DWP DC Reform Policy Team

By email only to:
quarryhouse.pensionsinvestmentreviewdcreforms@dwp.gov.uk

Lane Clark & Peacock LLP

95 Wigmore Street
London
W1U 1DQ

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Dear DWP DC Reform Policy Team

LCP's response to the Pensions Investment Review: Unlocking the UK pensions market for growth

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The provision of actuarial, investment, covenant, governance, pensions administration, benefits advice, and directly related services is our core business. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, whether DB or DC, including investment strategy. The remaining 20% relates to insurance consulting, energy, health and business analytics. LCP is authorised and regulated by the Financial Conduct Authority and is licensed by the Institute and Faculty of Actuaries in respect of a range of investment business activities.

Executive Summary

We are pleased to respond to this important consultation, Unlocking the UK pensions market for growth, which has the potential to radically reshape the UK pensions landscape and significantly impact the future savings of millions of UK savers. We are supportive of the idea of DC pension assets being invested productively, in an appropriate way, and agree that some subscale pension schemes (which we would say are typically not found in the UK DC Master Trust market) may not be delivering value for money or investing in the wider economy. However, we do not agree that driving such change to achieve greater scale across the industry as proposed is likely to be the optimal solution to increase investment into the government's stated policy direction of boosting the UK economy. We have proposed a 'refined' strategy which we believe will achieve a better balance between the 'productive finance' agenda and good member outcomes, and one that will deliver that boost much more quickly.

We see the key challenges to be addressed in delivering on this policy as follows:

- Ensuring that the member remains central to thinking on policy, and that structural changes do not undermine good member outcomes. For example, the consultation floats the idea of preventing larger employers from negotiating better deals with Master Trusts by removing price differentiation for the same pension product. We are concerned that this could lead to worse pension outcomes for many UK savers employed by these large employers. More broadly, we note that large-scale consolidation would require substantial and costly upheaval over a period of years, and we need to ensure that the costs of this, borne by members, improves their outcomes.
- There is a risk that the proposals could undermine high quality but "smaller" (than £25bn) schemes/investment strategies which are already investing in line with the government's priorities – in many cases proportionately more than in the Master Trusts into which they might end up being consolidated.
- The proposed changes are likely to cause considerable time, cost and disruption with member savings being consolidated into a smaller ranger of default arrangements/funds which is likely to impact tens of millions of UK savers. The sheer scale of the proposed changes will take a significant amount of time to progress to achieve the stated objectives.

- The government needs to be clear about the expected destination. If the workplace pensions world of 2030 has £1 trillion in assets spread between around ten providers, many will be much larger than the £25bn-£50bn range mentioned in the consultation. How confident is the government that a market with a small number of 'too big to fail' providers and with a colossal barrier to entry will produce the best outcomes and continue to foster innovation? If these requirements are set we believe the government must urgently look at the regulation and oversight required for these providers.
- The changes to limit the number of defaults, and gain scale in the short term, will become the focus of the industry. We are concerned that industry bandwidth will focus on scale and debating which defaults or schemes are excluded and the definitions surrounding this rather than focusing on investing in productive assets now.
- We believe there is a risk that all of this change and regulatory/legislative focus could still fail to address the government's fundamental concern about the lack of domestic productive investment by UK pension schemes. Is scale actually the biggest barrier or are there other obstacles (such as a lack of suitable 'investable' offerings, with the right mix of risk, liquidity etc. and in suitable structures for schemes to use)?

Our suggested refined strategy is as follows:

- Rather than spending the coming months and years debating the minimum scale threshold, the number of defaults and how we exempt certain schemes and/or default arrangements (for example, because they are already innovative/are growing at scale/are an accidental Master trust or have one of a long list of very valuable member protection characteristics) we instead suggest the government looks to define a productive assets test which we are suggesting is positioned as a comply and explain approach. This would be done by looking at the percentage of workplace pension assets the provider is investing in productive assets (and specifically UK productive assets). This would allow the focus to be on productive assets and increasing investment in those assets sooner. It would also have the benefit of being able to be applied in all value for members reports across all trust and contract-based assets so covers the whole DC occupational savings market – far more assets than these current proposals could cover. <u>Crucially, in the event that schemes do not 'comply' with the target asset allocation and opt to 'explain' why not, lack of adequate scale will not be an acceptable explanation.</u>
- As providers (and trustees) can only direct the assets they have in default strategies we should continue to support proposals to enable contractual overrides for contract-based pension arrangements, subject to appropriate member protections. This would enable transfers without consent into either a trust-based or contract-based arrangements if more modern defaults are needed to increase the amount in productive assets.

In addition to our idea above, our overall views on the consultation as it stands include:

- If the government wishes to pursue scale, we would urge you to proceed cautiously in setting minimum scale thresholds or limiting the number of defaults. Rather than start with a minimum scale of (say) £25bn, start with something rather smaller – eg £10bn (as mentioned in the FCA VFM consultation) – and evaluate the impact before moving to greater consolidation. We do not want to see barriers to entry or smaller innovative providers removed and members affected adversely from consolidating defaults that would be rated as green in your value for members assessments.
- We also believe it would be simpler to require a provider to have *one* default of scale to be an authorised commercial Master Trust or GPP (and in practice it might be used by both if a provider is product agnostic), and then let the provider decide the number of additional defaults it needs to offer from a commercial/member perspective. We note there are issues with unintended defaults and that many providers offer choices for different member requirements, which we wouldn't want to see restricted (as members cannot choose between Master Trusts or GPPs – this is decided by their employer). We are also concerned about the unintended consequences of an arbitrary number of defaults and establishing a list of exemptions to the rules which could impact members or innovative schemes.
- We would recommend that you consider allowing smaller default arrangements/funds and Master Trust schemes to opt out of minimum size requirements if they can demonstrate that they are already investing in line with the government's priorities (eg allocations to private equity / infrastructure etc) and generating good outcomes for members.
- The industry and government should focus on improving access and removing 'supply side' barriers to investment in UK productive finance.
- The impact of these proposals on employers should also be considered very carefully, as many UK employers go far above legislative minimums, to the benefit of their employees and members. Any legislation which

homogenises the UK DC market could have potential to disengage employers and cause those with more generous contribution structures and governance programmes to review these and instead spend on other benefits.

Clarity about what a "default" is

In your consultation document, you have attempted to establish a clear definition between default arrangements and default funds, however we believe there remains confusion across the industry on these definitions. Our interpretation of these is that the 'default arrangement' will be the overriding provision and default investment strategy used for auto-enrolment compliance, whereas default funds are the building blocks/ investments where member savings are invested. Hence, our understanding is that a default arrangement is likely to be a lifestyle or a series of target date funds and refers to your point that c95% of members are invested in these. Whereas default funds will be the underlying investments such as an equity, bond or multi-asset fund. We have used this understanding throughout our response. When discussing the number or the AUM in a default we believe it is appropriate to use the top level strategy and encompass all assets (whatever the product) that invests in that strategy.

In para.41, you reference the Australian system where schemes will offer a single default fund. However, these default funds will be multi-asset investments, investing in a large range of underlying investments. There are instances in the UK where a default arrangement is also a single default fund, but this is rare. Our view is that a single lifestyle strategy or target date fund series is simply a time-based asset allocation, which is a more sophisticated version of the Australian system's single multi-asset allocation used for all savers given the issues arising from intergenerational unfairness.

Clarity about scope of consultation

We also ask you to clarify what schemes you intend to be in scope of these proposals. Paragraph 29 refers to "multi-employer DC schemes" but this is open to different interpretations, and we have so far received mixed messages from government when we have asked about this. Specifically, can you confirm that neither of the following categories of scheme are intended to be in scope:

- "Non-commercial Master Trusts", such as those operating in the education or religious sectors.
- Trust-based schemes which are not Master Trusts but do provide pension benefits to several employing companies which are all within the same corporate organisation, often referred to as multi-employer arrangements.

Our survey of our clients

Given the important and radical proposals included in your consultation, we have undertaken a survey of our DC clients and wider market. We have collated the responses from around 60 key industry players including trustees and corporate sponsors. We have received and have incorporated the results appropriately in our answers below. We hope that you will find the views expressed by our clients and industry contacts interesting when deciding how to take these proposals forward.

Detailed answers to consultation questions

Chapter 2 - Achieving scale in the Defined Contribution market

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.

No, we do not believe providers should be restricted to the number of defaults. While we agree that fewer default funds would result in improved efficiency for providers of DC schemes (and consequently fully support the next chapter of the consultation in regards to contractual override without consent for contract-based arrangements) we do not believe it is appropriate to impose arbitrary and strict limits on how many default funds a provider is able to offer. There are many reasons as to why a provider will use (or need to have) a range of default funds, including maintaining "accidental" defaults created as a result of regulation; employer specific requirements; religious requirements, and competitive pressures. There will also be historic defaults that have guarantees or preferential terms for member that would be lost if members within these funds were consolidated into a different default. Therefore, limiting the number of default funds will prohibit providers from ensuring they can take their members interests into account and meeting these specific needs. Ultimately, we believe that DC pensions are members' own money for their retirement and that any consolidation of defaults should be done with the members' benefits at heart – and setting an arbitrary number would risk forcing detrimental change.

Further, it is common for providers to use default arrangements that support specific outcomes, e.g. cash lump sum, income drawdown, and/or annuity purchase, or different risk tolerances or for religious and ethical purposes, which may vary across employers. We believe it is important that providers are not limited in the offering by restricting the number of defaults and are instead able to offer these choices to better meet the specific requirements of their savers.

While there is the potential of efficiency across provider investments, we believe that this could be done in a member focused way (eg using the upcoming value for members (VFM) Framework and also the suggested contractual overrides). In our view setting an arbitrary minimum number of default funds could severely restrict the ability of providers to support their savers, instead (if scale is considered the most important factor) we suggest focusing on requiring providers to have one default of scale without limits to other defaults, with all other defaults not needing to be a minimum size but instead needing to ensure they are assessed with the upcoming VFM regulations. If investment in the UK or UK productive finance is the main aim of this consultation, then we suggest focusing on the "comply or explain" test, as described in our executive summary.

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?

Our view is that requiring all defaults to have a specific level of AUM is effectively imposing an arbitrary limit on the number of default arrangements, therefore we have the same view as noted in the previous question. While we appreciate there is good reason to have a main or central default arrangement available to employers, establishing an arbitrary number could restrict the ability of providers to support savers, stifle innovation and restrict them to be competitive in the market.

As discussed in the executive summary, instead of focussing on a minimum AUM size, we would suggest looking at the "bigger picture" and what you are intending to achieve, which we believe is increased investment in UK productive finance assets. To achieve this, we believe you should set out clear and explicit expectations about investment targets in UK productive assets, for example, UK infrastructure and UK private equity and to require schemes to either meet these requirements or explain why not – a "comply or explain" regime.

This comply and explain target in UK productive finance assets would have many benefits:

1. It focuses the energy of the industry in the same direction as the focus of the government – growing the UK economy. Rather than spending many years first defining and agreeing exemptions on what is a default fund and then years consolidating assets instead the industry would focus on investment in the UK and how to achieve that.

2. It could be legislated for relatively quickly: the government would want to define the types of assets it wants investment in, for example, any UK assets or UK productive assets (we have provided details on how productive assets have been defined in the industry in Appendix 1). This definition and the appropriate target could easily be achieved through collaboration between government and industry to set realistic targets that satisfy the government's ambitions whilst still enabling schemes to focus on the best possible member outcomes. We believe an industry body such as the PLSA would be able to convene this initiative relatively quickly so that commitments could start to be made this year.

3. A regulation like this could cover the whole market, for example similar to TCFD regulations required of all schemes over £1bn. With the introduction of LTAFs we do not think that productive finance is limited to only the largest "Mega funds", and as cited in the supporting documents of the consultation, several single employer trusts already invest in these assets.

If you wished to continue to focus on scale, we would suggest that the requirements regarding the number and size of default arrangements should be changed so that providers are expected to have an overriding default arrangement (a "default default" arrangement, if you will) that will accommodate most savers and will achieve "scale" but providers should then have the flexibility to also offer other more specialist default arrangements for specific situations. These could better meet specific requirements such as specific investment requirements, for example religious or ESG constraints, and also ensures that certain member benefits are not arbitrarily removed. This idea means there's still the incentive to consolidate assets where possible, but doesn't preclude smaller funds from being used where they are in members' best interests.

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?

As stated above, we do not believe that setting a minimum level for default arrangements is appropriate since it would lead to arrangements which are smaller and offering value for members being removed. If the aim is to increase investment in UK productive assets, then this can be achieved by incentivising these investments such as with more favourable tax treatment or by targeting investment in UK productive assets directly rather than using scale as a proxy.

If, as we stated in the question above, you proceeded with the suggestion of requiring providers to run one 'at scale' default, but allow them the flexibility to run other defaults which are smaller than we would suggest that the at scale default is £10bn to align with the requirements for the size of comparator schemes in the forthcoming VFM Framework that schemes need to compare themselves to. Whilst this suggestion does remove some of the complexity of not having to define every single possible exemption to all defaults being of scale, it would still have unintended consequences. For example, several smaller Master Trusts which already invest productively may struggle to reach even this threshold, depending on the required timescales, and there would still be concerns about significantly restricting new entrants to the market.

If the government defines an AUM test (that is regulated) we would also caution that different schemes are structured differently, so it will be important each can evidence how/if they have the required scale at an 'effective' level, for example by being able to combine all the target date fund AUMs that make up the default arrangement. We also believe this test should be product agnostic and cover all assets in the funds whether in a GPP or Master trust for example.

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)?

As noted previously we do not believe there should be a minimum size of AUM, but if one is applied then yes, we support discretion to disapply it at regulators discretion and also agree with the examples you give but there are others too, for example current innovative smaller master trusts investing in productive finance, or those that have a growth rate that shows they will achieve scale in due course and scheme's that are non-commercial master trusts that access scale via their DB scheme for example who could also be impacted by this suggestion.

Ultimately members' will pay the costs of consolidation. We support consolidation using the proposed VFM tests – ie red schemes should be consolidated as members are expected to benefit from changes and hence, a certain level of cost is merited. It should not be done on scale or an arbitrary number of defaults. It should instead be focused on improving our UK DC savers' outcomes. If scale is considered important to outcomes and good value we suggest it's consider to be added in to that test instead.

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?

No, we do not believe there should be targets to reduce provider default arrangements down to one. Our previous answers set out the reasons for this.

However, we record here that any implementation plan for these proposals should:

- Firstly, be based on a timetable that starts only once the required legislation has been passed into law by Parliament rather than an arbitrary calendar date such as 2030; and
- There should be phased implementation before any final target levels are introduced.

As previously answered, we don't believe there should be a minimum AUM level applied.

We remain concerned that an aggressive timeline is neither beneficial for UK DC savers, nor will it naturally achieve the governments aims of commitments and investment in UK productive finance.

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?

At this point the impact of setting a certain level of minimum AUM is uncertain in terms of which providers will be able to meet that or will be forced to consolidate. Market performance over this period is a factor among others, adding to the uncertainty. It may be that few providers can reach the set minimum and the market ends up as an oligopoly with a lack of competition and price pressures leading to worse outcomes for members.

From the provider research we do, we know that market distortion is already happening due to the announcement of this consultation and the mention of a £25bn threshold which is significantly larger than many Master Trusts. We know, and it's been mentioned in the media, smaller providers are now at the risk of losing business as they are seen as unlikely to hit the target. This is alarming, especially given some of these schemes are already providing more innovative investment solutions.

We're also concerned about a 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. Which would again negatively impact the ability of providers to invest in productive assets/improve investment strategies.

Consolidation and integration are resource-intensive processes – it takes many years to integrate providers after a transaction has been approved, hence a 2030 date is unlikely to be realistic. Service within providers for their members can suffer as a result.

Overall, as we've stated throughout, there is a risk that due to the necessary focus on scale and scheme mergers, providers deprioritise and cease investment in other important areas, such as new products and decumulation solutions, and importantly, productive finance. Whilst some scale is positive and we support the trajectory (particularly the recommendations in the next two chapters), instead we believe that the goal of the government should be the focus directly on UK investment.

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 believe the simplest way to focus on scale is a 'test' for a default of scale with flexibility around that on the number of defaults (as long as they meet the new VFM regulations). This then removes the need to spend time agreeing exclusions.

The list of potential exclusions is long, some of the exclusions being discussed by the industry include the following circumstances:

- An innovator to provide competitive challenge
- Those already investing productively (criteria to be defined)

- Those that include some sort of guarantee (eg With Profit or GAR-style arrangements)
- Those with additional member benefits (eg retirement benefits
- Those investing to meet specific religious requirements (you already noted an exception for Sharia funds in paragraph 42)
- Investing to meet specific ethical requirements
- A market event impact (either investment or employer driven)
- non-commercial Master Trusts that providing DC benefits on top of core DB benefits to the employees of a specific group of employers.
- Accidental defaults
- A provider with a high growth rate who has realistic plans to achieve scale
- Any default rated green on the VFM assessment

Overall, we believe that this list is at best random – it's focused on trying to protect sections of the industry and also not defeating the government's aim of investing in productive finance. We believe that we should focus instead on the savers' outcomes and the best way to do that is to ensure providers have the tools to consolidate legacy defaults in GPPs and then to consolidate red rated schemes via the VFM assessments (which could have scale targets in them if desired). To get the investment in UK productive finance, explicit targets should be set.

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?

As mentioned in the executive summary we undertook a survey of schemes and more than half (58%) of our survey respondents think that these proposals will, or could, affect their decisions about the pension schemes they run before the proposals come into effect. This evidence echoes our own concern that the long timescale to implementing these proposals is a key risk and could lead to paralysis of the pensions market during that time. By this we mean that it will be much more difficult for smaller providers to win business in scheme selection exercises if they are perceived to be "sub-scale". This could even lead to a self-fulfilling prophecy whereby smaller providers are unable to scale up in accordance with the government's timetable and therefore have to exit the market, even in cases where they are investing in UK productive finance at a greater rate than some larger schemes.

The other key risks are that of creating an oligopoly that lacks innovation and price competition, and systematic risk of the c.10 providers that provide all UK DC workplace pension provision. Regulation would need to be increased to mitigate this risk.

Finally, there is a real danger of winding up well-performing schemes and defaults – given these proposals are not based on performance. 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.

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?

Our answer to this question is the same as for question 7.

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

When considering further interventions or regulatory changes we believe it is very important to take into account the high pace of regulatory change and initiatives already happening in the DC pensions space. These include, in no particular order, Pensions Dashboards; Small Pots consolidation; VFM framework; enhanced VFM assessments for sub-£100m schemes; Guided Retirement; and the long-overdue review of auto-enrolment requirements.

All of these initiatives are taking up both governmental and industry resources to implement and most of them interact with others in some way (the obvious example of this is that the VFM framework is mentioned numerous times in your consultation and yet at present that has only progressed as far as a consultation by the FCA last autumn, where the results are yet to be published).

Therefore, we would strongly recommend that no further significant initiatives or regulatory changes are introduced until all of the above have reached implementation (or been formally halted) and time has been taken to assess the impact of them all holistically on the UK pensions market. There should also be an ‘indicative timeline’ so that the industry can understand where to prioritise its efforts. We recommend that small pots consolidation in particular should be delayed while the market is being restructured and dashboards are becoming available as we have concerns that members pots could be consolidated multiple times if both that and these proposals we enacted.

Having said that, a useful relatively minor regulatory intervention would be to revisit The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations SI 2006/349 as made under sections 259-261 of the Pensions Act 2004. These regulations should be reviewed and updated to provide better clarity about when consultation is required in consolidation exercises such as moving from a single-employer trust to a Master Trust, moving to a different Master Trust or changing GPP provider, as there are different interpretations of these regulations.

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

The pricing of a pension product usually consists of two components: investment charges and administration costs. The investment component is calculated based on the type of assets the provider invests in and these costs are defined between the provider and the asset manager(s). These costs would be the same whatever employer invests in that provider (assuming the same default funds). However, even if employers invest with the same provider and in the same funds, for most UK DC providers the administration costs are expected to vary between employers. The reason for this is that, administration costs are affected by the attractiveness of the employer’s workforce and the assets the employer has connected to it – so the larger the assets per member, the lower the expected administration cost per member – and other factors such as turnover, contribution rate, overall number of employers, complexity of payroll runs (and many more) can all impact this cost too. Larger employers typically have a greater level of assets connected to them (and larger contributions on an ongoing basis) so this means that at present, larger employers are often able to negotiate lower administration costs for their employees.

It therefore follows that moving to a single price for a default arrangement would, generally, be beneficial for smaller employers but negative for larger employers, since the imposition of single pricing would lead to cross subsidy between the employees of <u>different</u> employers, ie removing the ability of larger employers to negotiate to obtain a better fee. And as the largest employers often employ relatively low earners (eg in the retail and services sectors) it is this demographic of the workforce that would likely suffer most from a move to single pricing. Therefore, we do not support this.

We also do not believe that requiring each individual provider to offer a single price would achieve the stated objective of reducing the focus on price. One potential outcome is that larger employers would simply shop around for a lower cost provider, and in addition providers would have an incentive to ditch expensive/ smaller employers (perhaps leading to more expensive/ smaller employers going to NEST). In this scenario, price competition remains, but considerable disruption has been caused.

Our survey also supports this view with 75% of respondents saying that single pricing would negatively impact on members.

We also believe that if employers know they cannot negotiate on pricing, as they can with other aspects of business and employee benefits, then that will reduce their engagement on pensions matters. Ultimately, if we move to a more Australian style system – a single default with a single price – then logically we must re-open the conversation on pot for life as that is effectively akin to a retail, individual-led system – not an employer one.

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

(Note: we assume that Stakeholder schemes are intended to be in scope of these proposals, given footnote 1. However, we should be grateful if you would explicitly confirm this since it is members of such schemes who are most likely to benefit by being moved to a newer, more modern pension arrangement.)

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

Providers should be able to transfer savers to a new arrangement without their consent if they deem it to be in the best interest of those savers. We would also expect these providers, who are FCA regulated, to look at whether keeping members in these current funds is compatible with their consumer duty. For example, in terms of whether the transfer is in the best interest of savers. For example, across the UK we see few members opting to purchase an annuity, and yet members have been left in legacy annuity targeting strategies from a decision made pre "freedom and choice". For these members, it could be deemed in their best interest to be moved to an investment strategy more aligned with what they are likely to do, for example to opt for income drawdown (for larger pots) or to take a cash lump sum (for smaller pots).

There are many other examples of where members may be deemed to be in a less suitable strategy than an alternative one, such as where fees are high, the funds they are invested in are poorly performing or there is a lack of consideration of Environmental, Social and Governance factors. To determine whether an existing arrangement is value for members a prescriptive assessment under the forthcoming VFM framework should be carried out, and any "Red" rated (ie poor value) arrangement should either be modified to correct any shortcomings, or members should be moved to a better rated arrangement with or without their consent. We would also expect additional analysis for example on expected future returns for members to be carried out.

We note that providers would likely be keen to reduce the number of legacy arrangements that they administer and therefore this "tidying up" of these arrangements could be seen as mutually beneficial to members and providers.

We note that transfers could be made without consent but in each case an "opt out" should be considered. For example, in the case where members are in an annuity targeting strategy, they could be moved to an income drawdown targeting strategy if membership analysis indicates that they are more likely to take income drawdown, but members should be notified of any changes before they occur and in the pre-transfer communication it could note to members that they may wish to opt out of the switch (and remain in the annuity targeting strategy) if they are indeed intending to purchase an annuity. This assumes, continuing with our example, that the annuity strategy is a reasonable strategy offering value for members, since if not then it should be closed and members not given the ability to opt out (but could be notified of an alternative better value annuity strategy).

In all cases, any transfers should be undertaken only after notification to sponsoring employers where active employees are affected. This is in addition to notification to members (both active and deferred). We believe a minimum of 90 days' notice should be required.

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?

Yes, we believe that there needs to be strong governance and independent expertise to ensure members are only moved without consent if it is in their best interests an independent expert therefore could be responsible for undertaking the assessment of whether a transfer is appropriate.

While providers do have an IGC in place and part of this role is to oversee the investment arrangements, the IGC does not own the assets as the responsibility (and liability) with these decisions is with the provider. Therefore, while we believe that independent experts would be beneficial in general, we would suggest that IGCs, rather than approving the transfer, should be consulted by the provider with the IGC analysing and if necessary vetoing the proposal.

We would also note that IGCs may only have the resource/ expertise to do their current role. If they had to do this work as well, there should be a requirement on insurers to properly resource IGCs, both to ensure they are as independent as possibly, and also to bring in the additional expertise they will need (for example from regulated consultants/actuaries) to do this extra work to the standard required.

In any case, we believe it is very important that members are notified in advance of a planned change and given the opportunity to move their money to another available investment option (for example to self-select funds) if they are not happy with the intended transfer – as long as members are told about what is happening and why, and have a reasonable range of alternative investment options to meet their needs then we would struggle to see how a member complaint with any legal basis could hold up in court.

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?

Currently IGCs do not have the powers, like trustees do, to direct the assets of the scheme/provider. If IGCs do oversee such transfers, it may be that they are required to consult on transfers where the provider has conducted independent, and where necessary, actuarial analysis, but not necessarily need to approve them. IGCs would need to take independent advice to verify the proposed transfers, and could then pass judgement, with the provider ultimately responsible for the decision-making (as the liability sits with the provider and not the IGC).

For the purpose of the matter being considered, the changes that may be needed are to ensure that the IGC is truly independent and has the responsibility to carry out the value for member assessment on the existing investment options. We believe that nearly all bulk transfers that occur under these proposals will result in the pensions remaining in the original provider's portfolio (ie just being moved to a better value arrangement without changing provider). In the rare case that the original provider cannot facilitate a better value arrangement then consideration would need to be given to being able ensure the affected savers are transferred to a new provider. The purpose of this is to remove the possibility of any conflict of interest, actual or perceived, between the IGC and the provider since, whilst the IGC is meant to be independent, in some IGCs there are provider representatives (and in most cases the fees of the IGC are met by the provider).

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

We believe that employers **that still have active members** in the arrangement should be consulted on the proposal to determine where future contributions should go and make any transfer without consent of members relevant to that employer (ie the people that it employs). In many cases this scheme may be fulfilling its auto-enrolment duties and in some cases the employer would need to sign a new contract with the provider. Giving employers a more detailed role may cause confusion and adds complexity to what the aims of the proposals are (ie to consolidate assets and move them away from legacy less appropriate arrangements).

In terms of the transfer process itself, we do not believe there needs to be a role for the employer. Once the decision has been made (following analysis), and the employer has been consulted and comments considered, then it should be the provider to implement the transfer, including to communicate to members. Although we recognise that in some circumstances the employer may wish to be involved in the communication process and perhaps issue its own communication (for example if the legacy default was one the employer designed). We see it as good practice for the employer to be kept informed and allowed to comment on the transfer (eg timing may be a consideration if other changes occurring that impact the workforce) but we don't see the need to assign a formal role to the employer. We would also note that the legacy arrangements delivering poor value we are referring to are unlikely to have active employer participation, as if they did we would have expected that they would have looked to update their scheme.

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

This may be the case, but it will vary provider by provider and possibly where the transfer is moving from and to – for example if the transfer moved from GPP to Master Trust.

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?

This point is covered as part of answers given above, but to recap: we suggest that the provider is responsible for assessing the value for members of the existing arrangements. The IGC is consulted by the provider and, where relevant, employer(s) are also consulted where they have active members in the arrangement so they can confirm where future contributions go. On any transfer, independent expert advice is to be sought to make sure it is in the best interest of members. The provider is to consider feedback from the provider and employers, if any, and make the ultimate decision to proceed.

All of this process should be well prescribed in terms of what assessments should cover and it should be well documented as to the reasons why any transfer is being considered and how it is expected to improve value for members. Members should be notified at least two months in advance of any change being made, ideally with more than a single communication. The members need to be told what transfer is going to happen and why this is in members' best interests. The members should also be told what their options are; it may be they could opt out and remain where they are invested (this may be unlikely if the product is deemed bad value and closing), but in any case, members should be reminded of the other investment options available to them with the current provider and how they may change their investment choices (ie they can make their own decision if they are not happy with the transfer being planned).

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?

As noted, providers may be reluctant to move members without consent as they may be concerned about member complaints or legal cases brought against them. This is why we believe it is important that the government is clear on the circumstances under which a decision to transfer should be made, ie what should the value for members assessment cover.

We would also note some legacy products include guarantees and analysing if transferring is in a member's best interest can be very complicated and often would not likely be in the member interest.

If savers are moved from a contract-based scheme to a Master Trust a new contract is likely to be needed with the employer(s) of those members.

In the long term, if illiquid investments do become a material component of DC defaults, then that could present a challenge in the timing and disinvestment as part of the transfer process, although such challenges are likely to be more common in transfers between providers which we have already said we expect to be rare.

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

Transfers should only be allowed to move to green rated defaults, once independent experts have provided an assessment. Making it a requirement to communicate to members in advance of transfers also gives them protection as they have the opportunity to make an alternative investment decision.

We also note that many providers will be subject to the FCA's overriding Consumer Duty requirements which, if functioning properly, will be another level of protection for savers.

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?

Transfers should not be allowed to take place if it is unlikely to improve the member's outcome. In some very limited cases savers should be given the option to opt out, for example members being moved away from an annuity targeting strategy to a cash lump sum strategy may want to opt out if they actually do wish to buy an annuity. But savers should not be able to opt out and remain in an arrangement that is "Red" rated ie determined to be relatively poor value for members.

We also note that there is no right of opt-out for members when bulk transfers without consent are carried out by a trust-based scheme via Regulation 12(1A) of the Preservation regulations (SI 1991/167), although DWP guidance does suggest that members should be able to opt for a different destination fund. So we do not believe that savers should be able to opt-out generally and remain in the existing arrangement.

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

If a blanket opt out rule was put in place, then what may happen is that a lot of legacy arrangements that offer poor value for members will be forced to remain open due to a small number of members not understanding why the transfer is in their interest and opting to remain in the "Red" rated arrangement. In the worst-case scenario these legacy arrangements could have only a few members left in them, making those arrangements even less important and giving a stronger case for removing them completely with no choice to opt out. We believe member options should be in line with our answer to question 20.

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?

We don't believe that members should have the right to recourse if they have been told about the transfer happening well in advance and have been told what alternative options they have. The members should take responsibility for their own money and if the provider is operating on good faith and following procedures for assessing value for members, documenting their assessment and decision and making it clear to members what is happening and why, then we fail to see how a member has any right to find issue with this. The only circumstances that a member should have the right to compensation (barring typical points like errors/fraud etc) is if they have been misled and transferred to their detriment into a worse arrangement – this excludes investment performance since future performance would not be known in advance of the transfer.

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

We don't believe there are any additional safeguards needed beyond what we have already mentioned in prior answers.

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?

We believe that the existing fiduciary duties of pension scheme trustees mean that the receiving trustees should already be assessing the interests of both incoming and current members of their scheme. Therefore no extension of trustee duties should be required (although it might be helpful for the government to publish guidance about how receiving trustees should assess the transfer).

25. How should the cost of the transfer be borne?

We suggest that all the costs involved in a contractual override/bulk transfer that are not the transaction costs (see next paragraph) are borne by the provider. The provider would likely be benefitting from such bulk transfers by having less arrangements to administer, and may obtain cost savings that could be used to partly offset the costs of the transfer. Where the provider bears the cost and can't offset this in other ways then it will be their decision on a commercial basis to determine what platform charges should be applied to the membership. In other words the cost of such bulk transfers going on in the background is considered a "cost of doing business" and factored into the price of what they offer members ie the platform charge. We would hope that these proposals do not lead to an increase in platform charges for members, but this would depend on many factors including provider specific ones such as how many legacy default arrangements they have to assess and "tidy up". We note that the exercise should largely be "once and done", in that once the legacy arrangements have been removed and members are consolidated into the providers' main default arrangements, then there would only need to be ongoing assessment of those main default arrangements to ensure they remain competitive and offer value for members.

Relevant costs to members should only be the transaction costs, ie the selling of existing investment funds and purchasing of units in the new funds. For example the bid/offer pricing spread on the units of those pooled funds. The factors that influence the level of costs are what type of investment fund they are (for example property funds usually have a high cost compared to gilts funds) and also which manager and how the fund has been set up (some funds are single priced, so have no bid/offer spread, and costs are borne implicitly by all holders of units in the fund). We suggest that these costs should be considered in the assessment and decision regarding whether to bulk transfer, and if deemed to still be in the interest of members then we suggest it is fair that members should bear these costs.

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

Apart from transaction costs as set out in the previous question, other costs involved in a contractual override/bulk transfer include:

- The cost (time spent) in carrying out the assessment to consider whether a contractual override is going to materially improve value for savers and should take place in the first place.
- Time on consulting with entities.
- Independent expert time/advice on the proposals.

- Time planning the transfer.
- Communicating with members to notify of an intended bulk transfer (cost of creating the communication and issuing it, for example printing and postage).
- The administration cost (worker time spent) in processing the transfer.
- Any out of market exposure, where member savings are disinvested but not reinvested immediately. This would mean that a member is out of the market and hence, they will not receive any market performance for that period – this is considered a transition cost.

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

Whenever transfers are considered, issues about tax protections, early retirement, GARs and similar guarantees need to be considered and it will be the same here.

Benefits members could gain include lower fees, more diversified investments, better risk management including consideration of climate risk and other ESG factors, better investment performance, better administration performance (if changing provider).

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

Generally speaking, the regulators' role in this area should be the same as in any other area, ie oversight to ensure that regulations are followed, and that members' best interests are served. Therefore, we believe that the regulators should largely operate in an oversight capacity. We also would suggest FCA and tPR work together on this area to ensure a consistent approach.

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

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?

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?

(We are answering these two questions together.)

In principle, we support the idea of the employer having a duty to assess value in their pension schemes, and this should apply to all workplace pension schemes, whether Master Trusts, GPPs or Single-Employer Trusts. This should shift focus away from cost. It is difficult to think of what evidence could be produced since there has not been a duty placed on employers so analysis of value before and after does not exist. But having employers consider value for members should naturally lead to better member outcomes as it is logical to assume that employers would be making more informed and better appointments for members. The responses to our client survey question about this indicated that 89% of respondents supported the introduction of a duty and within those responses, 100% of responses identified as “trustees” supported it and 83% of “corporate” responses supported it.

We also note that changes to pensions taxation rules over the last twenty years have meant that many company executives have alternative benefits instead of membership in their company’s main pension scheme. As a result, it has been said that executives can be less engaged with workplace pensions since they have no direct personal interest in them. Placing a duty on employers and/ or making it the responsibility of a named executive will re-engage their interest in their employees’ pension arrangements, which we believe is positive. Although we note the practical limitations of introducing such a requirement, with believe flexibility is needed for employers on how any such duty is undertaken.

However, we also recognise that such a duty is likely to increase costs on business and therefore several factors have to be considered when deciding the way forward.

In practice the impact will depend on the size of the employer. Large employers will likely already have senior oversight of their pension arrangements (although it may not be at executive level) since they will be a large employee benefit cost. At the other end of the scale, owners of very small businesses will be involved in all aspects of the management of the business, including pension provision. Therefore, it is likely that a new duty will mostly affect middle-size companies where focus on pensions can be lost.

We are conscious that there is an argument to make that all workplace pension schemes should be subject to this duty – from an individual employee’s perspective, why should the assessment of value depend on the size of the employer that they work for? In our client survey, 100% of “trustee” respondents said that a duty should apply to all employers, however 67% of “corporate” respondents said it should only apply over a certain number of employees.

On balance we believe that a minimum threshold would be a pragmatic solution in this situation and suggest that 50 employees is a suitable threshold, noting that this is the level at which the Employer Consultation regulations (SI 2006/349) apply from.

One point of detail is that care would need to be taken about where this duty sits, particularly in corporate group pension arrangements where it may be that in practice decisions about the pension arrangements are made at the Topco level and subsidiary employers have little real input into the process.

The form for such a duty we suggest is written professional advice, in the same way that trustees of occupational pension schemes need to receive written professional advice prior to making investment decisions. To make it easier for employers to make value for money comparisons there should be more standardisation in reporting from providers, particularly around value for money reporting and administration data such as how member requests are recorded as being completed and the timescales measured. This would enable more straightforward like for like comparison between providers.

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 are not aware of any direct evidence, certainly not in the UK, about the impact of regulation on pension selection advice. However, generally speaking, regulation of advice usually requires advisory firms to have significant resources to meet the regulatory requirements and a consequence of this is that the quality of the regulated advice may improve although this is not guaranteed.

Therefore, we believe that if a duty (in whatever form) is placed on employers to consider value, then we believe that advice should be sought whether regulated or not.

Any regulation should state what the advice should cover, and this should make it clear that the advice should be holistic, considering value for money and the needs of both the workforce and the employer, not just price. However, any regulation should also permit advice to be proportionate so as not to add unduly to the costs of business.

We have had concerns that cost is very often the main or single focus when Master Trusts are selected. We would be keen to encourage an environment where value for money is the main driver of advice given to employers. We would however note that often this cost pressure will come from the employer not wishing to increase costs to their employees.

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?

It does not follow that regulating investment advice strategy will lead to more productive asset allocation. There are a number of other factors that affect the direction of investment strategy. For example, it may be that the investment strategy advice does lead to a recommendation for a greater productive asset allocation but the case for that will vary on a scheme-by-scheme basis.

It is also worth noting that, with any investment strategy review, there will be many steps taken before advice is given to a scheme to invest in broader private market investments. For example, setting investment beliefs. And it is not always the case that trustees accept the advice of their adviser.

There is also the consideration of cost to the scheme of incorporating more productive investments, the additional complexity and cost of which could deter the trustees and/or employer from allocating to these types of investments. And as we have stated more generally in our response when referencing these challenges, there are still corners of the provider market where it is still not possible to access these types of investments alth, due to, for example, provider size / sophistication.

Regulation 34 of the Scheme Administration regulations (SI 1996/1715) already includes advice on adopting a particular investment strategy within the definition of investment consultancy services so if this is area of advice is going to become further regulated then modifying these regulations seems the most effective way of achieving this, for trust-based schemes at least.

Regulated advice should be focussed on the best outcomes for clients and scheme members.

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

N/A – we are not a provider.

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

N/A – we are not a provider.

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?

N/A – we are not a provider.

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)?

N/A – we are not a provider

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?

We have consolidated many single employer trust schemes into master trusts. We have not experienced any key barriers in the sense of preventing such a transfer going ahead. The process of moving from a single employer trust to a MT takes around six months to a year from the decision to proceed with a provider to actually moving the assets (a provider selection would be done prior to this). Key factors influencing the time scale are the nature of the selection process and whether providers will be giving presentations to the trustees, the chosen provider’s capacity to implement the transfer and the member communications and need to ensure members are given sufficient notice of the transfer and time to ask questions and possibly move their money elsewhere if they wish.

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?

N/A – we are not a provider

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)?

N/A – we are not a provider

40. *For those who run both a MT and a GPP:* 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?

N/A – we are not a provider

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

We would estimate £5,000 to £25,000 but this could be higher if the employer then decided to change provider following the review.

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

We do not have access to this information, typically larger employers use advisors.

Conclusion

As we said in our executive summary, we recognise the importance of this consultation and support the investment of DC pension assets in productive finance in an appropriate way and we trust that our comments are read in that context. We would, of course, be very happy to discuss any of our comments in detail with you and we look forward to seeing the next stage of your proposals.

Yours sincerely

{By email only 16 January 2025}

Laura Myers
Partner
Head of DC

+44 (0)20 7432 6639
laura.myers@lcp.uk.com

Steve Webb
Partner

+44 (0)7875 494184
steve.webb@lcp.uk.com

Tim Box
Principal

+44 (0)1962 872739
tim.box@lcp.uk.com

Appendix 1: Existing definitions of productive finance

The Bank of England released a paper in 2016 called "Understanding and Measuring Finance for Productive Investment". This was not specifically aimed at the pensions industry, and instead was positioned as a more general Discussion Paper prepared by the Bank of England staff. The paper notes that 'there is no standard definition of finance for productive investment'. In the paper they set out a definition for productive investment: "Investment is productive as long as the expected social return to investment is greater than or equal to the social cost of capital". The paper goes on to explain that it considers an investment to be productive 'when the net expected benefits to society are positive.' The paper cites James Tobin's 1965 paper titled "Money and Economic Growth" as the source for this idea of the productivity of investment.

The Productive Finance Working Group (2020) expanded on this, defining productive investment as "spending by businesses that has the potential to expand the productive capacity of the economy, whilst also generating marginal returns to society that exceed the marginal cost of investment to society. Such investments include plant and equipment, research and development, technologies and infrastructure". They also went on to define productive finance as "Productive finance refers to the way that businesses finance this productive investment – such as cash injections from owners, loans, and external investors".

In September 2023, Barry Kenneth, CIO of the PPF, published an article detailing the PPFs view on productive finance. He explained "But to my mind, and from the PPF's perspective, productive finance assets are Equity (both Public and Private), and Real Assets (which includes Real Estate, Infrastructure, and Timberland and Farmland). They are investments which help support businesses and the wider economy".

The Pensions Regulator published guidance on private markets investment in January 2024 which included information on productive finance assets. This stated that, although the term lacks a formal legal definition, "it is often described as investment that expands productive capacity, furthers growth and can make an important contribution to the real economy". The guidance provides examples of productive finance investments, such as plant and equipment, research and development, technology (eg green technology) and infrastructure. It notes that pension schemes can invest in productive finance through equity, debt and real assets.

More recently the SPP published a report in September 2024 calling for policymakers to agree on an "unambiguous definition" for productive finance so that pension schemes are clear about what qualifies and what does not. The SPP believes it is reasonable to define productive finance as having three key features, it: 1) increases the UK's productive capacity, 2) improves UK growth and 3) makes a tangible and positive contribution to UK society.

In summary, the varying definitions of productive investment and finance highlight the need for clarity of terminology when the topic is discussed, and is on one of the key reasons why, if investing in UK productive finance is the Government's goal we would welcome clarity on the assets and definition the Government would look at when considering if the Pensions Industry should be investing more in UK Productive finance.