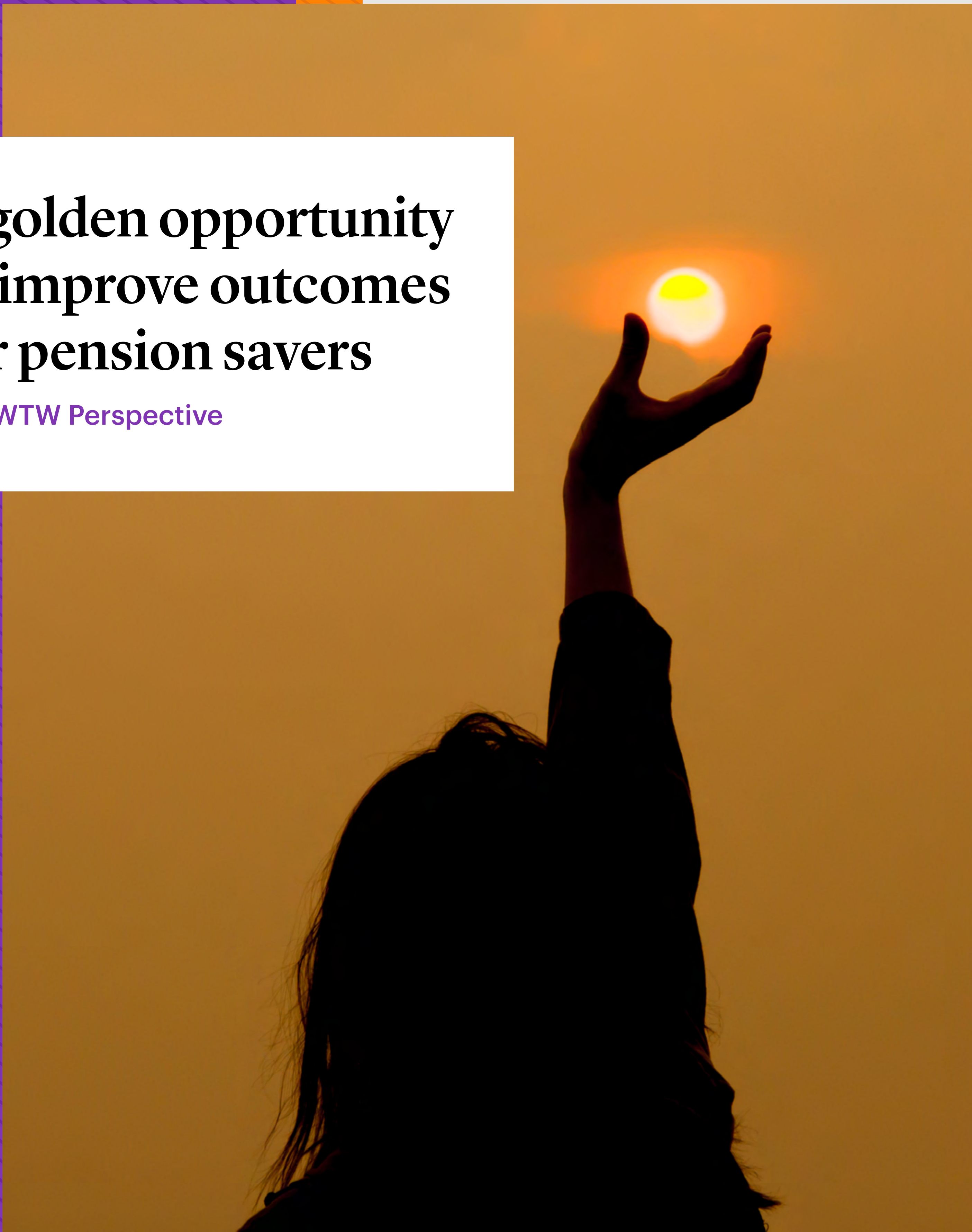
A golden opportunity to improve outcomes for pension savers

The WTW Perspective



The WTW perspective

Pension reforms are looming large: In his speech at Mansion House on 10 July, the Chancellor said he had set the direction of travel and that final decisions would be taken ahead of the Autumn Statement. What this means in practice, time will tell.

In this paper, we set out our perspective on the key points that should underpin policy reform. In summary, these are:

1. Across DB and DC, member outcomes will improve in a regulatory environment that encourages greater investment in growth assets such as equities, corporate bonds, property, private equity and infrastructure.

2. In turn, being able to remain invested in growth assets over a longer time horizon will make it more viable for DB and DC schemes to invest in productive finance assets.

3. In DB, policies that lead to more investment in growth assets will be those that make the risk/reward trade-off more symmetrical than is currently the case. Our white paper[1] set out six changes that we believe are needed to reduce the current asymmetry. Absent these changes, schemes are incentivised to de-risk beyond what is economically desirable at a macro level for the Government's productive finance agenda.

4. In DC, recent Government policies have sought to reduce the number of small schemes, by consolidating them into larger arrangements that can be governed more effectively. Policies should further encourage this trend. Larger DC schemes are typically able to deliver better member outcomes through a wider choice of decumulation options, lower costs, better investment solutions and better member communication and engagement.

5. The big untapped opportunity in DC is to enable investment in growth assets for longer through CDC decumulation options. Currently, the only income options available are annuities or drawdown and both have drawbacks. Annuities require conservative investment strategies, and most individuals are not well-equipped to make complex decisions on investing and how much to draw down to avoid running out of money. CDC decumulation provides a middle ground that would benefit millions of people already saving in conventional DC plans rather than just the small group that may get access to whole-of-life CDC.

6. Consolidation in DB would not help with the Government's growth agenda. A small percentage of DB schemes hold the vast majority of assets. These largest schemes are already very well equipped to invest, either directly or through fiduciary mandates, in sophisticated and/or illiquid growth assets. Their challenge is the asymmetry in the risk/reward trade off, which leads trustees and employers to de-risk excessively (see 3. above).

7. There is, however, a case for consolidation of small DB schemes, where around 1,800 schemes have fewer than 100 members, which don't have the scale to improve member outcomes through effective and efficient governance. However, this one-third of private sector DB schemes by number represents just 1% (£15bn) of the £1.5 trillion private sector DB asset base and so their consolidation would be insignificant for the Government's growth agenda.

8. The PPF (or any other public consolidator) does not have a role to play where employer support is voluntarily severed. Some proposals are impractical, such as the Tony Blair Institute for Global Change's suggestion to consolidate 4,500 schemes into the PPF on the basis that this would take 18 years even if onboarding schemes at a rate of one per working day (which is completely infeasible for the PPF). Having a single entity onboarding thousands of schemes on multiple and complex benefits structures has prohibitive operational challenges that is better addressed through commercial consolidation solutions.

9. In our experience, low allocations in the UK to productive finance assets are not because of deficiencies in trustee knowledge and understanding. The trustee model works well and there is a risk that changes in support of the narrow productive finance agenda could be more damaging than helpful. Furthermore, board effectiveness practices and the ability to engage with high quality advice from a range of specialists are significantly more important in driving good member outcomes than deep subject matter expertise of individual trustees.

We set out further commentary supporting these views in the remainder of this document.

[1] Six changes to seize the DB pension surplus opportunity, WTW, July 2023

Six changes to seize the pension surplus opportunity, WTW, July 2023

1. Create a legislative mechanism by which a DB scheme's surplus can be used to finance contributions to benefit DC members in a different scheme.

2. Reduce the tax rate on refunds of surpluses to an employer, ideally to align with the corporation tax rate.

3. Amend legislation to more readily allow refunds of surplus while a scheme is ongoing.

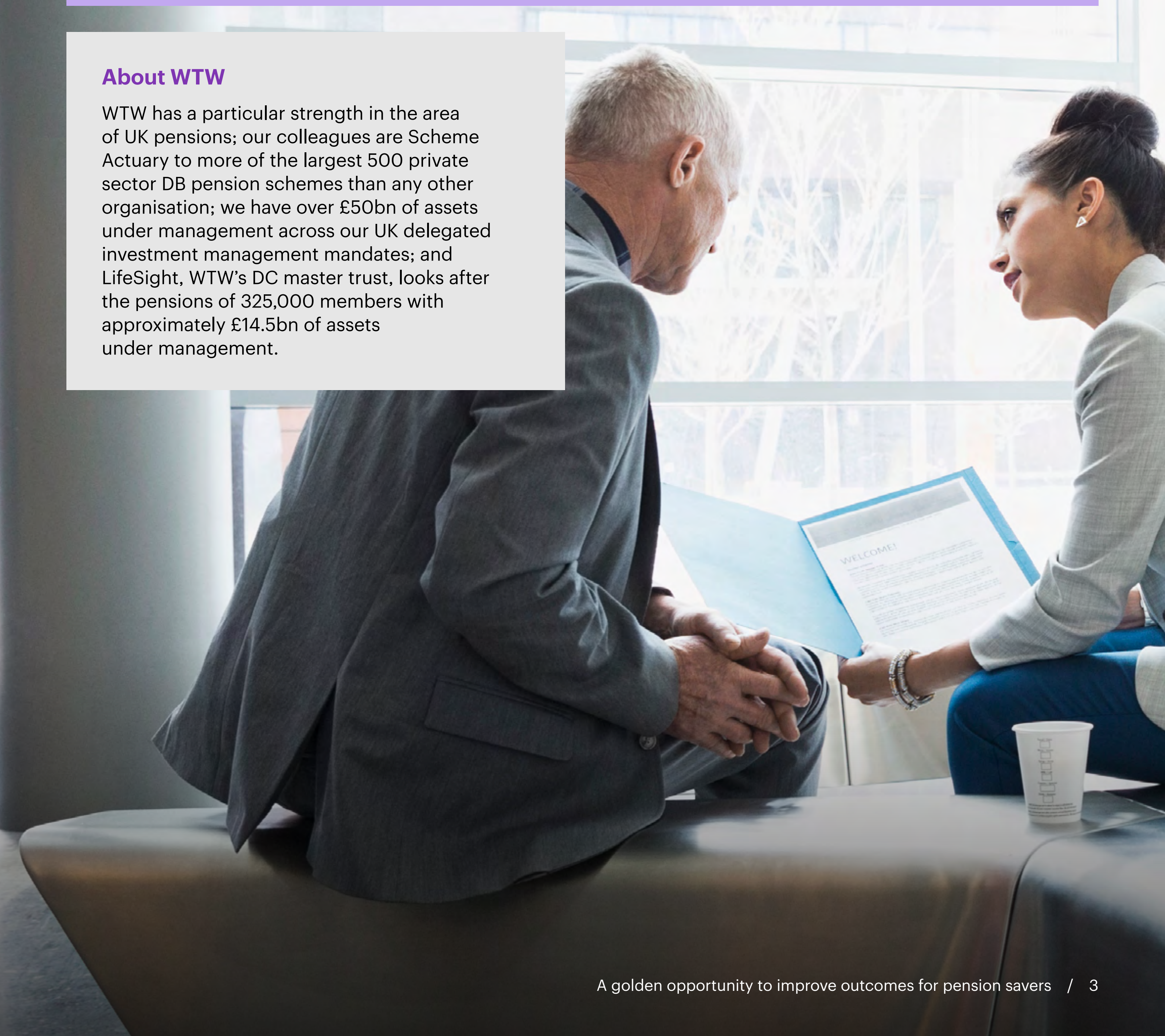
4. Remove some tax barriers to sharing surpluses with DB members.

5. Ensure that the final funding and investment strategy regulations do not funnel schemes into excessive de-risking, and that they allow open DB schemes to thrive.

6. Revisit the Pensions Regulator's statutory objectives to encourage an approach to regulating DB pension schemes that considers members' broader interests beyond solely protecting accrued pensions.

About WTW

WTW has a particular strength in the area of UK pensions; our colleagues are Scheme Actuary to more of the largest 500 private sector DB pension schemes than any other organisation; we have over £50bn of assets under management across our UK delegated investment management mandates; and LifeSight, WTW's DC master trust, looks after the pensions of 325,000 members with approximately £14.5bn of assets under management.



About WTW

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