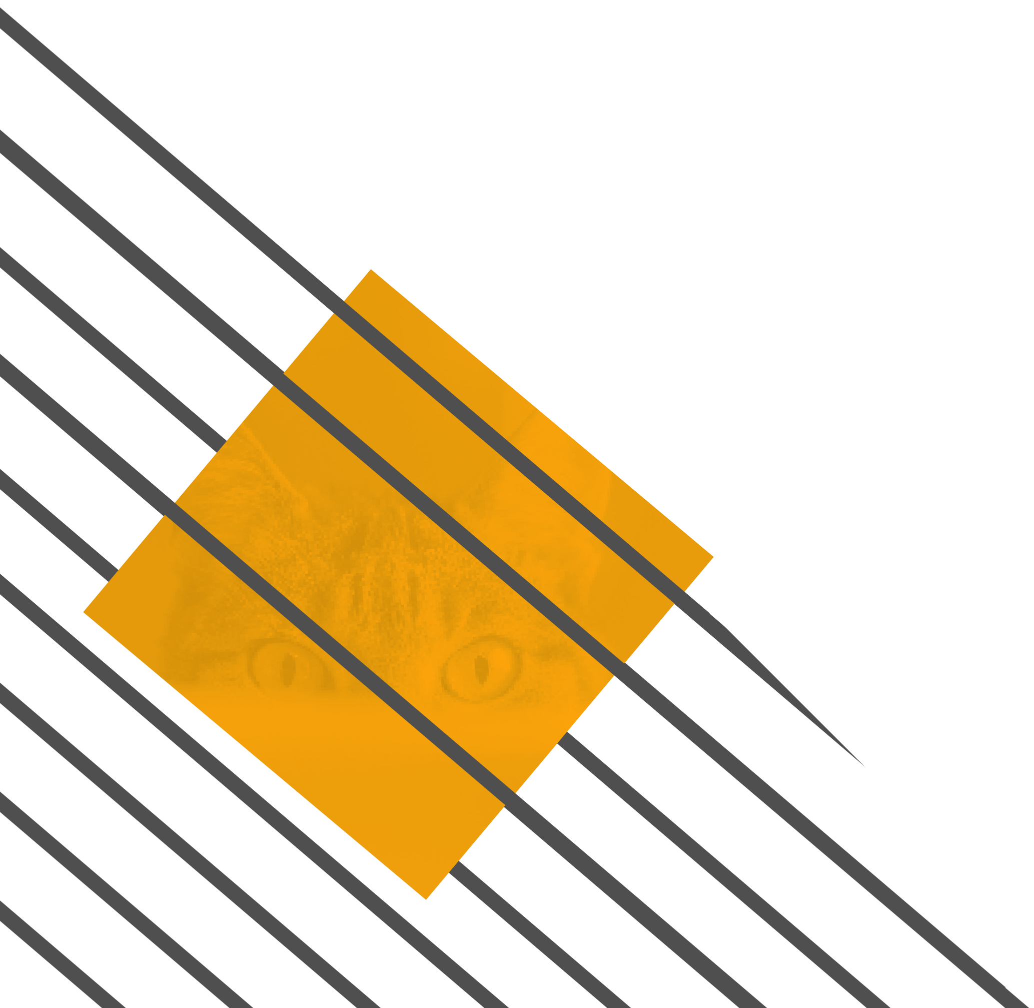
HOW DO YOU SOLVE A PROBLEM LIKE DC PENSIONS?

Key challenges facing the industry and why a long-term savings commision could be the answer



A Note About This Paper

Sometimes the lang cat partners with other organisations to produce white papers we think will add to the fabric of the industry. They might spark or progress debate, shine a light on a particular topic or, as in this case, aim to drive positive change which could benefit advice professionals, providers and – most importantly – investors.

People's Partnership asked the lang cat to explore what the immediate future looks like for the provision of Defined Contribution (DC) pensions in the UK. To look at the current trends in DC pensions, how they might interact and try to predict where we might find ourselves in a few years' time.

People's Partnership is one of the UK's leading providers of workplace pensions, through its Master Trust, The People's Pension. It is also a non-profit organisation; it has no shareholders and pays back any surpluses to its members in the form of rebates on its products.

This question of the immediate future for DC pensions is therefore of obvious interest to them, as it is to us and many others in the industry. It is also not an easy one to answer, predictions about the future being notoriously tricky. We agreed with People's Partnership that the best route to answer the question lay in crowd-sourcing views from across the industry. So, we tapped into the collective wisdom and insight of leading pension experts from across the industry to form a consensus view of how they see the immediate future playing out.

As it happens, while we were conducting this research, the government itself has been showing keen renewed interest in the UK's pensions sector, publishing a series of papers on various reform initiatives. As a result, what you get here is not just a view of how the industry expects the provision of DC pensions to evolve over the next few years, but also how that view reflects on the government's plans. There are, however, some notable disparities which lead to the conclusions we've drawn about what needs to be done next.

As regular readers will know, we have two strict golden rules for these projects:

1. We retain full creative control of the research and paper construction.
2. There is no discussion of the supporter at any point in the paper. Feel free to search.

Clearly People's Partnership has a vested interest. That's expressed in them sponsoring this paper and that's as far as it goes. Our independence is everything to us and we'll never compromise it.

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Executive Summary

The UK Defined Contribution (DC) pension market is stuck in a cycle of short-term thinking, driven by a merry-go-round approach from government. This clashes badly with what is a long-term product. We see positive indicators from the likes of the Mansion House speech and Autumn Statement, but nothing will happen quickly and consumers are still at risk. A long-term savings commission would provide stability and continuity for all concerned.

The government and the pensions industry are working together to provide retirement incomes for the people of the UK. This work is conducted in a largely collaborative, consultative and mutually supportive way.

Disconnected priorities

However, there's a clear disconnect between the government and the pensions industry. There's a clear sense of frustration from many in the industry that much of the government's focus is on the immediate tactical challenges it faces. The industry wants to see more of a strategic plan with clarity around what the pension system is for and its longer-term objectives.

The government has now set out a strategy, first in the Mansion House speech and subsequently with the Autumn Statement. The plan is for fewer, bigger, better run pension schemes investing in the UK economy and delivering healthier returns for members.

This is fine as far as it goes, but it doesn't address the whole picture and the government is at risk of not bringing people with it.

A recurring theme throughout our research is the disparity of expectations and aspirations between government and industry. This is partly about the pace of change and partly about what that change is intended to achieve.

Consolidation, consolidation, consolidation

Despite the policy proposals set out for consolidation of small pots and a focus on stronger governance, there is no industry expectation of anything like a rapid reduction in the number and scale of pension providers. Instead, this shift is expected to continue at a pace of steady incremental consolidation.

When the music stops we may eventually end up with between 10 and 20 Master Trusts dominating DC pension provision, but five years from now the consolidation music will still be playing. For single employer trusts and contract-based pensions such as GPPs and Group SIPPs, numbers will drop, but only very gradually; and no one displays any appetite for consolidating the ridiculously long tail of micro schemes (under 12 members).

There's a clear sense of frustration from many in the industry that much of the government's focus is on the immediate tactical challenges it faces. The industry wants to see more of a strategic plan with clarity around what the pension system is for and its longer-term objectives.

There's a significant disconnect between the government's hopes for the development of Collective Defined Contribution (CDC) pensions, and the industry's capacity or desire to deliver them. It's not that there aren't industry participants who think CDC schemes are a good idea, it's just that no one is yet offering a roadmap for how they will be delivered.

Everyone agrees we're not where we need to be in terms of pension contribution levels, but there's very little consensus on where we should be or how to get there.

Individual account consolidation, and mitigation of the small pension pots which continue to pour forth as if from a magic porridge pot, are likely to be driven more by the industry than by policy change over the next five years. Providers are committed to working with the DWP on delivering default consolidators, but they're not expecting to see more than the foundations laid over the next few years.

On the balance of probability, dashboards will be up and running five years from now, though the rollout and impact felt is likely to take longer as consumers onboard and adopt the technology. Any consolidation of small pots is likely to have been driven more by the industry engaging with customers at an individual level. However, in the long run, these initiatives could be overtaken by an evolution of auto-enrolment into a 'lifetime provider' pension system.

Pinch the screen, zoom out, look at the big picture. What remains is a lack of a meta-narrative setting out the purpose of our pension system.

Retirement goals

Retirement processes are improving and will continue to do so over the next few years. Regulatory interventions are shaping the way the industry serves its customers in transitioning from accumulating retirement funds to taking an income. The range of products and services available to consumers will continue to evolve, though service levels will still be impacted by delays to transfers as the industry faces its ongoing battle with pension scams and fraudsters. Further forward, the industry is pinning great hopes on the FCA's Advice Guidance Boundary Review to enable it to deliver help to customers at scale.

At one level, there is frenetic activity across policymaking and the industry. The government has set its sights on the consolidation of pension arrangements and on harnessing the country's pension savings to boot-strap economic growth. But, this is not the same as a strategic purpose for the pension system.

EXECUTIVE SUMMARY– *Continued*

Governments should always be free to set policy and legislation as they see fit; regulators should always be focused on consumer protection; the industry should always be focused on serving its customers and its owners. The downside is that there's currently a disconnect between these moving parts.

Pinch the screen, zoom out, look at the big picture. What remains is a lack of a meta-narrative setting out the *purpose* of our pension system. There is no explicit articulation of what public and private pensions are intended to deliver or how they interact with our welfare provision and housing market. In the absence of any guiding purpose, the system naturally leans towards complexity and inefficiency.

Good data exists around pension provision, thanks to the work of bodies such as the Pension Policy Institute, the IFS, the ONS, the FCA and the House of Commons Library. Here too there's a 'but'. The absence of a clearly articulated and widely accepted overarching strategy, combined with the fact that multiple public bodies have responsibility for different aspects of our pensions system, means data collection is random and patchy.

So not only are we unclear of our destination, we also don't know with confidence where we are at any given moment.

Individual actors are doing the best they can within the constraints of their roles, and in most cases they're doing a good job. This includes the ministers who come and go, civil servants, regulators, trade bodies and pension company employees. We know they currently talk to each other, but what's missing is high-level continuity of thinking and engagement between all parties.

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Continuity For Long-Term Clarity

A long-term savings commission would serve to bridge this gap. It could sit outside government, regulators and industry, helping each to achieve their respective goals in a more mutually supportive way with continuity guaranteed, despite changes in government.

A commission, tasked with providing ongoing long-term strategic insight into how the pension and savings system can best serve the needs of its diverse stakeholders could make more of a difference, at a smaller cost than any other policy intervention.

One of the reasons behind the success of the Turner Commission was that it enjoyed the backing of Downing Street. It was able to propose and see carried out a set of radical and disruptive changes to the UK's pension system.

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It is vital, if a commission were to be established, that it enjoys similar explicit support and engagement from senior levels of government and ideally opposition too.

Introduction: How We Got Here

Evolution is a slow process, something exemplified by pension policy. Changes are largely led by government; when governments and ministers change, so does the policy agenda. And with constantly changing regulation, the industry responds and evolves with new solutions, schemes and administrative systems. It's a wonder anything ever crosses the finish line at all.

To put this piecemeal approach to pensions into context, even though we were treated to two pensions ministers who served full five-year terms, over the past 25 years we've seen 17 pensions ministers, each with their own set of ideas and priorities.

More people, more dependent and living for longer

The backdrop to this slow chaos is an ageing population, with more people dependent on their pensions for longer. In 1908 when the State Pension was introduced for those aged 70 and above, people were only expected to live on average another nine years, and only a quarter of the population did so. Skip forward to today and we're now expected to live for 21 years or more after retirement,[1] with the majority reaching this milestone.[2]

Defined Benefit (DB) scheme membership has been in decline since the 1990s for well-documented reasons. Increased longevity is great for members but considerably less so for the employers footing the bill, particularly in the private sector. The Defined Contribution (DC) arrangements that have replaced them mean people are generally setting less aside for later life.

Ongoing efforts have been made to simplify and improve the landscape across state, private and workplace pensions. The simplification of private pension tax regimes in 2006 and the merging of the basic State Pension and the State Second Pension into one single tier new State Pension in 2014 have all helped. The triple lock was introduced in 2010 as a way of ensuring people have a decent minimum income, though its long-term future looks uncertain as the government seeks to rein in spending.

Improving consumer engagement with pensions is crucial

Alongside grinding evolution and constant change, we have the colossal task of increasing customer understanding and engagement, in the hope of ramping up levels of saving and improving outcomes. Research shows that 75% of UK adults have no idea of how much is in their pension and nearly a third aren't aware of who their main pension pot is held with.[3] It seems proper planning and saving for retirement is an issue too many consumers still find too much of a challenge to address effectively.

Some of the solutions to address these major issues have been a great success, most notably the 2012 auto-enrolment programme which has sharply reversed the trend in declining pension membership rates. But even this positive intervention has exacerbated another big issue the industry is struggling to solve more than a decade on – small pots.

More frequent jobs switches throughout our careers, plus auto-enrolment mean many people have accumulated multiple and often low-value pension pots. On average, UK adults accumulate 10 pension pots across their working lives.[4] Without change, the Pension Policy Institute projects that the number of small, deferred pots could expand to 27m by 2035.[5]

An associated worry is the increasing value of 'lost' pension pots, which has grown from £19.4 billion in 2018 to over £26.6 billion in 2022.[6] People change jobs, start a new pension, move house and over time, they lose track of their old 'frozen' pensions.

Central to the work underway to address this problem is the Pensions Dashboard project. By having information about their pensions located in one place, people will (hopefully) be empowered and informed to make decisions about their financial security in retirement.

The pension freedoms changed the retirement game

The pension freedoms, announced in the 2014 Budget and implemented in 2015, sparked a revolution. Suddenly DC members aged 55 and over (57 from 6 April 2028) had options in how and when they accessed their money, beyond simply buying an annuity.

This change was welcomed by many, and it has had beneficial effects, increasing people's interest in and their sense of ownership of their retirement savings. Generous tax treatment on death also means people have greater scope to pass on retirement savings to family members and others.

However, the freedoms were hastily introduced, without time for proper consideration and mitigation of the risks involved. Poorly informed consumers can easily end up drawing too much or too little income, paying too much tax, or acting without a good understanding of the long-term consequences of their decisions. Today, ten years after the freedoms were first announced, it's still not clear that the framework of checks and balances to protect consumers adequately addresses these various risks.

The pension freedoms were not aimed at those with DB schemes as these are likely to deliver better returns for retirees. However, another unintended consequence has been people transferring their DB or guaranteed pensions into DC schemes, for quick access to cash.

As access to savings became easier, so did incidents of pension scams, with fraudsters cold calling pensioners and persuading many to transfer some or all of their funds. As efforts have been made to tighten regulation and protect consumers, the industry continues to fail to meet customer expectations regarding the timely handling of legitimate transfers. With some transfers taking many months to complete, this barrier hinders already low levels of consumer trust.

Challenge accepted?

What these issues collectively highlight is that we've not yet solved the challenge of helping consumers convert their retirement pots effectively into an income that will help them live the retirement they wish for.

Talking more broadly, we have a system that lacks an overarching strategy, an essential part of ensuring that system is fit for purpose now and in the decades to come. The current government's recent focus on consolidation and investment in the UK economy, appears to have more to do with driving growth and efficiency than it does with addressing the question of *why* we have a pension system and *how* it serves the people of the UK.

So the path that brought us to where we are now has not run smoothly or directly; as we move through the paper we'll look at where the trajectory of these changes might take us over the next few years.

[1] ONS - How has life expectancy changed over time?, 9/9/15
[2] ONS - Past and projected period and cohort life tables, 12/2/22
[3] Standard Life - 75% of UK adults don't know how much is in their pension pot, 17/4/23
[4] Gov.uk - Government response to ending the proliferation of deferred small pots, November 2023
[5] PPI - Policy options for tackling the growing number of deferred members with small pots, July 2020
[6] DWP – Addressing the challenge of deferred small pots: a call for evidence, 30/1/23

Research Methodology

We talked to experts from across the industry to form a consensus view on what outcomes the current direction of travel for DC pensions is likely to deliver.

Conversations focused on a few key themes, which we finalised following the Mansion House speech in July.

- Pension provision and scheme consolidation
- Small pots and pension account consolidation
- Investing pension funds in illiquid investments
- Converting pension funds into retirement income

Input was also welcome on areas of pension policy which are not currently in scope for policymakers but the industry believes should be.

We ran a total of 24 one-to-one interviews, from 25 July to 30 August 2023. Interviewees are all recognised pension policy and/or technical experts from across the industry. All interviews were conducted anonymously to encourage a frank discussion of issues, unconstrained by any commercial considerations.

Organisations represented include:

- Trade bodies
- Master Trusts
- Pension scheme trustees
- Employee benefits consultants
- Decumulation experts
- Life insurance companies
- Fintechs
- Think tanks
- Regulatory experts

What follows is a distilled consensus view from the pensions industry on where we're headed (or not) and the likely pain points.

This next section makes repeated references to what 'the industry' thinks. We didn't ask the whole industry because, well that would be impossible, and even within the two dozen or so conversations we had, there were areas of consensus and areas of opposing views. Where we say 'the industry' believes… or 'the industry' is sceptical… we feel there was enough of a consensus for us to legitimately ascribe the view to being representative of the research participants.

Everyone interviewed for this project is an acknowledged expert in their particular field of activity in pensions; they are technical and policy specialists. Our thanks goes to each of them for taking the time to speak to us, although we suspect most quite enjoyed being able to indulge in a solid hour of pensions chat with a fellow enthusiast.

Research Findings: The Outlook For DC Pensions

Consolidation of pension providers

THE HEADLINES

- **The consolidation of the UK's highly fragmented pensions landscape is going to take a long time**
- **When the music stops there will be 10 to 20 Master Trusts, but the music will still be playing in five years' time**
- **No one is doing anything about the tens of thousands of micro schemes**
- **Standards of governance will improve…**
- **…but improvements to member services are less certain**

Everyone agrees the natural trajectory is towards fewer, bigger, better run schemes. Policy initiatives all push towards consolidation. These include the Value for Money (VFM) framework[7]– designed to increase the value delivered for savers; increased responsibility and accountability for scheme trustees; default consolidators, lifetime providers and a focus on the decumulation needs of scheme members. We also have the fair value assessment requirement under the FCA's Consumer Duty rules, as well as commercial pressures for providers to outcompete each other.

There's no doubt in anyone's mind that consolidation will happen.

However, while everyone agrees the number of single employer trusts and Master Trusts will reduce, no one is predicting rapid progress. A key factor here is the industry's capacity to process change. Merging Master Trusts takes time; it requires specialist skills, there are myriad processes which need to be gone through, significant responsibilities for those involved and no one wants to make mistakes. The consensus is we're heading for somewhere between 10 and 20 Master Trusts but, looking five years ahead, the consolidation process will still be in train.

The government's own forecasts for the DC sector as a whole,[8] published alongside a strategic objective to drive consolidation, suggest it is more optimistic than the pensions industry about the rate of consolidation.

It's worth noting too that some remaining single employer trust DC schemes are sections of existing DB schemes, where there are additional factors at play which may slow down the pace of consolidation.

Given the industry's limited capacity to process consolidations, there is an understandable bias towards focusing on the larger, high value projects that will benefit more people. There's less enthusiasm around consolidating smaller schemes, and no discernible appetite to do anything about the 25,000 or so micro schemes with fewer than 12 members.

RESEARCH FINDINGS: THE OUTLOOK FOR DC PENSIONS – *Continued*

The end result expected by the industry is not a radical collapse of pension providers into a concentrated core of mega-schemes, at least not yet. Instead, the expectation is for the pace to be slow, a gentle downslope to the graph, rather than a rapid contraction. For contract-based pensions, such as GPPs and Group SIPPs, the expectation is for a similar gradual downward trajectory in the number of employers sponsoring such schemes.

At the same time, away from workplace arrangements, the industry expects the market for individual contract-based pensions to continue to thrive. The self-employed and the more financially engaged, typically but not exclusively aged 40 and upwards, will carry on using individual personal pensions and SIPPs to manage their retirement savings. In some cases this is in parallel with a workplace pension to benefit from their employer's contributions.

Quality and Service

THE HEADLINES

- **Scale will bring benefits…**
- **… but service will remain a challenge**
- **The DWP's VFM metrics should bring positive movement but this will be slow and there are various difficulties which must first be overcome**
- **A primary concern is how the metrics will be acted upon**
- **Pension transfers are hamstrung by the conundrum of protecting consumers from scams while facilitating legitimate transfers in a reasonable time period**

Scale will bring benefits, as well as increased responsibility for those operating the schemes. This should extend to better service and engagement with members, helping them to make the most of their retirement savings.

There is, though, some hesitancy across the industry as to whether good intentions will translate into a genuinely improved customer experience. The DWP's Value For Money (VFM) framework is considered to be weaker on service than on either investment performance or costs and charges, both of which are easier to measure.

Service is likely to remain a significant challenge. In principle, the DWP's VFM framework sets out plans to address this issue, with specific metrics to assess scheme administration and service, focused on the outcomes experienced by members. However, there is little confidence in the industry that things will change at a systemic level in the next few years.

This is grounded in two key concerns regarding service delivery.

Firstly, welcome though the DWP's VFM metrics are, for them to effect change, scheme data will first have to be collected and published (as set out in the DWP proposals). More importantly, this data will have to be acted upon.

[7] Gov.uk – Value for money: A framework on metrics, standards, and disclosures, 25/7/23
[8] DWP – Evolving the regulatory approach to Master Trusts, November 2023

This could happen in one of three ways:

1. **Individual investors could vote with their feet.** They could access the data from the VFM assessments, identify their pension as a poor performer and elect to move their money elsewhere. However, this is unlikely to happen, at least not quickly or to any meaningful extent. If most consumers were engaged with retirement savings (never mind the minutiae of pension admin performance) and making active decisions, we wouldn't have needed auto-enrolment in the first place.

2. **Employers (or their advisers) could vote with their feet.** They could use the data to make informed decisions about the relative competitiveness of their workplace pension and elect to move it elsewhere. Again, past performance would suggest not. There is currently only a very weak secondary market in workplace pensions. Once an employer has set up an auto-enrolment scheme and it works, there is very little incentive to move it.

3. **The regulator(s) could force the hand of employers and their advisers.** This could be done by explicitly calling out poor performers in the new VFM tables and by applying varying degrees of pressure for improvement or replacement. The industry is unsure how much appetite the regulators have for such interference in the market. It seems there are bigger issues to tackle first.

The second problem with service is there's still a lot of detail not being captured by the VFM measures, in particular the perennial problem of transfer timescales and processes. Transfers are understandably being delayed in the interests of protecting consumers' investments, but they are also still bedevilled by bureaucracy.

Challenger fintechs and consolidators inject innovation and dynamism into the market. They develop better customer engagement and experience, create price competition, keep incumbent providers on their toes and bring new technologies to solve existing problems. All this should be welcomed and bodes well for the future.

At the same time, responsible providers and trustees want (and are obliged under the Consumer Duty) to ensure their members are protected from making ill-informed decisions and acting to their own detriment.

This isn't just about scams, it's also about transferring to well-marketed but poor value products outside the auto-enrolment system. The result is administrative paralysis. Everybody is wasting vast amounts of time and money, while consumers are subjected to bewildering delays and breakdowns in the execution of their instructions. We're not short of solutions with PASA, STAR, Origo, the ABI and the PLSA all trying to make the system work better. But, for whatever reason, none of these have achieved any real traction.

Many argue a 'safe list' of recognised providers could help cut down the bureaucracy. This isn't the whole answer though, partly because no one wants to take responsibility for such a list and partly because it isn't just about the provider. It is also about the process the customer has been through before deciding to transfer.

A checklist of questions customers should ask themselves is fine in theory, but some providers end up sending customers multi-page documents to verify the process they have gone through, before allowing them to transfer their own money to a provider of their choice. This may protect the provider but does it really benefit consumers?

In the face of such challenges, it seems optimistic to expect the service experienced by millions of pension investors to improve significantly in the next few years without further intervention to disrupt this unsatisfactory status quo.

Collective Defined Contribution Schemes

THE HEADLINES

- **In spite of DWP enthusiasm, whole-life CDC schemes are unlikely to form a meaningful part of the UK pension landscape in the foreseeable future**
- **There's more of a case to be made for CDC schemes as a decumulation vehicle, but even here the industry is sceptical**
- **Any employer demand is likely to be among former nationalised monopoly type employers (such as Royal Mail), or existing public sector employers**
- **CDC is more likely to work as an investment within a scheme, rather than as a standalone scheme in its own right**

Of all the subject areas we looked at for this project, it was on Collective Defined Contribution (CDC) schemes that we found the biggest disconnect.

It's abundantly clear from its recent consultations[9] that the DWP is more than enthusiastic about the opportunities and benefits of CDC pensions. They're a halfway solution, pooling investments and longevity risks to deliver greater certainty than conventional DC schemes, without the burden of the expensive guarantees that have scuppered DB. The promise of a silver bullet solution to the challenges of DC pension provision is obviously attractive to policymakers.

"As a policymaker, why would you mandate higher contributions in a cost-of-living crisis, when you're being told it's possible to squeeze more value out of the system by consolidating schemes, shifting to CDC and investing in illiquid assets?"

Fans of CDC have argued the schemes can deliver better value for money, higher returns and greater efficiency of risk and longevity pooling.

All of this may well be true in theory. The problem seems to be that no one in the industry believes it will work in practice.

Not one of our interviewees believes we are going to see operational CDC schemes in the foreseeable future.

No one could see employers lining up to support such a scheme, with the possible exceptions of, say, USS or Railpen; the big quasi or ex-public employers. Some thought public sector schemes could make good candidates for CDC, but no one believes either the sponsoring departmental employers or existing members would ever sign up to CDC while DB remains an option.

Several interviewees spoke of the significant practical problems with actually delivering CDC. Whether it's delivered as a bulk solution or sold to individuals, communicating to members the rights and responsibilities involved in CDC is seen as hugely challenging. Achieving fairness across different cohorts of members, across ages, years of entry and employers is not simple. It's also expensive to set up, both in terms of administration and authorisation costs, as well as the capital costs in seeding the scheme sufficiently to deliver smoothing from day one.

It was also pointed out that the nature of communication required will likely demand the kind of regulation and disclosures more commonly associated with the FCA than TPR.

So, on the one hand we have the DWP enthusing about CDC like it's the answer to all our problems; on the other we have a pensions industry collectively arguing the whole project is a pipe dream.

Except...

There are two possible answers. One is Decumulation-only CDC (D-CDC), (with apologies for the proliferating acronyms), as one interviewee put it:

"If there's any case to be made for CDC, it is in decumulation."

[9] Gov.uk – Extending Opportunities for Collective Defined Contribution Pension Schemes, 11/7/23

RESEARCH FINDINGS: THE OUTLOOK FOR DC PENSIONS – *Continued*

In theory, D-CDC is the perfect solution to some of the problems with decumulation. It's not guaranteed, so avoids all the complexities and costs of DB. It does, however, deliver what a lot of scheme members want: someone else taking responsibility for paying them a pension income for the rest of their lives. And it does so at a more generous rate than the average annuity. Still, even in decumulation only, CDC bumps up against the challenges of disclosures and member communication.

The other possible answer is that even if providers aren't willing to go to the cost and hassle involved in setting up a new CDC scheme, they could develop a CDC investment vehicle to sit inside an ordinary arrangement. Similar to a with-profits fund.

Back to that consensus view: if we're looking ahead over the next five years, the industry doesn't expect there to be more than one CDC scheme up and running; the rest will still be lost in the post.

Consolidating small pots

THE HEADLINES

- **The optimistic scenario is some, albeit minimal, progress in five years' time**
- **In the short term, all the progress will come from industry-led initiatives**
- **Dashboards should take priority**

Small pots, a.k.a. the problem everyone wants fixed, but no one seems to want to fix.

The industry consensus is we'll have made some progress on the problem in five years' time, but only in as much as we might have got to the point of implementing a legislative framework. There's no expectation around actually reducing the tens of millions of dormant pots sitting in the system.

Default consolidators, the DWP's proposed solution, does not enjoy universal support and is seen as complex to deliver. It was also argued that other policy initiatives, such as VFM, better support for decumulation, dashboards and scheme consolidation, should all take priority over the small pots conundrum.

There was some cynicism across the industry about the DWP consultation:

"Is this a 'long-grass' consultation?"

"The industry has a small pots problem; the customer has a multiple pots problem. This consultation seems more about the former than the latter."

No one appears convinced of any meaningful reduction in the numbers of small pots as a direct result of anything initiated by policymakers or regulators. Instead, in the immediate future any progress will come from one of three sources:

1. **Scheme consolidation:** even if not at the pace policymakers might want to see. Fewer schemes will probably mean fewer pension pots.

2. **Consolidation of pots within schemes:** internal consolidation is happening separate to scheme consolidation. But here too the pace is not what might be hoped for.

3. **Marketing and customer engagement activity:** pension providers are always geared up for individual transfers in.

Dashboards and pension account consolidation

THE HEADLINES

- **Dashboards should and will happen**
- **They should take priority over consolidating small pots**
- **Launching soon matters more than trying to tick all the boxes at once**

The general consensus is that dashboards should and will happen, though a minority of the industry question whether the DWP project is actually needed as fintechs already have the capability to deliver workable solutions. There are also concerns about the level of resources currently enjoyed by the dashboard project, with some £91.1 million allocated so far.[10]

Three clear messages emerged.

Firstly, the dashboard should be delivered ahead of launching any implementation work on default consolidators for small pots.

Secondly, there was a strong call not to try to deliver too much at the outset. The industry would much prefer to see a live minimum viable product, followed by incremental improvements, rather than an attempt to deliver a fully armed and operational dashboard from day one.

Finally, the State Pension must eventually be included, even if not at first.

Lifetime provider: auto-enrolment 2.0?

THE HEADLINES

- **A system of lifetime providers could help to solve the small pots problem**
- **The cost would be upending auto-enrolment, which may be a step too far**
- **There's also a risk of employers being both edged out and overwhelmed by admin demands**

As well as its published plans for default consolidators, the DWP also wants to develop the idea of a 'lifetime provider'.[11]

[10] PoliticsHome – Labour MP Demands Investigation Into Multimillion-Pound Pensions Project Running 7 Years Late, 15/12/23
[11] Gov.uk - Ending the proliferation of deferred small pots, 22/11/23

This involves moving away from the current auto-enrolment policy of allocating a new pension account to an employee every time they start a new job. Instead, once they have a pension account, when they change jobs, their new employer would contribute to their existing pension rather than enrolling them into a new scheme. For new employees joining the workforce who don't yet have a pension, there would have to be a system of allocating them their first pension account. Individuals would be free to change their designated provider as they go along.

This system has a number of advantages and some significant challenges. It could eventually go a long way towards solving the small pots problem and would put consumers at the heart of the system, giving them more agency over their pension savings. This could also help solve the engagement challenge.

However, it would involve a significant upheaval of the current system of auto-enrolment, which has been a notable policy success. Such a shift would also require some form of payroll modification or clearing house system, to avoid an intolerable administrative burden for employers.

We found opinion on the policy to be polarised, with a majority supporting it as the logical eventual evolution of auto-enrolment and a minority opposed to it. Even among supporters, there is a consensus that this is a long-term solution which will take time to implement.

Opposition to the concept centred around three principal concerns:

1. A lifetime provider arrangement would weaken the relationship between the employer and the pension provider (whilst potentially strengthening the relationship between the member and the provider). It was argued this could undermine the support given by employers to the cause of pension education and engagement.

2. The need for a payroll or clearing house solution to the problem of making multiple payments by the employer to different pension providers would involve cost and technical challenges. Who would pay for this?

3. The policy would lead to an escalation in industry advertising and marketing, with different schemes seeking to entice customers.

Investing pension funds in illiquid assets

THE HEADLINES

- **The industry is not enthusiastic about politicians dictating pension investment strategy**
- **Markets are privatising so it makes sense for pension schemes to follow**
- **Increasing pension scheme investment in illiquid assets will take time**
- **Fees are too high**

There has been much discussion in recent months from think tanks and politicians, about getting pension schemes to invest more of their assets into growing the UK economy and into illiquid assets. This is a broad term encompassing the likes of private equity, private debt and infrastructure.

The industry has clear concerns about the need to build research capabilities, systems and processes. While there is agreement that this will all happen, it will take time with larger schemes leading the way. We also encountered widespread cynicism about politicians telling pension schemes where to invest and then generating political capital out of boosting economic growth and investment returns.

Fiduciary duty should remain paramount, with trustees and not politicians deciding what's best for scheme members.

"It's not the job of pension funds to sort out the government's macro-economic policy for them. It will happen because it is the right thing for pension funds to do."

"This will happen where it's in members' interest. There has been some hesitation from trustees in the past. Admin requirements, managing trades, valuations etc. all need to be resolved."

"This is all about the legacy for politicians, not about the member outcomes. Good pensions don't follow political expediency."

Interviewees also highlighted the high fees associated with illiquid investments. This is not necessarily a problem with an auto-enrolment charge cap, provided the illiquid investments only make up a small percentage of the overall portfolio. Nevertheless, there's clear hope that increasing demand could lead to a more competitive market and lower overall charges.

Converting pension funds into retirement income

THE HEADLINES

- **No one thinks we've got to the right answer yet**
- **The FCA's Advice Guidance Boundary Review[12] is critical to solving the problem**
- **We can't default people into a product which has exit restrictions**
- **Most people need 'funnelling' to a bespoke solution through a series of decisions**
- **A 'cautious' standard income rate could help with engagement**

[12] FCA - Advice Guidance Boundary Review, 3/8/23

RESEARCH FINDINGS: THE OUTLOOK FOR DC PENSIONS – *Continued*

It's striking that over nine years since the pension freedoms were first announced, no one in the industry believes we have really answered the challenge of helping DC pension savers convert an accumulated pension pot into retirement income.

It's generally agreed that FCA initiatives such as shorter wake-up packs (which were themselves the result of industry lobbying for a 'pension passport'), retirement pathways and risk warnings have all helped. Similarly, the industry is welcoming and supportive of the DWP's work in bringing trust-based pensions up to speed.[13]

The FCA's Advice Guidance Boundary Review (AGBR) was widely cited as an important piece of work which could have a significant impact on potential solutions.

> *"Personalisation is needed, it's too easy to make poor choices, the answer is around guidance but you can't force it on people. We [guidance providers] have capacity but not demand, advice has demand but not capacity; we need to get people thinking about guidance."*

There's a consensus that defaulting pension investors into any one retirement income solution is likely to cause problems. One respondent proposed drawdown as a possible default because it's easier to use than other solutions and can be unwound if necessary.

A minority of respondents proposed D-CDC as the perfect solution, offering a decumulation outcome that minimises the necessity for customer engagement. Even here though, interviewees were clear that getting investors into D-CDC is far from straightforward and still carries risks of both consumer detriment and regulatory liability.

Once again, CDC could be the answer in theory but seems extremely difficult to implement in practice.

No one believes the foreseeable future will see everybody benefit from a retirement advice process giving personalised recommendations. The Money and Pension Service (MaPS), Pension Wise and the mid-life MOT were identified by a minority of interviewees as being a useful part of the solution, though the limitations of these services and their lack of take-up were also highlighted.

Interviewees argued in favour of all pension providers being required to offer savers a spectrum of product choices, catering for a broad range of needs. These would be combined with a guidance service that 'funnels' customers towards tailored solutions. The AGBR is seen as critical in creating sufficient space for pension providers to deliver this without straying into the realms of personalised advice. Customer engagement is an obvious challenge, in some cases to even getting started on a funnelling process.

No one believes any of this will be easy to deliver. The DWP's proposed questions set out in its consultation paper[14] are insufficient to resolve customers' needs:

- **Do you only want a regular income?**
- **Do you only want flexible access to your pension benefits?**
- **Do you want a combination of both?**
- **Do you want to do something else?**

A more complex and iterative interaction between pension provider and customer is needed. This would help consumers understand their requirements and enable providers to match appropriate solutions. Modelling tools, tutorials, interactive guides, videos and one-to-one conversations could all be used to good effect.

"We support the proposals in the DWP paper, a lot of people are building in-house products. The market could evolve quickly, most are supportive of the framework, the Advice Guidance review will help move things along."

One frequently proposed solution to the customer engagement problem is a 'standard' income rate. It could act as a conservative starting point, to minimise the risk of depleting funds too quickly, opening up a dialogue between pension providers and consumers towards a more tailored solution. 'Default' was rejected to avoid negative connotations.

Two notable omissions were also raised by interviewees. Firstly, the lack of high-quality data and insight from regulators and policymakers on what non-advised consumers are doing with their pension pots.

That the decision-making processes of ordinary savers aren't being examined is a point of concern. The FCA collects data on transactions conducted by firms it regulates.[15] TPR has very little corresponding data in the trust-based world and neither it nor any government department can state with authority whether consumers are making well-informed decisions about their pensions.

Similarly, there aren't currently any policy interventions aimed at consumers' longer-term retirement income decisions. Providers want to do more to help their customers minimise the inevitable risks of taking either too much or too little income but need structure and support to do so.

What policymakers aren't currently focused on, but should be

THE HEADLINES

- **The UK long-term savings system lacks any clear sense of direction or purpose**
- **Auto-enrolment is an effective but blunt tool; it's time to think more about savings adequacy**
- **Everything is complicated to the point of being self-defeating**

1. What's the point of our pensions system?

For all the important and worthwhile initiatives on which policymakers are focusing attention, there is a clear sense of frustration across the pensions industry at the lack of clear long-term strategy.

[13] DWP - Helping savers understand their pension choices: supporting individuals at the point of access: consultation response, 22/11/23
[14] DWP – Helping savers understand their pension choices, July 2023
[15] FCA - Retirement income market data 2021/22, 25/9/23

Policymakers and regulators are perceived as focusing on the day-to-day operational issues of pensions (some of which we have covered in this paper), without any sense of a North Star or a clearly articulated purpose.

The government can legitimately point to its agenda of 'fewer, bigger, better run schemes, investing in the UK economy',[16] but that doesn't equate to an overarching long-term savings strategy.

Repeatedly, we heard variations on this same sentiment:

"What's the pension system designed to do, whose benefit are we doing this for?"

"Think strategically, not just tactically."

"What's the big picture? What's the meta narrative? Is it about making sure people have an adequate amount? How does it all hang together? Pensions and non-pension savings, housing, welfare: do they all join up to a big picture?"

"Why isn't anyone looking at the whole picture: property, equity release, social care, renting in retirement, welfare structure? Change the benefits system and build more retirement homes."

Respondents expressed strong disquiet about the interaction of a quasi-compulsory pension savings system with means-tested welfare and with declining home ownership. This apparent failure to think strategically about the purpose of our pension system, and how it affects the lives of people, was repeatedly called out as something the pensions industry want to see addressed.

The three big pension policy interventions over the last 15 years – auto-enrolment, State Pension reform and pension freedoms – have all made sense in the context of the problems they set out to solve. The Turner Commission laid the groundwork for both auto-enrolment and State Pension reform, while persistently low interest rates (and possibly some political expediency) precipitated the pension freedoms.

Yet in recent years, no one in government has articulated a clear long-term vision for what all these reforms are intended to achieve. The Mansion House announcements[17] and subsequent Autumn Statement papers[18] set out strategic thinking around how the pension system can serve the economy, but that's not the same thing as a strategy for long-term savings.

At one level, the purpose of our pension system seems blindingly obvious: to make sure we're not destitute in old age. However, as the PPI set out in its Pension Framework,[19] when applying the principles of fairness, adequacy and sustainability, the challenge of what we're trying to achieve and how to go about it quickly becomes more complicated.

2. Adequacy of pension saving

"What trade-offs are you prepared to make between collective and individual interests? 12% is too much for some. How do we build in flexibility to AE minimums, what about financial resilience and sidecar accounts?"

Concerns around the adequacy of contributions highlighted perhaps the greatest dilemma of today's pensions landscape. The current auto-enrolment levels are clearly inadequate but, equally, there are many people contributing to a pension now for whom it will be a complete waste of money. Low earners who will never own their own home, for example.

"Adequacy and increasing employer contributions, at least to parity with employee. The government needs to take a broader view of pensions and how they fit with housing, benefits, etc."

"Adequacy is an issue but what about the self-employed? And we can't just move everyone to 12%."

"Adequacy – we worry about over-saving; lower earners are a problem. You need to think about people's wider financial situation."

While the impending implementation of the 2017 recommendations[20] is welcomed by the industry, further changes to auto-enrolment contribution rates should be part of a structured and coherent savings policy.

3. Keeping it simple (please)

Since pension simplification in 2006,[21] pensions have gradually been getting more complicated again. This is hardly surprising, given the constant evolution of the context in which the pensions system operates, and the myriad policymakers exerting influence. Between government departments, the DWP, Treasury, HMRC; and financial regulators such as TPR and the FCA, not to mention quasi-regulatory organisations such as the FRC and FOS, there are a lot of institutions forming policy.

The inevitable result is a complex regulatory ecosystem. Whether it's the implementation of increases to the normal minimum pension age, or anti-scam transfer regulations, the pensions industry finds itself in a Sisyphean struggle against bureaucracy. It's not that regulations aren't necessary, but several interviewees called out the mutually contradictory and almost perverse way in which their jobs are made harder by policymakers apparently not thinking about how things fit together.

"Simplify the system; scam regulation is too bureaucratic, we need a 'safe' list for transfers."

"Give industry time to cope with legislation, get rid of archaic laws, simplify scheme rules and historic benefits."

The industry recognises that it's the policymakers' job to get on with stuff; decisions have to be made. Expediency can dictate the sequence and timing of reforms and often it's a case of doing what you can, when you can. Nevertheless, the inevitable consequence of lacking a clearly articulated sense of purpose is a savings system that naturally leans towards complexity and inefficiency.

4. Pension taxation

We deliberately avoided talking about taxation with interviewees, simply because this is a huge subject in its own right. However, it did still come up, particularly in relation to death benefits and the anomalous situation created by pension freedoms. Tax incentives help individuals (particularly the high earners and public sector employees) to build a retirement pot and then IHT exemptions encourage them not to draw on those savings. This makes very little sense.

[16] DWP – Letter to the Chief Executive of The Pensions Regulator, 22/11/23
[17] Gov.uk - Chancellor Jeremy Hunt's Mansion House speech, 10/7/23
[18] Gov.uk - Autumn Statement Pensions Reform 2023, 22/11/23
[19] PPI – UK Pensions Framework, November 2022
[20] Gov.UK - Automatic enrolment review 2017: Maintaining the momentum, 11/7/23
[21] House of Commons Library – Pension tax simplification Standard Note, 11/12/08

Conclusion: A Long-Term Savings Commission Is The Answer

The UK's pension architecture is remarkably complex, an intricate ecosystem of overlapping government departments, regulatory bodies, employers, financial institutions, and technology and service providers. It needs a single, central, independent body to instil continuity, clarity and focus.

There's a lot that's good about the current system but there's also much that could be better. Everyone is pulling in approximately the same direction, wanting consumers to get the best possible outcomes from both the pension system and their savings.

But, for all the good relations and consultations across public policy, trade bodies, think tanks and financial institutions, there's a lot of activity that's uncoordinated. At an individual and institutional level, there will always be conflicting agendas and interests. That's why we must, from time to time, step back and take a critical look at how the whole system interacts.

A pension commission is not a new concept

It's been over 20 years since the government originally proposed a pension commission. This subsequently became the Turner Commission, which between 2004 and 2006 published reports forging a consensus on policy reform. This paved the way for auto-enrolment, State Pension reform and an increase in State Pension age.

There's a lot that's good about the current system but there's also much that could be better.

Thanks to the consensus generated by the Commission, these main recommendations were able to survive changes of government and a global financial crisis. One final recommendation was not taken up; that a successor body be established to deliver regular policy reviews.

DC pensions are inseparable from the wider financial ecosystem

Our research focused on a relatively narrow question set around the provision of DC pensions. Nevertheless, the challenges and issues faced are inextricably linked to much broader questions around housing, social care, employment, DB pensions, non-pension savings and financial advice.

Not only are there disconnects in expectations and intentions within the pension system and between pension providers and government, there are also gaps between pensions and the wider economy.

An Independent Long-Term Savings Commission Could Empower Stakeholders

Politicians are elected to govern; that's their job, and responsibility for making decisions should continue to be theirs. However, an independent long-term savings commission could provide valuable support to government and to other stakeholders such as the pensions industry, helping to:

1. Establish and maintain a consensus on the purpose of the UK's pension system
2. Provide continuity of thinking across parliamentary cycles
3. Identify and where necessary commission relevant data and research requirements

An independent commission could help everyone get the right things done more effectively.

An independent commission could help everyone get the right things done more effectively. It was a missed opportunity in 2006 when then Chancellor Gordon Brown chose not to extend the Turner Commission's remit into an ongoing advisory body.
The at-times erratic and fragmented nature of UK pensions since then is at least in part the result of that decision.

Whatever other pension policy initiatives are delivered by the present government, initiating the establishment of a new and ongoing pensions commission could be among the most effective decisions they take.

Appendix: The Evolution Of UK Pensions – Highlights From The Last 25 Years

The pace of change is necessarily slow

The slow pace of change is largely because changes in the pensions sphere are steered by government initiatives, so as governments change, successive pensions ministers understandably realign the initiatives to their party-led priorities.

Demographic change is also slow and thus moves made in response are necessarily at walking pace. There is inertia inherent in the system; multiple government departments, thousands of pension schemes, numerous computer systems and countless records stretching back decades are all involved in looking after tens of millions of members and trillions of pounds of assets.

This measured rhythm of evolution is interspersed with occasional abrupt seismic moments, whether economic, such as the global financial crisis of 2007/2008, or political, such as the pension freedoms.

Defined Benefit pensions continue their steady decline

By the year 2000, there were 10.1 million active occupational pension scheme members out of a working population of 42.7 million, compared to the high point of 12.2 million in 1967 out of a lower working population (40.1 million). This has coincided with the shift in the type of occupational schemes, with employers closing DB and replacing them with DC arrangements.[22]

By 2021/22 the number of active members sitting in private sector DB and hybrid pension schemes had fallen by 62.6% in 10 years – from 2.1 million in 2012 down to some 745,000. Contrast this with the public sector, where there are still 6.83 million active members of DB pension schemes.[23]

This means fewer and fewer employees can look forward to secure guaranteed pensions in the decades to come. It also means lower overall levels of pension saving, due to the disparity in contribution rates between DB and DC pensions.

We're living longer, but someone has to pay the bill

On average we're living longer,[24] owing largely to improved public hygiene, immunisations and the widespread availability of healthcare, free at the point of use. As a consequence, while State Pension age is slowly edging up, we're having longer retirements and increasingly need to work longer to pay for this. The composition of the population is also changing; there are increasing numbers of older retired people relative to workers.[25]

Demographic data from 2017 shows that men and women at State Pension age (65) were expected to live for about 24 more years, so we need to make our pensions last more than twice as long as 115 years ago, when the State Pension was first introduced. What's more, the proportion of people reaching State Pension age has increased to 85%.[26] There's some indication that the incline in longevity may have stalled with the pandemic, and even during the decade leading up to it.[27] However, the issue remains that longer lives in retirement compared to decades ago is one of the biggest shifts we've seen in pensions this century.

The changing dependency ratio is a critical element of this equation. It's estimated that between 1992 and 2067 the number of retired people per 1,000 people of working age will have increased from 300 to around 400.

Pension simplification freed up contributions, but with limits

Taking effect from 6 April 2006, Labour's 'pension tax simplification' tidied up eight different overlapping pension regimes and related tax allowances, a complicated legacy of successive governments.

The new regime provided more freedom in the tax-exempt contributions that could be made into pension schemes, and the assets that could be invested in. But caps were also imposed on the size of tax-favourable pension funds that could be accumulated by one individual. The new single 'Lifetime Allowance' was initially set at £1.5 million. The maximum annual contribution was set at £215,000.

The Turner Commission took a long-term view

This was instigated by the Labour government in 2002 to analyse the UK's retirement provision and identify solutions. The Commission[28] was charged with looking at the UK's long-term savings and pension system, and making recommendations on what changes should be made to address the prevailing challenges of declining rates of participation and contributions.

The Commission published its First Report on 12 October 2004, setting out a detailed analysis of the UK pensions system. Its Second Report (30 November 2005) presented conclusions on the likely evolution of UK pensions if policy remained unchanged, and the Commission's recommendations[29] for a new policy direction. Amongst other suggestions, the concept of a flat-rate universal pension paid on the grounds of UK residency, not NI contributions, failed to ignite the government. However, auto-enrolment was favourably received.

Auto-enrolment addressed the problem of low pension scheme take-up

Legislated for in 2008 in response to the Turner Commission Report and launched from 2012, starting with the largest employers, auto-enrolment[30] in workplace pensions was designed to fix the problem of low participation in pensions savings.

For the first time, it was established that when an employee meets certain minimum age and earnings criteria, they become a member of a workplace pension scheme without asking to join. This reversal of the abolition of automatic pension membership, which had been introduced under Margaret Thatcher, has been widely welcomed as an effective policy intervention. Default membership, contribution rates and investments were used to circumvent the inertia of people not joining a pension of their own volition. The government stopped short of compulsory membership as this was felt to be politically unacceptable.

[22] PPI - Briefing Note 2 - The shift from Defined Benefit to Defined Contribution, 2/07/2003
[23] The Pensions Regulator - Annual report on UK defined benefit and hybrid schemes 2022, 8/12/22
[24] ONS - How has life expectancy changed over time? 9/9/15
[25] ONS – Overview of the UK population – Office for National Statistics, 25/2/22
[26] PPI – General Election 2017: State Pension age rises, 2017
[27] The BMJ - Stalled improvements in mortality and life expectancy predate the pandemic, 3/3/23
[28] National Archives - [ARCHIVED CONTENT] The Pensions Commission, 16/7/06
[29] The Guardian - Q&A: the Turner report, 4/6/06
[30] The Pensions Regulator - Employers

Austerity kick-started a series of pension allowance cuts

From 2010, pensions policy changed radically under the Conservative and Liberal Democrat coalition government in response to the 2007/2008 global financial crisis. The series of cuts and changes[31] included reversing previous increases in the pensions annual allowance to £255,000, cutting it to £50,000, and later to £40,000. Constant disruption in policy became a norm. The Lifetime Allowance, which by then had risen to £1.8 million, has been subject to a series of subsequent cuts and adjustments, reducing it to £1,073,100. It is now set to be abolished, though with an ongoing cap on the tax-free lump sum that can be taken; Labour has mooted to reinstate the Lifetime Allowance cap if elected to government.

The Retail Distribution Review (RDR) has improved transparency and standards but excluded many from financial advice

The RDR was introduced on 31 December 2012, a Financial Services Authority (FSA) initiative intended to shake up retail financial advice by boosting standards and eliminating commission received by advice firms and platforms on investment product sales.

The overall objectives were to bring greater transparency to the investment sector, improve advice services via higher qualifications for advisers, and try to make sure that consumers understood the fees and costs associated with receiving independent professional advice.

A 2014 review by The FCA (successor to the FSA)[32] was focused more on flagging up any immediate issues than fully assessing whether the desired impacts had emerged. Early indications suggested that the reforms were on track. Financial advisers were seen to be offering investors an increasingly professional service tailored to their specific needs.[33]

The flip side is that this professionalism has removed access to financial advice for the majority. Just 11% of the UK adult population has paid for financial advice in the past two years.[34]

State Pension has undergone its own evolution

The coalition government recognised that millions of people weren't saving enough to provide sufficient income for a reasonable retirement. Meanwhile, the complexity of the existing State Pension system made it hard for people to make informed decisions. Inequalities were seen to adversely affect certain cohorts such as those with interrupted work histories and the self-employed. Then Pensions Minister Steve Webb led a 2013 initiative to simplify State Pension provision,[35] merging the basic State Pension and the State Second Pension into one single tier new State Pension.

In 2022 research found that UK adults generally thought of the State Pension as a level of government financial support to ensure pensioners achieve a 'basic' standard of living in retirement. While worried about issues such as the fairness of the full-pension qualifying process and geographical inequalities vis-à-vis cost of living differences, they viewed the triple-locked State Pension as a fair benefit for all and wanted these features to remain intact.[36]

Pension freedoms heralded swift, efficient and far-reaching change to retirement income

Announced to some surprise in the 2014 Budget and implemented in April 2015, the onset of pension freedoms[37] was a major change to the pensions arena. It precipitated a revolution by giving people much flexibility over how and when to draw a retirement income from their DC pension savings. Those aged 55 and over (57 from 2028) suddenly had a much broader range of options, including cash withdrawal, retirement income products or a combination of the two.

Rather than retirees having to use their pension pot to buy a near-compulsory annuity and receive a fixed regular income for life, DC pension scheme members aged 55-and-over could now take out more than their 25% tax-free sum if they chose to. This could be right up to the remaining value of the pot – with this subject to income tax. The pension death benefit rules were also made more generous, allowing individuals to pass on pension funds with relatively light tax penalties for beneficiaries.

Pension freedoms were not aimed at DB scheme members, as for the majority, it was likely to be in their best financial interests to remain where they were. However, an unintended consequence of the freedoms has been people transferring their guaranteed pensions into DC schemes. Sometimes people have been poorly advised for the purpose of taking advantage of the increased access to cash.

The government launched Pension Wise as a response to the pension freedoms

To help people navigate the wider range of options opened up by pension freedoms, the government established Pension Wise[38] in 2015, offering free impartial guidance to the over 50s, including those about to enter retirement.

No minimum pension value would be required to access the government-backed service helping people make an informed decision about taking money from their DC pension pot(s). However, it remains the case, some eight years after pension freedoms were introduced, that a significant minority of people buying an annuity or going into drawdown are not making use of advice or Pension Wise guidance. While in the case of taking cash lump sums out of pensions, there is a clear majority of people still not taking advice or guidance.[39]

Lifetime ISAs were designed to encourage long-term saving from a younger age

In response to the Conservative government's 2015 review of pension taxation, Chancellor of the Exchequer George Osborne introduced Lifetime ISAs[40] to help and encourage young people to save flexibly for the long term throughout their lives.

[31] Annual allowance and money purchase annual allowance - Royal London for advisers
[32] FCA - Post-implementation review of the Retail Distribution Review – Phase 1, December 2014
[33] FCA - Post-implementation review of the Retail Distribution Review,, 6/1/17
[34] The lang cat - Advice gap report - The Lang Cat, 11/5/23
[35] Gov.uk - 2010 to 2015 government policy: State Pension simplification, 8/5/15
[36] The Policy Institute at Kings College London – The future of the state pension, May 2023
[37] House of Commons Library - Pension flexibilities: the 'freedom and choice' reforms, 23/12/19
[38] MoneyHelper - Welcome to Pension Wise
[39] FCA – Retirement income market data 2021/22, 25/9/23
[40] Gov.UK – Lifetime ISA: updated design note, September 2016

From April 2017, adults under the age of 40 could open a Lifetime ISA and pay in up to £4,000 each tax year, with the government adding a 25% bonus to these contributions.

Tax-free funds saved, including the government bonus, could be used towards buying a first home, or withdrawn tax-free from age 60 for any purpose or at any age if holders became terminally ill. Withdrawals for other purposes or circumstances could be made, minus the government bonus related element and with a small additional penalty applied.

Plans for further pension tax reform were shelved following the Brexit referendum result in June 2016.

The small pots issue is largely an unintended consequence of auto-enrolment

As people change jobs during their career they may have accumulated relatively low value pension savings in numerous schemes. The number of deferred small pots has been steadily growing in the UK,[41] accelerating significantly as an unwelcome by-product of auto-enrolment with people enrolled into a new pension with each change of job.

Evidence suggests that in 2020, there were around eight million deferred pots and without intervention this is likely to reach 27 million by 2035. The total value of 'lost' pension pots is estimated to have grown from £19.4 billion in 2018 to £26.6 billion in 2022, which might be a consequence of the increasing number of small pots.[42] Meanwhile, data from the ABI indicates there are over 2.2 million deferred pots valued under £1,000 currently held within contract-based schemes.[43]

While auto-enrolment has largely fixed the problem of pension participation, intervention is now needed to head off the issue of everyone accruing multiple pots. And then there are the escalating and unnecessary administration costs of both running pension pots and any subsequent transfers undertaken to consolidate these.

There is also a danger of individuals losing track of pots; good planning is being undermined because people can make better decisions looking at one big pot rather than many small ones. The DWP called for evidence en route to developing potential solutions to this, including default consolidators and a pot follows member model. In July 2023 the DWP revealed it favours the default consolidators solution,[44] and legislation is set to follow.

Demand for annuities can be tracked to the changing economy

The rise and fall and rise again[45] of annuity rates, and their popularity as a retirement income vehicle, has mirrored the movement in interest rates over the past 25 years, as well as being affected by the advent of pension freedoms and consumer concerns about persisting inflation.

In the aftermath of the pension freedoms, which coincided with a period of very low interest rates, guaranteed incomes became less popular. This does now seem to be changing and in addition, the industry has progressed towards more innovative solutions such as annuity-like investment assets that can sit inside drawdown arrangements. There's also growing interest in CDC schemes.

Investment lifestyling is a popular default strategy, but may no longer be fit for purpose

Lifestyling[46] focuses on adjusting pension investment objectives to suit the life stage of the investor. In this approach, pension contributions from younger scheme members are invested more heavily in higher risk growth vehicles, such as equities and property. Then, as the member nears retirement these automatically, gradually switch to lower risk funds and other potentially 'safer' investments such as bonds and cash.

Many workplace pension schemes favour lifestyling as their default investment strategy. Its suitability for any individual investor depends on their retirement intentions. People looking for flexibility over their retirement age may be disadvantaged by this pre-determined automatic glide path.[47] Market volatility at the time of a fixed retirement date can also be detrimental with lifestyled pensions. A 2022 DWP consultation called for evidence on which lifestyle strategies providers should give pension savers, amongst other issues.[48]

Investment pathways help non-advised consumers make informed decisions

In response to concerns about retiring investors' ability to make informed decisions about their retirement investment strategies, the FCA introduced investment pathways.[49] These are intended to guide those who haven't received advice or guidance to opt for an investment solution more likely to suit their needs. This reflects a recognition that giving investors complete freedom of choice over their savings and investments is not necessarily the path to achieving optimal outcomes – many people need help.

The Pensions Dashboard has great potential, if it can get off the ground

The initiative to enable everyone who has contributed to any pension scheme to locate all their pension investment information in a single online location is a laudable, consumer-friendly concept. However, this has proven to be a formidable task for the industry. Repeated deferrals of the launch date have now resulted in a further delay until October 2026, as announced by then Pensions Minister Laura Trott.[50]

[41] DWP – Addressing the challenge of deferred small pots: a call for evidence, 30/1/23
[42] PPI - Policy options for tackling the growing number of deferred members with small pots, July 2020
[43] ABI -Small pots cross industry co-ordination group: Spring 2022 report, June 2022
[44] Gov.uk - Government response to ending the proliferation of deferred small pots, 22/11/23
[45] ABI - Annuity sales surge after turbulent 2022, 28/5/23
[46] MoneyHelper – Pension investment options – an overview
[47] IFA magazine - Do we need to rethink the risk around asset classes & the 'lifestyling' in pensions? verdict from IFAs after a turbulent two weeks, 5/10/22
[48] Gov.uk - Helping savers understand their pension choices, 11/7/23
[49] FCA - FCA proposes rules on investment pathways and other measures to improve retirement outcomes for consumers, 29/01/19
[50] UK Parliament – Pensions Dashboard Update, 8/6/23

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HOW DO YOU
SOLVE A PROBLEM LIKE
DC PENSIONS?