Consultation on reforms to the Defined Contribution pension market to build scale and put savers first

14 November 2024

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Introduction

About this consultation

Purpose of the consultation

This consultation seeks views and evidence on proposals to reform the Defined Contribution pension market.

Who this consultation is aimed at

We expect this consultation to be primarily of interest to:

- pension scheme trustees and managers, including those from Defined Contribution Master Trust schemes
- those operating sector wide pension schemes
- Independent Governance Committees (IGCs) and managers representing contract-based pension schemes
- employers, their representative groups and adviser community
- pension scheme service providers, other industry bodies and professionals
- individuals
- trade and representative bodies
- Trade unions, member representative and consumer groups

Scope of consultation

This consultation applies to Great Britain as pensions is a reserved matter for Scotland and Wales.

Occupational pensions are a devolved matter for Northern Ireland. It is anticipated that Northern Ireland will take the same approach that is taken in Great Britain.

Duration of the consultation

The consultation will run for nine weeks and begins on 14 November 2024 and will run until 16 January 2025. Please ensure that your response reaches us by that date. Any replies received after that date may not be taken into account.

How to respond to this consultation

Please send your consultation responses via email to:

DWP DC Reform Policy Team, at the following email address:

quarryhouse.pensionsinvestmentreviewdcreforms@dwp.gov.uk

Please indicate whether you are responding as an individual or representing the views of an organisation.

Government response

This consultation is linked to the Interim Report of the Pensions Investment Review and the analytical paper - Pension fund investment and the UK economy: Analysing the trends of UK pension fund investment and the implications for UK economic growth, which have been published at the same time. We will publish the government response to this policy consultation on the GOV.UK website.

How we consult

Consultation principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in March 2018. These principles give clear guidance to government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
Legislative Strategy Team
4th Floor, Caxton House
Tothill Street
London
SW1H 9NA

Email: caxtonhouse.legislation@dwp.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, HM Treasury, Financial Conduct Authority and The Pensions Regulator, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP and HM Treasury, please contact the Central Freedom of Information Team:

Email: freedom-of-information-request@dwp.gov.uk and
FOIrequests@hmtreasury.gov.uk

The Central Freedom of Information team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.

Data Protection and Confidentiality

For this consultation, we will publish all responses except for those where the respondent indicates that they are an individual acting in a private capacity (for example, a member of the public). All responses from organisations and individuals responding in a professional capacity will be published. We will remove email addresses and telephone numbers from these responses, but apart from this we will publish them in full.

For more information about what we do with personal data, you can read DWP's Personal Information Charter.

Ministerial Foreword

As the first ever joint Treasury and DWP Minister, it is a pleasure to be leading the Pensions Investment Review. We must seize this opportunity to drive reform in our pensions system to deliver better outcomes for future pensioners and investment into the UK economy.

Our timelines for the review have been ambitious because growth is the leading priority of the government. Industry and other stakeholders have been generous with their time. I am grateful for the swift responses they have made to contribute to our thinking. We received over 200 responses to our Call for Evidence. I look forward to continuing to work constructively with all stakeholders as we develop these proposals.

Since coming to power, this government has taken immediate action to start to improve the workplace private pension system. We have announced a new Pension Schemes Bill, which will include measures to improve saver outcomes and increase opportunity for investment, including in the UK. One of those measures being a Value for Money Framework for Defined Contribution schemes, to shift the focus from cost to value, so that pension schemes are focussed on delivering for savers over the long term.

Our Manifesto was also clear that this government will take further action to ensure that workplace pension schemes take advantage of consolidation and scale, to help deliver our objectives. Responses to the Call for Evidence and wider international evidence suggests that the benefits of scale start to be realised at around £25 billion, but our analysis also shows that real benefits from an investment capability and economic growth perspective come into effect when funds reach over £50 billion.

Whilst the UK pension market has been consolidating, the pace is too slow. I want to do more to facilitate and accelerate consolidation to ensure UK schemes have the scale to compete for investment opportunities with their international counterparts. This consultation includes proposals for further reforms, designed to ensure there are fewer, bigger, better run pension schemes with the resources to pursue the investment diversification that can deliver improved returns for hard working savers.

Respondents to the Call for Evidence also highlighted the need to ensure all participants in the market are focussed on driving value for savers. This consultation seeks evidence on possible options for helping all employers and their advisers evaluate the best workplace pension for employees. I am interested in hearing your views on the efficacy of the different suggested approaches.

Together we can build a pension system that is amongst the best in the world, driving higher investment into our economy and the returns to give our future pensioners better pensions.

Emma Reynolds MP, Minister for Pensions

Chapter 1 – Background

1. In July 2024 the Chancellor announced a landmark Pensions Review, the first phase of which was purposed with exploring new ways to boost investment, increasing saver returns and tackling waste in the pensions system. The joint HM Treasury-Department for Work and Pensions Minister Emma Reynolds MP was asked by the Chancellor to lead the first phase of the review, which is focussed on four specific areas:

- Driving scale and consolidation of defined contribution workplace schemes.
- Tackling fragmentation and inefficiency in the Local Government Pension Scheme through consolidation and improved governance.
- The structure of the pensions ecosystem and achieving a greater focus on value to deliver better outcomes for future pensioners, rather than cost; and
- Encouraging further pension investment into UK assets to boost growth across the country.

2. The review launched a Call for Evidence in September and has consulted widely to develop its analysis and policy options, collaborating with industry and the Local Government Pension Scheme. The government committed that it would report its interim findings this year ahead of the introduction of the Pension Schemes Bill in 2025, with the final report due in the Spring.

3. In developing its interim recommendations, the review has considered the following:

- Boosting returns for pension savers.
- Improving the affordability and sustainability of the Local Government Pension Scheme in the interest of members, employers and local taxpayers.
- The role of pension funds in capital and financial markets to boost returns and UK growth.
- Any implications for wider government financial stability policy objectives such as with respect to the gilt market.
- Fiscal impacts, which will need to be considered in the context of the public finances.
- The progress already made on in-train policy initiatives such as the Value for Money Framework and other live reform programmes.
- A wide range of external viewpoints, including employers, trade unions, the pensions industry, financial services, local government and consumer voices.

Introduction

4. The responses to the Call for Evidence demonstrated wide support and agreement that scale leads to economies, efficiencies, reduced risks as well as enabling greater expertise and diversification in investments which can importantly deliver better long-term returns for savers.

5. Respondents to the Call for Evidence also called for action to help enable the transfer of assets for contract schemes without savers' consent when this is clearly in their best interests. This was highlighted as a key measure which could help accelerate the pace of consolidation, address the fragmentation in the pensions system and help disengaged savers.

6. We also heard a broad consensus that the market is not operating effectively and an excessive focus on price risks crowding out more diverse investments into a wider set of asset classes which can deliver better returns over the long term. There was some support for action to ensure all participants in the pensions ecosystem are focussed on value and we would like to hear more about the potential options.

Policy Proposals

7. This consultation proposes two key measures designed to accelerate and help enable scale and consolidation in the Defined Contribution (DC) market –

    i. **Achieving scale in workplace DC schemes.** The government is clear that the future of the workplace DC market lies in fewer, bigger, better run schemes, with the scale and capability to invest in a wide range of asset classes that can deliver better returns for savers long term and invest in the UK, which benefits savers and their communities. Chapter 2 sets out our proposals to remove complexity and fragmentation from the market and ensure that the vehicles used for Automatic Enrolment (AE) are operating at a large scale. To help achieve this, we are seeking views on proposals to introduce minimum size requirements for default arrangements as well as limits on the number of default arrangements.

    ii. **Overriding individual contracts to allow the bulk transfer of assets for contract-based schemes without individual savers' consent**. Responses we received highlighted how the requirement to obtain individual consent from savers to override individual contracts is a real barrier that currently restricts consolidation and the transfer of savers into arrangements that have the potential to deliver better outcomes. Respondents have called for a legislative solution to resolve this that would be wider than what will be required under the new Value for Money (VFM) Framework. Chapter 3 sets out our proposals to do this, with the additional consumer protections and safeguards that we are considering.

8. **Furthermore, this consultation explores what could be the ongoing roles of employers and those who advise them.** Chapter 4 seeks views on what the role of employers should be in a more consolidated market and also whether those who advise them should be subject to more oversight.

Next steps

9. In addition to the responses to this consultation, we will continue our collaborative approach of working with the pensions industry, business, regulators and other key stakeholders on the development of these proposals before delivering changes.

10. We recognise many of the proposals in this consultation could lead to fundamental changes which will require primary legislation. A decision on whether to include these measures in the upcoming Pension Schemes Bill will be made in light of the outcome of this consultation.

11. In addition to the proposals explored here, DWP, TPR and the FCA are already taking action to improve saver outcomes and increase investment opportunity which complement the proposals set out here, such as with the VFM Framework.

12. These reform proposals are an interlocking package of measures which sit under the overarching aims of the Pensions Investment Review to boost investment, increase saver returns and drive a greater focus on value over cost in the pensions system. They support the government's aim of fewer, bigger, better run schemes, with the scale and capability to invest in a wide range of asset classes that can deliver better returns for savers long term and invest in the UK, which benefits savers and their communities.

Chapter 2 – Achieving scale in the Defined Contribution market

13. Getting to the right level of scale in the DC market means building on existing market consolidation. Enabling more consolidation and opening up greater opportunities for investment should rightly come with the highest levels of protections for savers.

14. Automatic Enrolment (AE) has led to growth in the DC pension scheme market. Currently, there are over 1,000 DC pension schemes (12 members or more), including around 30 authorised Master Trusts (MTs) and 30 providers of contract-based workplace pension schemes (e.g. Group Personal Pensions (GPPs)). The vast majority of savers are now within these multi-employer arrangements, with around 10 million active savers in Master Trusts and around 6 million active savers in workplace contract-based arrangements[1].

15. The number of DC schemes has been falling, particularly on the trust side with a fall from nearly 3,700 schemes in 2012 to just over 1,000 in 2024[2]. If this rate of consolidation were to continue, it could mean the number of DC trust-based schemes falling to just over 500 by 2030[3]. There is also ongoing expansion in this market, and it is projected, for instance, that the trust-based market could grow from around £140 billion in 2023 to about £400 billion in 2030 in real terms[4] and that overall assets in DC workplace schemes could grow to about £800 billion[5].

16. There remains, however, wide variation in member outcomes and limited diversity in how pension providers can and do invest. Many schemes are either not currently at or making use of scale to help seek better returns for members and more productive investment including in the UK.

17. Both MTs and GPPs vary greatly in size, from tens of millions of pounds in assets under management (AUM) through to around £100bn. The largest GPPs tend to be bigger in terms of total AUM, often as they have been operating in the market longer. However, only a small number of GPPs have reached £50bn in AUM, whilst no Master Trusts have yet reached this size, though a number are growing significantly and likely to reach this scale in the near future[6].

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[1] Workplace contract-based arrangements are largely Group Personal Pensions (GPPs) but may also include other types including Group SIPPs and Group Stakeholder Pensions.

[2] Occupational defined contribution landscape in the UK 2023 | The Pensions Regulator

[3] Trends in the Defined Contribution trust-based pensions market - GOV.UK

[4] Trends in the Defined Contribution trust-based pensions market - GOV.UK (www.gov.uk)

[5] PPI The DC Future Book 2024

[6] Trends in the Defined Contribution trust-based pensions market - GOV.UK

18. However, GPPs often have many more default arrangements[7], meaning the average assets per default can be lower, which can cause fragmentation in the market and impact the ability of schemes to invest these smaller funds in productive assets. This is something the government intends to explore.

19. The government recognises, and several respondents to the Call for Evidence acknowledged, that the DC workplace market is already consolidating. However, the rate of decline has been most prominent for very small schemes[8]. Scale and consolidation among larger schemes may drive additional benefits, such as helping achieve a greater level of investment diversification by accessing a wider range of assets and schemes' ability to negotiate lower investment fees. Consolidation has been greater at the smaller end of the market, with a decline of around 70% of trust-based schemes with 12-99 members over the last 10 years compared to around a 45% fall in trust-based schemes with 1,000 to 4,999 members[9]. This consolidation has usually been driven by a desire to achieve lower investment costs and to reduce governance and administrative burdens.

Call for Evidence findings/evidence on scale

20. DWP have previously reviewed evidence[10] and recently sought new evidence[11] in relation to the potential benefits, risks and barriers to consolidation and optimal size of pension schemes. From the findings, we understand that schemes at a large scale can lead to better governance, deliver economies of scale and help access and invest in a wider range of assets[12]. However, there are some challenges of increased concentration, such as higher barriers to entry and lower incentives to innovate. Furthermore, some respondents to the recent Call for Evidence[13] noted that there could be increased systemic risk and suggested that there could be monopolistic issues with an excessively consolidated market. As well as highlighting that consolidation and scale alone will not result in investment bias towards the UK.

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[7] 2220922-the-dc-future-book-2022-final.pdf

[8] Trends in the Defined Contribution trust-based pensions market - GOV.UK

[9] Occupational defined contribution landscape in the UK 2023 | The Pensions Regulator

[10] Facilitating investment in illiquid assets - GOV.UK

[11] [find more information in Workstream 1 of https://www.gov.uk/government/publications/pensions-investment-review-interim-report

[12] [find more information in Chapter 4, p32 of https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy

[13] Pensions Investment Review: Call for Evidence - GOV.UK

21. The Pensions Investment Review 2024 Call for Evidence[14] set out the government's aim to drive better outcomes for members and support the UK growth agenda. Some key ways to achieve this aim were noted in many of the Call for Evidence responses[15].

22. There was wide acknowledgement that scale leads to efficiencies and enables greater expertise and diversification of investments. Some respondents pointed to existing research[16] which suggests that schemes which operate with assets under management of around £50bn can make meaningful investments in productive finance as it is estimated that is about the level where the efficiencies and benefits of scale can happen. Other respondents suggested that benefits of moderate scale can be found between (£25-50bn) but that the true benefits of scale come into effect at over £50bn in assets under management (AUM).

23. The findings in DWP's reports suggest a clear link between scale among pension providers and the ability to diversify investments. This particularly seems to be the case for investment into asset classes such as infrastructure and private equity. This is because, it was argued, as pension providers reach between £25bn-£50bn, the ability to hire skilled staff rises and, in some cases, investment can be brought in-house, with the scale also allowing more funds to be allocated to these asset classes. As pension providers reach £50bn or more the scale can therefore also help with greater direct investment and an increasing ability to negotiate lower investment fees.

24. In terms of the diversity of investment that operating at scale allows, there is evidence that infrastructure and private equity are asset classes that may have relatively high impact on economic growth[17]. This suggests that greater scale among UK pension providers could, through greater investment in these asset classes, lead to higher economic growth.

25. In reaching these conclusions, government and respondents to the Call for Evidence looked at international evidence. That international evidence[18] suggests that the benefits of scale may occur from anywhere between £10bn and £100bn AUM, with additional benefits at larger AUM.

26. The international evidence from comparable Australian and Canadian schemes is consistent and suggests that scale can give schemes access to a wider set of investment opportunities, including to categories such as infrastructure and unlisted assets. In addition, they invest ten times more in private equity than UK schemes.

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[14] Pensions Investment Review: Call for Evidence - GOV.UK (www.gov.uk)

[15] [find more information in Workstream 1 of https://www.gov.uk/government/publications/pensions-investment-review-interim-report

[16] Evolving the regulatory approach to master trusts

[17][find more information in Chapter 3, Table 4 of https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy

[18] [find more information in Chapter 4, p29-33 of https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy

Proposed reform measures

27. We believe there is clear evidence, supported by international comparisons (as described above) – that larger, more consolidated pension funds are better placed both to achieve efficiencies of scale and diversity of investment that can help improve savers long term outcomes.

28. The measures proposed below will, in light of this consultation, be considered for inclusion in the Pension Schemes Bill and are designed to build upon and complement other measures which respondents to the Call for Evidence pointed to such as the VFM Framework.

29. We want to remove complexity and fragmentation from the market and ensure that the multi-employer vehicles used for AE are operating at a large scale. To achieve this scale, we are proposing introducing the following requirements:

    Proposal 1: Multi-employer DC schemes used for AE should have a maximum number of defaults.
    Proposal 2: Multi-employer DC schemes' defaults should operate at a minimum size.

30. The following sections explore whether the maximum number and size of defaults should be applied at arrangement or fund level, what the maximum number of defaults should be, what is the correct minimum size of AUM to apply to these defaults and when such scale should be achieved by. We are also looking at what flexibility there should be to allow innovation. Additionally, we explore whether differential pricing should be allowable within the same default and, if there are multiple defaults permissible, whether differential pricing is acceptable between them. While the schemes serving only a single employer sit outside of the scope of these measures, we see the VFM Framework as ensuring that those single employer schemes achieve value for their members.

Level at which to apply the requirements: default arrangement or default fund

31. Through defining our proposals, we have become increasingly aware that amongst the industry and in responses to the Call for Evidence there has been a range of terms used in relation to 'defaults' such as - default investment, default arrangement, default fund, default fund arrangement and default investment fund. These often appear to be used interchangeably. If it were to implement the proposals set out in paragraph 29, the government wants to ensure that the investment layer is operating at a level that facilitates the benefits of scale and removes fragmentation and complexity from how schemes are structured.

32. In order to identify a suitable maximum number of defaults and a required minimum size of AUM at default level, it is important that we understand how pension contributions are handled and invested by the pension provider. The AE rules that apply to qualifying workplace pension schemes require that employee and employer

contributions are paid into a qualifying scheme and where no decision is made by the employee as to where those contributions should go, the scheme provider puts these contributions into a default arrangement. This concept of a default arrangement is more precisely defined in regulation 3 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015, but of most relevance to this consultation is broadly defined as one where the contributions made by members and employers are invested in a fund or funds where those members have not expressed a choice to have their contributions allocated elsewhere. The vast majority – over 95% of all members in trust-based schemes – are allocated to such default arrangements[19].

33. Within a default arrangement, the pension scheme provider will choose how those contributions should be invested. Responses to the Call for Evidence suggest that contributions which flow into a default arrangement may all be invested in one default fund or, alternatively, they may be invested in a range of default funds. The default arrangements will reflect the investment strategy chosen by the provider for their AE membership. That strategy will inevitably differ from provider to provider but may often take the form of a group of funds investing in assets carrying varying levels of risk and potential return, but which ultimately reflect the objective of delivering a suitable return for members who have not made an active choice. We also have heard from industry that, in many cases, different schemes (and their default arrangements) may use the same range of default funds, which effectively pools assets. That can occur across both sides of the market, and within a provider for example, a provider's GPP and Master Trust may allocate savers' contributions to the same default arrangements or funds, albeit not necessarily in the same proportions.

34. Before specifying a maximum number of defaults and a minimum size of AUM rule, we must consider at what level Proposal 1 and Proposal 2 could be applied:

Option 1 – Apply the rule at default arrangement/scheme level
Option 2 – Apply the rule at default fund level

35. **Option 1** – applying the maximum number of defaults at default arrangement/scheme level. A pension provider has complete flexibility when it comes to the design and size of their default arrangements. They may create an arrangement that applies to their entire membership, or they may for example offer default arrangements to single employers, or groups of employers. Setting a required minimum size of AUM at default arrangement level could allow the provider continued flexibility in terms of how they invest in the sense of into which funds, which would be driven by both the member interests and commercial objectives of the provider. It would, however, significantly reduce the number of different arrangements as each one would need to achieve the required minimum size of AUM.

[19] Occupational defined contribution landscape 2023 annex | The Pensions Regulator

36. It may also help to address an issue of differential pricing between employers using the same provider in that they would all be using the same default arrangement and thus receive the same product service. We understand that multiple default arrangements have been established for commercial reasons, with each separate arrangement potentially attracting a different charge for the employer that is offered by that arrangement. This issue is also considered separately in paragraph 59. As part of this consultation, we are keen to understand what commercial considerations may drive differential charging.

37. **Option 2** – applying the maximum number of defaults at default fund level. Once pension contributions have been collected through the default arrangement, the pension provider will allocate those contributions into one or more default funds. These funds will invest in different types of assets, which could offer different returns and risks, but which ultimately are intended to offer savers the prospect of returns which suit where they are in their retirement savings journey. We also understand that within each default fund there may be multi-asset funds which allocate to other asset classes. Our view is that, if applying the maximum default and minimum AUM scale rule, it should be done at an "entry" level default fund, in order to allow for continued flexibility of investment for the range of members. However, we are also aware that some existing default funds are very large already, and it may be that applying a minimum AUM scale requirement to those funds may have limited impact.

38. We would like to obtain feedback on these options for applying our proposals to the arrangement or fund level and we have therefore posed questions on them under each of the measures in this chapter below.

Maximum number of default funds

39. In paragraphs 34-38 we discuss the options for achieving scale in the AE pension market. In both trust-based and contract-based pension schemes, the default arrangement will enable the collection and pooling of contributions, but the default fund will be the vehicle into investment for millions of savers. The size of those default funds will vary significantly between pension providers. Furthermore, the number of those funds managed by single providers can also vary significantly. Analysis suggests there are hundreds of default arrangements, potentially with multiple default funds beneath them, which results in the average value of assets in a default fund being significantly lower than the total AUM held by the provider[20].

40. We believe that having larger numbers of default funds is likely to mean that overall investable assets held by a provider will be spread across potentially many smaller value funds with each fund likely to have its own strategy. This fragmentation means too many providers – particularly amongst those that serve the contract-based market – may not have the flexibility or requisite scale to invest in productive finance assets.

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[20] 2220922-the-dc-future-book-2022-final.pdf

41. Moving to a market of fewer but larger default funds could enable the associated assets to be better invested for the longer-term gain of their members. The Call for Evidence echoed this view, with a number of respondents identifying fragmentation in the market and the proliferation of small funds as key barriers to investment in productive finance. Respondents to the Call for Evidence highlighted how the Australian system effectively requires schemes to offer a single default fund. This has been beneficial not just in terms of scale but in improving transparency as it makes it easier to see who is offering Value for Money and who is not. This has helped drive consolidation in Australia with underperforming funds having to merge with larger, better performing ones.

42. Therefore, we propose to set a maximum number of default funds a provider may operate. However, we want to understand what respondents would consider the right number and/or conditions to limit the number and what if any exceptions there should be for example - sharia compliant funds. We would want to ensure, for example, that innovative default funds, those investing in productive assets including in the UK or those offering exceptional value for members can continue to compete in the 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.

Achieving a minimum size of assets under management at default fund level

43. We are minded to require schemes to reach a minimum size of AUM at default fund level in combination with limiting the maximum number of default funds. This is to create the most productive investment environment and maximise consolidation of funds. Although this would appear to have the most impact in terms of consolidation for investment purposes, we remain interested in understanding whether default arrangement fragmentation has any negative impact on member outcomes or means there remains a focus on the price set for each arrangement.

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?

44. Although there is no conclusive evidence of optimal size of AUM at default fund level in DC pension schemes, a number of papers suggest a greater number of benefits can start to arise at £25bn-£50bn (or greater)[21], including on in-house investments, access to wider asset classes, and other scale benefits.

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[21] [find more information in Chapter 4, Table 6, p32 of https://www.gov.uk/government/publications/pension-fund-investment-and-the-uk-economy

45. We are keen to understand your views on what you think the minimum size of AUM, at default fund level, may be best to support members and drive more investment in the UK economy.

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?

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)?

Implementing a minimum size of AUM at default fund level

46. Government recognises that moving to a model that requires a minimum size of AUM in AE schemes even at default fund level and setting a maximum number of default funds are significant market changes and could not be achieved without a sufficient lead in time. Therefore, we propose that such a requirement would not apply before 2030, at the earliest.

47. It is inevitable that for many providers this will be a considerable change and so we are considering putting in place a process for progress reporting against predetermined criteria for these schemes to 'staircase up' their value and reduce the number of default funds they operate. This could involve an expectation pathway to meet the required minimum size of AUM or for schemes to set out their plan for how they can meet the requirements or consolidate. These plans would be monitored by the regulators who will also be able to support and provide guidance. To minimise additional requirements, we propose utilising existing reporting requirements where possible, such as the business plan requirements for master trusts.

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?

48. As mentioned above, we propose that a minimum size of AUM at default fund level and a maximum number of default funds should be required by a date no earlier than 2030. The intention is that this would enable business strategists to sequence measures arising from this consultation with other large scale Bill measures that have already been announced for example small pots consolidation and the VFM Framework.

49. Furthermore, we believe this date will ensure the pace of consolidation increases and the associated benefits of this are realised. We believe that implementation no earlier

than 2030 gives the market sufficient warning and time for corporate planning towards taking the necessary action.

50. We know that some smaller MTs and GPPs are unlikely to achieve the scale we are suggesting before 2030. Where schemes are unlikely to achieve a minimum size of AUM at default fund level earlier than 2030, they may look to consolidate into a receiving scheme, and this could support other schemes to meet scale requirements. For MTs there are existing mechanisms through the authorisation framework that will support consolidation.

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?

51. After achieving the minimum size of AUM at default fund level, it may be possible that in the future, investment fluctuations mean that a provider's size of AUM at default fund level may fall below the required minimum size of AUM. We propose that schemes could have a fixed period to re-reach the required minimum size of AUM and have a suitable plan to do so.

52. There may be some providers who expect to achieve a minimum size of AUM at default fund level, but who face challenges to achieving this size by 2030 for various reasons. For example, where they are in the process of consolidation but haven't completed the process or where they are close to meeting the required scale and have a credible plan to do so within an agreed time period. We are considering whether these schemes should have an extended period to meet the required scale.

53. There may be schemes with specific characteristics such that it would be in the public interest for them to be exempted from these proposed policies. We would be interested in understanding whether there are any schemes in this category. It should be noted that the long-term plan is that all schemes will nonetheless be subject to the VFM Framework requirements and so any exempted schemes will ultimately be expected to achieve the same levels of value for money as large, consolidated schemes.

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?

Impacts of these measures

54. As already stated, setting a required minimum size of AUM at default fund level for pension providers would inevitably consolidate the multi-employer market, into a much

smaller group compared to the roughly 30 authorised MTs and 30 contract-based workplace providers we see today.

55. In the government's Call for Evidence feedback, some respondents suggested possible risks, including the potential for a more concentrated market to stifle competition and innovation, and the possible risks of asset price bubbles for UK investment and poor investment performance.

56. We also want to ensure that we encourage innovation and competition in the market. We therefore want to explore options around this, including the potential for a glide path for new entrants to achieve scale.

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?

57. Maintaining innovation in occupational pensions will be critical to ensuring members engage with their pension in the future, and that pension products meet the needs of employers and employees. We also need to ensure that pensions keep pace with innovations elsewhere in the wider financial services sector. For example, collective defined contribution pensions (CDCs) have recently become available to certain employees, and we expect will become more prevalent in the market in due course. This will include CDCs being used for multi-employer schemes. It is important that their growth can be maintained in a market that becomes generally more consolidated. Given the collective nature of CDC schemes, we would anticipate that they would have only a very limited number of funds and so would be able to operate under any such restrictions. Nevertheless, we would welcome views as to whether these requirements could limit the growth of such schemes.

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?

58. Beyond the proposed measures set out above, government wants to explore whether further measures are needed to facilitate consolidation. It is anticipated that to achieve greater consolidation and following the introduction of the VFM Framework, there will need to be an increase in transfer and merger activity both from single employer trusts (for example where they do not demonstrate value) but also between multi-employer schemes which do not meet the scale requirements. Responses to the Call for Evidence suggested that cultural, legal and practical barriers exist to the process of consolidation.

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

The role of differential pricing in a consolidated market

59. AE pension savers already benefit from a charge cap of 0.75% of funds under management within the default arrangement, or an equivalent combination charge. This cap applies to the charges their pension provider can apply for the investment and administration costs of running their pension. This cap continues to work successfully in protecting savers. However, we wish to explore an additional issue.

60. Several responses to the Call for Evidence stated that employers have traditionally focused on the price charged by a pension provider for a workplace DC pension as a key differentiator when deciding on a new default arrangement, or when deciding to retain their current pension scheme.

61. This was also the consensus view from the Call for Evidence, in part due to the ease of comparison compared to other metrics (e.g. investment performance) creating pressure for providers to quote lower fees. DWP research[22] has found employers, when choosing a DC pension scheme, consider a range of factors (ease/convenience of using the provider (64%), advice from a professional body colleague/employer (51%), employer fees (49%) and value for members (49%), with investment performance a lower consideration (31%)).

62. We want to explore if a focus between providers and employers on price, which can lead to differential pricing for the same default pension products, is something we might need to address under a future AE model where a minimum size of AUM at default fund level and setting a maximum number of default funds were requirements of providers. In particular, we want to understand if it would be appropriate to remove the ability of providers to set differential pricing for the same pension product.

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

[22] Department for Work and Pensions Employer Survey 2022 - GOV.UK (www.gov.uk)

Chapter 3 – Contractual override without consent for contract-based arrangements

63. We are setting out proposals to enable contractual overrides for contract-based pension arrangements, subject to the appropriate protections. These proposals could enable transfers without consent into either a trust- or contract-based arrangement (such as GPPs). These could include bulk transfers from workplace personal pensions, and in some circumstances non-workplace pensions, to improve outcomes for pension savers. There are many factors that need to be considered in regard to this policy, including the circumstances in which contractual overrides and bulk transfers are allowed, the role of the different parties in the decision and process to transfer members, whether consumers have a right to challenge a transfer, a consumer's right of recourse if things go wrong, and any liability of the parties involved. The respective roles of the relevant regulators (FCA and TPR) will also need to be considered where transfers are between GPPs or to trust-based arrangements.

Context

64. The contract-based workplace pensions market is dominated by a small number of large insurance companies (79% of assets held by multi-employer providers managed by just 7 providers)[23]. However, due to the way the contract-based market operates and has developed, providers can have thousands of pension arrangements for different employers. This will include a large number of legacy (pre-AE) arrangements, including those where the employer may no longer exist. We expect that some of these arrangements may not be delivering value for members, which can be due to investment performance, costs and charges agreed with an employer, or quality of service.

65. Contract-based workplace pensions can be established through individual contractual arrangements. This means that firms usually need to get individual consent to lawfully transfer savers from one arrangement to another. In practice this can be very difficult and costly to do, particularly where savers are disengaged and do not respond to correspondence from the provider. This means that even where poor value is identified, it can be very difficult or impractical for providers to move members into newer, or better performing arrangements, or even to improve current arrangements.

66. We heard in the Call for Evidence responses that this is one of the biggest differences between contract- and trust-based arrangements, where bulk transfers in trust-based schemes are already possible, and that it is a barrier to greater consolidation for

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[23] pensions-investment-review-abi-response-september-2024.pdf

contract-based workplace pensions. It can also result in disengaged members being "stuck" in arrangements that are not delivering for them.

Proposal

67. To enable disengaged members to be transferred to better performing arrangements and to establish equivalence with the trust-based DC market, we are proposing to legislate to allow contractual overrides and replacement without individual consent for contract-based pensions, with appropriate protections that would be set out in FCA rules and possible revised requirements for receiving trustees. The introduction of this legislation will likely require an amendment to the Financial Services and Markets Act 2000, and we are considering whether the FCA may need additional powers to monitor and enforce this.

68. The enabling provisions and parameters of this policy would be set out in legislation, which will empower the FCA to consult and make appropriate rules in its Handbook to cover the specific conditions and protections for a transfer to take place. If changes are made to the rules regarding receiving trustees, then DWP would also need to work with TPR to amend the relevant regulations and guidance.

Why it is needed

69. Under current proposals, the VFM Framework, due to be introduced following further joint work of government and the regulators, will set out metrics and standards to assess value for money of DC workplace pension default arrangements. The VFM Framework is being developed to shift the focus from short-term costs to long-term value for savers and increase transparency and competition in the market. Where arrangements are found not to be value for money and unlikely to be improved sufficiently to deliver it within a reasonable period, an arrangement will be rated "Red". The FCA currently proposes that the firm must consider transferring affected members from the "Red" rated arrangement into an arrangement that is providing value for money. The FCA flagged the need for legislation in order to enable bulk transfers without individual consent in their recent consultation on the VFM Framework[24].

70. Alongside this, there may be wider circumstances in which pensions arrangements may be considered as not delivering for its savers (e.g. they are sub scale) and it is therefore in the best interest of savers to transfer to a new arrangement. Setting a threshold for the size of defaults may also mean that some providers exit the market, and, in these circumstances, they will want to transfer assets and members into a consolidating scheme. The detailed rules on the use of contractual override and transfer without consent would be developed by the FCA and consulted on in the usual way. TPR may also need to review rules regarding receiving trustees of bulk transfers from contract-based schemes.

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[24] See CP24/16: Value for Money Framework (fca.org.uk).

71. The introduction of a contractual override could also enable a smoother implementation of the Multiple Default Consolidator Model, which government intends to introduce in the Pension Schemes Bill. This will enable the automatic consolidation of millions of deferred small pots into a small number of high-quality arrangements, helping to protect members from the risks that multiple deferred pots present. However, for this policy to be implemented at scale, it is essential that contract-based arrangements are able to undertake transfers for eligible deferred pots without seeking members' consent (although members will be given the opportunity to opt out). Consequently, we believe a contractual override will be essential for contract-based arrangements to fulfil their obligations under the forthcoming Multiple Default Consolidator legislation. The DWP has been working with a cross-sector industry Delivery Group, which is helping to inform policy concerning the conditions for transfers in the context of deferred small pots, including protections for scheme members.

Conditions/circumstances for transfers

72. Currently, there is not a cost effective or proportionate way for providers to transfer members from a contract-based arrangement without gaining individual consent. The proposal would give providers the power to override the existing contract of an arrangement to transfer members into a new arrangement (either contract- or trust-based), subject to conditions and appropriate protections to be set out by the FCA and where relevant, TPR.

73. We believe that there may be multiple situations where, with the necessary protections, the contractual override of an arrangement (both bulk and individual transfer) may be appropriate. For example, under the current proposals for the VFM Framework, when an arrangement is rated as not value for money and cannot or will not be within a reasonable period ("Red" rated) then the firm will be required to consider transferring savers to an arrangement that is assessed as providing value for money.

74. It is also possible to envision situations where a contractual override is carried out under a permissive situation, rather than being required. For example, it may be the case that the transfer of members to a new arrangement is a better option than improving the value for money of an existing arrangement, i.e. where the firm could do enough to improve without transferring members, but a transfer is a better solution and could be in the best interest of members. A firm has existing obligations under the FCA's Consumer Duty to ensure good outcomes for members.

75. Pension providers often have multiple products, many of which will be legacy arrangements that are now closed to new entrants and may have been obtained via the acquisition of other companies. These arrangements are often administered on different platforms, have differing terms and conditions and have different rules. Therefore, different savers could have different experiences, with some being potentially negatively impacted relative to members of other arrangements. In this case the saver would be better off being moved to a new arrangement.

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

Process

76. To ensure the assessment of whether a contractual override and transfer meets specific requirements, an assessment should be undertaken by an independent third party with sufficient expertise. The FCA would consult on proposed requirements and who may undertake such an assessment. For workplace pensions, this role could naturally fall to the firm's Independent Governance Committee (IGC).

77. Every FCA-authorised firm providing workplace personal pensions must establish an IGC. The FCA's rules give IGCs clear duties and strong powers and the IGC must act independently of the firm. The majority of IGC members must be independent, including the IGC chair. Governance Advisory Arrangements (GAAs) play the same role as IGCs and are provided by third parties for firms with fewer relevant customers and less complex products to oversee. For simplicity in this consultation, when we refer to IGCs this should be taken to include GAAs as well.

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?

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?

78. When an employer originally set up their employee pension arrangement, they will have made the decision to choose a specific pension provider and related investment choices. This means, if savers are transferred to a new arrangement, this will also override the decision taken by the employer who will also likely continue to use the successor arrangement for AE. However, there may be cases, particularly for legacy schemes, where the firm may no longer have a relationship with the employer, the employer no longer exists, and the employee may have left the employer. While we expect in most cases the IGC should be the responsible party for assessing the transfer, we expect the employer will have some role in the process of a bulk transfer. For example, the provider could be required to consult with employers so that they are part of the decision-making process, and employers could determine where future contributions should go.

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

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

79. As part of the proposal for transfer, we expect the provider would decide on the destination of the new arrangement, which could be either a contract- or trust-based arrangement. As part of its assessment, an independent-third party expert (e.g. the IGC) will include a view on the proposed new pensions arrangement and whether the transfer is in the best interests of members, ultimately deciding to agree or object to the transfer.

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?

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?

Consumer safeguards and protections

80. The proposal to allow contractual overrides and bulk transfers involves the overriding of the contractual rights of a consumer. It is therefore fundamental to ensure that it is developed with appropriate consumer safeguards and protections in place, including ensuring that the FCA has the necessary powers to monitor and enforce. There are a number of risks to consumers that need to be mitigated:
    - *Savers are worse off in the new arrangement.* Because future investment performance is uncertain, there is a risk that savers could be moved to a new arrangement that performs worse e.g. investment returns than their old arrangement.
    - *Savers are moved to a new arrangement and lose valuable safeguarded benefits*. Savers in older legacy arrangements may have Guaranteed Annuity Rates (GARs) or other valuable safeguard benefits that could be lost in a transfer.
    - *Costs and risks of the transfer are placed on savers rather than the provider*.

81. Savers will only be moved where it can be demonstrated it is expected to deliver better outcomes and will have to be assessed and assured by an independent third-party expert (e.g. IGC). We would expect FCA rules to require that consumers be informed and be provided with appropriate support in relation to a transfer by the provider, including opportunities to make representations to be considered as part of the assessment. There is a question of whether savers should have a right to opt out of a transfer if they do engage and do not agree to the new terms. Allowing this risks a small number of savers remaining in a poor value arrangement that then can't be closed.

This is unlikely to be a good outcome for savers overall, given the cost of continuing to operate it may go up.

82. It will be important that consumers have access to recourse and that there is the potential for compensation if savers are moved to an arrangement where due care is not taken, or proper process is not followed. We will consider with the FCA how access to the Financial Ombudsman Service and the Financial Services Compensation Scheme cover will apply.

83. Where there are GARS or other benefits, it may not be in the best interest of savers to transfer them. Additional safeguards may be appropriate, for example actuary advice on the value of the additional benefits and whether the benefits offered by the receiving arrangement are broadly similar or better. We would expect the FCA to make appropriate rules on these specific issues.

84. We expect that liability to savers would sit with the transferring firm (if proper process was not followed) or the receiving firm in the event the transfer was to another provider (if misrepresentations were made). The IGC Chair or other independent expert could also be liable to a firm if negligent assurance was given to it, which then acted upon in order to carry out a transfer. We expect these legal rights to be enforceable in court.

85. Bulk transfers of savers without consent are currently enabled from trust-based schemes into other trust-based schemes in specified circumstances under DWP regulations. The ceding trustees must take the view in accordance with their fiduciary duty to members, that the transfer is in savers' best interests, and it is expected that in most cases trustees will obtain independent advice that this is the case. Ceding trustees will also approve the specific terms and conditions of the transfer. Receiving trustees must decide whether the transfer will fit with the savers that they already have and that accepting the transfer is within their trust deed and rules. Savers also have the right to legal recourse against trustees if they are moved without consent, they are worse off and the decision to transfer was made negligently. We are keen to understand from industry how this has been working and whether any of the safeguards or protections that apply in transfers from trust-based schemes should be considered for contractual overrides and transfers for contract-based schemes (into either contract- or trust-based arrangements) or any changes to the requirements on trustees.

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

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?

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

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?

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?

Cost of transfer

86. Transferring members from one arrangement to another, whether this transfer is internal within a provider or from one provider to another, will inevitably involve a cost. This is a cost that will need to be covered by either the provider or the members. In some cases, the employer may also choose to pay for or subsidise the move. If it is the case that the cost of the transfer will be borne by the members, then it will need to be considered by the provider and independent expert as part of the assessment whether the proposed transfer is appropriate and is in savers' best interests. A transfer should only be approved if the benefits of the transfer and the long-term saver outcomes would outweigh any cost.

87. As well as any potential costs involved in the transaction, the independent expert will need to consider any potential benefits a member may lose if transferred into a new arrangement. These could include tax protections, guarantees, or other safeguard benefits. Factors such as the environment, social and governance of an arrangement would also need to be considered. This will require the independent expert to make a value judgement about whether the transfer is in the best interest of the members, considering all the relevant factors. The FCA would set out rules to ensure a suitable and standardised approach to assessing the value of benefits.

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

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?

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

Role of the Regulators

88. The FCA is responsible for regulating and supervising contract-based pensions, including contract-based workplace pensions. As stated above, while legislation is needed to override individual contractual rights and enable transfers without individual member consent, the FCA, as the regulator responsible, will be empowered to use its rule-making powers to make appropriate rules, including those setting out consumer protections, for contractual overrides and transfer without consent.

89. As part of this, the FCA may need new powers in legislation to monitor and enforce contractual overrides in particular if these are made mandatory. For example, under the VFM Framework.

90. We expect that the FCA would have supervisory oversight of the process. For example, under the proposed VFM Framework, the FCA will be notified and sent an action plan from the firm where an arrangement is "Red" rated or not providing value for money. The action plan must include consideration of transferring savers and a timeline for actions.

91. Further options for FCA involvement could include:
    - The power for the FCA to mandate or force a transfer, including to another provider - or a backstop destination(s) for such transfers may be needed, e.g. default consolidators for small pots could potentially be a destination, or Nest.
    - Other built-in supervisory protections, monitoring and controls, such as continued requirements for the FCA to be notified of details and progress of transfers, the ability to object or permit a transfer, or request more information.

92. TPR is responsible for regulating trust-based workplace pensions. If it is appropriate to make changes to the requirements on receiving trustees of bulk transfers without member consent from contract-based schemes, then DWP would work with TPR to amend the relevant regulations and guidance.

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

Chapter 4 – Costs versus Value: The role of employers and advisers

93. The value delivered by DC workplace pensions, particularly in terms of investment returns, can have a significant impact on saver outcomes. The government has been clear that the DC market is operating with an excessive focus on costs which comes at the expense of considering a broader range of metrics of scheme quality and limits budgets to enable investment in a broader set of asset classes. Respondents to the Call for Evidence suggested that to drive a shift in culture, all participants in the pensions ecosystem should be focused on value. This chapter explores the role of employers and advisers and seeks further views on the relative merits of proposals to encourage these groups to make this shift in focus.

Automatic Enrolment to date

94. Prior to the introduction of the workplace pension reforms, the proportion of private sector employers providing pensions had been declining since around the mid-2000s. Since 2012, this trend has been reversed with 2.5 million employers[25] meeting their AE duties and around 9-in-10 eligible employees saving into a workplace pension[26], showing the crucial role employers have played in making AE a success.

95. The current duties can be best summarised as an obligation on employers to place eligible jobholders into a 'qualifying' scheme which meets certain rules to qualify for use for AE. This could be the employer's existing workplace scheme or a new arrangement with a multi-employer scheme. For qualifying DC schemes, the employer must ensure contributions represent at least the statutory minimum of 8% of a band of earnings including a statutory minimum of at least 3% on the part of the employer. The intent underpinning the design of AE was aimed at making the process as simple as possible for employers, whilst letting the government and regulators set minimum requirements for workplace pension schemes (for example, in respect of the charges that scheme managers and trustees can levy on members) to be used for the purposes of AE depending on the type of scheme.

96. Many employers recognise the importance of their pension arrangements for their employees and put in place good quality arrangements. However, this level of engagement is not consistent across all employers, and we know that outcomes for members, for example because of differences in investment returns, across qualifying schemes can vary significantly. Members can become long-term savers in schemes which, whilst compliant with legislation and rules, perform less well than other schemes.

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[25] Automatic enrolment declaration of compliance report | The Pensions Regulator

[26] Workplace pension participation and savings trends of eligible employees: 2009 to 2023 - GOV.UK

97. To support their decision making, some employers seek advice from third party advisers when making decisions, typically when they are selecting a scheme or seeking to move from an existing scheme to a new one. There are also other important participants in the market including investment consultants, who provide advice to pension scheme trustees about investment strategy and related matters.

98. There was a broad consensus amongst respondents to the Call for Evidence that an excessive focus on price risks crowding out a more diverse approach of investments into a wider set of asset classes which could deliver improved outcomes for members. Many respondents noted there was sufficient room for more sophisticated investment approaches under the existing charge cap (for default arrangements in qualifying schemes). Some respondents cited examples of decisions by employers around tendering for new pension provision coming down to price differences of just a few basis points.

99. The government has already announced plans to introduce a VFM Framework and regulatory regime covering DC pension schemes in the upcoming Pension Schemes Bill. The VFM Framework looks to ensure that schemes deliver the best possible value and better long-term outcomes for pension savers. The Pensions Investment Review is considering what further action might be required to drive an increased focus on value over cost to deliver better outcomes for future pensioners with some support amongst respondents to the Call for Evidence for action that ensures all participants in the ecosystem are focussed on value.

100. This chapter explores the role of employers and their advisers in influencing the focus on cost in the DC pensions market, drawing on ideas raised in the review's Call for Evidence. This includes discussion of:

- the factors that go into employers' decision-making to select a qualifying AE pension scheme;
- the role of employer advisers in that decision-making process;
- the role of any other professional services in the schemes' investment strategies;
- the appropriate relative balance between employers, advisers, schemes, members, regulators and the government in ensuring members are in the best possible arrangement for them; and
- possible solutions to improve scheme selection.

Call for Evidence/existing evidence on employer decision making

"A focus on cost"

101. Some evidence suggests that employers currently take several factors into account when choosing a pension scheme[27]. This included issues such as time and financial resource, the reputation and security of a scheme, value for members and advice or recommendations from outside bodies but the most popular factors were those that affected the employer rather the employees. For those choosing a DC scheme, the top 3 factors included:

    1. Ease or convenience of the provider/scheme (64%)
    2. Advice from professional body or formal advice from colleagues or other employers (51%)
    3. Fees on the employer (49%)

102. While there can be significant variation in performance across pension providers[28], only around 5% of employers have switched pension schemes[29].

103. In the Call for Evidence, many pension providers observe a focus on cost over value from employers when selecting an arrangement for their employees. Some respondents stated that when employers are complying with their duties under AE, they primarily consider the ongoing charges placed on them or their employees.

104. The focus on cost means that the diversified investment strategies which ultimately deliver improved member outcomes, including by fostering investments into high-growth businesses, are crowded out in favour of the default arrangement that is the cheapest.

105. Some respondents stressed the role of decision-makers in a company to select a pensions arrangement for their employees. Small and Medium Enterprises, in particular, view selecting a scheme as a compliance activity. Some respondents reported that the human resources department or a procurement team, particularly within smaller businesses, could have little understanding of pensions and investment. They thus tend to negotiate based on price alone as this is a metric with which they are familiar rather than projected investment returns which are, by their nature, not certain to occur.

106. Market participants pointed to the role of charge cap regulations in limiting most ongoing charges that can be levied on the member to 0.75% of the member's pot.

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[27] Evolving the regulatory approach to master trusts - GOV.UK

[28] For example, around 8ppt difference in investment returns between the highest and lowest performing schemes: LINE - YOUNGER 5-YEAR - capaDATA

[29] dwp-employer-survey-2022-data-tables.xlsx

Respondents to the Call for Evidence noted that there was room for manoeuvre under the cap. Almost all default arrangements are now priced well below the charge cap at an average of 0.48% which means that the cap itself is not restricting schemes from investing in productive assets. Employers are also not bound by the charge cap which is levied on the schemes themselves and so it is not likely that charges feature heavily in employers' decision-making. This is further evidenced by the fact 'employee charges' does not feature in the top three considerations for employers when choosing a scheme.

The role of advisers

107. Respondents to the Call for Evidence indicated that professional advisers can play a significant role in influencing the decisions taken by multi-employer pension schemes in relation to cost and investments.

108. Specifically, some stakeholders have raised concerns that professional advice, especially advice provided to employers, may be placing excessive weight on cost savings, aggravating the problem described above. The government wants to understand the prevalence of this, recognising that these advisers are ultimately driven by their clients' preferences.

109. The advice in question may be provided either to employers (to support their decision making when choosing or reviewing a pension scheme) or to pension schemes directly (such as in respect of asset allocation strategy). For example, an employer with its own "single employer" DC pension scheme might approach an adviser to help it to identify a suitable multi-employer scheme, such as a MT, as a replacement for its current scheme. The employer may be motivated by multiple considerations such as the possibility of lowering its own pensions-related administrative costs or accessing better service levels. This sort of advice can be provided by Employee Benefit Consultants, or other types of professional investment consultant.

110. Advice may also be provided to pension schemes on asset allocation. For example, the trustees of a MT may seek advice on the proportion of a portfolio to invest in different assets, geographies, or currencies, taking into account risk appetite, the profile of scheme members, and other factors. This sort of advice can be provided by a range of independent consultants and is sometimes provided by advisers employed by the provider of the pension scheme.

Potential solutions

111. The government would value inputs, pros and cons, on the following policy approaches suggested by respondents to the Call for Evidence.

Employer Duty

112. Some respondents to the Call for Evidence suggested amending the AE legislation to include a duty on employers to 'consider' the overall value of the arrangement during scheme selection. AE applies to all employers and so 'selection' choices are currently only made by new employers and those employers making an active decision to switch. Some respondents suggested a duty to routinely 'review' the selection e.g. every 3-5 years should be introduced to ensure that the scheme continues to deliver value for members.

113. Employers would thus be legally required to review their choice of pension scheme. This could take the form of a duty on all employers to conduct a self-assessment of their pension arrangement against specified criteria i.e. the relative investment returns, charges and quality of the arrangement relative to comparable arrangements. The duty could apply on a one-off basis to begin with and then reoccur, for example, every 5 years to ensure that employers consider their pension arrangement on a regularised basis. The input to this decision could be the VFM Framework's outputs and the legislation could bring the two together.

114. Amending the legislation would send an important signal that employers should consider carefully the default arrangement into which they and their employees contribute. Various degrees of requirements might be placed upon employers, mindful of potential burdens on employers. Employers may respond by upskilling internally or bringing in external advice from advisers whilst the hope would be that they are more receptive to advice focused on metrics other than cost, such as net investment returns.

115. Respondents to the Call for Evidence expressed concerns about ensuring the proportionality of solutions targeting employers. DWP have undertaken informal engagement with an employee benefit consultant which suggest compliance with a duty could cost between £5,000 to £10,000 to an employer.

116. More generally, some respondents highlighted the difference in consideration of pension scheme selection between small and large employers. For large employers and particularly very large employers, there will likely be an in-house pensions team or function. They may consider the pension arrangement to be part of a suite of employee benefits, influenced by their overall company culture. As a result of this difference driven by employer size, some respondents suggested that any new duties should apply solely to large employers because: a) resources are sufficient to deal with the added administrative load b) more employees would benefit from these duties and c) employee benefit consultants are more likely to be used.

Executive Responsibility

117. An alternative to explicit duties on the employer under the AE framework, would be to build up responsibility for the pension arrangement at the Board level. We have seen action from corporates on other areas such as social mobility, diversity and inclusion and Modern Slavery, through duties – including via the UK Corporate Governance Code – placed on the Board. Alternatively, responsibility is made explicit in other ways for certain considerations the government and regulators deem central to the role of those running large employers.

118. This could involve a requirement for a nominated executive with responsibility for ensuring the pension arrangement delivers good value retirement outcomes for staff. The aim here would be to prevent the duties over the pension scheme falling to a junior member of the HR or procurement department and instead becoming a Board level consideration with the hope this would stimulate regular reviews of the value of the existing scheme.

> **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?

Advisers

119. At present, there is no specific regulatory regime regulating the services provided on pension scheme selection advice or investment consultancy. However, some firms are regulated by the FCA due to other activities which they carry out.

120. Investment consultants, in particular, play an important role in advising pension scheme trustees on their investment strategy. There has been interest in the regulation of these services. However, industry engagement suggests any focus on cost in the advice provided on investment strategies is driven by client choice and preference.

121. There were some suggestions in the Call for Evidence to bring advisers into FCA regulation. Some respondents noted that this form of regulation would mean that advisers are required to consider the value of schemes or investment strategies in their advice, which could mean a lesser focus on cost.

122. Therefore, the government wants to understand exactly to what end and how new regulation could play a role in ensuring that advice consistently considers returns alongside costs to ensure that the best interests of pensions savers are being served.

Value for Money Framework

123. Some respondents referred to the government's VFM Framework as a key part of any solution to address value in scheme selection. The VFM Framework is currently being developed by the FCA, TPR and the DWP and the proposals that emerge from

the Pensions Investment Review will be considered as part of the VFM Framework's design in particular we have listened to the concerns raised around the risk of herding and moving forward we want to ensure our VFM measures allow space for investment innovation. Once implemented, the measures will provide important qualitative information to employers regarding the value offered by their pension scheme as well as other available providers in the market.

124. Through the VFM Framework, comparative metrics on the quality of a default arrangement will be made publicly available for the first time. Employers and consultants will be able to access accurate, timely, consistent, detailed information on the relative performance of a range of similar default arrangements, information that is not readily available to them at the moment.

Consultation questions

Employers

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?

Regulation of advice

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?

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?

Chapter 5 – Impacts & Evidence

125. Building on the insights from the Call for Evidence, we are keen to understand the potential costs and benefits of the proposals mentioned in this consultation. Developing the evidence base will enable us to design a pensions landscape that maximises benefits and minimises costs.

Default funds

Question 33: How many AE workplace default arrangements and default funds do you have?

Question 34: What is the total AUM you have across all these AE workplace default arrangements and default funds?

Question 35: Do you have a small number (for example 3-5) of AE workplace default arrangements/funds that cover the majority of these assets and if so, how many of these are there?

Combining funds and schemes

Question 36: Have you previously combined default funds or arrangements together within the same organisation?

If 'yes', do you have an estimate of the cost of this (overall or on a per pot basis)?

If 'no', do you have an estimate of how much you think this might cost (overall or on a per pot basis)?

Question 37: Have you previously consolidated Single Employer Trust assets into a MT or GPP?

If 'yes', did you experience any barriers in this process? If so, could you set out what these were, if and how they were overcome, and how long the process took?

Differential Pricing

Question 38: Do you currently charge different price levels to different employers for the same default fund?

If so, what is the average price charged to members compared to lowest decile charge and 90th decile charge?

GPP and MTs

Question 39: Do you have experience of bulk transfer of pots within the same organisation?

If 'yes', do you have an estimate of the cost of this (overall or on a per pot basis)?

For those who run both a MT and a GPP:

Question 40: Do you use the same defaults across the two offerings?

What has been the comparative investment performance and average cost/charge between the two for young (30 years before retirement) and older savers (1 day before retirement)?

Do you see a noticeable difference in the offer between your MT and GPP product?

Employer Duty and Advisers

Question 41: What is the estimated cost to an employer of reviewing a pension scheme every 3 to 5 years?

Question 42: What proportion of employers are estimated to use formal advisers when choosing, or switching, a pension scheme?