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A golden opportunity to improve outcomes for pension savers

DC and CDC — Improving outcomes and consolidation

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Improving outcomes and consolidation

Key policy questions

- Do DC schemes offer access to the full range of asset classes, including infrastructure and private equity?
- Do they have the scale and expertise to deliver Value For Money (VFM) and better member outcomes?
- Do they offer access to drawdown at the point of decumulation? Should the options available be extended to include decumulation Collective Defined Contribution (CDC)?
- How should small pots be consolidated?

WTW viewpoint in a nutshell

Scale and expertise are important in DC. We welcome the revised VFM framework and expect it to deliver better member outcomes and to encourage further consolidation in DC.

Requiring DC schemes to offer access to and communicate the full suite of retirement options, including drawdown, will be a step forward (bearing in mind most members prefer drawdown to buying an annuity).

Legislation to enable decumulation only CDC should be brought in as soon as possible. This has huge potential to reach many more savers than whole of life CDC and to substantially improve their expected retirement incomes.

We welcome the extension of auto-enrolment and proposals to consolidate small pots into a consolidator vehicle.

Mansion House Compact

One of the big announcements by the Chancellor in his Mansion House speech was that nine large DC pension providers have pledged to allocate five per cent of assets in their default funds to unlisted equities by 2030, as part of the 'Mansion House Compact' — a new, non-legally binding agreement. This is expected to channel £50bn of DC assets to productive finance assets. The Chancellor believes that this, in combination with the other measures being announced, will have the dual benefit of boosting investment in UK industries while also potentially increasing a saver's retirement outcomes.

The effect of this is to gain commitment from the pensions industry to enable DC savers to invest in a broader range of assets. This should help create an impetus and lead to innovation, which can only be good for savers.

Will the new VFM framework encourage further consolidation?

Unlike the DB market, significant consolidation is already happening in the DC landscape through an increasing move from single-employer DC trusts towards multi-employer commercial master trusts.

We support this direction of travel, which we expect to continue. This is on the basis that with the master trust model, when compared with both contract and single employer trust-based schemes, we see:

- Significantly better member communication and access to a fuller suite of retirement options, which should lead to better outcomes for members
- Fees that may be lower, sometimes by multiple tens of basis points.

We welcome the new VFM framework, which will broaden the current limited focus on costs to a more holistic and informed assessment of value for members. By focusing on value, the proposals also seek to encourage schemes to consider factors critical to improving longer term member outcomes, including those in relation to investment. We expect that the new VFM requirements will increase the pace of DC consolidation.

Equally, those remaining single-employer trust-based schemes that are well run and have sufficient scale and resources available to them, could fare well under the new assessment approach and will continue to be the vehicle of choice for some employers.

The DWP has said it will work with the FCA to consider allowing the bulk transfer without consent of contract-based arrangements. This is something that WTW has been advocating. If successful, it will broaden the focus on value for members and DC account consolidations to a much wider audience.

However, fundamental to consolidation being catalysed will be the effectiveness of regulators in compelling poorly performing schemes to take the necessary action.

Decumulation only CDC — the missing piece of the jigsaw?

Laura Trott MBE, the Minister for Pensions, has stated that CDC in decumulation is a key policy aim and we are pleased to see the Government's intention to develop a decumulation-only framework.

CDC decumulation offers a middle ground between annuities and drawdown options. We strongly believe it will have a very significant beneficial impact on member outcomes and the ability to benefit the broadest subset of current pension savers. It has the potential to:

- materially increase, by around 50%, members' expected annual incomes compared with traditional annuities; and
- enable a generation of millions of existing DC savers to remain invested in growth assets into retirement without the risks presented by drawdown of drawing too much or too little of their savings each year.

A market for CDC decumulation could mean around £5bn over the next 10 years being invested in productive finance assets, depending on how popular CDC becomes as an option.

Moreover:

- Within a CDC arrangement, investment decisions are taken by trustees on behalf of individuals, rather than by individuals directly. This should support investment in a broader range of return-seeking assets.
- Growth assets will be held for a longer period of time as there is no need to "lifestyle" out of them as individual members approach retirement.
- Unlike with DC (including drawdown options), there is no need for daily pricing of assets, given that assets are held collectively rather than each member having their own 'pot'. This facilitates investment in illiquid assets which are more difficult to incorporate into a traditional DC vehicle.
- Unlike with annuities, there are no capital or regulatory constraints when it comes to investing in certain return-seeking asset classes.

Despite strong support from Government for decumulation only CDC, it is disappointing that there is no clear timetable as to when the Government will bring forward legislation in this area. We urge the Government to do so to help provide clarity and certainty to providers who would be crucial in ensuring that this market evolves.

However, we are pleased to see draft regulations permitting a wider range of whole-of-life CDC vehicles (through an extension to multi-employer and master trust arrangements) and designs (which will also benefit single employer schemes). In practice these will take longer to have a meaningful impact on member outcomes than focusing on the needs of the many DC savers who could benefit from CDC decumulation more rapidly and in respect of a much greater proportion of their retirement savings.

Enhancing DC decumulation options further

In our view, it is important that the minimum level of retirement support offered by trust-based schemes is improved. In particular, we believe that:

- Trustees should ordinarily be required to facilitate a full suite of retirement solutions which includes access to a drawdown facility (either within the scheme or via an external arrangement).
- Where they do not, trustees should be able to clearly articulate why access to these solutions is not appropriate for their membership.
- Whilst there are likely to be some set-up costs with these proposals, we do not see this as a significant barrier to the objective of helping members access solutions at retirement.
- Trustees should facilitate access to guidance and advice, even if this is paid for by members.

Over time, we see merit in having minimum quality standards for retirement support and facilitated options including an assessment approach similar to the VFM assessment.

Automatic enrolment (AE)

We support requiring that automatic enrolment contributions commence from the first pound of earnings and bringing forward the enrolment age to 18 from 22. The pensions minister has said she hopes to consult on the implementation of these changes in the autumn, and we hope changes will begin as soon as possible after elevated short-term cost of living pressures ease. Whereas most of the initiatives under consideration aim to improve outcomes by making the money that is saved for retirement work harder, increasing the amount paid into DC pensions in the first place is also necessary to improve adequacy.

Small pots

The Government has been grappling with the issue of small pots (i.e. small DC pots left behind across multiple arrangements as individuals move jobs) for some years. Our high-level views on its proposals are:

- We broadly welcome the concept of small pots being aggregated with a consolidator vehicle, which means ruling out other proposals such as "pot follows member".
- However, we believe there are strong merits in having a single consolidator rather than a panel of multiple consolidators (which we expect are likely to be master trusts).
- We believe the regime should allow refunds for micro-pots (of, say, less than £100) rather than forcing consolidation of these.
- It would be sensible if the timing for when small pots are considered to be dormant is aligned to AE re-enrolment timescales.
- Suggestions that employees, rather than employers, should select the pension provider risk much higher marketing costs being passed on to savers through higher charges.

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